

PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

Question: What makes crop agriculture fly so high and then crash so quickly?

When we began writing this column more than 15 years and over 800 columns ago, we laid out some basic principles and understandings of the nature of agricultural production which we would be using in our analysis. At that time, US agricultural policy had just moved away from programs designed to support crop prices. Subsequently, crop prices fell well below the cost of production and farmers were dependent upon Loan Deficiency Payments and emergency payments. The anticipated boom in corn exports to China had not materialized; China was still exporting corn.

For some major agricultural states, direct government payments were over 150 percent of net farm income and crop farmers were desperately looking for ways to add value to the crops they were producing. We saw corn being used to make clothing fibers and soybean oil being used to make printing ink and provide dust suppression on unpaved roads. Some farmers were shifting to feeding corn in low-margin-high-volume confinement hog production.

But the holy grail of the value-added movement was ethanol. Corn could be converted to ethanol just like it had been by generations of moonshiners, only this time it would be used as a fuel additive and the protein that remained could be used as feed for cattle. Ethanol, it turns out, when added to gasoline, could replace tetra-ethyl lead—it was being phased out due to environmental contamination concerns—increasing octane and eliminating the “ping” in car engines when gasoline with too low an octane was used.

Ethanol was also a fuel oxygenate that when mixed with gasoline would result in cleaner burning engines. By blending it into gasoline at the 10 percent level, no engine changes were required and cars ran smoother and cleaner.

With the price of corn below \$2.00 a bushel, farmers began to lobby their state legislators to institute a 10 percent ethanol mandate that would support farmers in their districts, address environmental problems, and reduce US dependence on imported oil. At the same time farmers’ meetings were set up to raise the money needed to build and operate corn-ethanol plants. Proponents told farmers that these plants would allow them to capture added value for their commodity corn as well as a share of the profits of the ethanol plant.

We saw farmers put money down in multiples of \$1,000 for the right sell a bushel of corn at a 2- to 5-cent premium over local elevator prices for every dollar they invested in the plant as well as receive unspecified future profits. This was at a time when corn farmers were losing much more than that on each bushel they produced. Farmers were desperate.

Through a series of events, the major competing

product that could serve as a fuel oxygenate, MTBE, was determined to be a carcinogen, and the renewable fuels standard was set by Congress. A period of high gas prices made ethanol plants extremely profitable and a flood of money from beyond the farm sector was invested in ethanol plants, increasing the domestic demand for corn by half.

Even though China has not imported significant amounts of corn, they have become a major importer of soybeans, making soybean production quite profitable. In the last half of the last decade we saw most crop prices soar as the demand for corn by ethanol plants increased from less than a billion bushels a year to over 5 billion bushels a year; farmers increased planted acreage to meet the growing demand.

With profitable prices for both corn and soybeans, many land grant agricultural economists began to posit that corn had hit a new plateau of \$4.00 and above, just as it had done in the mid-70s when the price plateaued above \$2.00 a bushel.

On the farm policy front, we saw crop revenue insurance become the major element of farm safety net programs accompanied by direct payments. Little attention was paid to safety net programs as conventional wisdom held that crops would remain profitable for as far as they eye could see. In the latest farm bill, direct payments were given up as politically untenable when farmers were making record profits. That money was captured to enhance crop insurance programs and provide a low-level safety net in the form of the Price Loss Coverage (PLC) and Agricultural Risk Coverage (ARC) programs.

All the while, we pointed out the upside down nature of crop revenue insurance programs and the lack of a true safety net. We argued for policies that would provide a safety net by sequestering a small portion of storable commodities from the market, providing a reserve that could be used in the case of a significant production shortfall. We also urged farmers to make the choice between PLC and ARC based on locking in protection from unthinkably low crop prices rather than achieving potential payment maximization if prices were to fall only a little.

Many of our colleagues, farm and commodity organization leaders, and legislators suggested that we needed to get with the program. Our policy conclusions were passé and agriculture was entering a new era, we were told. We were even accused of “purposefully taking the ‘other’ [or the ‘opposite’] side of many policy issues.” In reality, from day one our analytical approach and the resulting policy implications have been grounded in a pragmatic understanding of the forces in agriculture—economic and noneconomic—

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Question: What makes crop agriculture fly so high and then crash so quickly?
Cont. from p. 1

that are longstanding and continue to be powerfully pervasive.

In the coming articles, we will lay out the social and economic model we have used and will continue to use in our writing of this weekly column. We believe that the recent plunge in prices—following the politically-driven demand expansion that caused the multi-year surge in crop prices—confirms that the model is as relevant today as it was in the 1933-1995 era when this model was the dominant justification for even having farm programs.

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