THE INCOME CERTIFICATE PLAN FOR AGRICULTURE

An analysis based on
"Certificate Plan" bills
introduced during the
1939 regular session
of Congress.

A Memorandum Prepared in the
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C O N T E N T S

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THE INCOME CERTIFICATE PLAN FOR AGRICULTURE

Summary 1/

1. The plan.

The income certificate plan is a combination of processing taxes and benefit payments. It takes its name from the certificates which would be employed to make benefit payments to producers of certain agricultural commodities and to collect taxes on the occasion of the first domestic sale of these commodities in processed condition. Both operations would be conducted by the Secretary of Agriculture independently of the United States Treasury.

1/ The summary of the Income Certificate Plan for Agriculture is based on "certificate plan" bills introduced during the 1939 regular session of Congress. Throughout the analysis the principal differences between the provisions of these bills and those of the plan currently sponsored by the Department of Agriculture are noted. These differences are:

(1) In the wheat and cotton bills introduced at the last session, the price of the certificate was to be equal to the difference between average farm price and parity price or cost of production, whichever is higher. Under the Department of Agriculture's plan the price of the certificate would be equal to the difference between average farm price and parity price. The criterion "cost of production" is eliminated.

(2) The "certificate plan" bill for wheat introduced at the last session provided that farmers receive parity prices on their production for domestic consumption as well as for normal exports. This would have required domestic consumers of wheat products to pay 120 percent of the parity price of wheat. Under the Department of Agriculture's plan, parity prices would be paid only on domestic consumption.

(3) Under the "certificate plan" bills benefits would be paid and taxes would be collected by the Secretary of Agriculture independently of the United States Treasury. Under the Department of Agriculture's plan the existing facilities of the Treasury Department would be utilized in collecting certificates from the processors.

2. Objective of plan.

The certificate plan is a device to enable producers of selected agricultural commodities to obtain the equivalent of parity prices for part or all of their production, without at the same time affecting their competitive position in foreign markets. It is a method for providing one type of agriculture benefits - parity payments - outside of the Budget and without direct recourse to the general fund of the Government.

3. Mechanics of plan.

The Secretary of Agriculture would issue certificates to correspond in volume to the estimated domestic consumption (and in some cases normal exports) of a given agricultural commodity. These certificates would be distributed to producers in accordance with their marketing quotas. To receive the certificates producers would have to comply with the requirements of the agricultural program. The certificates would have a cash value generally equal to the excess of the parity price of the commodity (or cost of production, if it is higher) over its average farm price. In effect, the producer would receive on that portion of his production required for domestic consumption (and in some cases for exports) a total amount equal to its parity price or cost of production whichever was greater. Part of that amount would come from the sale of his produce at prevailing farm prices; part of it from the sale of his share of the certificates.

The producers would realize the value of their certificates by selling them through the facilities of a pool operated by the Secretary of Agriculture, to those required to buy them. The certificates would have to be purchased by those making the first domestic sale of all articles processed or manufactured from the farm commodity affected. Persons making such first sales would be required to make a monthly return to the Secretary of Agriculture showing the quantities of such manufactured articles sold by them. They would have to attach to these monthly returns, an amount of certificates corresponding to the physical quantity of the particular agricultural commodity used in the manufacture of the sold article.

4. Legislative history.

The certificate plan is advanced by its sponsors in an attempt to place part of the agricultural program on a permanent financial basis, without dependence upon annual Congressional appropriations. At the 1939 regular session of Congress six bills were introduced, which provided for the application of the plan to cotton, rice and wheat. The Senate Committee on Agriculture and Forestry has held hearings on the plans for wheat and rice; the House Committee on Agriculture on the plan for rice. The rice plan has been approved by the Senate Committee and by the Secretary of Agriculture. The Director of the Budget has reserved judgment "as to the relationship of this legislative proposal to the program of the President."

5. Relation to the agricultural program.

The certificate plan is proposed as an addition to the present agricultural program. It not only leaves the principal features of the present program unchanged but is in fact conditional upon the retention of that program. The certificate plan can be coordinated with the acreage allotment, soil conservation, crop loan and marketing quota features of the present agricultural program. In the case of the commodities to which it applies, it will replace the so-called parity payments now made from general revenues. (Appropriation for parity payments for the 1940 program, $225,000,000).

6. Tax features.

(a) Commodities taxed. Adoption of the certificate plan would be equivalent to the enactment of a processing tax. The certificate tax, however, would differ in some respects from the invalidated processing taxes. Certificate taxes would be imposed on specific commodities presumably by the enactment of separate bills applying to each individual commodity. The bills thus far introduced would tax cotton, rice and wheat.

(b) Tax rates. The rate of the certificate tax on rice is specified at 1 cent per pound of clean rice. Rates on cotton and wheat would be set at the beginning of each crop year. For cotton the rate would be equal to the excess of the parity price or cost of production, whichever is higher, over the estimated average farm price, including parity payments. For wheat the rate would be 120 percent of this excess. A compensating tax is imposed on imports. No floor stock tax is provided. On the basis of November 15, 1939 farm prices, it is calculated that the tax rates indicated by the certificate plans would impose a 7.1 cents tax per pound of lint cotton and a 48.1 cents tax per bushel of wheat. If parity prices on normal exports were not provided, the tax rate for wheat would be 40.1 cents. Under the processing taxes the rate on cotton was 4.2 cents and the rate on wheat was 30 cents.

(c) Base of tax. The tax would be levied with respect to each commodity on a quantity basis - so many cents per pound or bushel - without regard to variations in type, grade, or price. It would be collected on the occasion of the first domestic sale of any article manufactured wholly or partly from the given agricultural commodity.

(d) Exemptions. The sale of commodities for export would be exempt. To prevent pyramiding, articles processed or manufactured from another article which had previously been taxed would be exempt.

(e) Tax load. On the basis of price conditions as of November 15, 1939, and on the basis of available estimates of volume of consumption (both sets of data from Department of Agriculture sources), it is computed that the "certificate plan" bills would impose an annual tax of approximately $11,000,000 on rice, $238,000,000 on cotton, and $240,000,000 on wheat.

(f) Date of termination. The certificate plans contain no specific provision regarding length of time for which the taxes are to remain in effect. They would presumably continue until repealed.

(g) Administration. Responsibility for the collection of taxes, for the distribution of benefits, for the receipt of monthly tax returns, and for all determinations is vested with the Secretary of Agriculture.

7. Effects on agricultural producers.

(a) The certificate plan would afford large benefit payments to the producers of agricultural commodities affected. These benefit payments would probably be considerably higher than are likely to be made available through appropriations from the general fund of the Treasury. They would be in lieu of parity payments, but probably would be additional to most of the other categories of Federal agricultural expenditures.

(b) In the long run, the certificate plan would probably provide benefit payments with greater regularity than would direct Congressional appropriations.

(c) The plan would not affect adversely the competitive position of the American farmer in the foreign markets. On the contrary, it could be so devised as to place the American farmer in an advantageous position with respect to exports.

(d) The plan would provide a kind of gratuitous crop insurance. It would assure the growers a minimum annual revenue without regard to the actual yield of their acreage.

(e) The plan would make the control of the volume of agricultural production relatively more easy to enforce.

(f) The plan could not be applied with uniform effectiveness to all commodities. It could not serve effectively to raise the income of farmers producing commodities for which the domestic demand is appreciably reduced as the price increases.

(g) Since the certificates for any one agricultural commodity would have a uniform price, the plan would afford relatively larger benefit payments to producers of a low priced variety than to producers of a high priced variety product.

(h) Land owners would stand to be the largest gainers. Agricultural labor would probably be a substantial loser. Sharecroppers and tenant farmers would gain in some, but lose in other respects.

8. <u>Effect on agricultural trades</u>.

Processors and distributors of agricultural commodities and their products would be adversely affected.

(a) Because the margins of profits of processors and distributors are small, any substantial part of the tax burden which they would have to absorb would cut their profits.

(b) Reduced consumption resulting from the imposition of these heavy taxes would reduce the volume of the processors' and distributors' trade.

(c) Periodic changes in tax rates would be likely to disrupt processors' and distributors' business methods.

(d) Processors and distributors would bear the bulk of the burden of tax compliance, through advancing the amount of the taxes, filing monthly tax returns, and maintaining prescribed records.

9. Fiscal effects.

(a) Fiscal management.

(1) The plan would sanction large public expenditures outside the budget, exempt from periodic executive and legislative review. In consequence, the effective use of fiscal policy as an instrument of economic control would be impaired and a safeguard against unwise allocation of public funds would be sacrificed.

(2) The adoption of the plan would make it more difficult to determine the amount of actual public expenditures and the actual tax burden of the various groups of taxpayers.

(3) The plan would establish a dangerous precedent which other economic groups would strive to emulate, thereby seriously endangering fiscal planning.

(b) Tax administration.

(1) The tax features of the certificate plan are (almost of necessity) insufficiently integrated and therefore would be likely to create inequities.

(2) Because of the severity of the tax burden, tax evasion would be stimulated, especially by farm and rural consumers of taxed products.

(3) The plan makes no provision for compensatory taxes on floor stocks and on competing commodities. Such compensatory taxes are essential to safeguard processors and distributors against losses when rates are reduced and to prevent profiteering when rates are increased.

(c) Federal expenditures.

Adoption of the certificate plan would greatly increase total public expenditures for the benefit of agriculture. Whether on balance it would increase or decrease expenditures from the general revenues of the Government cannot be forecast with assurance.

(1) On the one hand, if the certificate plan is adopted, that portion of parity payments now financed from general revenues, which is expended in behalf of the commodities covered by the plan, could be eliminated.

(2) The enactment of the plan might weaken agriculture's resistance to reductions in appropriations.

(3) On the other hand, if the plan were adopted, it might result in increased expenditures on behalf of the producers of non-certificated commodities in order to give them benefit payments on a par with those obtained by the producers of commodities covered by the plan.

(4) If the plan resulted in reduced consumption and increased surpluses, the net cost of surplus disposal programs might be increased.

(5) The increased cost of living, resulting from the adoption of the certificate plan, might indirectly raise Federal expenditures for relief purposes.

(d) Distribution of burdens and benefits.

(1) The certificate plan would impose what in effect amounts to a processing tax on some necessities. The burden would fall largely on consumers. It would be a regressive tax, imposed not only without regard to taxpaying ability but without regard to the price of the consumed commodity.

(2) The imposition of a tax of this magnitude, superimposed on the present tax system, would severely affect the purchasing power of the lower-income groups.

(3) Payments under the plan would be made to about three million producers, some of which now receive substantial incomes, at the expense of another group comprising four million farm families, more than twenty-two million non-farm families and several million single individuals, and including the unemployed, the relief recipients and many others with very low incomes. In the process, some purchasing power would be transferred from low-income families to higher-income families and some from high to lower income families.

(4) Aside from limitations on maximum payments to individual producers, the benefits under the certificate plan would be distributed among producers approximately in proportion to the present distribution of incomes, those producing large amounts receiving more money from the plan than those producing smaller amounts.

FOREWORD

This memorandum examines the proposed income certificate plan for agriculture, with special reference to its tax aspects and fiscal implications. It is concerned only with the principal features of the plan and makes no attempt to describe in detail all variations between the several Congressional bills embodying the proposal, except insofar as such variations are deemed to be of basic importance.

No attempt is here made to inquire into the Nation's agricultural problem itself; what the nature of that problem is and whether the present agricultural program attacks it in a rational way. Only sufficient description of the existing complex agricultural program is provided (for the benefit of readers not conversant with its many features) to reveal clearly the projected role of the proposed certificate plan. The legal problems raised by the certificate plan are here wholly ignored.

