

Policy Pennings by Daryll E. Ray & Harwood D. Schaffer

Parallels to earlier "new eras:" And to the hangover that ensued?

As we write this column, March 2011 corn futures closed at \$6.87/bu., wheat at \$8.53/bu., soybeans at \$14.33/bu., rice at \$15.80/cwt., and cotton at \$1.67/lb. Compared to February 2006 those prices are stratospheric. What we are seeing is a second wave of a general price increase for commodities that began in late 2006 and saw its first peak in 2008 followed by a retrenchment.

In this column, as elsewhere, parallels have been drawn to the situation in the early 1970s when prices began to rise as the result the Soviet Union entering the international grain market after a crop failure. The subsequent increase in prices produced a wave of optimism in the farm community.

The positive outlook was bolstered when the US Secretary of Agriculture told farmers to plant fencerow to fencerow. In 1974, the World Food Conference was held in Rome at a time when over 800 million people around the world were undernourished. The conference delegates established a goal of eliminating hunger within a decade. Farmers were being told that demand for food would exceed production for the next quarter century so the statement by the Secretary seemed reasonable. It appeared that farm prices had reached a new plateau.

Unfortunately for farmers, commodity prices weren't the only things that went up. Input prices went up as well—fuel, fertilizer, and farm equipment. When farm prices began to retreat, they were quickly at levels below the cost of production, farmers were desperate; and the late 70s spawned the American Agriculture Movement, farmers marching down Pennsylvania Avenue in 1978, and a massive tractorcade in February 1979.

An agricultural price peak, both in the 70s and 2006-2011 is not the only parallel that can be drawn between the two periods. As soon as agricultural commodity prices began to remain high into 2008, we began to hear that prices had established a new plateau, similar to what we saw in the 1970s.

Another parallel is the expectation that demand will exceed supply for the foreseeable future. First, this expectation was tied to ethanol and the production of biofuels. Then, the expectation of the increasing need for US grain exports to produce the meat that is being demanded by a growing middle class in developing countries began to be circulated once again—well that is an expectation that refuses to die, it just

keeps getting moved into the future. Yet, the US is expected to export only about 2 billion bushels of corn this crop year, which is well below the 2.4 billion bushels exported in 2007 and in 1989-yes 1989.

And concern is being expressed over whether or not agricultural production can grow quickly enough to feed the 3 billion increase in population that is projected to occur by 2050.

Those talking about a new price plateau use increased production costs, increased middle class demand from developing countries, and the projected population increase as factors that will support continued higher crop and livestock price levels. The parallels to the 1970s are indeed striking, a time when production costs were increasing and the expectation was that demand would outstrip production for the foreseeable future.

As we saw in the 1998-2001 period, the connection between production costs and price are tenuous at best.

Also, "we" tend to focus on future demand growth considerations but also tend to, unconsciously perhaps, give much less consideration to supply growth potential. Since the 1970s, corn yields in the US have increased by 60 percent and until farmers spurred the development of the ethanol industry, production outstripped demand.

We know that there are now over 300 million additional acres in Brazil that can be brought into production. That is more area than the US devotes to major crop production. Seven-dollar corn, \$14 soybeans, and buck-and-a-half cotton will draw some of these acres, and acres in other countries, into production in the near future. Both China and Brazil are ramping up investments in yield-advancing research and production practices.

In the 1970s, neither production costs nor demand growth were enough to sustain prices. It is this final possible parallel that scares us. Farmers have no direct means and in the short-run, limited indirect ability, to pass production costs on to purchasers of grains and other crop commodities. Crop agriculture will not see a 4 billion bushel growth in the use of corn for ethanol production like in the preceding half-decade. That leaves exports. But over the last three decades grain export

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Cont. on p. 2

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Cont. from p. 1

expectations has been a pot of gold at the end of an ever-distant rainbow. Maybe this time.

To us it is clear that the odds are not in crop-agriculture's favor. While in the 1970s Congress increased the price floors under major crops when prices fell below ballooning production costs, provisions in recent farm programs are not designed to do that. There is nothing to stop a freefall of crop prices. Today's version of the price declines that drew the tractorcade in the late 1970s could easily occur again.

So what would happen this time if prices tumble to well below the cost of production? Congress can do nothing and thereby watch land prices drop by one-half and potentially bankrupt even some of the most efficient crop producers or it could subsidize

grain users and bankrupt farmers in other countries by providing emergency payments to US crop farmers to help offset their low prices.

Not a very appealing choice. And it is not a choice that other industries face since firms in other industries can and do adjust output to demand conditions. The hundreds of thousands of US crop farmers do not have that luxury.

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