

## Toward a Broader Agenda

Although traditional commodity programs still command most attention, the focus of discussion for farm policy has broadened considerably. Besides consideration of alternatives or modifications to current policy tools, the farm bill discussions now encompass issues that are critical to the performance of U.S. agriculture but that are not directly controllable by the agricultural sector (or any other). Some of the issues which arise in this regard--international trade; credit, tax, and macroeconomic policies; and resource conservation--are addressed here.

### AN INTERNATIONAL FARM POLICY

U.S. crop producers export much of their production. Hence, maintaining a strong export market is important to the overall health of the agricultural sector. But, events outside the realm of price and income support programs significantly affect the demand for U.S. imports.

Many countries tend to insulate their domestic markets from changes in foreign supply or demand. They become "adjustment exporters," using the world market as a residual supplier or buffer to ease internal adjustments in prices, stocks, or supplies. Unexpectedly good crops mean an exportable surplus, especially if storage is inadequate. Bad crops may invite a scramble for sudden importing. The result is that uncertainty--over the terms of trade, sources of demand and supply, and the duration of the buying and selling--pervades the world market. Political tensions and foreign relations also add variation in agricultural trade. This uncertainty, together with the importance of exports to the domestic agricultural sector, point to the desirability of incorporating flexibility into farm program legislation to allow U.S. export sales to respond to prevailing world market conditions.

A second observation that can be drawn from recent experience is that establishing relatively high and rigid price floors for U.S. farm commodities may reduce U.S. exports. Relatively high price supports tend to encourage foreign producers to expand their own production. A similar reaction usually follows implementation of production control programs designed to increase domestic farm prices. In most instances, the United States is alone in practicing supply control.

Despite the present rigidities in commodity programs, there are several policy instruments at hand that can help improve the United States' export market share: trade negotiations, food aid programs, credit extended to customer nations, bilateral and multilateral trade agreements, and even barter. When the terms of trade deteriorate, there is often a temptation to implement programs to offset adverse events in the world market. Two-price plans are one example. Under a two-price plan, domestic prices are higher than foreign prices. Domestic producers receive higher returns, assuming a more price-responsive foreign than domestic market. But, consumers also pay higher food costs. In addition, it is difficult to simultaneously advocate free trade and erect a two-price plan.

Perhaps the key international trade issue for U.S. agriculture is the value of the dollar in foreign exchange markets. The rapid increase in the value of the dollar relative to other currencies--an increase of about 70 percent in nominal

terms since 1980--raises the prices other countries must pay for U.S. exports. Hence, not only does the demand for U.S. commodities drop, but the import demand for commodities from countries which peg the value of their currencies to the dollar (as do many Latin American countries) also declines. The decline in Latin American exports has caused their debt problems to continue to mount.

The relatively high value of the dollar tends to be caused in part by the flow of foreign investment capital into the United States to take advantage of our unprecedented high real interest rates. Many attribute these interest rates to the large Federal budget deficit. Thus, U.S. agriculture has an important stake in attempts to control the budget deficit, not only in terms of the interest rates domestic producers must pay for operating loans, but also for the possible repercussions in world commodity markets.

As increased attention is given to the role of exports in U.S. agriculture, several issues arise. What should be the objectives of a U.S. trade policy? What are the most cost-efficient means of promoting exports? What effects, both in the short and long term, would export credit programs have in expanding exports? What is the likelihood of reducing trade barriers around the world for U.S. products? What are the likely reactions of our export competitors to U.S. efforts to expand export sales? What are the potential impacts of third-world debt problems on efforts to expand U.S. exports? What are the prospects for changes in the value of the dollar relative to other currencies and the subsequent effects on U.S. trade? Policy decisions regarding these questions will likely play a role in efforts to strengthen the United States' share of world trade.

#### RESOURCE USE AND CONSERVATION

The initial purpose of resource conservation policy inaugurated 50 years ago was to stop the erosion of the domestic natural resource base, but the problem was how to accomplish this. Over time, the problem was perceived as a tradeoff between protecting environmental quality and sacrificing productivity. The problem has since evolved from how to stop environmental deterioration to how to identify and provide the incentives that will lead farmers to adopt effective conservation techniques.

Studies have found that while soil erosion remains a significant problem in aggregate terms, the most serious effects tend to be found on a relatively small percentage of total cropland. Gross soil loss of 40 to 50 tons per acre per year is not uncommon and it has reached levels as high as 200 tons per acre per year in some areas. Soil loss of 100 to 150 tons per acre translates into approximately an inch of topsoil across an acre of land being lost due to erosion.