Finally, it should be noted that this analysis is based on "Certificate Plan" bills introduced during the 1939 regular session of Congress. Such differences between the provisions of these bills and those of the plan currently sponsored by the Department of Agriculture as have thus far been indicated are noted.1/

1/ Statements regarding the plan currently sponsored by the Department of Agriculture are based on a tentative and confidential memorandum entitled "Summary description of the Farmers' income certificate program", December 20, 1939 (revised), submitted to the Fiscal and Monetary Committee and hereafter referred to as the Department of Agriculture memorandum.

I. Introduction

The certificate plan is a combination of benefit payments and processing taxes. It is a device to enable domestic producers of agricultural commodities to obtain parity prices for that segment of their production which is consumed domestically (and in some cases exported), without at the same time affecting their competitive position in foreign markets. 1/

Viewed in another light, the certificate plan is a method for providing one type of agricultural benefits, so-called parity payments, outside of the Budget and without recourse to the general fund of the Government. It takes its name from the certificates employed to provide benefit payments to producers of certain agricultural commodities and to collect taxes on the occasion of the first domestic sale of these commodities. Both operations are conducted by the Secretary of Agriculture, independently of the United States Treasury. 2/

Certificates would be issued in volume to correspond to the estimated domestic consumption (and in some cases, normal exports) 1/ of a given agricultural commodity. These certificates would be assigned to the producers of that commodity in accordance with their allotted share in the Nation's production quota, provided that they complied with the eligibility requirements of the agricultural program. The certificates would have a cash value generally equal to the excess of the parity price of the commodity

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1/ The "certificate plan" bill for wheat introduced at the last session provided that farmers receive parity prices on their production for domestic consumption as well as for normal exports. This would have required domestic consumers of wheat products to pay 120 percent of the parity price of wheat. Under the Department of Agriculture's plan, parity prices would be paid only on domestic consumption.

2/ Under the Department of Agriculture's plan the existing facilities of the Treasury Department would be utilized in collecting certificates from the processors.

(or cost of production, if it is higher) over its average farm price. 1/ Thus, on that portion of his production required for domestic consumption (and in some cases, for exports), each producer would receive a total return equal to parity price or cost of production, whichever is higher. He would receive that return in two parts: one from the sale of his product in the usual manner at prevailing farm prices; the remainder from the proceeds of his share of the certificates.

Producers would obtain the value of their certificates by selling them (indirectly) to those required to buy them. The plan prescribes that certificates be purchased at the fixed price in connection with the first domestic sale of all articles processed or manufactured from the commodity. Persons making such first sale would be required to make a monthly return showing the quantities of such manufactured articles sold. They would be required to accompany such returns with an amount of certificates, corresponding to the physical quantity of the particular agricultural commodity used in the manufacture of the sold article. Compensating provisions would apply in connection with importations of certificated commodities. Exports would be exempt.

The principle of the certificate plan has been in use in foreign countries for several years. In the agricultural countries of Central Europe it was adopted in the late twenties and in a modified form remains in use today.

1/ In the wheat and cotton bills introduced at the last session, the price of the certificate was to be equal to the difference between average farm price and parity price or cost of production, whichever is higher. Under the Department of Agriculture's plan the price of the certificate would be equal to the difference between average farm price and parity price. The criterion "cost of production" is eliminated.

In the United States it appears to have been proposed originally as a feature of the old domestic allotment plan a dozen years ago. 1/ The scheme received its recent impetus as a result of the invalidation of the processing taxes by the Supreme Court in United States v. Butler, January 6, 1936 and in Rickert Rice Mills v. Fontenot, January 13, 1936.

The certificate plan is advanced in an attempt to place parts of the agricultural program on a permanent financial basis without dependence upon annual Congressional appropriations. Secretary Wallace's speech of December 5, 1939, leaves no doubt on this point:

> "The National Farm Program which began in 1933....is a far-flung effort in which more than three-fourths of the farmers of the United States are taking part.....
>
> "....How really permanent is that program? The Agricultural Adjustment Act of 1933 was hailed as the 'Magna Charta' for American agriculture. It gave to our farmers the unifying support of government and provided a source of revenue to keep their program going. Then a Supreme Court decision in 1936 destroyed that 'Magna Charta.' Much of it has been regained, and improved upon. But the most vital part of all -- the continuing source of revenue -- has never been put back.
>
> "Up to the present, that loss has not been seriously felt by farmers. Congress has directed that the farm programs be financed from the general Treasury. Like the appropriations for public works and unemployment relief, for the rescue of business and finance, and for building up the army and navy, these funds have come in large part from borrowed money.
>
> "Now a new situation has developed. One country after another in the Old World has fallen victim to aggression by predatory powers, and a war involving three of the strongest nations in Europe is now being fought. We in the New World find it imperative to make our own defense impregnable, lest the

1/ Henry A. Wallace, "How permanent is the farm program?" Address at the twentieth annual meeting of the American Farm Bureau Federation at Chicago, December 5, 1939. Department of Agriculture press release, page 13.

depredations that have become all too common in the Old World spread to our shores. That means we must undertake the biggest peacetime expenditures in our history for the army and the navy. That means our entire Federal budget must be given sharp scrutiny and review.

"And so in the next few months, the farmers are bound to come face to face with the question, How really permanent is the National Farm Program?" 1/

During the last session of Congress (First Session, 76th Congress) six bills were introduced to apply the certificate plan to cotton, rice and wheat. 2/ The plan for wheat (S. 2395) advanced to the hearing stage in the Senate and that for rice in both the House (H. R. 6654) and the Senate (S. 2573). The rice plan (with minor amendments) was approved by the Senate Committee on Agriculture and Forestry 3/, but failed to reach the discussion stage on the floor. The plan also has the approval of the Secretary of Agriculture. In his report on S. 2573, the Secretary stated:

1/ Ibid. page 4.
2/ The six bills are:
(1) S. 2395 (wheat) introduced by Senator Wheeler, May 10, 1939;
(2) S. 2434 (cotton) introduced by Senator Lee, May 17, 1939;
(3) H. R. 6482 (cotton) introduced by Representative Nichols, May 23, 1939;
(4) H. R. 6671 (cotton) introduced by Representative Cartwright, June 5, 1939;
(5) H. R. 6654 (rice) introduced by Representative De Rouen, June 5, 1939; and
(6) S. 2573 (rice) introduced by Senator Ellender, June 7, 1939.
3/ Report from the Committee on Agriculture and Forestry to accompany S. 2573. Report No. 763, 76th Congress, First Session.

"It is believed that the certificate program set forth in the bill constitutes a sound and desirable means for making further progress in bringing about a fair and equitable participation by rice growers in the national income. The program would be administratively practical and would avoid burdens on the Federal Treasury. Under a certificate program the increased income of farmers would be obtained in the form of increased returns from the domestic market. For this reason, a certificate program would not be subject to the difficulties, limitations, and uncertainties involved in any program that relies greatly on net appropriations from the General Fund of the Treasury."

"....the Department favors enactment of the bill." 1/

The Secretary of Agriculture went on to inform the Committee that the bill incorporating the certificate plan for rice was referred to the Bureau of the Budget and that the Director of the Budget advised the Department of Agriculture that there would be no objection on the part of his office to the submission of the Secretary's report on S. 2573 to the Congress, "with the understanding that no commitment would thereby be made as to the relationship of this legislative proposal to the program of the President."

The testimony on the wheat bill indicates that the certificate plan is sponsored by the National Farmers Union, whose representatives participated in the drafting of the wheat, cotton and rice bills. 2/ They are presumably engaged in drafting bills to cover other farm commodities. 3/

1/ Hearings on S. 2573 before a Subcommittee of the Committee on Agriculture and Forestry, U. S. Senate, 76th Congress, First Session, pages 69-71.
2/ Hearings on S. 2395 before a Subcommittee of the Committee on Agriculture and Forestry, U. S. Senate, 76th Congress, First Session, page 29.
3/ Ibid. pages 68-9.

That it is contemplated to apply the certificate plan to some of the other agricultural commodities as soon as practicable is indicated by the fact that each of the bills pertaining to cotton (and wheat) provides that:

> "Whenever the Secretary (of Agriculture) has reason to believe that a substantial majority of the producers of any agricultural commodity are in favor of establishing for that commodity an allotment-certificate plan similar to the cotton-allotment-certificate plan set up under this section, he shall conduct a referendum among the producers of such commodity. The Secretary shall report the results of such referendum to the Congress, and if two-thirds of the producers of such commodity voting in the referendum vote in favor of such a plan the Secretary shall recommend to the Congress any provisions which he deems appropriate to be included in an allotment-certificate plan for such commodity." 1/

The sponsors of the certificate plan, however, recognize that its usefulness from the agricultural point of view is limited to those commodities in connection with which the burden of a processing tax tends to be borne by consumers, processors and distributors and not by producers. "It would apparently be especially well suited to such export commodities as cotton, wheat and rice. But it would not work the same way if applied to corn. Like the old corn and hog processing taxes, it would tend to come out of the farmer's price." 2/

1/ H. R. 6482, Sec. 350A(1).
2/ Wallace, "How permanent is the farm program?" page 13.

II. Relation of the Plan to the Agricultural Program

The several certificate plans are proposed as amendments and additions to the basic agricultural program as provided by the Agricultural Adjustment Act of 1938, approved on February 16, 1938. Their workability is conditional upon the retention of the present program in most of its pertinent features. To appraise the significance of the certificate plans it is, therefore, necessary to comprehend the broad scope and operations of the agricultural program under the Agricultural Adjustment Act of 1938, the principal features of which are here summarized.

1. Acreage allotments and conservation payments.

The agricultural program provides for production control of corn, cotton, wheat, rice and tobacco. 1/ Each year, the Secretary 2/ proclaims the national acreage allotments required to produce, on the basis of average yields, the quantities of these commodities for normal domestic consumption, normal exports, normal carryover, and for various reserves. The national acreage allotments are then apportioned among the States producing these commodities. The State allotments are in turn divided among counties within the States and among farms within the counties. The bases for these apportionments vary with the commodities, but in general the basis for the State and county allotments is past acreage while that for the individual farms must take into consideration tillable acreage, crop rotation practices, type of soil, topography and production equipment.

1/ The program applies to six different kinds of tobacco, each divided into types, and each handled largely as a separate commodity.
2/ "Secretary" means Secretary of Agriculture.

Compliance by farmers with the acreage allotments is voluntary. Farmers, however, are induced to conform to the allotments by the fact that their degree of compliance is taken into account in determining eligibility for conservation and other benefit payments. The appropriation for the agricultural conservation program in fiscal year 1940 amounts to $500,000,000.

2. Crop loans.

The Commodity Credit Corporation is authorized, upon recommendation of the Secretary and with the approval of the President, to make loans on all agricultural commodities. In the case of wheat, cotton and corn, loans are mandatory. For the first two of these commodities the Secretary is free to set a loan rate between 52 percent and 75 percent of parity prices. The loan rate for corn also ranges between these limits but specific rates applicable under specific conditions are prescribed by statute, leaving no discretion to the Secretary. However, in the case of the basic commodities, if the marketing quotas discussed in the next section are rejected, no further loans on that commodity can be made until the beginning of the next marketing year.

The law specifies that "no producer shall be personally liable for any deficiency arising from the sale of the collateral securing any loan." Thus, in effect, if the market price is low, the farmer can forfeit his collateral unless the loan is extended for his future benefit; if the price rises, he can repay the loan, and reclaim and sell his commodity.

