

Land and Capital in Agriculture

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AN ANALYSIS of house prices in the U.K. over recent years has indicated that the land cost in housing has shown a tendency to increase faster than other relevant costs. That agricultural land is no exception to this tendency when compared with general consumer costs is evident from the findings of a comprehensive study of the financial requirements of modern agriculture made by the OECD'S* Agricultural Committee and Working Party on Agricultural Policies.

The study which appears as a new OECD publication, *Capital and Finance in Agriculture*, is summarised with charts and graphs in the *OECD Observer* October 1970.

Economic pressures are making it necessary that viable farms be made capital-intensive, by machinery replacing labour and by the enlargement of farms through the purchase of additional land. This means that those farmers who remain in agriculture will need more financial backing than ever before.

Says the report: “The physical stock of capital in the whole agricultural sector appears to be increasing rather slowly in countries where agriculture is highly developed, much of gross investment being absorbed by depreciation

“Except in certain regions where agriculture and other activities are declining, the value of land is steadily rising because it is the object of competing and growing demands while its supply is limited and inflexible.

“Within agriculture itself demand for land is growing as a result of the pressures for structural change, farm amalgamation and the enlargement of plots. The marginal value of extra land for a farmer wishing to expand may be considerable and may justify a high price; at the same time such a price level may give great difficulties to a farmer trying to purchase an entire farm.

“In most countries external influences are exerting growing pressures on land prices, especially in certain regions, as a result not only of urbanisation and industrialisation but also growing requirements for recreation, nature protection and secondary residences. Such pressures may cause the market price of land to diverge increasingly from its value in agriculture use. As the chart shows, farm real estate prices have been rising much faster than prices in general in most countries, Finland being an exception because of the large amounts of land available.

“One result of the considerable increase in the price of land is the growing gap between the market value and the rental value of farmland. The level of rents is controlled in one way or another in most European countries, and as a result often amounts to a very small rate of return on real estate for the non-occupying owner by comparison with the U.S. where there are no controls. Account should of course be taken of the compensation which the owner may have from capital gains on his property; the “key money,” customarily paid by tenants in some countries may offset to some extent an unduly low level of rents.”

It is significant that Belgium which has the highest values of capital per hectare, also has the highest land values. This would appear to indicate the presence of a vicious circle, *i.e.* higher land prices lead to the need for more intensive use of land, and more intensive use of land (with greater rewards) leads to higher land prices.

The tendency for improvements in the modes of production to be ultimately capitalised in the market value of land is paralleled in the effect of subsidies and grants to agriculture which represents in economic terms a lowering of the costs of production.

This is observed in the report when it deals with state loans to farmers. “The repayment of certain loans could be postponed during the initial years, though it would be necessary to ensure that such a system would not simply postpone the difficulties or result in further inflationary pressures on land prices.”

The OECD Committee has emphasized that whatever the method of assistance used, such assistance should be given on a selective basis since any one of these methods could have “undesirable effects.”

The reduction in interest rates too far below market rates, on loans to agriculture, carries the risk of the mis-allocation of financial resources and the Committee advocates selectivity supervision and scrutiny to avoid these undesirable (but in our view inevitable) effects of state-subsidized interest rates.

Again the Committee shows awareness of the ultimate effect on land prices of state aid in this paragraph:

“A special risk occurs when interest-rate subsidies are available for the purchase of land: the effect of this is likely to be to add to the pressures pushing up the price of land, and the long-term benefit to the farming community might thus be negligible.”

It was the conclusion of the Committee for Agriculture
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that the major problem in many countries is that of financing the purchase of real estate. If more people left the land and non-viable farms were abandoned, the supply of land would be thereby increased, thus counteracting the upward pressures on land prices and this may help, says the Committee, but it adds: "The progress of structural reform, however, will not fundamentally alter the fact that in most regions real estate will remain a very large part of the total value of the farm."

The Committee is conscious of the different problems created by the different systems of land tenure and the problem of reconciling the claims of landowners with those of land users and a tentative suggestion is made that a "land-owning institution" might be set up which could hold land and rent it out in order to create viable farms. While not specifically making this recommendation the Committee considers the matter worth more study.

The farm problems outlined in this report are not to be solved by any "plan" nor by more state intervention, but by recognising the distinctive economic and ethical difference between land and capital and by ensuring that all the advantages of increased production go to those who provide the labour and capital and are not siphoned off in ever-increasing land values.

Only by channelling the rent of land back to the community and using it in lieu of the taxation which falls on labour, industry and trade, will the vicious circle referred to earlier be broken.