During the seventies, when U.S. agriculture was producing near capacity with the technology then available, a key question was what impact soil erosion would have on environmental quality and on future food and fiber production. As export growth dampened and surplus production accumulated in the eighties, conservation program evaluations began to address the issue of the consistency between conservation and commodity programs.

Inconsistencies between current programs and land stewardship have recently become more pronounced. For example, farmers have been paid to retire land from production while erosive land has been permitted to be drawn into production. Commodity price support programs may provide an incentive to continue farming

operations on marginal land. These and other inconsistencies incur costs to society. In the short run, society incurs costs in the form of taxes and higher food prices; and, in the long run, future productive capacity is diminished as soil and water resources are depleted.

Conservation proposals may be evaluated on the basis of targeted effectiveness. That is, is the program targeted to be effective on the most erosive land? A 1980 analysis by USDA estimated that more than half of Agricultural Conservation Program (ACP) payments went for conservation practices applied on land with soil losses of below the tolerable level (5 tons per acre or less). Hence, tax dollars were not spent in a manner that assured maximum impact. Conservation reserve programs, or conservation coupled with acreage reduction, was found to entice the most erosive land out of production in exchange for some form of Government rental payment.

Conservation and resource programs may also be evaluated with regard to their cost-effectiveness. By definition, using conservation programs to carry out policy objectives implies an inequitable distribution of costs and benefits to be effective. Soil productivity is not equally distributed and neither is erosion. Some farmland, under normal conditions, is not likely to experience any appreciable erosion problems. At the other extreme, even with sound farm management practices, soil loss on some farmland would be considered excessive. This lends credence to a localized, targeted approach to conservation and resource policy.

A number of conservation issues likely to be widely discussed during the 1985 farm bill debate include the following. What incentives are needed to encourage farmers to adopt effective conservation techniques? Can soil erosion efforts be effectively targeted to the most critical areas of the Nation? What approaches can be implemented to address the apparent inconsistencies between current commodity and conservation programs? Should producers who cultivate fragile lands be eligible for program benefits? What effect will efforts to expand exports have on soil and water conservation initiatives? What are the potential conservation implications of reduced emphasis on acreage reduction and other forms of supply control programs? What are the pros and cons of longterm retirement of highly erodible lands? These issues will require attention as we attempt a balance between production and conservation.

#### CREDIT POLICY ISSUES 1/

A number of issues are likely to arise during future discussions of commodity programs. These concerns may be overriding: Is there an economic rationale for Federal credit assistance to farmers today given the progress in performance of commercial sources of credit; and, will short-term credit assistance improve the financial viability of farmers currently experiencing financial stress?

Is there an economic rationale for credit assistance? That depends on whether farmers are discriminated against in capital markets. Such discrimination can result from artificial barriers arising from legal and institutional restrictions, inadequate information, habit, or tradition. Some evidence suggests that discrimination may have existed before farm credit legislation was enacted in the thirties.

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1/ Information on credit policy issues was contributed by Ronald Meekhof, chief, Finance and Aggregate Analysis Branch, National Economics Division.

There are no definitive studies of credit market performance which address how well farm credit markets work today. However, there have been major changes in those markets over the last 50 years, and agricultural finance experts agree that it is no longer apparent that farmers are seriously disadvantaged in their access to loanable funds relative to borrowers in other business sectors.

For farmers producing price-supported commodities, the flow of funds from the Commodity Credit Corporation (CCC) has been very important at times and enables them to meet short-term cash or debt repayment needs. CCC funds have also found their way into bank deposits, thereby increasing bank liquidity and making new credit available to bank borrowers, including farmers. The CCC has also provided loans, almost always at subsidized interest rates, for building farm storage and for other purposes.

Perhaps the most significant recent development affecting the credit supply and performance of credit institutions is the phased deregulation of financial institutions stemming from the Financial Deregulation and Monetary Control Act of 1980. The purpose of the act (as well as follow-up legislation in 1982) is to provide a more market-oriented, competitive financial environment. This should increase economic efficiency, allowing sources and uses of funds to flow more smoothly to and from economic sectors, geographic locations, and individual enterprises according to their ability to earn competitive rates of return.