The availability of crop loans may have an important bearing on the scope of the certificate plan. Insofar as the loans tend to set what in effect amounts to a bottom for agricultural prices, the size of the differential between parity prices or cost of production and average farm prices is affected.

3. <u>Marketing quotas</u>.

The agricultural program authorizes limitations on the marketing of the five basic commodities through the establishment of marketing quotas. These marketing quotas become effective only when total supplies exceed the proclaimed normal supplies by amounts specified for each commodity in the Act. However, the quotas become effective only after they are approved in a producers' referendum. Sales in excess of marketing quotas are subject to a penalty per pound or bushel.

After approval of two-thirds of the voting farmers who will benefit by them and who ballot in a referendum conducted by the Secretary, marketing quotas for the basic commodities are allotted to the various States, counties and individual farmers. 1/ On commodities withheld from markets and stored, farmers receive commodity loans through the Commodity Credit Corporation. 2/ In this manner, some supplies otherwise available for marketing are in "surplus" years withheld from the markets by storing under seal any quantities above the marketing quota. In years of low yield and high prices these sealed supplies will be released for marketing by farmers paying off the loans.

1/ For the coming marketing year marketing quotas have been approved by referendum for cotton.

2/ Non-cooperating farmers receive only 60 percent of the amount of loans available to cooperating farmers, on that part of their crop that would be subject to penalty if marketed.

4. Parity payments.

As an additional benefit, the Act provides that when appropriations are made therefor the Secretary is authorized to distribute parity payments. Insofar as appropriations permit, these payments are intended to increase the income of farmers who comply with the Act up to the amount represented by their normal production times the parity price. The appropriation under this authorization was $212,000,000 for the 1939 program and $225,000,000 for the 1940 program.

5. Crop insurance.

The Agricultural Adjustment Act of 1938 established the Federal Crop Insurance Corporation to provide crop insurance for wheat farmers against loss through crop failure. Such insurance covers not less than 50 percent and not more than 75 percent of the average wheat yield of insured farms. The insurance premiums are payable in actual wheat or in its cash equivalent. Insured farmers may also be paid in actual wheat if they so elect.

6. Appropriations to encourage domestic consumption and exports.

In addition to the appropriations for crop loans, parity payments and the conservation program, two others require special mention.

Under Section 32 of the Amended Agricultural Adjustment Act, 30 percent of customs receipts is permanently appropriated for use in encouraging the domestic consumption and exports of all agricultural commodities. 1/ For the current fiscal year an additional appropriation of $113,000,000

1/ Total customs collections amounted to $359,000,000 and $319,000,000 in fiscal years 1938 and 1939.

is available for encouraging the domestic consumption and export of agricultural commodities. These two appropriations are used for export subsidies and payments for the Food Stamp Plan, the purchase of "surplus" agricultural commodities for relief distribution, and for diversion of "surpluses" to such unusual channels of trade as potatoes for livestock feed or starch and cotton for bagging bales of cotton.

Of the basic commodities, an export subsidy is now provided cotton. A wheat subsidy was inaugurated in September 1938 and later was extended to the current crop year, but was discontinued on December 29, 1939. Sales of wheat and flour for export totaled approximately 118 million bushels for the fiscal year ending June 30, 1939. Of this total approximately 94 million bushels were subsidized at a cost of about $25,700,000, or about 27.4 cents a bushel. 1/

A cotton export subsidy was initiated in July 1939. The rate of payment was 1½ cents per pound of lint cotton exported, with corresponding payments on cotton goods. Effective December 6, 1939, the rate of the export subsidy was cut in half to 3/4 cents per pound. On December 8 and 11 it was further reduced to 4/10 cents and 2/10 cents, respectively. Information on the cost of the export subsidy during its four months of operation is not available. However, sales and deliveries for export during the four-month period (July 27 - December 4) amounted to 4,344,354 bales 2/ or 982,000 more than the entire export in the 1938-39 crop year. 3/

1/ U. S. Dept. of Agriculture, Press Release, July 18, 1939.

2/ This represents 2,076,601,212 pounds, which at the rate of 1½ cents per pound, amounts approximately to $31,150,000.

3/ New York Times, December 6, 1939, page 39. It is not intended to imply that a causal relationship necessarily exists between the increase in exports and the availability of an export subsidy.

III. Essential Details of the Certificate Plan 1/

The provisions of the various bills incorporating the certificate plan are identical in general outline but differ with respect to some important details. The following description of the principal details of the plan is based on the proposal for rice, which is the simplest of the three commodity proposals. 2/ Where the provisions for wheat and cotton differ in important respects from that for rice, the differences are noted.

1. Certificate allotments.

Prior to the end of every calendar year the Secretary will estimate the quantity of milled rice required for domestic consumption during the next marketing year. 3/ The estimated domestic consumption will be based on domestic consumption during the preceding 5 marketing years, adjusted for recent trends. 4/ This will constitute the rice certificate allotment for that marketing year. In the case of wheat and cotton, the domestic consumption is calculated on the basis of a 10-year average and adjustments. Moreover, the certificate allotment for wheat includes, in addition, an amount equal to a normal year's exports. 5/ These certificate

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1/ The purpose of the bills providing for the certificate plans is stated in the preambles to be:

"To amend the Agricultural Adjustment Act of 1938, as amended, for the purpose of regulating interstate and foreign commerce in wheat (cotton or rice) providing for the orderly marketing of wheat (cotton or rice) at fair prices in interstate and foreign commerce, insuring to wheat (cotton) producers a parity income from wheat (cotton) based upon parity price or cost of production, whichever is higher and for other purposes."

2/ H. R. 6654 and S. 2573.

3/ The marketing years for rice and cotton begin on August 1; for wheat on July 1.

4/ The bill, however, provides that the Secretary may in the course of the marketing year make such adjustments in the domestic consumption quota as he finds to be necessary "to permit the orderly marketing of rice at prices fair to both producers and consumers...."

5/ See page 2, footnote 1.

allotments, it will be noted, are based on and are correlated with the acreage allotment, marketing quota and loan provisions of the 1938 Agricultural Adjustment Act.

2. <u>Certificates issued</u>.

At the beginning of the marketing year the Secretary will issue rice certificates corresponding to the number of pounds of the milled rice allotment for that marketing year. Thereafter he will apportion the total amount of the certificates issued among the rice producers on the basis of their respective shares in the total normal production allotted for the marketing year. The acreage allotments estimated to produce the normal production, it will be recalled, will have been made by the Secretary under the conservation program. The apportionment among producers, it will be noted, will be made on the basis of the normal production of their allotted acreage (average adjusted yield of such acreage times the allotted number of acres) without regard to yields actually realized.

3. <u>Apportionment formulae</u>.

The plan for wheat and cotton specifies that a farm's certificate allotment is to be divided among the landlords, tenants and sharecroppers in the same proportion that they are respectively "entitled to share in the proceeds of the (wheat or cotton) crop with respect to which the allocation is made."

The rice certificates will be apportioned among rice producers in proportion to the estimated normal yield of their share of the total acreage allotment. In the case of wheat and cotton, however, a reduction will be made in any person's share of these certificates (person meaning landlord, tenant or sharecropper and not the farm) in accordance with the following formulae:

For wheat:

That portion of the share which is included within the following intervals	Percentage reduction of such portion
10,000 to 12,000 bushels...........................	10
12,000 to 14,000 bushels...........................	20
14,000 to 16,000 bushels...........................	30
16,000 to 18,000 bushels...........................	40
All over 18,000 bushels...........................	50

For cotton: 1/

That portion of the share which is included within the following intervals (pounds of lint cotton)	Percentage reduction of such portion
More than 0 pounds but not more than 2,500 pounds....	0
More than 2,500 pounds but not more than 3,000 pounds	15
More than 3,000 pounds but not more than 3,500 pounds	30
More than 3,500 pounds but not more than 4,000 pounds	45
More than 4,000 pounds but not more than 4,500 pounds	60
More than 4,500 pounds but not more than 5,000 pounds	75
All over 5,000 pounds................................	90

1/ The plan for cotton appears to specify that the reduction factor shall apply to landlords in only exceptional cases. That it shall not apply "in the case of that part of a landlord's share of the allocation to any farm which calculated on the basis of the division of the proceeds of cotton produced under a tenancy or sharecropper relationship if the division of such proceeds between the landlord and the tenant or sharecropper is determined by the local committee to be in accordance with fair and customary standards of renting or sharecropping prevailing in the locality." (H. R. 6671, page 4, lines 3-11.)

4. <u>Distribution to producers</u>.

At the beginning of the marketing year the Secretary will distribute to each rice grower his pro rata share of the rice certificates on condition that "prior to the beginning of such marketing year (he) has established to the satisfaction of the Secretary that he does not have, and will not have, available for marketing during such marketing year rice .... in excess of the normal production or the actual production, whichever is the greater, of his acreage allotment for the current calendar year." Producers who fail to meet this requirement for marketing will not be eligible for the time being to receive their share of the certificates. However, small producers who plant an acreage which normally would produce not more than 100 barrels of rough rice qualify automatically. 1/

In the case of wheat and cotton the physical certificates themselves would not be given the producers but would instead be sold to a pool operated by the Secretary. (See section 6 below.) Those entitled to certificate allotments would receive their cash equivalents.

5. <u>Price of certificates</u>.

In the case of rice the price of the certificate is specified in the proposed legislation at 1 cent for each pound of milled rice it represents. No provision is made for changing the price of the rice certificate in the event of changes in the market price of the commodity.

The price of wheat and cotton certificates, however, would not be specified by statute. Their price is to be determined on the basis of

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1/ A barrel is the equivalent of 162 pounds of rough rice and will yield approximately 100 pounds of milled or clean rice.

statutory formulae. It is to be determined by calculating "the amount by which the parity price or the cost of production, whichever is the higher, exceeds the estimated average farm price.....(including parity payments) for the next succeeding marketing year." 1/

The Secretary is instructed to appoint an advisory committee, consisting of three representative wheat (or cotton) growers, one representative consumer and one representative of the Federal Government, to recommend to him the price to be fixed for wheat (or cotton) allotment certificates for the coming marketing year. The bill prescribes the statistics to be employed in determining cost of production and provides that "after considering the recommendations of the advisory committee, the Secretary, on the basis of the same statistics used by the committee, shall determine the amount by which the parity price or the cost of production, whichever is the higher, exceeds the estimated average farm price......including parity payments." This difference (after adjustment for errors in the previous year's calculations) is the fixed price of the certificates.

6. Sale of certificates.

Rice producers receiving certificates can obtain their cash value by selling them. For the purpose of facilitating transactions in certificates the Secretary is authorized to establish and operate a pool with branch offices; he may authorize local banks or other approved agencies to buy and sell certificates at a fixed price.

1/ For definitions of "parity price" and "cost of production" see page 23 below. With reference to "cost of production" see also page 3, footnote 1.

To facilitate the operation of the program the Secretary is authorized to borrow from the Commodity Credit Corporation free of interest "the funds necessary to initiate the plan." 1/ The amount of any such loan "shall be repaid from funds collected from the sale of certificates." The Commodity Credit Corporation's authority to issue obligations, which the Secretary of the Treasury is authorized to purchase, is increased by the amount loaned to the Secretary of Agriculture.

7. Ineligible producers.

Rice producers, who were ineligible to receive their share of the certificates at the beginning of the marketing year, may qualify at the end of the marketing year to receive a distribution of money equal to the value of the certificates allotted them at the beginning of the marketing year, (1) if they establish that they have not marketed rice during the marketing year in excess of the normal or actual production, whichever is the greater, of their acreage allotment, and (2) if, in addition, they have qualified to receive certificates issued for the new marketing year (meaning that they reduced their allotted acreage by the amount of the excess of their planted acreage the year before).

