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# Managing through a recession: options for farm operators

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*Managing through a recession: options for farm operators and agriculture lenders, continued from page 2*

As we stated earlier, farmers and lenders need to think in terms of contingencies – what should be done if conditions worsen, asset values decline or if rural and agricultural lenders start to experience liquidity problems. For some

concrete suggestions that can assist with good management decisions during a very difficult and uncertain period see the next article, “Managing through a recession: options for farm operators,” by William Edwards.



## Managing through a recession: options for farm operators

*By William Edwards, extension economist, 515-294-6161, wedwards@iastate.edu*

**A**fter several years of high grain prices and generous margins, crop producers are facing a 2009 that looks less than rosy. Higher inputs costs and selling prices well below the peaks of 2008 will result in fewer dollars left over to pay landlords and put into savings. Livestock producers have had to endure many months of thin or negative margins, as well.

Here is a list of possible financial management practices and strategies that could come in handy this year.

### **Prepare an accurate set of financial statements.**

Highly variable inventory prices and increasing land values will make this year’s balance sheet look quite different from last year’s. And for grain farmers, a net income statement for 2008 may be something you to share with your lender. Check out the handy spreadsheets under the Finance section of Ag Decision Maker Web site.

**Prepare a detailed cash flow budget.** Many crop farmers will have a hard time meeting all their cash commitments from sales in 2009. Higher input costs and rents will increase operating line requirements. Livestock farmers will need to budget feed purchases carefully. More AgDM decision tools are available to make the task easier.

**Shop around for inputs.** Depending on when suppliers booked fuel, fertilizer, pesticides and other inputs, prices may vary dramatically.

**Consider both cost savings and yield effects when applying inputs.** For example, cutting back on nitrogen fertilizer when costs are high makes sense, but only up to a point. Use the ISU Nitrogen Calculator to find the right level for current prices.

**Know your costs of production.** When profitable selling opportunities arise, lock them in. Watch for opportunities to price crop inputs, feed, and feeder livestock, as well.

**Document yields for a possible crop insurance or SURE payment.** Many crop producers will receive an insurance indemnity payment due to falling prices in 2008 as well as from damage caused by rain or floods. Additional payments may be available under the SURE disaster program in the new farm bill.

**Increase crop insurance coverage for 2009.** Higher production costs may require higher levels of protection to assure a breakeven level of revenue. Cattle, hog, sheep and dairy producers can set price floors using LGM or LRP insurance programs.

**Consider enrolling in ACRE.** Under the new farm bill program, Average Crop Revenue Election, crop producers can substitute a gross revenue protection plan for the current price counter cyclical program, with guarantees based on higher price levels and current yields.

**Use flexible lease agreements.** Tying cash rents to a formula that takes into account both yields and prices will help protect margins. Land owners can share in high profits when they are available with a flexible lease agreement.

**Defer capital purchases.** When margins are narrower, replacing machinery, putting up new storage bins, or bidding on more land may have to wait. Replacement parts and over-hauls are cheaper in the short run.

**Defer income taxes.** Potential tax bills can be put off until future years through actions such as using expense method and early depreciation, deferring crop insurance payments based on yield losses, prepaying farm expenses, and using income averaging.

**Compare financing rates.** Federal interest rates are at historic lows. There may be wide differences among agricultural lenders. Marketing loans from the Farm Service Agency are also available for short term financing.

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**Consider refinancing long-term obligations.** Compare possible interest savings to the costs of rewriting the loan. It may be a good time to convert variable rate loans to a fixed rate.

**Keep assets liquid.** If gross revenue is not enough to cover production costs and family living expenses this year, keep funds in savings or short-term investments rather than assets that would be hard to convert to cash.

**Use equity in land, livestock and equipment.** If cash

reserves aren't enough, talk to your lender about borrowing against fixed assets, with a multi-year repayment plan.

Agriculture has always been a cyclical industry. A good financial manager learns to balance the profits and losses to ensure long-term survival.

You can learn more about the strategies mentioned above by enrolling in Financial Decision Making, an on-line home study course available from the ISU Ag Management E-School.



## Brazil's ethanol industry - part two\*

*by Don Hofstrand, co-director AgMRC, Iowa State University Extension, 641-423-0844, dhof@iastate.edu*

**B**razil has made great strides in running its economy on renewable energy. Renewable energy represents 46 percent of Brazil's total annual energy supply. By comparison, renewable energy accounts for only seven percent of the U.S. annual supply. The largest source of renewable energy in Brazil is ethanol, accounting for over one-third of Brazil's renewable energy.

In addition, 90 percent of Brazil's electricity comes from renewable sources, predominantly hydroelectricity. By comparison, only nine percent of the U.S. electricity supply is from renewable sources. About half of our electricity is generated from coal.

Due in part to its ethanol program, Brazil became net energy independent in 2006 after many years of energy dependence.

Although we need to remember that the U.S. economy is much larger than that of Brazil (the U.S. economy is nine times larger), Brazil's accomplishments in renewable energy and energy independence are nevertheless impressive.

### Ethanol history

During the 1970s, Brazil was importing over 80 percent of the oil it consumed. Large oil imports and high oil prices were damaging Brazil's economy. In 1975 Brazil implemented the National Alcohol Program. It contained four policies to stimulate ethanol production.

- 1) It required Petrobras, its major oil company, to purchase a required amount of ethanol.
- 2) It provided \$4.9 billion of low-interest loans to stimulate ethanol production.
- 3) It provided subsidies so that ethanol's pump price was 41 percent lower than the price of gasoline.
- 4) It required that all fuels be blended with a minimum of 22 percent ethanol (E22).

Although crude oil prices were low in the 1980s and 90s, Brazil kept its ethanol program alive and moving forward. In 2000, Brazil deregulated the ethanol market and removed its subsidies. The ethanol mandate was maintained. Depending on market conditions, all fuels were required to be blended with 20 to 25 percent ethanol. The current mandate is 25 percent ethanol in gasoline set June 1, 2007.

Brazil aggressively developed cars that operated only on 100 percent ethanol. In 1979 the Fiat 147 was the first modern car to run on pure ethanol. By 1988 almost 90 percent of all new cars manufactured in Brazil were E100 (alcohol only) cars. However, an ethanol shortage in early 1990 caused a major downturn in the demand for E100 cars. In 1990, only 10 percent of the new cars were E100.

Flex-fuel vehicles were introduced in 2003. These vehicles can run on 100 percent ethanol, 25/75 percent ethanol/gasoline blend (the 25 percent minimum ethanol mandate) or any combination of the two. Today more than 70 percent of the new cars sold in Brazil are flex-fuel as shown in Figure 1. Consumers have 49 models to choose from. Flex fuel vehicles have electronic sensors that detect the fuel blend mix and automatically adjust the engine combustion. The production of E100 cars, popular in the 1990s, has virtually disappeared. The remaining 28 percent operate on the mandated E25 minimum blend. There are no light vehicles running on pure gasoline.

Seventy percent is the generally accepted tipping point of whether consumers purchase ethanol or gasoline for their flexible fuel vehicles. In other words, if ethanol price is less than 70 percent the price of gasoline, they will purchase ethanol. Anything over 70 percent and consumers will purchase gasoline. The need for the discount is due to ethanol lower energy level per gallon than gasoline. However, the prices

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