For agriculture, deregulation has led to a closer interlocking of rural credit conditions with national, rather than regional and local, financial markets. Farmers are now less insulated from national monetary shocks, and increased interest rate volatility nationally has translated into increased volatility in local rates. Management strategies at rural banks must now include hedging against future changes in interest rates, as well as more traditional portfolio and balance sheet considerations. Also, because Farm Credit System banks have not been deregulated, deregulation should make commercial banks more competitive and halt or reverse their recent trend of declining market share. Deregulation implies that credit crunches--a complete shut-off of credit to certain sectors--are a thing of the past, being replaced by less harmful credit squeezes whereby credit is rationed by price. Finally, financial deregulation means that U.S. agriculture will have to earn its access to credit in more direct competition with other sectors.

A large share of farmers are experiencing financial stress brought on by aggressive investment practices, high interest rates, natural disasters, an unfavorable turn in commodity markets, and other causes. The most widespread type of financial stress is an inability to meet cash flow obligations for operating expenses, debt repayment, taxes, or family living expenses. Cash flow stress is different in concept from other types of financial stress such as low income or profitability, although the actual outcome may be the same.

Short-term credit assistance has been widely discussed as a means for the Government to ease farmers' cash flow stress. Private lenders have voluntarily provided financially troubled farmers with assistance, primarily in the form of forbearance. The Farmers Home Administration (FmHA) has also worked with its borrowers to ease financial stress. The deepening farm financial situation has brought additional demands for Government assistance. Short-term credit from lenders or the Government could take several forms.

### Forbearance

Forbearance is a strictly voluntary approach taken by the lender to assist borrowers who are in financial stress. Forbearance would most likely take the form of waiving some portion of principal, interest payments, or both. After market conditions improve, the waived portion of the loan can be repaid. The carrying costs to the lender are high when interest rates are high. Generally, other options to assist the borrower, such as debt restructuring and reduced payment, would have been taken prior to forbearance. Forbearance is an approach that can work for some farmers under limited conditions. It is most likely to have favorable results if conditions underlying financial stress are short-lived and if the farmer does not have a severe cash flow problem.

### Subsidized Interest

Subsidized interest rates have been widely used in the past by FmHA to assist farmers. Generally, interest subsidies are provided as a means of addressing social objectives--assisting farmers who can't obtain credit elsewhere at a reasonable cost and terms, helping young and limited-resource farmers become economically viable, or easing the financial impact of natural disasters.

Various criteria could be established for determining eligibility for obtaining a subsidized rate on new loans or refinancing existing loans. The extent of the subsidy could be fixed or vary on the basis of financial stress. A subsidy program could be administered only by FmHA to its borrowers or it could be administered with participation of private lenders to assist other farm borrowers. The period over which the subsidy is in effect could vary, as could the extent to which the subsidy is to be repaid after conditions improve. An interest rate subsidy program could be employed in a number of ways.

The primary issue concerning an interest subsidy is equity. Society at large may rightfully question why farmers and not other financially stressed sectors should have available such a potentially costly program. Other questions may raise concerns about the appearance of providing additional interest subsidy to a sector in financial stress in part because of its availability in the past. Lastly, concerns may be raised concerning the extent to which private lenders can or should be able to shift their financially stressed borrowers to the public lenders.

### Debt Restructuring

Debts can be restructured through rescheduling loan obligations over a longer repayment period, by refinancing the loan at a lower market interest rate, or both. The result for the farm borrower is a reduced annual payment since the principal due each year and debt service costs are reduced. Consequently, there can be some immediate improvement in the farm's cash flow situation depending on the extent of restructuring. Over the rescheduled term of the loan, the farmer's total obligation would increase.

Most indications are that a significant amount of restructuring has taken place and that little more remains for those farmers in financial difficulty. Debt restructuring is a voluntary action that a lender is likely to take at the first signs of repayment difficulty and many lenders have reached the point where further restructuring may not be possible due to the impact on bank profitability and their loan portfolio collateral structure. Some recent proposals would provide incentives for the lender to extend debt restructuring further. Government guarantees on restructured debt would be the primary incentive.

### Loan Write-Downs

A loan write-down is a voluntary action taken by a lender to reduce some portion of the loan principal. The lender may take this action in response to lower loan collateral values, to ease the repayment schedule of a borrower, or both. Obviously, if the loan principal is only reduced on the bank's books, it is of little assistance to the farmer.

A loan write-down is costly from the lender's viewpoint and is not likely to be employed voluntarily on a widespread basis. Some proposals have combined the write-down option with action by the Government that would provide an incentive to the lender that would, in part, compensate for the costs. For example, the lender would write down some portion of the loan to a farmer in exchange for a Government guarantee on some portion of the remaining principal.