8. Purchase of certificates.

Every person making a first domestic sale of milled rice, or of any article manufactured wholly or partly from milled rice, is required to obtain from the Secretary, prior to or at the time of such sale, rice

1/ The original rice bills (and the wheat and cotton bills as well) provided for borrowing from the Reconstruction Finance Corporation. The rice bill, as reported out by the Senate Committee, has been amended to provide for borrowing from the Commodity Credit Corporation. Corresponding changes are being made in the other bills.

domestic-allotment certificates representing the number of pounds of milled rice involved in the sale. The amount of certificates required to be purchased in connection with the sale of articles manufactured from rice is equal to the milled rice equivalent of the article sold. The Secretary will prescribe the conversion factors for all such manufactured articles.

A compensating provision requires importers of rice or rice products to obtain certificates in connection with each importation. The certificates are to be purchased from the Secretary at their prescribed price and are valid to cover only sales made during the marketing year for which issued. Unused certificates will be redeemed by the Secretary. Trafficking in certificates is prohibited. No certificates are required in connection with the sale of manufactured goods for export. In the event of exportation of goods for which certificates have previously been purchased, provision is made for refund by the Secretary. No certificates are to be used in connection with the sale of rough rice by producers. All transactions in unprocessed commodities, whether for export or for the domestic market, would be carried out in the usual manner.

The provisions respecting the purchase of wheat certificates differs in one important respect from those governing rice and cotton certificates.1/ While the plans for rice and cotton provide that each first sale of the manufactured products must be accompanied by the purchase of certificates in direct ratio to their rice or cotton content, the plan for wheat prescribes that the first domestic sale of every article representing one

1/ See, however, page 2, footnote 1.

bushel of wheat shall require the purchase of certificates representing 1-1/5 bushels of wheat. This 20 percent surcharge is necessitated by the fact that the wheat certificates are distributed to the growers in proportion to their total normal production, which includes allotments for both normal domestic consumption and for normal exports, while the purchase of certificates is required only in connection with the domestic sale of wheat products. Exports are exempt.

9. Monthly returns.

Every person making sales of milled rice or any article manufactured from milled rice and every importer of such products is required to file a monthly return with the Secretary of Agriculture, showing the quantity of milled rice imported or sold during the preceding month and attaching thereto the certificates required to be purchased in connection with such sales or importations. The Secretary is authorized to issue such regulations and make such examinations as he deems necessary in connection with the enforcement of this provision.

10. Miscellaneous provisions.

None of the funds collected from the sale of certificates "shall be covered into the general fund of the Treasury." Any surplus or deficit resulting from the operations of the certificate pool in any year will be adjusted in the following year by increasing or decreasing the number of certificates issued. In case of a surplus, additional certificates will be issued to producers and when repurchased by the pool will be canceled. A deficit in the funds will be made up by issuing an equivalent quantity of the certificates in the following year directly to the pool to be sold by it, and deducting the quantity from the certificates issued to producers.

The Secretary is authorized to use the funds collected from the sale of certificates or borrowed from the Commodity Credit Corporation to cover necessary administrative expenses incurred in connection with the operation of the plan in and out of the District of Columbia. He alone is responsible for all accounting, disbursements and determinations under the Act. Penalties are provided for non-compliance.

IV. Tax Features of the Certificate Plan Compared with Processing Taxes 1/

In substance the adoption of the certificate plan, as proposed, would be the equivalent of the enactment of a processing tax. Such a tax, however, would differ in some respects from the processing taxes imposed under authority of the Agricultural Adjustment Act of 1933, as amended.

1. Commodities taxed.

Bills introduced at the last session of Congress provide for the imposition of certificate taxes on wheat, cotton and rice. 2/ It is, however, the intention of the sponsors of the certificate plan to propose its extension to some other farm commodities as soon as practicable. Presumably, it is not intended to apply certificate taxation to those commodities a processing tax on which would tend to fall on producers and not on consumers, processors or distributors. (See page 7 above).

The Agricultural Adjustment Act of May 12, 1933 did not directly impose any processing taxes. Instead, it provided that "When the Secretary of Agriculture determines that rental or benefit payments are

1/ The discussion of the invalidated processing taxes in this section is adapted in large part from a memorandum entitled "Processing Taxes," submitted by Carl Shoup at the request of the Division of Tax Research of the Treasury Department, December 24, 1938. (In files of Division of Tax Research, Treasury Department.)

2/ As here used, the term "certificate tax" refers to the required purchase of certificates by those responsible for the first domestic sale of manufactured rice and its manufactured products, as prescribed under the certificate plan. It is to be distinguished from the processing taxes imposed under the Agricultural Adjustment Act of 1933, as amended.

to be made with respect to any basic agricultural commodity (wheat, cotton, field corn, hogs, rice, tobacco and milk and its products, to which by later acts were added rye, flax, barley, grain sorghums, cattle, peanuts, sugar beets, sugar cane and potatoes) he shall proclaim such determination, and a processing tax shall be in effect with respect to such commodity from beginning of the marketing year therefor next following the date of such proclamation."

The Sugar Act of 1937, approved September 1, 1937, imposes an excise tax on manufactured sugar manufactured in the United States and a compensating tax on imports of manufactured sugar.

2. Rate of tax.

In the case of rice, the plan specifies the rate to be 1 cent per pound of clean (milled) rice. For cotton no rate is specified. Instead a formula is prescribed. The rate is equal to the excess of the parity price or the cost of production price, whichever is higher, over the estimated average farm price, including parity payments. 1/ For wheat

1/ See page 3, footnote 1. The "parity price" for basic agricultural commodities is defined as that price "which will give to the commodity a purchasing power with respect to articles that farmers buy equivalent to the purchasing power of such commodity in the base period; and, in the case of all commodities for which the base period is the period August 1909 to July 1914, which will also reflect current interest payments per acre on farm indebtedness secured by real estate, tax payments per acre on farm real estate, and freight rates, as contrasted with such interest payments, tax payments, and freight rates during the base period. The base period in the case of all agricultural commodities except tobacco shall be the period August 1909 to July 1914, and, in the case of tobacco, shall be the period August 1919 to July 1929."

"Parity income" is defined as "that per capita net income of individuals on farms from farming operations that bears to the per capita net income of individuals not on farms the same relation as prevailed during the period from August 1909 to July 1914." (Agricultural Adjustment Act, as amended, Title III, Subtitle A, Section 301(a)(1)(2).)

the rate is 120 percent of this excess. 1/ In figuring cost of production rent, labor costs and allowances for unpaid family labor are to be included.

Under the processing taxes the rate was such as to equal "the difference between the current average farm price for the commodity and the fair exchange value of the commodity." Later, the rate was this amount plus a percentage of this difference, not to exceed 20 percent, sufficient to cover the refunds on deliveries to charitable organizations and the tax that was not levied and collected owing to the fact that the processing was done by a State or its instrumentality.

The formula for the rate of the certificate tax is nominally similar to that for the rate of the processing tax. "Fair exchange value" is but a different term for parity price. It was defined in the 1933 Act as the price "that will give the commodity the same purchasing power, with respect to articles farmers buy, as such a commodity had during the base period." During the intervening period, however, the definition of parity price has been broadened. It will be noted by reference to the definition quoted on the preceding page, that at present parity price must also "reflect" "current interest payments," "tax payments" and "freight rates." This change in definition, together with a rise in the prices of articles farmers buy, has served to raise parity prices and thereby to widen the differential between parity prices and average farm prices.

The formula for the certificate tax introduces the element of "cost of production" which did not appear in the earlier tax. 2/ Although the cost of production data now available indicate that cost of production

1/ See page 2, footnote 1.
2/ See page 3, footnote 1.

is less than parity price, there are no grounds for assuming that it will remain so. However, the certificate plan significantly prescribes that cost of production be calculated on the "most recent United States cost of production" data published by the Bureau of Agricultural Economics.

Finally, the two formulae differ in one other important respect. In the case of the certificate tax the differential between parity or cost of production and average farm price is the mandatory tax rate. 1/ Under the processing taxes, on the other hand, the Secretary had considerable discretionary authority. If he found that the differential between "fair exchange value" and average farm price would "cause such reduction in the quantity of the commodity or product thereof domestically consumed as to result (a) in the accumulation of surplus stocks of the commodity or products thereof, or (b) in the depression of the farm price of the commodity" he was to set the tax rate at such a level as to prevent such accumulation of stocks and such depression of prices. Moreover, the Secretary could change processing tax rates at such intervals as he found necessary, whereas the rate of the certificate tax can be changed only annually.

1/ It is understood that consideration is being given by the Department of Agriculture to the desirability of providing minimum and maximum value limits for the certificates.

On the basis of current data, the tax rates indicated by the certificate plans are estimated to compare approximately as follows with those imposed under the processing taxes. 1/

	Certificate tax rate	Processing tax rate
Rice	1¢ per lb. of milled rice	1¢ per lb. of rough rice, equivalent to 1.62¢ per lb. of milled rice.
Cotton	7.1¢ per lb. of lint cotton 2/	4.2¢ per lb. of lint cotton
Wheat	48.1¢ per bushel of 60 lbs. (40.1¢ if parity prices on exports are not provided) 3/	30¢ per bushel of 60 lbs.

1/ The certificate plan specifies the inclusion of "parity payments" in determining average farm price. Since, however, the plan itself is offered in lieu of parity payments, such payments are ignored in the computation of the above tax rates.

2/	Average farm price (11/15/1939) per lb. of cotton 4/	= 8.80¢
	Parity price (11/15/1939) per lb. of cotton 4/	= 15.87¢
	Average cost of production (in 1937 on 10-year average yield basis) 5/	= 12.4 ¢
	Excess of parity price over average farm price	= 7.07¢
3/	Average farm price (11/15/39) per bushel of wheat 4/	= 73.1 ¢
	Parity price (11/15/39) per bushel of wheat 4/	= 113.2 ¢
	Average cost of production (in 1937 on 10-year average yield basis) 5/	= 103.0 ¢
	Excess of parity price over average farm price	= 40.1 ¢
	120 percent of excess	= 48.1 ¢

4/ U. S. Department of Agriculture, Agricultural Marketing Service, November 29, 1939, pages 3, 21.

5/ Hearings on S. 2395, pages 9, 80.

3. Base of tax.

The certificate tax is to be levied on the "first sale of any article manufactured wholly or partly" from the given agricultural commodity. It is to be paid by the person making such sale at the time the sale is made and evidence of compliance must be submitted before the end of the month following that in which the sale was made. The processing taxes were "levied, assessed and collected upon the first domestic processing of the commodity, whether of domestic production or imported" and were paid by the processor.

The certificate plan taxes, like the processing taxes, are to be levied simply on a quantity basis - so many cents per pound or bushel - without regard to the type and quality of the commodity or price of the agricultural product.

4. Compensating tax.

Under the certificate plan a tax corresponding to the tax on the domestic sale of the manufactured commodity is imposed on imports. This has its counterpart in the import compensating tax provided under the processing taxes, which imposed upon any article processed or manufactured wholly or partly from the commodity in question and imported into the United States from any foreign country a compensating tax equal to the amount of the processing tax in effect with respect to domestic processing at the time of importation.

The processing taxes provided for compensating floor stock taxes on any article (excepting the stocks of persons engaged in retail trade) that, on the date a processing tax "first takes effect," was "held for sale or other disposition (including articles in transit) by any person," provided the article was "processed wholly or in chief value" from the commodity in question. No corresponding compensatory floor stock tax is provided by the certificate plan.

