APAC Agricultural Policy Analysis Center
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PolicyPennings by Dr. Daryll E. Ray

Have we reached a new permanent plateau in crop prices?

Over the last year as corn prices, followed by those of soybeans and wheat, have risen to levels only dreamed of a couple of years ago, we have increasingly heard discussion about farm commodity prices reaching a new plateau. A recent article in the "Kansas City Star" by "Wall Street Journal" reporter Scott Kilman captures this perspective with the title, "The days of cheap grain are gone, according to agriculture experts" (http://www.kansascity.com/business/story/295686.html).

In that article Kilman quotes Dan Basse, president of AgResource Co., a Chicago commodity forecasting concern, as saying, "The days of cheap grain are gone." Kilman goes on to write, "In the past…increases have been caused by temporary supply disruptions. After a poor harvest, farmers would rush to capitalize on higher crop prices by planting more of that crop the next season, sending prices back down. But the current rally, which started a year ago in the corn-futures trading pit at the Chicago Board of Trade, is different."

Kilman offers three pieces of evidence in support of the "new plateau" thesis. The first piece of evidence is the spread of the price increase beyond corn to other commodities and the fact that it has lasted for more than a year. The second piece of evidence is no surprise to anyone: the increased demand for corn as the primary input for ethanol production supported by government incentives.

The growing middle class in Asia and Latin America constitutes the third piece of evidence. The expectation is that a growing middle class in these areas will shift from a grain based diet to one that includes more milk and meat which will result in the need for increasing amounts of grains and seeds as feed ingredients. It is implicitly expected that the US will benefit from this rapid rise in demand for bulk commodities like corn and soybeans.

In these arguments, Kilman's article matches the arguments we have heard from many quarters including farmers, members of farm commodity groups, legislative aides, and farm reporters.

Kilman notes one of the reasons why many want to believe in a "new plateau" when he writes, "The prospect of a long boom is riveting economists because the declining real price of grain has long been one of the unsung forces behind the development of the global economy. Thanks to steadily improving seeds, synthetic fertilizer and more powerful farm equipment, the productivity of farmers in the West and Asia has stayed so far ahead of population growth that corn prices dropped 75 percent and wheat 69 percent, adjusted for inflation, since 1974."

The last shift in commodity prices took place in the 1972 and 1973 crop years. To better help us evaluate what is happening today, let us look what happened in that plateau shift.

The 1970s plateau shift began with the boom in export demand brought on by a decision by USSR leaders to import large amounts of grain in response to a crop failure. At that time, the price of corn doubled, moving from the $1.00+ level to the $2.00+ level.

While the boom in exports was triggered by the Soviets, it was sustained for much of the 70s by the availability of petrodollars enabling developing countries to borrow large amounts of money, some of which they used to purchase grain to feed their citizens.

The second factor in the 70s plateau shift was a period of high inflation and high interest rates that drove up the cost of farm production. Among the price increases was the price of fuel brought about by OPEC's efforts to increase the price of oil.

The higher prices were locked-in in 1977 when the loan rate was raised to $2.00 from the $1.05 to $1.10 level in effect from 1965 to 1975. The higher loan rates set a floor under commodity prices that prevented them from plummeting in the early 1980s when the export-fueled price boom collapsed.

Comparing the current price boom to that of the 1970s, both periods saw a general price increase across a range of commodities. Fuel prices increased in both periods driving up the cost of production. Both periods also experienced a dramatic increase in demand that was expected to continue unabated.

So far the current price increase has not been accompanied by a high inflation rate. Given current Federal Reserve policies it seems unlikely that they will allow inflation to get out of hand.

It also seems highly improbable that the current Congress will double loan rates. Loan rate levels are now irrelevant anyway since continuation of the Loan Deficiency Payment program is almost a sure bet. Meaning, of course, that loan rates would continue to be incapable of putting a floor under prices, whether they are raised, lowered or left unchanged.

Do the current prices represent a "new plateau" or just a temporary peak that will be followed by a downhill return to the level we have seen for the last three decades? We are not prepared to provide a definitive answer to that question. As we see it, the jury is still out.

Part of the answer will depend upon answers to a number of other questions.

Question number one: How quickly will we see a break-through in the cellulosic production of ethanol that displaces large amounts of corn as the primary ethanol feedstock?

The second question: Will crude oil prices stay at the same level or increase for the foreseeable future, or will they fall?

The third question: How quickly can the ethanol industry solve the current logistic problems that make it difficult to get ethanol from the Grain-Belt plants to distant seaboard markets?

The fourth question: To what extent will farmers in countries like Brazil and Argentina respond to the current high prices?

Question number five: Will developing countries like China choose to feed their growing middle class with imported foodstuffs or will they choose to produce it themselves?

Question number six: Do the current world-wide-weather-based crop yield problems we have seen this year represent a pattern that will be common over the next decade or two?

We want to see the answer to these questions before we are ready to declare that we have entered upon a new plateau in crop prices.

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