

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

Farmers adjust acreage to high prices

Several weeks ago when we were in Texas to speak to a group of farmers, the talk turned to the price of cotton on the futures market. At that time, it was around 150 cents per pound, a far cry from the 50 cents per pound futures price just two years earlier. Most said that they would be growing more cotton in 2011 than they had grown a year earlier. And, that was before the mid-February 2011 30 cent increase in the futures price.

Farmers who had never grown cotton before said they were putting in a couple of hundred acres. They said they couldn't afford not to. Others said that their bankers were pushing them to shift more acres into cotton. We were told that peanut acreage will take the largest hit.

But cotton is not the only crop experiencing high prices. Corn, soybeans, and wheat are all up there too. The February WASDE (USDA's supply and demand report) surprised most analysts by tightening up the 2010-2011 corn supply, leaving the year ending stock-to-use ratio at the lowest level in a decade and a half. The response of the markets was nearly instantaneous.

With spring planting just weeks to a couple of months away, depending on the part of the country, the competition among the crops for acres is under way. Each price, by itself, is a call for more acres. And that is fine when at least one crop price is relatively low; acres can flow out of the lower priced crop and into crops where the relative profitability is greater—well, cotton is probably not going to be grown in Minnesota, even at 200 cents a pound.

Between 1998 and 2001 we saw a significant movement of acres among crops. Relative to corn and wheat, soybean demand was up and farmers lost less on soybeans than the other two crops, so acres flowed into soybeans. In 2007, the projected demand for corn from increased ethanol production resulted in millions of acres shifting from soybeans into corn.

At this point in 2011, the price of cotton, rice, soybeans, and wheat all look good, and, while they can't all be grown in every county, the scramble for acres is on. As farmers, we know that most acreage decisions are zero sum games—an acre increase for one crop is a one-acre decrease for another. As obvious as that near one-to-one substitution is to farm operators, it is a characteristic of agriculture that is not so obvious to most non-farmers. Those non-farmers believe, either consciously

or unconsciously, that farmers utilize all their cropland when prices warrant and plant only a portion of their available cropland when they don't. That belief can lead to unrealistic expectations about adjustment of total acreages devoted to major crops when prices tank.

But that characteristic of agriculture does not mean that when prices double or triple that farmers cannot find some additional land that can be newly considered for crops. Farmers will attempt to plant every wet spot, sandy knob, and inconvenient corner they can find, along with some hay and pasture ground and a portion of acreage coming out of the Conservation Reserve Program. And there are other things that can be done too such as a significant increase in the area planted to double crop soybeans. In the northern tier of states, some fallow ground may come into production early on the theory that at these prices even half a crop is profitable.

If the domestic response were all that we are dealing with, the price consequences done the road could be serious enough, but it is not just domestic response. Current price signals are being received loud and clear by farmers around the world. Brazil for example has the ability to break-out tens of millions of fresh acres into crop production over multiple years, and farmers in Brazil can increase existing acreage of multiple crops in the blink of an eye. Depending on the area, they can double and, in limited cases, even triple crop their land. As soybeans are taken out of the field, they can come in behind and plant corn. With current prices, they have every incentive to do so.

Part of the tightness in grains is a consequence of the searing heat that reduced wheat crops in Russia and in the Ukraine last year. Barring another year of high temperature extremes, wheat production can be expected to rebound. With high prices, farmers in Russia and Ukraine will have every incentive to bring ground that was idled after the collapse of the Soviet Union back into production. They also have the means as the result of Western investments in agricultural land and technologies.

With an increase in the use of drought tolerant seeds and a so-so year in weather, the additional acreage could result in record production and a

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severely downward trending price line. As the farmers in Texas told us, input prices have risen dramatically and they will be in trouble long before the cotton price hits 50 cents.

Euphoric production response to the current exceptionally high prices-domestically to some extent but especially worldwide-sets crop agriculture up to hit the wall down the pike. Economic-driven or politically based demand expansions or continuing weather extremes that severely disrupt worldwide crop production could allow agriculture to avoid the wall and remain profitable. Let's hope so.

Otherwise, non-farmers, politicians, and farmers alike will be confronted with a historical reality: Once resources are brought into agricultural production, they tend to come out of production very slowly when prices crash, too slowly to be of much help in jacking prices back upward. It is that total crop output (and to a real extent demand) is sticky on the way down the price charts that chal-

lenges the standard market self-correction prognosis for crop agriculture. Depending on the extent of increase in resources brought into agriculture and the nature of subsequent demand growth, farmers may need help to adjust resources out of agriculture for multi-year periods or to adjust production from one year to the next.

It is this lack of responsiveness that farm programs have historically addressed. Perhaps, the circumstances will be different this time. If not, the market challenge to dealing with slow production response after a price crash is likely to turn into a political challenge.

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