Under the processing tax the Secretary was instructed to ascertain whether "the payment of the processing tax upon any basic agricultural commodity is causing or will cause to the processors thereof disadvantages in competition from competing commodities by reason of excessive shifts in consumption between such commodities or products thereof." If he so found, he was to proclaim a tax, at a rate "necessary to prevent such disadvantages in competition" on the first domestic processing of the competing commodity. No corresponding compensating tax on competing products is provided for under the certificate plan.

5. Conversion factors.

Under the proposed bills, as well as under the processing taxes, the Secretary is given the power to establish conversion factors for any commodity and article manufactured from agricultural commodities taxed.

6. Exemptions and refunds.

Under the certificate plan the sale of commodities for export is exempt. In those instances in which a commodity exported had previously been subjected to the tax, refunds are provided. To prevent pyramiding, the tax is to be imposed only once. Articles processed or manufactured from another article which had previously been taxed are to be exempt. These constitute the only exemptions and refund provisions under the certificate tax plan. Unlike in the case of the processing tax, no provision is made for refund on or exemption to "products used for charitable distribution or use."

7. Tax load.

On the basis of the tax rates indicated above and on the basis of the Department of Agriculture's estimates of consumption, the annual tax liability under the proposed certificate taxes for rice, cotton and wheat, together with corresponding collections under the processing taxes, are calculated below. 1/ No allowance is made for the effects of the tax on the volume of consumption. 2/

	Rice (Milled)	Cotton (Lint)	Wheat
Estimated domestic consumption (in 1,000,000 units)	1,100 lbs.	3,350 lbs. 3/	500 bu.
Tax rate (per unit of volume or weight)	1¢	7.1¢	48.1¢ (40.1¢) 4/
Calculated tax liability (rounded)	$11,000,000	$238,000,000	$240,000,000 ($200,000,000) 4/
Processing tax collections, fiscal year 1934	5/	$144,767,233 6/	$117,621,175
Processing tax collections, fiscal year 1935	$ 29,120	$ 95,926,302	$123,860,932

1/ Processing tax collections are shown in detail in Exhibit 1.

2/ For some commodities this, of course, is an important factor. It has been estimated, for instance, that in the case of cotton (under conditions existing in 1934 and 1935) a tax which is equivalent to 4 cents per pound gross weight, if all passed on to consumers (raising prices to 10-12 cents), would probably reduce domestic consumption about 400,000 to 500,000 bales annually. (Bureau of Internal Revenue, An Analysis of the Effects of the Processing Taxes Levied under the Agricultural Adjustment Act, page 36.) In the case of wheat, on the other hand, the 30 cents per bushel processing tax was estimated to decrease consumption not more than 3 percent. (Ibid. page 27.)

3/ Representing 7,000,000 bales of cotton; 1 bale (net) is equal to 478 pounds.

4/ Amounts in parenthesis apply if parity prices on normal exports are not provided.

5/ Processing tax on rice did not become effective until April 1, 1935.

6/ Includes $58,000,000 floor stock tax.

8. <u>Date of termination</u>.

The bills providing for certificate taxes on wheat, cotton and rice contain no specific provision regarding the length of time for which the taxes are to remain in effect. In the absence of a statement to the contrary, it is to be assumed that they will remain in effect until specifically repealed. Secretary Wallace's public statements tend to indicate that the proposed certificate plan is intended as a permanent feature of the agricultural program. The rates proposed in the case of wheat and cotton are such that by implication, the plan would be discontinued, when the average farm price of these agricultural commodities was not less than either the parity price or the cost of production.

The processing taxes were to terminate at the end of the marketing year current when the Secretary proclaimed that rental or benefit payments of the commodity were to be discontinued. In addition, the taxes might have been terminated by either the President or the Secretary.

9. <u>Tax administration</u>.

Responsibility for the administration of the certificate plan in all its aspects, including the receiving of monthly "tax" returns and the collection of "taxes," is vested with the Secretary of Agriculture. 1/

In the case of the processing taxes imposed under the Agricultural Adjustment Act of 1933, the Bureau of Internal Revenue, under the direction of the Secretary of the Treasury, was charged with the collection of taxes.

1/ See page 2, footnote 2.

Collections from the excise tax on sugar are paid into the general fund of the United States Treasury. Collections from processing taxes were also paid into the general fund, but the Act stated further that "the proceeds derived from all taxes imposed under this title are hereby appropriated to be available to the Secretary of Agriculture for expansion of markets and removal of surplus agricultural products and the following purposes under part 2 of this title (part 2 was entitled "Commodity Benefits"): Administrative expenses, rental and benefit payments, and refunds on taxes." The proceeds of the import compensating tax upon articles coming from the possessions of the United States to which this title did not apply were to be "held as a separate fund and paid into the Treasury of the said possessions, respectively, to be used and expended by the Governments thereof for the benefit of agriculture."

V. Incidence of Proposed Certificate Taxes

The certificate plan proposes to make benefit payments to the producers of selected agricultural commodities from the proceeds of certificate taxes imposed on the first domestic sale of these agricultural commodities in processed condition. The determination of the incidence of such taxes presents complex problems. Conceivably, a tax such as this might ultimately be borne, in whole or in part, by the processors, the several distributors, the consumers and even the producers themselves. 1/

The incidence of certificate taxes on particular commodities may be expected to approximate in a general way the incidence of the old processing taxes on these particular commodities. However, two or three conspicuous differences in the conditions under which the two groups of taxes were and would be imposed should be noted.

The processing taxes were imposed for a relatively short period; in no instance for more than 30 months (wheat) and in one case for only 9 months (rice). In consequence, the incidence of any of the processing taxes may differ from the incidence of corresponding certificate taxes, which presumably would be of more permanent duration.

1/ Although, as has been noted above, there is no intention to propose the application of the plan to those commodities a certificate tax on which would tend to be shifted to producers.

The two groups of taxes may be expected to exhibit differences, particularly in their effect upon supplies coming from producers. The duration of the processing taxes was probably too short to enable producers to adjust their plantings to the changed marketing conditions - a situation which was intensified by the fact that the processing taxes were accompanied by rigid limitations on agricultural production. In a general way the proposed certificate plan contemplates similar limitations upon production.

A further difference in the incidence of the two groups of taxes may be expected to result from differences between economic conditions prevailing in 1934 and 1935 and those which may prevail when the proposed certificate taxes are in effect. Changes in the income and purchasing power of consumers, for instance, are of great importance in this connection.

Finally, as must already have become apparent, the technical features of the processing taxes (however crude in the abstract) were more carefully integrated - with respect to exemptions, refunds and compensatory levies, for instance - than is practicable in the case of a tax administered as an incident in the agricultural program rather than as an integral part of the Government's tax system.

The distribution of the tax burden of the processing taxes has been subjected to detailed examination by several investigators. Notwithstanding the limitations upon the applicability of the "incidence experience" under the processing taxes to the proposed certificate taxes, it may be assumed that, in view of the complexity of incidence determination, more weight can reasonably be attached to the careful findings respecting the processing taxes than to such findings as might be made after an independent but more limited (as to statistical evidence, time and technical skill) investigation of the probable incidence of certificate taxes. For that reason no attempt was made to estimate independently the probable incidence of certificate taxes.

The most authoritative analysis of the incidence of the processing taxes appears to be one made by the staff of the Bureau of Agricultural Economics and published by the Bureau of Internal Revenue as An Analysis of the Effects of the Processing Taxes Levied under the Agricultural Adjustment Act (Washington, 1937, 111 pages). It was based largely on an examination of prices and spreads before and after the particular taxes were imposed (or changed) and after they were abolished. The general conclusions of the incidence analysis of the Bureau of Agricultural Economics have been previously summarized and their limitations indicated in a memorandum prepared for the Division of Tax Research by Carl Shoup and need not here be repeated. 1/ For purposes of ready reference, however, the conclusions of the Bureau of Agricultural Economics study respecting the incidence of the processing taxes on the three commodities for which certificate plan bills have already been introduced are here enumerated.

1/ Carl Shoup, "Processing Taxes." Memorandum in the files of the Division of Tax Research, Treasury Department.

In connection with these conclusions, it should be kept in mind, in addition to the reservations already made, that they are derived with a technique which assumes that any changes in prices and spreads during the imposition of the processing taxes were due exclusively to the processing taxes themselves. In other words, it does not consider the possibility (although it recognizes its existence) that other changes may have occurred which on the one hand may have neutralized the effects of the taxes or which on the other hand may have been neutralized by the taxes.

Finally, the reader should be cautioned against accepting these conclusions as definitive findings, particularly since they are here presented out of context and shorn of all the reservations and qualifications which clothe them in the Bureau's publication.

1. Cotton (page 36) 1/

   (a) "....from the standpoint of the cotton-textile industry as a whole very little of the processing tax was borne by manufacturers as a group in the form of lower mill margins;

   (b) "....distributors of cotton goods were able to increase their margin more than enough to take care of the processing tax;

   (c) "....the processing tax in large part was passed on to consumers in the form of higher prices for cotton goods or passed back to the producers in the form of lower prices for their raw cotton;

   (d) "....the portion of the tax borne by domestic producers was probably slightly less than one-half cent per pound."

1/ Page references are to Bureau of Internal Revenue, An Analysis of the Effect of Processing Taxes under the Agricultural Adjustment Act.

2. Rice 1/ (page 59)

(a) "....only a small portion, if any, of the processing tax was absorbed by rice millers;

"....there is no evidence that the tax was passed on to consumers;

"it follows, that a large part of the tax represented in effect a deduction from the price which otherwise would have been received by producers."

3. Wheat (page 27)

(a) "....the millers did not absorb an appreciable portion of the tax, if any;

(b) "....the price of wheat appeared substantially unaffected by the tax;

(c) "it follows....that the tax must have been passed on to consumers of the products of wheat milling."

1/ "The period in which the processing tax was in effect was very short, and it is doubtful whether the long-run effects would have been the same as during the short period."

VI. Analysis of Certificate Plan

In considering the probable effects of the enactment of the certificate plan upon the various phases of the Nation's economy, it is essential to keep in view the basic philosophy of the agricultural program. The certificate plan is but the current instrumentation of an economic objective which runs through all of the agricultural adjustment legislation (proposed and enacted) of the last two decades. In its barest form that philosophy starts with the assumption that for 20 years the farmer has not received a "fair share" of the national income; that agricultural income must be increased substantially and maintained permanently at the higher level; that the improvement of the economic position of the farmer is prerequisite to the stability and progress of the whole economic system.

Speaking of the 1933 farm legislation, Secretary Wallace said:

> "Its basic purpose, first of all, is to increase the purchasing power of the farmers. It is, by that token, farm relief, but it is also, by the same token, national relief, for it is true that millions of urban unemployed will have a better chance of going back to work when farm purchasing power rises enough to buy the products of city factories." 1/

The philosophy has changed little during the past seven years. In an address before an agricultural group within the past few days, the Secretary's philosophy takes on even more concrete form:

> "The 7 million farm families, constituting 25 percent of the population of the United States, are educating 31 percent of the children of school age, but they receive only 11 percent of the national income. This is substantially higher than the 7 percent which was their share in 1932 and is about equal to

1/ Henry A. Wallace, radio address, March 18, 1933.

the share they received in the five years before the Great Depression.. But farmers are still at a severe handicap in comparison with non-farm groups. Even with government payments figured in, they are still more than a billion dollars short of parity income as defined in the Agricultural Adjustment Act of 1938.

