PolicyPennings by Dr. Daryll E. Ray

Is ethanol the exploding demand that will save crop agriculture?

After years of struggle by corn farmers and other biofuels advocates, the realization of the impact of dozens of ethanol plants coming online hit the corn market just as this year's crop was being brought in out of the field. Corn nearest futures that closed at $2.19 per bushel on August 17, 2006, gapped and began to soar on September 15 and closed on December 29 at $3.90. Since then the price has backed off some but the discussion surrounding corn is still very bullish.

Livestock producers are concerned about the impact of higher feed prices on their profitability. It is expected that many farmers will switch from other crops to corn for the 2007/2008 crop year. Some are calling for the opening up of CRP acres to ensure that we have enough corn to meet food and fuel demand. The Earth Policy Institute under Lester Brown has even projected that, with an additional 79 plants under construction, ethanol could use over half the 2008 corn crop.

Some are giddy with the idea that ethanol might be the exploding demand that will sop up surplus crop production and lead US farmers into an era of prosperity, all without federal commodity programs.

Remember the old adage, "Once burned, twice shy"? US farmers have been burned by exploding demand three times in the last century. Let us look at some words we wrote back in March 2000.

World War I brought a surge in agricultural exports as war-torn Europe turned to the U.S. for food and fiber. Historian Wayne Rasmussen wrote: "Farm prices rose, the government called for increased production, and farmers responded...Then, agricultural prices collapsed in July 1920." Prices never recovered in the twenties and fell considerably further in the 1930s.

World War II ushered in the second export boom. Again, as exports soared so did prices. Rasmussen wrote, "Secretary of Agriculture Claude Wickard called for increased production of many commodities…" Following reconstruction, exports stopped being a growth market and excess capacity again set in.

This time around, few expected a return to brisk export growth any time soon. In fact, agricultural export demand was characterized as fickle and inherently unstable. Few believed that hundreds of thousands of farmers would voluntarily idle land to eliminate excess supplies. After the war, farm programs reduced production through short and long term land retirement and eased the adjustment process by providing a measure of price and income stability.

The third grain export boom began in 1973 and peaked in 1981. Just as in the previous two export booms, a sizable share of the surge in exports had political roots. Its beginning coincided with a USSR decision to import grains when their production fell short of needs rather than slaughter livestock to cut feed demand as they had previously done. In addition, a portion of this export boom was related to the decision of the Organization Petroleum Exporting Countries (OPEC) to raise oil prices, profits, and bank balances by forming an oil cartel. As OPEC profits began to pile up in major western banks, the banks began to look for opportunities to recycle the petro-dollars back into the international community.

With the help and encouragement of the U.S. government, loans were negotiated with underdeveloped countries. The money was intended to be used to spur economic development and facilitate trade. However, much of the money was used to import agricultural products. Our exports of major crops took off. Unaware of the quicksand nature of the newfound export demand, government officials, including Secretary of Agriculture Earl Butz, told farmers that agriculture had finally turned the corner and urged them to plant fence row to fence row.

Exports remained strong until the loans came due. Excess capacity returned, despite repeated assurances by policy and agricultural leaders as late as 1981 that the farm problem of the future would be how to expand capacity not constrain it. Agriculture again faced declining exports of major crops and to this day, twenty-five years later, farmers continue to face a flat crop export market.

Given that history you will have to pardon our skepticism when we hear some proclaim that this flowering of biofuel demand is ushering in an era of $3 plus corn for as far as the eye can see, as in decades into the future.

We have no doubt that ethanol and biodiesel demand could provide significant price support for bulk agricultural commodity markets for the next three to seven years. But the advent of new yield technology—recent press reports suggest that 300 bushels of corn per acre will be the norm http://www.truthabouttrade.org/article.asp?id=6702—resulting from massive investments by seed firms, the development of cellulose-to-biofuel production, and expanding crop acreage in the US and overseas have the potential to put a damper on crop prices as they come online.

As we look ahead to the farm bill debate, we hope that our legislators will focus on the writing of legislation that will serve agriculture well not just during times of exploding demand, but also during times of stagnant demand. What we need is a "Policy for All Seasons."

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