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Capital Purchases and Lower Net Incomes

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During recent years, capital purchases on grain farms have more than tripled on a per acre basis. Capital purchases will need to decrease given the lower net incomes projected over the next several years. Not reducing capital purchases by enough could result in financial stress in future years.

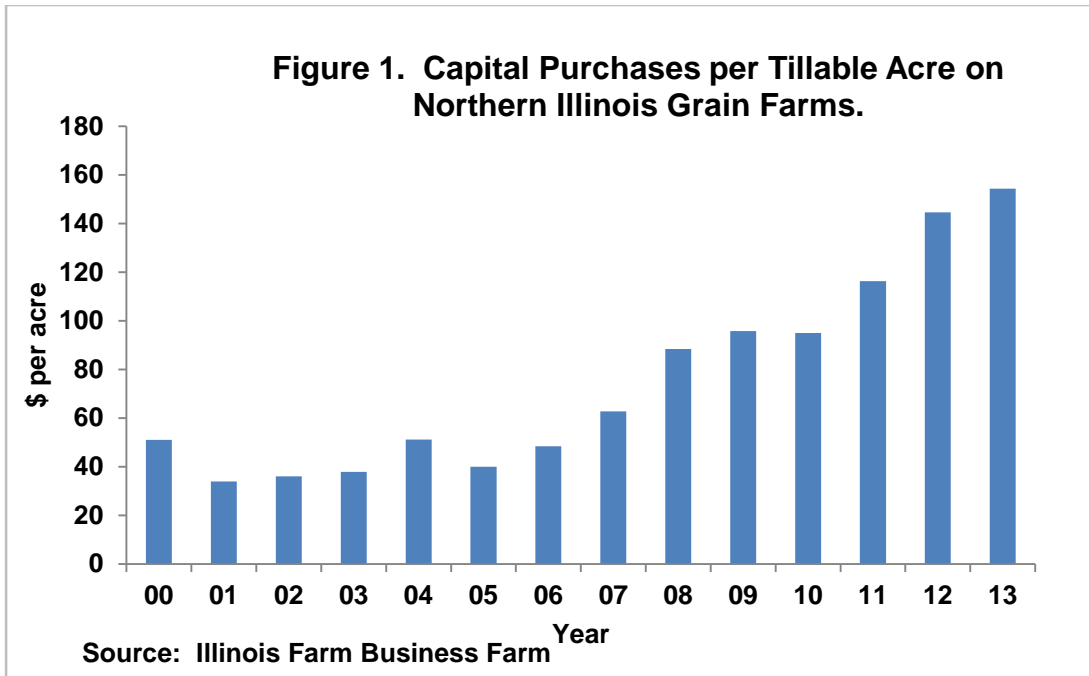
Capital Purchases on Northern Illinois Grain Farms

Figure 1 shows capital purchases on a per tillable acre basis. These per acre values are averages over Northern Illinois grain farms enrolled in Illinois Farm Business Farm Management having usable data. Capital purchases include machinery, building, and other items typically having a life longer than one-year.

On a yearly basis, capital purchases averaged \$43 per tillable acre between 2000 and 2006. There was some variability in averages. The highest average occurred in 2000 and 2004, when capital purchases were \$51 per tillable acre. The lowest average occurred in 2001, when purchases were \$34 per acre.