"As a matter of fact, farmers never have received as much income on the average as the rest of the people. Even in the pre-World War period the farmers' net income per capita was only 60 percent as much as the net income per capita of non-farm groups. In other words, the farmers have constantly fed the nation at a 40 percent discount. Steadily they have contributed not only half of their children to the cities, but a considerable part of their wealth in the form of interest payments on mortgages, held as a result of inheritance by the farm children who have moved to town. Also, the farmers have always absorbed more than their fair share of the unemployment shock....

"For 20 years the organized farm groups of the United States.....have struggled to attain a fair share of the national income for agriculture. For 20 years they have striven for equality of bargaining power with the other great economic groups. For 20 years, no matter how desperate their own circumstances, they have faithfully fed the nation while they fought this grim uphill fight. I don't think they'll run up the white flag now." 1/

A. Effects on agricultural producers.

1. Amount of benefit payments. The adoption of the certificate plan will afford large benefit payments to the producers of the agricultural commodities affected. These benefit payments will probably be considerably higher than are likely to be made available through appropriations from the general fund of the Federal Treasury. They may in fact be the maximum that agriculture could obtain if it were free to determine the domestic market prices of agricultural commodities. The possible upper limit on the prices of certificated commodities

1/ Wallace, "How permanent is the farm program?" pages 7-8.

is so high that whether agriculture can in fact derive the maximum income from the domestic market will depend only on its ability to set that price which, with the given domestic demand, will yield the maximum farm income. 1/

The benefit payments to producers of basic agricultural commodities under the certificate plan will be in addition to some of the "farm benefit" expenditures now financed from general appropriations. 2/ Expenditures under the soil conservation program, for instance, would be continued.

> "This program for saving our soil, water, grass, and trees is not in the interest of agriculture only. It is in the interest of the entire nation. Conservation of the land and the living products of the land must be done by the farmers if it is going to be done. But paying for it is not the sole responsibility of the farmers. It is a national responsibility. Money for the conservation program, therefore, can logically come from the general Treasury." 3/

From the point of view of agriculture, adoption of the certificate plan should also leave unaffected expenditures from the general fund to stimulate consumption of agricultural products by direct distribution of surplus farm products to needy families and through such devices as the Food Stamp Plan and free school lunches.

> "If the workers of the United States were fully employed at good wages, there would be no need for these measures to expand domestic consumption. But when 20 million persons must look to Federal, State or local government, if they want to stay alive, then food consumption is below normal......The added food

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1/ Of course, the resulting artificiality of agricultural prices may be considered a serious disadvantage.

2/ See, however, page 52 below.

3/ Wallace, "How permanent is the farm program?" page 11.

consumption in the cities naturally means a great deal to farmers, because it helps to use up their surplus production. But it also means a great deal to the city business men and city workers. And it means most of all to the needy families themselves. Since this government-subsidized consumption of food has been made necessary by unemployment, there is a serious question whether it should be charged up to agriculture at all." 1/

Instead of reducing, the adoption of the certificate plan may increase Federal expenditures for the stimulation of consumption. The marked price increases may reduce consumers' purchases, increase surpluses and hence government expenditures for the disposition of surpluses.

2. Regularity of benefit payments. In the long run, the certificate plan would probably provide benefit payments with greater regularity than is possible by direct Congressional appropriation. Once enacted, the plan would not be subject to annual Congressional review to which the budget is regularly subjected. 2/ In a sense the plan would constitute a permanent appropriation. Since the plan itself incorporates no termination date as such, it would presumably remain in effect until specifically repealed. 3/ The permanency of benefit payments appears to be greatly desired by agriculture. 4/ It regrets the necessity of

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1/ Ibid. pages 11-12.

2/ In a sense, this may be interpreted as a disadvantage, even from the point of view of agriculture itself, for it would tend to postpone such fundamental readjustments in agriculture as may be urgently needed.

3/ Section 32 of the Agricultural Adjustment Act as amended already earmarks 30 percent of customs receipts for the expansion of agricultural markets.

4/ "....I feel it is essential that the farmers should - as quickly as possible - get behind some plan that will assure them a permanent source of revenue they need." (Statement of the Secretary of Agriculture, Washington Star, December 1, 1939).

annually coming "back to Congress.....to ask for the necessary funds to run the farm program." 1/

It might also be of advantage to agriculture that the benefit payments under the certificate plan would be hidden from public view in the sense that they would not appear in the actual statistics of governmental tax collections and expenditures. In the form of certificate taxes they would be less likely to provoke public criticism and inquiry than processing taxes. 2/

3. Volume of exports. The increased benefit payments resulting from higher domestic agricultural prices will have the added advantage of retaining for the American farmer substantially the same competitive advantage in the foreign markets as he would have without the operation of the certificate plan. This follows from the fact that the plan leaves

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1/ "Ever since the Hoosac Mills decision in 1936, the farmers, hat in hand, have had to come back to Congress -- representing all the people -- to ask for the necessary funds to run the farm program. Each year the people through Congress have granted the request. But each year the farmers are asked by spokesmen for industrial and financial interests, How long is this going to go on, with agriculture getting this amount of money? The farmers naturally wonder why they alone, of all the great economic groups, have to come back each year and meet a fresh challenge by other economic groups to their method of attaining bargaining equality. Farmers have not asked that labor come back and seek a renewal of the bargaining power laws which give working men an added income of billions of dollars a year. They wonder why business should not have to come back each year and have its tariff validated. They would like to ask, How long are we going to pay tribute of billions of dollars a year in the form of tariff-protected prices? If agriculture has to come back to Congress each year to get a partial equality in bargaining power, farmers would like to know why labor, corporations, and tariff-protected industry should not be forced to pass a similarly-rigid annual inspection." (Wallace, "How permanent is the farm program?" page 9.)

2/ However, there is the possibility that the existence of these special taxes falling on the masses of the population would present a constant target for political action which might lead to a reaction against both the tax and the benefits.

the "farm price" unchanged, but imposes the certificate tax after the processing of the farm product. It is interesting that when the certificate plan was first evolved for use by Central European agrarian countries (depending entirely on agricultural exports for foreign exchange) its sole purpose was to stimulate agricultural exports.

Far from hindering exports, it is clearly the intention of the advocates of the certificate plan to use it to stimulate exports. In the plan for wheat, it will be recalled, a tax is imposed on domestic consumption to yield the wheat producer (at the expense of the domestic consumer) a parity price both on domestically consumed wheat and on wheat exported (in quantities equal to 20 percent of domestic consumption.) 1/ 2/ The certificate plan is ideally suited for the subsidizing of

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1/ See Hearings on S. 2395 before the Subcommittee of the Committee on Agriculture and Forestry of the U. S. Senate. (page 5).

<u>Senator Ellender</u>. Would payments be made on that which is set aside for export purposes?

<u>Mr. Thatcher</u>. The bill provides that in the 600,000,000 bushels of wheat, which, over a period of time, has annually disappeared, 500,000,000 in the United States and 100,000,000 abroad, the bill provides that the farmer would be paid parity price or cost of production, whichever is higher. And for this reason: We believe that if it is desirable to maintain foreign markets for that much wheat, that the shock of producing that wheat at foreign prices, which are admittedly, usually below, much below cost of production, the whole country should share in the maintenance of that foreign market and not leave the shock to the wheat producer alone, who buys all of his supplies for his production and his living at domestic prices which are protected by tariffs, and if he is going to have the money to pay for those supplies he is going to have to have the income from the things that he produces.

2/ However, see page 2, footnote 1.

exports, at domestic consumers' expense, of those agricultural commodities for which the domestic demand is such that the quantity consumed will not be curtailed directly as the price is increased.

4. Miscellaneous considerations. The certificate plan would have several other advantages from the point of view of agriculture. It would, for instance, provide a kind of gratuitous crop insurance. The crop allotment certificates would be distributed among the growers of the particular commodities in proportion to the normal yield of their respective allotments. These benefit payments would thus constitute a kind of fixed income received by growers without regard to the actual yield of their acreage. Moreover, if eligible, they would receive these benefit payments sometime at the beginning of the crop year and before harvest.

The certificate plan may be expected to make regulation of the volume of agricultural production more effective. The magnitude of benefit payment would be so large that only the exceptional producer could afford to remain a "non-conformer."

5. Degree of applicability. The certificate plan, however, has several shortcomings, even from the point of view of agriculture. First, it cannot be used with uniform effectiveness for all commodities. It cannot serve effectively to raise the income of farmers producing commodities, the domestic demand for which is relatively elastic (where consumer purchases are appreciably reduced as the price increases). 1/

1/ Except, of course, as a means of differentiating between cooperating and non-cooperating farmers in the distribution of benefit payments.

Hogs are a case in point. The demand for pork and its products appears to be such that, irrespective of price, total consumers' expenditures remain the same; an increase in price tends to produce a corresponding decrease in the volume of consumption and vice versa. Under the processing taxes, for instance, the total amount expended by consumers for pork products apparently was no greater with the tax than it would have been if the tax had not been in effect. The effect of the tax was to cause prices received by hog producers to be lower than they otherwise would have been by approximately the amount of the tax. 1/

Wheat, as has already been noted, presents a different case. The demand for wheat and its products appear not to be affected to any appreciable extent by changes in wheat prices. Wheat farmers would apparently derive great benefits from the certificate plan. However, there are a variety of agricultural commodities with a variety of demand conditions, each with prospects of deriving varying degrees of benefits from the certificate plan.

The advocates of the certificate plan recognize its weakness in this respect and propose to devise other means for the benefit of commodities with relative elastic demands -- where an increase in price tends to reduce consumers' purchases appreciably. 2/

1/ An Analysis of the Effects of the Processing Taxes Levies under the Agricultural Adjustment Act, page 7.

2/ "If, in spite of all our ingenuity, no equivalent for the certificate plan can be found for corn, I am sure the Corn Belt will not stand in the way of the good fortune of their brother farmers from the other regions. I know how broad-visioned the Corn Belt leaders are, and I am sure that their outstanding concern is to see the maximum unity of agriculture in presenting to the people and to Congress the farm program that will best serve the General Welfare." (Wallace, "How permanent is the farm program?" page 16).

6. <u>Different quality products</u>. Another weakness of the certificate plan from the point of view of agriculture stems from its failure to recognize variations in type, quality and regional differences as reflected in the market prices of any one general agricultural commodity. The plan contemplates the distribution of certificates on the basis of physical units of normal production. Since all certificates for any one commodity would have uniform value, they would represent a relatively larger benefit payment to producers of a low-priced variety and quality of product than to the producer of a high-priced variety and quality. The extent of this inequity is indicated by the following data. 1/

	Cotton (lb.)	Rice (bu.)	Wheat (bu.)
Average farm prices:			
United States	8.80¢	-	73.1¢
State with lowest average	8.10¢	67¢	59.0¢
State with highest average	10.40¢	80¢	120.0¢
Parity prices	15.87¢	-	113.2¢
Value of certificate	7.07¢	27.8¢	40.1¢
Value of certificate as percent of average farm price for producer in:			
State with lowest average price	87%	41%	68%
State with highest average price	68%	35%	33%

For the three commodities here analyzed, the value of the certificate as a percentage of average farm price would range between 68 percent and 87 percent for cotton; between 35 percent and 41 percent for rice; and between 33 percent and 68 percent for wheat. These variations are on the basis of State averages. The range in relative benefit will, of course, be considerably wider between individual producers.

1/ Prices as of November 15, 1939. (Agricultural Marketing Service, November 29, 1939).

