

Are “things different now” so that low prices will cure low prices?

In a story titled, “Gulke: Could bumper harvest reap \$2 corn,” AgWeb’s Debra Beach writes about an interview Pam Fretwell of Farm Journal Radio had with Jerry Gulke. In that interview they talked about the Pro Farmer Crop tour estimate of the US corn yield of 170.2 bushels per acre in contrast to USDA’s estimate of 175.1 bushels per acre.

“By either estimate, ‘we’ve got too much of everything,’ observed Gulke. ‘...Now, they’ve got piles of wheat and piles of corn, so it’s like we’re chasing each other downwards to see what the lowest prices we can achieve to where we can get rid of the stuff.’ The market could slide downward without a wholesale disaster to bring yields down below 168 to 166 bu. per acre in corn and around 46 bu. per acre in beans, he noted.

“‘Markets will seek a level that says, ‘How do I get rid of 2 billion bushels of corn and 300 million or 400 million bushels of beans or at least half of that to get to equilibrium again,’” Gulke explained.”

Those comments provide us with some context for the discussion of the fundamental behavior of agricultural markets that we promised at the end of last week’s column.

The equilibrium that Gulke is talking about is where the price of a bushel of corn equals the cost of production for that last bushel of corn needed by the market.

If the demand for corn were relatively elastic, reaching that equilibrium would not be a problem. The thing is, there are two problems.

First, the demand for corn is very inelastic—that is it would take a large drop in price to achieve a relatively small increase in the consumption of corn.

We shudder to think how low prices would have to go to achieve a reduction in the 2016-2017 year-ending US commercial corn stocks by 1 billion bushels or even if it would be possible to achieve that, short of the failure of the safrinha corn crop in Brazil.

Even at low prices, consumers of corn are not likely to buy additional low-priced corn in anticipation of possibly higher prices next year. If they want to protect their price, they can do that on the futures market and avoid the cost of transportation, storage, and management. They don’t have to touch even 1 of those 1 billion bushels we need to take of the year-ending stock level.

At this late date, it is possible that a surprise customer could come into the market and buy a large amount of grain. But that has not happened since the early 1970s.

Second, the amount that will be produced for the 2016 crop is out of the hands of producers. As Doris sang in the 1956 Alfred Hitchcock movie, *The Man Who Knew Too Much*, “Que sera, sera, whatever will be, will be.”

Only when the combines finish rolling will we know the size of the crop. Between now and then there is very little that US farmers can do to affect it. In most other industries, faced with lower prices, managers would begin ratcheting production down to match anticipated demand between today and a year from now.

We could get a better price for next year’s crop if US farmers were to reduce corn acreage by 3 or 4 million acres and forego any yield enhancing technology in the seed they buy. But that’s not going to happen. With wheat prices in LDP territory it is likely that some of those wheat acres will be dedicated to corn plants come next spring.

If a given farmer wants to give up some rented land to reduce production, there will be someone willing to rent that ground and take on a potential loss in hopes of a crop failure somewhere else and long-term access to that land. But that land will be planted to something and eventually drive all prices down.

In the years that we have been around this business, there have always been those who say, “But today things are different and with purchased inputs (or whatever), farmers will make adjustments that reduce total production. So far, that hasn’t happened.

When a decade ago ethanol came on strong, farmers quickly converted pastureland into cropland and increased crop production to keep up with demand. But the opposite does not happen quickly on the downside. It will take many years to wring out all those acres that were brought back into production when prices were “high.”

The low prices will reduce the number of commercial farmers as banks curtail lending, but the total number of crop acres and total crop production will decline slowly.

And those farmers who earn 90 percent or more of their income from town will keep planting their 20 to 400 acres. Their production is relatively impervious to prices because their land is paid for and they are using a 1970 tractor.

Without a change in farm programs that takes into account the low price elasticity of both demand and supply, we are likely to be in for a long painful time in crop agriculture.

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