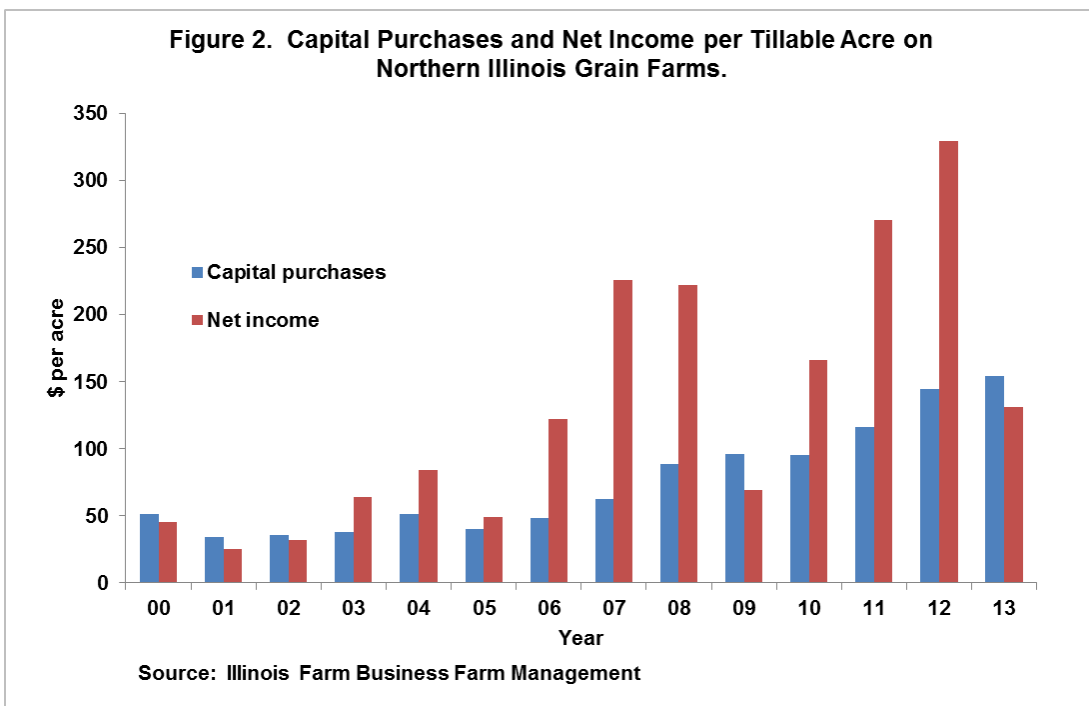
Between 2006 through 2013, capital purchases increased by a large amount. Capital purchases averaged \$116 in 2011, \$145 in 2012, and \$154 per acre in 2013. From the 2000-2006 average of \$43 per acre, capital purchases more than tripled during the 2010 through 2013 period.

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Capital Purchases and Net Income

Increases in capital purchases can be attributed to higher net incomes, as is illustrated in Figure 2. Figure 2 superimposes net income per tillable acre on the graph of capital purchases. As can be seen, capital purchases increased during the period of higher incomes from 2006 through 2013. There appears to be a lagged relationship where net incomes increased first followed by an increase in capital purchases.



Two factors cause higher incomes to lead to higher capital purchases. First, higher net incomes mean that farmers have more disposable income to use for purchasing machinery and other capital items. Second, higher incomes usually result in higher taxable incomes. In recent years, tax methods allow farmers to write off much of the capital purchases against current incomes, thereby shielding current income from taxes. Therefore, purchasing capital items is a way to defer paying taxes.

Lower Net Incomes

Capital purchases will need to decrease now that it appears that an extended period of lower incomes may be occurring. One question is: How long will the lag be before capital purchases decrease? Note that 2013 net income was down from 2012 income (see Figure 2). However, capital purchases in 2013 were higher than in 2012.

Incomes in 2014 could be near levels in 2000 through 2005 ([farmdoc daily, June 24, 2014](#)), suggesting that capital purchases should also decrease to 2000-2005 levels. A decrease of this magnitude would mean that capital purchases decrease from the mid-\$100 levels seen in 2010 through 2013 back to around \$40 to \$50 per tillable acre.

When incomes fell in the 1980s, there was a lag before capital purchases decreased ([Henderson and Kauffman, 2013](#)). This lag contributed to financial stress during the 1980s. Lowering capital purchases now could lessen the potential for financial stress in the next several years.

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Henderson, Jason, and Nathan Kauffman. "The Wealth Effect in U.S. Agriculture." *The Main Street Economist*. 2013. http://www.kansascityfed.org/publicat/mse/MSE_0113.2.pdf