It should be recognized that these wide State-by State variations in average farm prices for specific commodities are in part variations between commercial and non-commercial areas. Within commercial areas the variations are considerably smaller. Since a State which constitutes a commercial area for one crop is generally a non-commercial area for one or more others, it might be assumed that benefit payments distributed on the basis of production of individual commodities without regard to price or quality, would tend to equalize. A relatively high cash benefit on a low priced commercial crop might be offset by a relatively low cash benefit on a high priced non-commercial commodity. The plan here under consideration, however, will be applied only to few agricultural commodities and equalization of advantages will therefore have little opportunity to occur.

7. Landlords and farm labor. Finally, the proposed certificate plan would bestow unequal benefits upon different elements in the agricultural economy. Landowners, as the equity holders in farm enterprise, would of course be the largest gainers. Unless the plan resulted in a substantial increase in the wages of farm labor (not likely in view of the relatively large supply of farm workers) it would probably be of little benefit to that group. In fact, it is quite likely that agricultural labor, insofar as it purchases food and clothing, would be a substantial loser as a result of increased consumers' food and clothing

prices. The farm labor group would lose also if the adoption of the certificate plan were followed by reduced consumers' demand, higher surpluses, leading ultimately to lower agricultural production and lower farm employment.

The certificate plan in the case of wheat and cotton provides for the distribution of these certificates between landlord and tenant or sharecropper on the basis of the respective shares of these groups in the net farm product. It will be noted that to the extent that the present distribution between these parties is now in favor of the landlords (as it is frequently alleged to be) it will be perpetuated by the adoption of the certificate plan. This tendency, however, should be offset to a considerable extent for wheat and to a lesser extent for cotton by one feature of the certificate plan: The amount of certificates per unit of normal production decreases as the amount of a person's total product increases above a given level. 1/ This provision might reasonably be expected to encourage farm tenancy and increase farm employment.

1/ However, with regard to the present provisions of the certificate plan bills for cotton, see Section III (3) above.

B. Effect on agricultural trades.

The adoption of the certificate plan may be expected to affect adversely processors and distributors. These adverse effects would flow from three general causes.

1. Margin of profit. The margins of profits of processors and especially distributors are so small in relation to the amounts of the proposed taxes that the necessity of absorbing any small part of the tax would seriously affect their profits. Such necessities doubtless arise when the addition of the tax to the price would require a fractional price adjustment. Under the processing taxes processors do not appear to have borne any appreciable proportion of the taxes, with the possible exception of certain corn and tobacco products. 1/ However, even though a processor bore no appreciable proportion, he might have been severely burdened. His margin of profit may be so small relative to the tax that even if he shifts nine-tenths of it, for instance, the part that he does bear may take a very large percentage of his profits. 2/

1/ An Analysis of the Effects of the Processing Taxes Levied under the Agricultural Adjustment Act, page 5. See also Nourse, Davis and Black, Three Years of the Agricultural Adjustment Administration, pages 313, 414: "...during the period of application of processing taxes on tobacco, a substantial part if not all of it was absorbed by the manufacturers of tobacco products. It is extremely doubtful if this situation would have continued indefinitely.... and it certainly must not be regarded as typical of the commodities covered."

2/ In this connection it is of interest to note that at the time of the processing taxes it was argued that the burden would not be shifted in its entirety to consumers but would go to reduce "excessive" distributors' and processors' margins. (For evidence on this point see Three Years of the Agricultural Adjustment Administration, pages 412 et seq.)

2. Volume of trade. Processors' and distributors' profits would also be affected adversely by the decline in the volume of consumption which would follow the imposition of heavy taxes. The severity of this factor would vary with the demand conditions for the several commodities. The more elastic the demand the more marked the reduction in processors' and distributors' volumes. 1/ They may also be affected adversely by shifts in demand. Thus, some of the demand for bakery products may be shifted to flour and home baking.

3. Business methods. A third general source of burden as far as concerns the agricultural trades would flow from the business disruptions which would accompany the periodic determination of the "tax levy" for the marketing season. Speculation on the probable changes in the price of certificates will probably produce "serious ups and downs" in the milling industry immediately before and after the annual proclamation of the certificate price. To this (generally in the case of processors) would be added the burden of filing monthly returns and complying in other respects with Department of Agriculture regulations. 2/

1/ For a statement of the processors' grounds for opposition to the certificate plan, see letter from the Vice President of the Millers' National Federation to Senator Wheeler, in Hearings on S. 2395, pages 22-23. Rice processors, on the other hand, appear not to oppose the plan.

2/ Anticipating the opposition of the processors to the certificate plan, Secretary Wallace said: "I am hopeful the processors will cooperate with us. Among the processors are many able and progressive men. If they can be persuaded that we are right - and I believe they can - they will go along with us. But die hards might as well abandon the idea that American farmers are willing to continue to exploit themselves, their families and their land to grow cheap farm products." (Washington Star, December 1, 1939.)

C. Fiscal effects.

The broader view of whether the agricultural program, including the certificate plan now under consideration, would have beneficial or harmful effects on the economy in general would require a lengthy and involved analysis in a very controversial field. Although pertinent, the subject is not considered in this memorandum. Some of the probable fiscal effects of the certificate plan, however, are so significant and predictable as to require discussion here.

1. Fiscal management. The certificate plan would in effect sanction large public expenditures financed from taxes and probably growing in magnitude, without inclusion in the Budget. At the outset, it should be noted that the elimination of such an important item as this from the Budget would limit the effective use of fiscal policy as an instrument of economic control.

Furthermore, any plan for the payment of agricultural benefits would be less subject to abuse and would be more likely to promote the public interest over the long run if the tax collections and benefits were included in the Budget and handled in the same manner as other taxes and appropriations.

There is need for a better general comprehension rather than a concealment or confusion of the detailed receipts and expenditures of the Federal Government. The adoption of the income certificate plan would make it more difficult to determine the amount of actual public expenditures and the actual tax burden of the various groups of taxpayers. 1/

1/ Representative Andresen (Minn.): "Well, this is more or less a plan to fool the people so they will not know they are ever paying the taxes....." (Hearings on H. R. 6654, page 56.)

Only by the inclusion of all public expenditures in the Budget and by the submission of all public expenditures to periodic executive and legislative review can there be any assurance that the proper allocation of public funds among the many public uses is approximated.

In the memorandum submitted by the Department of Agriculture the view is expressed that "It is more appropriate to compare the Certificate Program with tariff legislation or minimum wage and collective bargaining legislation than with expenditures under the Budget. The issue is primarily one of agricultural policy rather than fiscal policy, except as it may affect other appropriations."

Certain legislation for the benefit of agriculture, such as the Agricultural Adjustment Act of 1938 appropriately may be compared with tariff legislation, minimum wage and collective bargaining legislation. The certificate plan, however, may more properly be considered from the point of view of fiscal policy. Under its provisions taxes would be collected and revenues would be distributed by an agency of the Government. The operation of the plan would not differ materially from the processing taxes and benefit payments provided under the Agricultural Adjustment Act of 1933. The fact that in this instance some of the actual operations would be conducted by a special revolving fund and not the general fund does not alter the fact that the fiscal aspects of agricultural benefit payments are substantially similar to those of other governmental services or expenditures.

Furthermore, the parity payments provided the producers of the 3 or 4 commodities covered by the certificate plan would not differ significantly (excepting perhaps in amounts) from the parity payments which are now provided through the Budget and from the general fund to the growers of agricultural commodities and would no doubt be continued for the commodities not covered by the plan.

In the Department of Agriculture's memorandum the view is expressed that "under existing circumstances," an increase in direct governmental payments "is neither practical nor desirable." It is urged that since Congress is not likely to continue to make direct appropriations for the benefit of a particular group, an indirect subsidy should be provided.

The democratic process assumes that Congressional determination represents the nearest possible approach to the expression of the public will. This is recognized in certain parts of the Department of Agriculture's memorandum. In respect to the parity payments, however, a contrary position appears to be taken, namely, that while the present Congress represents the public will, succeeding Congresses may not represent it.

Although there is thus an apparent anomaly, those taking this position hold that agricultural aids should be adopted as a permanent policy outside the Budget, because other economic and industrial groups have protective legislation of various kinds which need not be reconsidered at each session of Congress. The tariff is the principal example mentioned.

Many agricultural commodities are protected by tariffs and, in recent years, even the tariff on wheat has been effective in raising the farm price. Aside from this consideration, however, the observation may be made that the tariff is either a policy or a disease. If it is a policy intended to achieve a certain result the measures should not be taken which would operate to nullify it. If instead the tariff is a disease, the cure would seem to be its elimination rather than to spread the disease by measures which in no respect reduce the economic loss caused by the tariff in misdirecting the use of the nation's productive resources. The tariff hits primarily consumers. This proposal would hit them again.

Moreover, the type of tax pressure afforded by the tariff is very different from the payment of governmental cash benefits financed from taxes. The distribution of burdens is different, the distribution of benefits is different, and the effect on internal competition and productive efficiency is different.

A line must be drawn somewhere between the incidental effects of governmental policy on the fortunes of people and the direct payments of money forcibly collected from the people. The latter is more susceptible to the dangers of misuse, and accordingly requires more careful scrutiny to achieve an allocation of governmental burdens and benefits in accordance with the public interest. Although similar scrutiny should no doubt be accorded to tariffs, the fact that it has not been given does not warrant extending the lack of scrutiny to direct governmental payments. In addition to what has already been said on this point, it should be noted that the pursuit of the proposed policy would logically involve the granting of indirect subsidies to numerous additional groups. The plan would establish a dangerous precedent, which other economic groups would strive to emulate. If the plan is suitable for agriculture, why not for mining, for instance? The plan is so ideally adaptable to various kinds of income-redistribution schemes that its sponsorship for other groups seems reasonably probable. The resulting multiplicity in tax-levying and collecting bodies, operating independently within the Federal Government, would raise havoc with fiscal planning.

2. <u>Tax administration</u>. From the point of view of tax administration, several shortcomings of the Certificate Plan should be noted.

Sound tax policy endeavors to keep tax changes as infrequent as possible to minimize dislocating effects on industry. Under the certificate plan rate changes of substantial magnitude might be made from year to year. The rate changes would probably occur more frequently than they occurred under the invalidated processing taxes because the Certificate Plan, unlike the processing taxes, apparently allows the Secretary of Agriculture no discretion in this respect. The tax rate for each marketing year is automatically equal to the difference between the average farm price and parity price. 1/

Furthermore, the crudeness of the Certificate Plan as a tax measure, lacking in integration of technical details (with respect to definitions of tax base, and exemptions, deductions and refunding provisions), can be expected to create many inequities.

The effective application of processing taxes requires the imposition of compensatory taxes. Floor stock taxes are a case in point. Under the invalidated processing taxes provision was made for compensatory floor stock taxes on any article that on the date the processing tax became effective was held for sale or other disposition.

Such compensatory taxes are essential to prevent undue profiteering. The need for such taxes is present especially when rate changes are likely to occur from time to time. Moreover, in those instances where, on

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1/ See, however, page 25, fn. 1.

occasions, reductions in tax rates are likely, provision should also be made for refunds on floor stocks. In the absence of such provisions, processors and distributors are exposed to heavy losses merely because of a change in the tax rate.

Under the processing tax, the Secretary of Agriculture was instructed to ascertain whether "the payment of the processing tax upon any basic agricultural commodity is causing or will cause to the processors thereof disadvantages in competition with competing commodities by reason of excessive shifts in consumption between such commodities or products thereof." If he so found, he was to proclaim a tax at a rate "necessary to prevent such disadvantages in competition" on the first domestic processing of the competing commodity. The need for this type of compensatory levy is particularly important in a commodity, such as cotton, for which important competitive substitutes are available, such as paper, jute and rayon. This problem may be more serious in the case of the industrial uses of cotton.