Farm borrowers would realize improvement in cash flow. Write-downs might not be available to farmers in the most severe financial stress because the cost to the lender and Government of providing such borrowers an adequate cash flow would be substantial. Also, questions of equity among farmers and other sectors arise, because a write-down eliminates a previous obligation.

### Interest Rate Buy-Downs

In this option the Government and the lender would share the cost of reducing the interest rate on outstanding loans to financially stressed farmers. The Government could compensate banks directly for lost revenues or, in exchange for the interest rate reduction, offer banks a loan guarantee or security that would reduce the future potential for loan losses. The action to reduce the interest rate on a farm loan would be initiated by the lender and would thereby determine which farmers would benefit from such assistance. The loan interest reduction could be for the remaining life of the loan or could end when economic conditions improved. The effectiveness of the policy would depend upon the degree of Government cost.

A major issue in the effectiveness of short-term credit assistance is whether the general economic downturn in agriculture is transitory. If it is not, adjustments farmers make in the form of balance sheet restructuring or trimming costs will not likely bring about a long-term improvement in liquidity. Many farmers will likely experience continued shortfalls after the benefits of short-term assistance run out.

Significant excess capacity in the sector will not decline as a result of debt restructuring or interest rate buy-downs. Capacity will decline only if resources committed to production decline. If this does not occur, income will remain at low levels and many farmers will have difficulty servicing their debts.

Federal credit policies shift resources to those sectors of the economy that society believes have been disadvantaged or have had restricted access to credit because of a market imperfection. When resources are shifted to activities that would otherwise not have received them, the economy may incur a cost in the form of reduced economic efficiency.

To the extent that farmers are not restricted and, in fact, have easier access to loan funds, the sector will be larger than otherwise, consuming greater amounts of fertilizer, tractors and other inputs, producing more, and receiving lower prices. Consequently, this assistance aids farmers, owners of farm assets,

input manufacturers, foreign and domestic consumers, and marketing firms handling large volumes of output.

There are losers, too: other sectors of the economy that must pay higher prices for financial and physical resources, farmers and nonfarmers not receiving credit assistance who may benefit from the use of resources held by those who do, tenant farmers, and parts of the labor force affected by reduced growth. These tradeoffs will likely be judged in light of more general economic policy issues: how to reduce and finance the deficit, whether to reduce Federal credit activities, how to improve the administration of credit programs, and whether specialized Government lending institutions are needed.

#### FEDERAL TAX POLICY 2/

Agriculture and most other industries benefit from a variety of special tax provisions. It is not clear whether agriculture benefits more or less than average and, in farming, the relative importance of tax policy versus commodity and credit programs and other Government policies is uncertain. However, it is clear that tax policies have played a role in the changes that have occurred within the sector and that they will continue to affect the organization, allocation, and control of farm resources. This section examines Federal income tax provisions such as special farm tax provisions, the treatment of land investments, the corporate income tax, and emerging issues with respect to agriculture in light of the renewed interest in general tax reform.

Since 1915, farmers have been able to use the cash method of accounting for Federal income tax purposes. Under cash accounting, expenses are deducted in the year they are paid, income is recognized in the year it is received, and changes in the values of inventories are ignored. This greatly simplifies the recordkeeping requirements for farmers. However, it also permits investors to mismatch income and associated expenses by generating deductions in the early years of an investment while delaying the recognition of income by building inventories that are not taxed until they are sold. This can cause the accumulation of larger inventories than would otherwise be justified.

As a result of the abuses of cash accounting by tax-shelter investors, Congress has attempted to limit its application. The Tax Reform Act of 1976 prohibited farm syndicates from deducting prepaid expenses for feed, seed, fertilizer, and other supplies. It also prohibited the use of cash accounting by corporations with gross receipts in excess of \$1 million. However, the scope of this provision was greatly reduced by a number of exceptions intended to avoid its application to closely held family corporations.

