APAC Agricultural Policy Analysis Center
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PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

Exceptionally high prices are nice, but they usually worsen future low-price problems

The high prices being fetched this year for corn and soybeans this year may turn out to be a mixed blessing for crop farmers.

For those with a crop to sell or adequate insurance, the high prices will virtually guarantee that they make a healthy profit. For those who went light on insurance this year and have little to harvest, the high prices will bring little consolation.

But, we need to remember that the impact of high prices extends well beyond the current year. High prices send a signal to the market that more production is needed in the future. When the high prices are the result of a sizeable shift in demand, then the signal will result in an increase in production needed to meet this new demand level.

In fact that is exactly what we saw in 2007 as the US corn market struggled to meet the rapid increase in the amount of corn going into ethanol production. The price went up in anticipation of this shift in demand and farmers responded, dramatically increasing the number of acres put into corn production.

But it is another thing altogether if the high-price spike is amplified by a one-year weather aberration. The planted corn acreage this year was large enough to send prices downward before the rains shut off at the beginning of summer while the increase in the price of corn did nothing to increase rainfall.

However, the price increase did send a signal to farmers around the world who want to cash in on today's lucrative corn and soybean prices. To a person, they are hoping that they can get a crop in the bin while the prices remain high.

And that would not be a problem if the US has another drought next year, and the year after. But add a bountiful US crop, like the one expected this year, to the increase in production elsewhere and it could be "Katie bar the door."

If this were only a discussion of economic theory, there would be nothing for US crop farmers to worry about.

But, recent news stories out of South America suggest that the scenario we just discussed in anything but theoretical. With the timely arrival of late winter rains in Brazil, the 2012-2013 soybean crop could allow farmers there to eclipse the US as the world's largest soybean producer.

The current prices give Brazilian farmers every incentive to sharply increase acres (well hectares to them) planted to soybeans while adopting a strategy that will maximize their chances of sowing second crop corn as soon as the beans come out of the field. Forecasters are expecting soybean planted area to increase by 8 to 12 percent from last year.

Combine that with a return to trendline corn and soybean yields in the US and we could see prices that brings a smile to those who have to buy feed for their livestock, not to mention industrial users. For the current crop year, US farmers planted 96.4 million acres to corn, exceeding the 95.4 million acres planted in 1944 at the height of WWII. With the current high prices, there is every reason to believe that US farmers will plant something close to 96.4 million acres in the coming year. And, if the yields are in the vicinity of the 166 bushels per acre expected this year, we could easily go from a 10.7 billion bushel crop in 2012 to over a 14 billion bushel crop in 2013.

With the first and second crop corn that could come out of Brazil along with an ordinary crop from Argentine, we could go from a short crop and high prices this year to a massive crop and prices that tickle the loan rate next year.

But it gets worse. While high prices can bring fairly rapid increases in acreage, those acres wring out exceedingly slowly when prices fall, even to prices well below the full cost of production. Everyone hangs in there year after year, hoping that someone else will suffer from a drought and they will be able to reap the resulting high prices.

A review of agricultural history suggests that extended periods of over production and low prices is the norm interrupted by shorter periods of high prices.

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Cont. from p. 1

Cont. on p. 2