Farm policy and price plateaus

With the passage of the 2018 Farm Bill in the rearview mirror, it’s an appropriate time to look at farm bills and other factors that have an impact on the farm economy over a longer period of time to see what they might tell us about the next four years. It turns out that the two events in the last 50 years that have had the greatest impact on the farm economy and farm profitability were not brought about by changes to the farm bill.

The first occurred in 1972 and is desiriously referred to as the “great grain robbery.” It occurred in July of that year when the Soviet Union entered the world grain market and purchased 10 million bushels of grain from the US at subsidized prices. In previous years, when the Soviets had a partial crop failure, they slaughtered livestock to preserve the grain to feed to their population. The 1972 purchase was a deviation from their usual pattern and their continued presence in world grain markets coupled with grain purchases by underdeveloped countries, financed by international lenders, resulted in higher grain prices.

As farmers in the US and around the world ramped up production, crop prices would have plummeted if the US had not raised the loan rate for most row crops. For example, the loan rate for the major crop grown in the US, corn, was raised from the $1.05/bu. it had been since 1965 to as high as $2.65 in 1983. In an attempt to “recapture lost export markets” the loan rate fell to $1.92 in 1986 reaching a low of $1.57 in 1990. In 1994 the loan rate was raised to $1.98.

While the price of corn had remained in the low $1.00 range since 1953, the initial export demand along with these loan rates and the CCC and FOR grain storage programs put corn prices on a $2.00 plateau that lasted from 1973 until 1997.

With the passage of the 1995 Farm Bill and the adoption of the Marketing Loan Gain program, farmers no longer had to forfeit the grain they had put up as collateral when the loan came due. They could receive loan forgiveness and retain ownership of their crop; this was called a marketing loan gain (MLG). Farmers who did not take out government loans on their crop could collect a loan deficiency payment (LDP) on a date of their choice from the local Farm Service Agency office.

The 1996 Farm Bill was adopted at the height of corn prices brought on by a short crop in 1995. It took two more years for prices to ratchet down, but with surplus production remaining on the market, the price fell below the $2.00 level for the 1998-2001 crop marketing years. Tight supplies in 2002 and 2003 kept corn prices above the $2.00 level through the 2005 crop marketing year.

The second of the events with a high impact on farm profitability was the adoption of the Renewable Fuels Standard (RFS) in 2005 and its expansion in 2007. The RFS set a standard for the blending of ethanol into the US national automobile fuel supply. Beginning in the post-1996 Farm Bill period, corn farmers began to lobby for using ethanol as a fuel oxygenate, competing with MTBE, a petroleum-based product.

The resulting mandates for 10 percent ethanol blends occurred at the state level in farm states like Iowa and Minnesota. Meanwhile the 10 percent blending of ethanol into the national fuel supply, even with the argument focused on energy independence, was not getting anywhere nationally.

It took the combination of the identification of MTBE as a carcinogen and a spike in gasoline prices to more than $4.00 per gallon due the 2005 record hurricane season in the Gulf of Mexico, which shut down oil rigs in the gulf and refineries onshore, to get the Bush administration to support a national 10 percent ethanol blend requirement.
Most of the initial corn-to-ethanol plants built before 2005 were farmer-owned. Farmers had invested in these plants to secure a market for a portion of their corn crop. Higher gasoline prices in 2005 resulted in higher ethanol prices, making these ethanol plants highly profitable. This caught the attention of Wall Street investors who invested in many of the ethanol plants needed to meet the RFS.

When the USDA crop supply and demand forecast took the rapid increase in the number of ethanol plants coming online into account, the price of corn began to increase rapidly to above the $4.00 level in 2007. Soon people were talking about a new price plateau, one that moved from the earlier $2.00 level to a new $4.00+ level.

As crop prices rose, so did the expense of producing those crops. One of the new-price-plateau arguments was that as corn demand for ethanol production leveled off, the increased cost of production would keep prices from falling significantly below the $4.00 level. But by 2009, the corn price had fallen to a season average price of $3.55. It took below trend-line corn production in 2010 and 2011, and a significant crop failure in 2012 to send corn prices well above the $4.00 level.

With corn production returning to trend-line or above trend-line levels after 2012, corn prices began to fall. In the 2014 crop year corn prices dropped below $4.00 and have remained there since. Unlike the earlier plateau, where excess production was taken off the market and put into a reserve, there is no such price stabilizing mechanism at present.

The 2018 Farm Bill would have been an excellent time to rethink post-1996 farm policy orthodoxy, but many farm and commodity groups stuck to their guns and doubled down on “enhancements” to the Agricultural Risk Coverage and Price Loss Coverage programs from the 2014 Farm Bill.

It is our expectation, based on the above analysis, that with near-trendline corn production and no price floor, prices will continue to mosey lower. As a result, almost all farmers will feel the financial pinch of low prices in the coming year.

It turns out that some policies make a significant difference in farm commodity prices.

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