Another feature of Federal income tax law that applies primarily to farmers is the current deductibility of various capital expenditures. Normally, expenditures that are made to acquire or to develop assets that will contribute to the production of income over a long period of time must be apportioned over the period during which they can reasonably be regarded as contributing to the production of income. However, a Treasury regulation issued in 1919 permitted farmers to deduct the cost of developing certain farm assets in the tax year in which they are incurred or paid. For example, the costs of raising dairy, draft, breeding, or sporting livestock to maturity, the costs associated with caring for

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2/ Information on Federal tax policy issues was contributed by Ron Durst, agricultural economist, Finance and Aggregate Analysis Branch, National Economics Division.

orchards and vineyards prior to their producing crops, the costs of clearing land, and expenditures for lime, fertilizer, and other materials may be deducted in the tax year in which they are paid.

This "expensing" of development costs results in a distortion or mismatching of expenses and income from the developed assets. This mismatching has been used to generate losses which can be written off against income from other sources. Thus, farm assets for which development expenses may be deducted have attracted tax-motivated investment. Legislation has since been implemented to control tax-motivated investment in orchards and vineyards.

Certain assets, even though they are not capital assets for tax purposes, are eligible for capital gains treatment. These assets include depreciable property and real property used in the trade or business of farming. Thus, most agricultural land, farm machinery, equipment, and livestock held for draft, dairy, breeding, or sporting purposes are eligible for capital gains treatment. When these assets are held for more than 6 months (24 months for cattle and horses and 12 months for other livestock), 60 percent of the gain from sale is excluded from taxation.

The capital gains treatment for these farm business assets provides the most beneficial results when combined with the cash method of accounting and the deductibility of capital expenditures. For example, the cost of raising livestock held for draft, dairy, breeding, or sporting purposes is currently deductible, while the proceeds from the sales of such livestock are eligible for capital gains treatment. The result is a reduction in current tax liability, an increase in the amount of potential income eligible for capital gains treatment, and a deferral of the taxation of such gains until the assets are sold. Thus, the tax benefits from the early deductions often exceed future tax liability on the income from the investment.

In some cases, farm management practices have been altered to ensure that a large amount of the income from current farm operations is taxed at the more favorable capital gains rates. Such alterations in management practices can increase an investor's after-tax income, but may adversely affect productivity.

The tax policies which affect investments in land are particularly important for the agricultural economy. Those provisions of primary importance include the deductibility of nominal interest payments, the capital gains treatment of appreciation in land values (only 40 percent of long-term capital gain is taxed), and the deferral of such gains until they are realized as a result of a sale or other disposition. The combination of these provisions makes farmland an excellent tax shelter during times of inflation.

Generally, inflation raises interest rates by the expected rate of inflation in the general economy. However, since nominal interest rates are fully deductible for tax purposes, an increase in the nominal rate could cause a reduction in the real after-tax rate. This reduction in the real cost of borrowing is greatest for those individuals with the highest marginal tax rates. In some cases, the real cost of borrowing may actually be negative. This increases the incentive to finance investments with debt, particularly those which generally appreciate in value during inflationary periods.

During inflationary periods, both farm and nonfarm investors have considered farmland as a good hedge against inflation. Inflation creates the expectation that returns to assets will grow over time. Expected growth in returns to assets leads to increases in current asset values and hence, capital gains to owners of

those assets. As expected inflation in land values and the net returns to land increase, the price paid for land becomes more a function of expected inflation than of current returns. Thus, inflation may lead to a persistent division of economic returns between current cash returns and deferred capital gains returns. With low current returns relative to asset values and high rates of interest, payments on debt-encumbered assets can exceed the cash flow from those assets. The resulting negative cash flow provides a tax shelter, further increasing the value of the assets by their potential return from tax sheltering.

The net effect is to restrict land purchases to those with sufficient outside resources to meet the negative cash flow which occurs when a large portion of the total return to land is capital gains rather than current income. This creates barriers to entry into farming and increases the concentration of land ownership. It also may contribute to the instability of land prices.

Between 1974 and 1978, the number of corporate farms increased from 28,442 to 51,270. This growth can almost entirely be attributed to an increase in the number of family and other closely held farming corporations. In fact, widely held corporations actually declined over this period. A substantial portion of the growth in family farm corporations can be attributed to Federal tax policies.

A corporation is a separate taxable entity for Federal income tax purposes. While many of the rules with regard to the computation of net farm income are the same for corporations and individuals, various aspects of the corporate form of business have encouraged the incorporation of farm businesses. Those aspects of the corporate income tax which have encouraged family farms to incorporate include lower and less progressive tax rates, the ease of transferring the farm business and other estate planning reasons, and the availability of business deductions for various fringe benefits.

