POLICY PENNINGS By Daryll E. Ray

Drought induced price spike could cause even lower prices later

As this column is being written the markets for corn, soybeans and wheat are jittery with prices vacillating up and down as traders try to figure out the impact of weather on the size of 2002 crops in the U.S. The weather between now and the middle of August will have a major impact on determining the price level of major crops for the next year. In years past, the yield drops have been dramatic. In 1983, hot summer weather in the corn belt resulted in a 32 bushel per acre drop in U.S. corn yield compared to the previous year. In 1988, the drop in yield was 35 bushels per acre below its 1987 level.

We have not had a yield related disturbance remotely approaching those levels in recent years, but some long range forecasts imply that we might have one this year. The next three weeks are a crucial time for the development of the corn crop. With an auspicious mix of adequate moisture, cool nights, and a sufficient number of degree days, a relatively normal crop will result and prices will probably languish.

On the other hand if the weather factors combine to create yield losses like those we saw in 1983 and 1988, prices could skyrocket. In the past 30 years when we had an extreme weather-related yield reduction, the markets could depend upon the availability of grain from government and farmer-owned grain reserves. This year we have none of that. There are no reserves sitting out there.

In 1983 when summer heat and drought caused a 28 percent drop in yield, beginning inventories were at 3.5 billion bushels, the bulk of it in the Farmer-Owned Reserve and in stocks held by the Commodity Credit Corporation. By the end of the 1983, crop year inventories had shrunk by 2.5 billion bushels leaving a carryout of 1 billion bushels. The season average price for corn rose from $2.55 a bushel in the 1982 crop year to $3.21 in the 1983 crop year.

Beginning stocks for the 2002 crop year are projected to be 1.6 billion bushels with no government or farmer owned reserves. Worldwide the carryover level of corn and four other major feed grains (grain sorghum, barley, oats and rye) are at 19.5 percent of demand, the lowest level since the carryover level dropped to 18.7 percent at the end of the 1995 crop year.

That means that we will be going into the 2002 crop year with one of the lowest stocks-to-use ratios of the last twenty years. If the crop is normal or near normal, then prices will probably not see an appreciable rise. On the other hand if hot, dry weather in the corn belt brings about a significant drop in yield we could see prices go through the roof. Under a worst case weather scenario corn prices could skyrocket to well over $4.00 a bushel. That might look nice but consider what it means.

U.S. farmers will only receive that price if they have corn to sell. For those who lost most of their crop to the heat, they would be hit by a double whammy. They will not have much corn to sell and they will not receive the counter-cyclical payment as the season average price will exceed the target price. That will leave them dependent upon Congress approving a crop disaster bill, which, under the present budget circumstances, might be more difficult to come by than it was in the past.

But the double whammy is not the end of the story. In the past we have argued that raising the loan rate by a quarter or so will not have a significant effect on crop acreage. But we do not believe the same is true for a $2.00 increase in the price of a bushel of corn. A price rise of that magnitude undoubtedly would bring significant additional resources into corn production as producers around the world try to cash in on "good prices." All that additional production would cause those initial high prices to drop to even lower levels a year or two later.

As we know, under current legislation major-crop prices have neither a floor nor a ceiling. Low grain prices appeal to livestock feeders and high prices appeal to crop farmers. But could it be that we are "better off" with relatively stable prices that moderate the booms so that busts are less likely to follow?

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