Conceivably, a certificate plan of the type proposed could be supplemented by compensatory taxes within the internal revenue system. Whether such compensatory taxes are in fact contemplated by the proponents of the plan has not yet been indicated. It would appear that the imposition and administration of compensatory taxes as well as the disposition of the revenues raised would be more cumbersome as adjuncts of the Certificate Plan than was the case with the processing taxes imposed from 1933 to 1936.

3. Federal expenditures. The adoption of the certificate plan would clearly result in a large increase in total expenditures for agricultural purposes. Part of the expenditures would be inside the Federal budget and part outside the Federal budget. There appears to be some question whether the amount of Federal expenditures within the budget would be reduced.

Some features of the plan would indicate the possibility of reduction in budget expenditures. With respect to certain commodities, the certificate plan is proposed as a substitute for "parity payments" now financed from general revenues. These expenditures presumably could be discontinued upon the enactment of the certificate plan. It is also possible that the enactment of the certificate plan might make agriculture's resistance to reductions in appropriations less effective than it would otherwise be.

On the other hand, if the plan reduces domestic consumption and increases farm surpluses, it will increase the demand for crop loans (so-called) which constitute a drain on the Treasury. Moreover, the adoption of the plan may serve merely as an entering wedge for larger farm benefits. Pressure may be expected to develop to secure for the noncertificated commodities government benefit payments on a par with those obtained by commodities covered by the certificate plan.

Federal expenditures also may be increased in other directions because of the plan. The increased cost of living due to the taxes may indirectly raise expenditures for relief purposes. Such expenditures would also be increased if the tax so reduced the volume of consumption as to decrease the volume of employment.

4. <u>Distribution of burdens and benefits</u>. The certificate plan would impose a tax on certain necessities. It would tax the consumption of wheat, cotton and rice. Experience with the processing taxes under the Agricultural Adjustment Act of 1933, invalidated in 1936, indicates that the burden of taxes on these commodities would fall, in large part, on consumers. Inasmuch as the consumer expenditures for the products of these agricultural commodities account for a much greater proportion of the total expenditures of individuals and families with small incomes than of the total expenditures of those with larger incomes, the burden of the tax would be regressive. It would bear more heavily on those with small incomes than on those with larger incomes.

The tax would be unusually regressive for it would be imposed on physical units of an agricultural commodity, without regard to the price of the product consumed. Unlike a sales tax which is imposed on the basis of price, the certificate tax would be imposed on the basis of weight or volume. Low income consumers purchasing low-priced cotton articles would pay a higher tax with each dollar spent than higher income consumers purchasing high-priced cotton articles.

It may be that in some cases processors would find it necessary and practical to transfer some of the tax burden from their low-priced to their high-priced products. Under the invalidated processing taxes cigarettes, for instance, appear to have borne more than their share of the tobacco taxes. This type of adjustment, however, is very uncertain and cannot be predicted as a likely occurrence in the case of other products.

The rate of taxation contemplated by the proposed certificate plan would be far heavier than the rates which in the past usually have been applied to necessities in the United States. The general sales taxes imposed by states in no instance exceed 3 percent of the amount of the transaction, and moreover, in many cases, exempt farm products from taxation.

The rate of the tax under the proposed certificate plan would be equal to the difference between estimated parity prices and the average farm prices of the particular agricultural commodities affected. In some instances, the rates of these taxes would be even higher than those imposed under the invalidated processing taxes. Even on the basis of United States average farm prices prevailing on December 15, 1939, the difference between parity prices and farm prices amounts to 30.8 cents per bushel of wheat and 6.2 cents per pound of cotton. A 6-cent tax on 10-cent cotton, for instance, would be equal to 60 percent of the farmers' selling price. The imposition of indirect taxes of this magnitude, superimposed on an already regressive Federal-state-local tax system, would severely affect the already limited purchasing power of the low-income families.

The effects of the certificate plan would be especially burdensome to those who, just like wheat, cotton and rice farmers, are receiving less than "parity" incomes. There are large numbers of other persons on farms and in the cities who have incomes and standards of living as low as the growers of wheat, cotton and rice. The whole body of the unemployed and the under-employed laborers in all industries have less than "parity" incomes and would be subjected to a heavy burden on account of the tax. 1/

Underlying this method of financing parity payments is the assumption that the existence of low agricultural prices bestows an unfair advantage on consumers, and that such an advantage might properly be recaptured for the benefit of agricultural producers. It presupposes that the rewards accorded by the market place to the producers of certain commodities are not just and require supplementation to raise them to some specified but variable levels.

Although it may be agreed that "the farmer is entitled to a fair price," that does not dispose of the question as to what is the fair price. Even defining it as a price which will give the producer a fair income leaves undetermined the essential question of what is fair. Furthermore, a price that will give a fair income to the producer is not necessarily a fair price to the consumer. The consumer ought not be required to pay more than the price resulting under a sound organization of agriculture. A sound organization of agriculture giving fair returns

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1/ In answer to this problem, Secretary Wallace replies: "The fact is that many of the people who can't afford to pay for pork when the farmers are getting 13 cents a pound for hogs probably can't buy pork when hogs are down to 3 cents either. Isn't it a wiser policy to ask that all consumers who are able, pay a fair price for their food, and then to aid the others if necessary through the methods of making surplus foods available to those without jobs, such as the Food Stamp Plan and the school lunch program?" (Wallace, "How permanent is the farm program?" page 14.)

to those engaged in farming would almost certainly afford lower prices to consumers than "parity" as now computed. To impose on the consumers through a processing tax the burden of giving the farmer a fair price —whatever that may be found to be—may thus result in serious unfairness to consumers.

In the Department of Agriculture it is recognized that the certificate plan would constitute, in effect, a tax on consumption. It has been maintained, however, that the regressive effects of the tax would be offset by the "progressive" effects of the expenditures and that the net result would be "progressive." Underlying this position is the assumption that the plan would benefit a low-income farm group largely at the expense of a higher-income non-farm group.

At the outset, it should be noted that this distinction between farm and non-farm population is not wholly relevant to the issue. The certificate plan has been designed for the benefit of wheat, cotton and rice (and possibly some tobacco) growers only. It probably cannot be employed successfully, and it is not proposed, for the benefit of the growers of the many other farm commodities. In consequence, the plan does not propose to benefit the entire farm population at the expense of the entire non-farm population. It proposes, rather, to benefit wheat, cotton and rice growers as distinct from all other farm groups as well as all the non-farm groups.

There are at present in the United States approximately 7 million farm families. About 3 million of these are engaged, to a small or large extent, in the growing of wheat, cotton and rice. Thus, even if all wheat, cotton and rice growers cooperated in the AAA production and soil conservation programs and were eligible for parity payments, the certificate plan would benefit not more than 3 million farm families, at the expense of another group consisting of 4 million farm families, more than 22 million non-farm families, and several million single individuals.

Moreover, the plan, if adopted, may not be of much help to some wheat and cotton growers. That likelihood is indicated by the fact that a portion of the wheat and cotton growers produce these commodities in such small quantities that the benefits they would receive from their share of the certificates, if they complied with the farm program, would be offset largely by their share of the tax burden as purchasers of wheat, cotton and rice products.

The certificate plan is said to have "progressive" effects because the average income of the farm population which would be benefited is lower than the average income of the non-farm population which would be taxed. However, a comparison between farm and non-farm population on the basis of per capita incomes is subject to misinterpretation. The incomes of the two groups are not comparable. A dollar of income in a rural area is something entirely different from a dollar of income in an industrial area. Its purchasing power is different because the cost of living generally is lower in rural than in urban areas. For those on farms, food, housing and clothing, three important elements in the budget of the low-income groups, require a smaller expenditure than for those in the cities.

In comparing the income of the farm and the non-farm population it is emphasized that a larger proportion of the farm population falls in the low-income group than is the case in the non-farm population. It is pointed out, for instance, that a considerably larger percentage of the families on cotton farms have low annual incomes than is the case with an industrial population. Such use of percentages, however, does not bring out some of the important aspects of the low-income problem. The percentages relate to entirely different magnitudes. The adoption of the certificate plan would result in the taxation of at least 5 million non-relief families with incomes of less than $780, for the benefit of wheat, cotton and rice growers, only part of whom have such low incomes. In addition, there were 4,500,000 relief families, of whom 600,000 were farm families. 1/ In other words, it is not evident

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1/ In 1935-36, one-third of American families are estimated to have had incomes of less than $780. No information is available on the income distribution among wheat, cotton and rice farmers specifically. However, in that year, 37.6 percent of all non-relief farm families were estimated to have had annual incomes under $780. For all non-relief families, the corresponding proportion was only 23.5 percent. However, in actual numbers, over 6 million non-relief families had incomes less than $780. Non-relief farm families accounted for a little over 2 million of the six. However, families of wage earners also accounted for over 2 million. Even if the percentage of wheat, cotton and rice growers falling in this low income group were much larger than that reported for all farm families, the adoption of the certificate plan would result in the taxation of at least 5 million non-relief families with incomes of less than $780, for the benefit of wheat, cotton and rice growers, only part of whom have such low incomes. In addition, there were 4,500,000 relief families, of whom 600,000 were farm families.

that the net effect of the plan would be a distribution of income from higher to low income groups.

Moreover, we are here dealing with families whose incomes range from minus quantities upward. Therefore, even if, on the average, the families taxed had a higher income than those which received the benefits, the families taxed would still include a number whose incomes would be lower than the incomes of many receiving the benefits. In other words, despite the fact that on the average farm families have lower incomes than urban families, the plan would tax some consumers with little or no income for the benefit of some farmers with relatively larger incomes. To this extent the effect of the plan would be the converse of "progressiveness."

Finally, it should be noted that, aside from limitations on maximum payments to individual farmers, the benefits under the certificate plan would be distributed among farmers approximately in proportion to the present distribution of incomes. Wheat, cotton and rice growers would benefit in proportion to their normal production. Therefore, in general, farmers with large farms, producing large amounts of wheat, cotton or rice would receive more money from the plan than small farmers producing smaller amounts.

These considerations indicate that (1) the cost of the plan would be distributed inversely to taxpaying ability, (2) the benefits of the plan for these commodities would be apportioned roughly according to the present distribution of incomes among the growers, and (3) some purchasing power would be transferred from low income families to higher income families.

At all events, even if it could be agreed that the certificate plan tax on consumers for the benefit of producers might have "progressive" effects, it would still be true that the degree of such "progressiveness" would be less than could be achieved under practically any other method of taxation.

EXHIBIT I

Collections from Agricultural Adjustment Taxes

Source of receipts	Fiscal year ending June 30		
	1934	1935	1936
Wheat	$ 117,621,174.82	$123,860,932.23	$ 9,441,516.44
Corn	4,496,193.74	6,849,629.87	924,823.31
Cotton	144,767,232.64	95,926,301.71	5,387,539.30
Tobacco	18,088,426.05	32,725,501.44	13,226,127.31
Hogs	77,034,611.24	184,601,009.46	8,973,083.16
Paper and jute fabrics ...	9,244,830.78	3,221,707.27	637,265.85
Sugar	170,416.37	71,093,970.65	30,357,599.06
Rice	-	29,119.97	665,721.04
Rye	-	-	175,475.88
Peanuts	-	3,571,936.01	138,051.04
Cotton-ginning tax	-	1,110,874.86	451,223.03
Tobacco-sales tax	-	3,231,374.77	1,214,880.64
Potato-sales tax	-	-	43,900.64
Total, agricultural adjustment taxes	$ 371,422,885.64	$526,222,358.24	$71,637,206.70