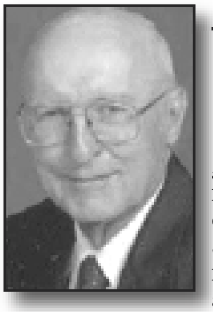
Farm Profitability In A Financial Crisis



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With the U. S. economy facing major financial problems and Congress working to restore confidence with the largest bail out plan in history, it is not surprising that farmers and farm leaders are concerned about future profitability and survival for many farmers.

Recent net farm incomes have been above the 10 year average for many farms. But crop and livestock prices have been extremely volatile and input and fixed costs have increased significantly. Since 2007, variable production costs have increased by 50 percent and land values are up 20 percent.

Many farmers may measure their profits by their tax returns based on cash accounting. But two agricultural economists at Purdue University say these figures may not accurately measure true profitability. They point out that structural changes will affect the long term success and survival of a farming operation. Many farmers are investing in "soft assets" such as leasing agreements for machinery, chemical and fertilizer applications, and hiring consultants rather than permanent employees.

So management on many farms involves more than farming operations and marketing skills. Success will also depend on linking up with suppliers and distributors, and having external partners. The hiring of these outside services will require more of the income and cash flow to invest in and support these outside services.

In December, University of Illinois agricultural economists staged a series of "Farm Economic Summits" to analyze the risks in today's financial climate. They suggested that weak prices and declining demand for corn, soybeans and wheat place profitability at risk. Stable prices expected for hogs, and weak demand for beef add risks for livestock producers facing increased costs.

The financial crisis in banking and mortgage industries has caused problems for many nonfarm industries. However, agricultural lenders are generally in a strong financial position with adequate liquidity to supply farmer's credit needs. However many agricultural lenders will be more cautious about expanding agricultural loans and may require more loan documentation.

Production costs pose one of the greatest risks for farmers on the coming year. Fertilizer costs for corn are expected to be more than double in 2009. Fertilizer applications for soybeans could be up more than 50 percent. Some declines in fertilizer prices in recent months offer hope for some farmers.

Projecting 2009 farm incomes is extremely difficult because of the usual uncertainty of yields, volatile commodity markets, and rental arrangements for some farmers. Land values may not show as much increase in 2009, but leasing arrangements fueled by rising land prices and cash rents could place higher risks for those renting large acreages.

Agricultural economists in several states have suggested owners and tenants look at the current situation and work out flexible rents to reduce risks for operators. Crops share leases have traditionally provided for sharing risks. The trend for more cash leases in recent years has placed higher risks upon the farm operators. Setting up flexible provisions in leases can help protect the operators but also assure the owner of adequate return when prices are good and returns are available to reward land owners a fair share of the farm returns.

The 2008 farm bill will be implemented for 2009 crops. Farmers will have new decisions about the types of payments and programs to follow. The new ACRE program replaces countercyclical payments and guarantees state level revenues on a crop specific basis. But to participate a producer gives up 20 percent of direct payments and a 30 percent cut in loan rates. Combination of these and other factors makes the decision between the traditional programs and ACRE fairly complicated. And if a producer chooses ACRE, he must stay in the program and cannot go back to the old program during the life of the new farm legislation.

The new Administration will be implementing many features of the 2008 legislation. Farmers and their leaders will need to watch carefully to see that the new regulations are in line with what Congress intended.

Energy produced from ethanol, biodiesel, and farm based wind turbines open up another dimension that offers opportunities and risks. Falling petroleum prices have dampened the profit prospects for ethanol. Government support for renewable fuels will determine if it provides profit opportunities for farmers. The growth of wind turbines on farmland offers rental income opportunities for land owners but in many places, environmental interests may oppose such development.

The key question for agriculture profitability in coming months may depend on how fast the nonfarm sector recovers from its major financial problems. Δ

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