An important feature associated with the corporate form of organization is the ease with which annual gifts of farm property can be made. Current estate and gift tax laws permit an individual to transfer \$10,000 per year to any individual free of tax. A married couple can make gifts of \$20,000 per year to any individual free of tax. Thus, a substantial portion of the farm business can be transferred through the gift tax exclusion. However, the transfer of the actual farm assets can cause problems due to the difficulty in partitioning the farm business. By incorporating, the transfer of the farm business can be accomplished by transferring shares of stock in the corporation. This avoids the partitioning of farm assets and allows the individual to transfer a substantial amount of farm property without losing control of the farm business.

The corporate form of business organization permits a number of fringe benefits to be provided to the shareholder-employee at a lower after-tax cost. The cost of many fringe benefits including health insurance, meals and lodging on business premises, and pension and profit-sharing plans are fully deductible to the corporation and often not included in the taxable income of the shareholder-employee. This incentive to incorporate has been reduced somewhat by expanding the fringe benefits available to noncorporate businesses and by limiting those available to corporations.

The shift to the corporate form of organization which has occurred over the last decade may have allowed farms to expand more rapidly as a result of the reduced taxes and retained earnings to the corporation. It may also have facilitated the transfer of the farm business to the next generation, resulting in the continuation of many farm businesses.

The examination and revision of Federal tax policies has occurred with increasing frequency in recent years. In fact, in 3 of the last 4 years major tax legislation has been enacted. With the growing dissatisfaction with the current tax system, an increasing awareness of the various agricultural tax issues, and a continuing need to generate additional revenue to reduce the deficit, either limited agricultural tax reform or general tax reform are possible. This potential raises a number of important issues for agriculture. Two of these issues which may resurface in 1985 include the potential inconsistency of farm commodity policies and tax policies and the continued existence of tax-sheltered investments in agriculture.

The use of the tax system to implement economic and social policies has increased the potential for conflicts between tax policies and farm commodity policies and programs. A recent example of potentially inconsistent policies involves the paid diversion program for dairy farmers, and those tax incentives which encourage increased investment and expanded production. With the growing need to achieve public policy goals for agriculture in a cost-effective manner, various tax policies may be reexamined in light of prevailing agricultural policies and programs.

The existence of tax-shelter investments in agriculture is not a recent development. However, over the last 15 years the number of farms reporting losses for tax purposes has increased from one-third to two-thirds of all farms. These losses are often used to offset income from other sources, resulting in a substantial loss in Federal tax revenues. Unless this trend is reversed, proposals to limit tax-loss farming or to reduce or eliminate various tax preferences could receive increased attention.

With regard to general tax reform, a number of options for a fairer and more efficient tax system have been suggested. One option involves a broadening of the tax base accompanied by a reduction in marginal tax rates. The impact of the implementation of such a system on the agricultural sector would depend upon those exclusions, deductions, and credits either reduced or eliminated, the changes in the timing of income recognition (if any), and the manner in which various tax provisions were adjusted for inflation.

Another type of tax which has been suggested as a tax reform option is the value-added tax (VAT). A VAT is a multistage sales tax that is collected at each stage or point in the production and distribution process based on the value added at that stage. Implementation of a VAT could have a significant impact on capital intensity, tax liability, and efficiency of U.S. farms. The European VAT taxes contain special provisions for agriculture, but arguments can be made for and against a VAT exemption for U.S. farmers. Reasons to exclude agriculture from a general VAT scheme include the substantial compliance costs to small farmers for keeping adequate records and the substantial administrative costs to the Internal Revenue Service for handling a large number of returns. Also, a large portion of agricultural production is exported. Since a VAT on exported goods is refunded, revenue gain would be reduced. Advantages of a VAT are that it is simple, neutral, leads to stable tax revenues for the Government, and does not discriminate with regard to type of business or method of financing. Disadvantages are that a VAT is regressive, causes a one-time price increase as the tax is passed on to consumers, and could potentially conflict with State sales taxes. Impacts of a Federal VAT tax on U.S. agriculture would depend upon the nature of any tax exemption, and upon whether the VAT revenues were used to offset reductions in other taxes or to reduce the Federal deficit.

The enactment of major changes in the tax code eliminating tax shelter opportunities throughout the economy would alter the relative rates of taxation for various investments. Generally, the relative rate of taxation of investment in industries which currently receive relatively favorable tax treatment would be increased. This could result in sudden and substantial changes in investment patterns and asset prices. The identification of these potential changes and the development of transitional rules to minimize these changes could be particularly important for the agricultural sector.