

High prices cure high prices

In the past, when we have advocated for supply management programs, others have disagreed with our analysis by making the argument that “low prices cure low prices.” By that they mean that in response to lower corn prices, for instance, farmers will reduce their corn acres which reduces the quantity supplied—that is, it causes a move down the corn supply curve which successfully drives the price upward.

In making that argument, they ignore the fact that farmers tend to plant all their crop acres all the time. On ground that they own, farmers have no incentive to idle acres as long as the price is above the variable cost of production (or even has the potential to be above the variable cost of production).

They do this because any income they receive above the variable cost of production can be used to cover fixed costs and reduce the total farm loss.

And if they don't reduce planted acres on ground they own, it is doubly true on rented ground. Who is going to pay for a field and leave it partially unused because of low prices? Besides that, what landlord will look kindly on unplanted acres that may be allowed to go to weeds?

Thus, we have seen nearly a decade of crop prices that are significantly below the full cost of production resulting in an increase in farm bankruptcies with many farmers hanging on by their fingernails.

This came to mind as we looked at the February 9, 2021 WASDE (World Agricultural Supply and Demand Estimates) report (<https://tinyurl.com/2sybfs6y>). In that report, they project that the corn price for the 2020/2021 (2020) crop year will jump from \$3.56 for the 2019 crop year to \$4.30. Farmers will go from losing money on the 2019 crop to making a significant profit on the 2020 crop.

As mentioned, this result is in part triggered by an increase in corn exports from 1.8 billion bushels in the 2019 crop year to 2.6 billion in 2020.

That same report shows soybean exports increasing from 1.682 billion bushels in 2019 to 2.230 billion bushels in 2020, a 38 percent increase with projected soybean planted area increasing from 76.1 million acres in 2019 to 83.1 million in the 2020 crop marketing year.

Turning to the “USDA Agricultural Projections to 2030” (<https://tinyurl.com/j9wh8mz8>) to get the longer-term picture we see corn planted acres declining slightly from 91 million acres to 89 million acres in 2030. Because yields are projected to steadily increase from 178.4 bu./ac. in 2020 to 198.5 in 2030, we see production increasing from 14.7 billion bushels to 16.2 billion bushels, sustaining exports between 2.3 billion bushels (2020) and 2.8 billion bushels (2030).

Looking at soybeans in that same report, we see soybean acres jumping from 83.1 million acres in 2020 to 89.0 in 2021 then slowly moving to 90 million acres in 2020. Soybean exports which were 1.7 billion bushels in 2019 are projected end the decade at 2.4 billion bushels.

Our years of observation of crop markets would suggest that while low prices **do not** cure low prices for the reasons described. At the same time, we have observed that high prices **do** “cure,” or more accurately clobber, high prices. Bear with us as we explain our reasoning.

When crop prices increase from a position well below the full cost of production to significantly above the full cost of production, farmers convert grasslands and in other ways bring additional acres into crop production. The USDA projections to 2030 show planted acres for the 8 major crops increasing from 238.2 million acres in 2019 to 253.3 million acres in 2024, declining slowly to 251.3 million acres in 2030, well above the 2019 level.

But US farmers are not the only ones who respond to price signals. A recent report indicated that China will increase its corn acreage by more than 667,000 hectares (1.65 million acres). We would not be surprised if soybean acres increase as well. The increase in Chinese production will result in lower corn and soybean imports from the US, driving prices downward and most likely below the full cost of production.

High prices will have clobbered high prices, but farmers will tend to keep the additional acres in production anyway for the reasons described above.

High prices are often the result of a temporary decline in production domestically or by another major crop supplier.

When this happens, farmers need to be patient and allow production to return to long-term trend levels. When farmers respond by sharply increasing acres, what was a temporary shortfall-availability problem becomes a long-term price problem.

The overall results are: In the market for major crops, low prices do not cure low prices, but high prices do cure/clobber high prices.

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