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Decision-Making in a Declining Economy

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As the farming economy enters a period of decline, farmers are facing issues many of them have not had to deal with in recent years. Net Farm Incomes are low or even negative in many cases. Cash flows are becoming extremely tight. Some farmers are having difficulty renewing operating loans. These issues, along with others, are requiring farmers to take a close look at their management practices and what they can do to improve profitability and cash flow. In doing so, there are several options a farmer can consider in determining what decisions they need to make to improve their operation.

Input Costs - Fertilizer, seed, and chemical expenses are some of the biggest expenses a farming operation has each year so this is the first area that should be examined to decide what improvements can be made. Farmers are very loyal to their input suppliers, but they may need to compare prices among input suppliers to find if they are getting the best prices on the market. Proper soil testing is another practice to implement, to ensure they are putting the correct amount and type of fertilizer needed for each farm. If farmers are not having soil tests done, they may be spending more money on fertility than needed or there may be a deficiency resulting in lower yields. Farmers need to closely look at their input costs to make sure they are getting the most benefit out of every dollar they spend.

Equipment - Equipment costs are another extremely large and important expense a farmer needs to examine to decide what improvements can be made. In years past, many farmers have traded combines and other major purchases every year or two to keep newer equipment and to take advantage of tax benefits these purchases provide. Many farmers have already cut back on equipment purchases, but there are other decisions they need to consider regarding equipment. Do they have the right-sized equipment needed for their current operation? Can they downsize some of their equipment or find more acres to run it over through custom-hire situations? Is there any equipment that they do not need and can sell to lower their equipment costs?

Another major decision concerning equipment is whether a purchase or a lease is the best option. There are times when purchases are more advantageous and there are times when leases are more advantageous. In some cases, farmers trade a piece of equipment they own for a leased item that lowers the annual lease payment on that new item. There is one major issue with this transaction that many farmers fail to consider. The amount received for the item traded-in will have to be counted as taxable income, while the only expense offsetting this income is the lease payment. This is very different from the potential write-off a farmer can receive from an equipment purchase that includes a trade-in.

Labor – Depending on the size of the farm and the type of operation, labor can be a large expense for a farming operation. In many cases, a farming operation may have more employees than is really needed. A farmer may need to closely look at their labor costs and determine if they can cut back on this expense without hurting the operation. In some cases, this may require the farmer to provide more of the labor than they are used to.

Land Rent – Land rental agreements can vary from farm to farm and from area to area, but they are another expense that may need to be examined. In cash lease situations, the farmer should put pencil to paper to make sure the land is profitable enough to justify the rent they are paying for each farm. If not, they are subsidizing that farm with income from other farms and decreasing their total profitability by keeping this rental agreement. In most share lease agreements, other than 75/25, the landlord is paying at least some of the input costs on that farm, but that is not always the case. The farmer should look closely at these leases and make sure the landlord is paying the amount of expenses they need to pay. The farmer may need to sit down with the landlord and try to renegotiate their rental agreement. If the landlord is unwilling to agree to a renegotiation, the farmer may need to examine whether they should keep farming that farm, especially for less productive ground.

Grain Marketing and Storage – Many farmers currently still have quite a bit of 2023 grain, especially corn, which is unsold due to the low prices. As we get further into the 2024 fall harvest, farmers are being faced with decisions of having to sell old crop grain at low prices to clear up storage for 2024 grain or find other ways to store the 2024 grain because bins are full with 2023 grain. If grain is stored at an elevator, the farmer needs to consider if the potential upswing in prices they are hoping for will be enough to offset the storage fees and interest they may be paying. There may come a time when the farmer must decide to cut their losses and sell the old crop grain because they need the cash flow and storage space.

Cash Flow – Overall, farmers need to take a close look at what they can do to improve their cash flow situation. One way to do this would be to closely look at your equipment purchases over the last several years to determine if any of them were paid for with cash or by the operating loan. If so, these purchases may need to be refinanced on a term loan to free up operating funds for other expenses. There are many expenses, such as land rent and inputs, that may be due at the very end of the year or the very beginning of the following year and the market situation may not be at a point where the farmer wants to sell grain, but they need money to cover those expenses. Two options that farmers may want to consider are to either take an advance on grain that will be sold later or to take out a CCC loan on a portion of their grain inventory. If a farmer is interested in taking out a CCC loan on grain inventory, they need to start that process now because it can be a lengthy process that should not be put off until the last minute. In some extreme situations, a farmer may even have to examine the possibility and need of selling capital assets, such as land and equipment, to increase cash flow.

This economic downturn is greatly impacting farming operations of all sizes. If they have not already started examining their management decisions and practices, they need to start soon to be as proactive as possible. The longer they put off making the decisions, the more likely they are to get into a financial situation that may take them a long time to recover from.

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