APAC Agricultural Policy Analysis Center
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PolicyPennings by Dr. Daryll E. Ray

Fact or fantasy?: Farm legislation need not prepare for $2 corn

In last week's column we talked about the likely high-price consequences of a major drought in the Midwest. We noted that in the case of the Senate's Average Crop Revenue provisions and existing crop insurance products and government payment programs, crop farmers will be largely protected if a one-year severe drought occurs and prices skyrocket, because these programs protect farmers against short-term yield and short-term price disturbances.

We also noted that with the absence of reserve stocks, crop demanders have no upside price protection at all, potentially calling into question the US's reputation as a dependable supplier of agricultural crops to domestic users as well as international customers.

This week we will be looking at the opposite scenario. The November 30 nearby futures close was $4.01 for corn, $10.80 for soybeans, and $8.85 for wheat. These prices compare to 2005 crop year pries in which corn brought a mere $2.00, soybeans $5.66, and wheat $3.42.

We interpret the current high prices as a signal that the market is bidding for crop acreage among the three crops. Last spring, farmers in the US responded to the signal of relatively high priced corn by bringing in an additional 15.3 million acres. Much of the additional acreage came from cotton and soybeans. Winter wheat acreage was unaffected because it was being planted just as the price rise began.

Our concern is less about the way in which US farmers will arbitrage among the various crops based on price. Unless farmers convert a substantial amount of hay ground and pasture, the aggregate US crop acreage is relatively stable.

As we all know, farmers worldwide see the same signals that guide the planting decisions of US farmers. Nine dollar wheat could grab the attention of European farmers, particularly those in wheat growing regions of the former Soviet Union. If they increase their planting and get reasonable weather, we could see a bumper crop of wheat hitting the world market next summer and fall.

Soybean farmers in Brazil and Argentina have already responded to the high prices by attempting to bring in more acreage during the current summer season in the southern hemisphere. For them, this year's weather conditions have been the factor limiting a bumper crop. Certainly they will try again if prices continue anywhere near the $10 level.

Four dollar corn certainly will attract the attention not only of Argentine farmers; it will also attract attention of farmers in many countries around the world. The closer these developing countries come to meeting their own needs for corn, the less likely they will need to import corn on the international market.

And then there is China. Certainly they will not turn a blind eye to the current high price structure. It is one thing to import $5 and occasional $6 soybeans. It is another thing to import $10 beans. Suddenly soybean farmers who weren't able to make a profit at five and six dollars can make a good profit at $10.00. Will Chinese farmers respond? We would not want to bet against it.

Combine the additional acreage around the world with decent weather and some gain in yield, and we could be awash with corn, wheat and soybeans, despite the demand for biofuels. And if we are awash with product, there is only one place for the price to go and that is down. We have a tendency to focus on current demand optimism and ignore future supply-response realism.

After the last price boom in 1995, prices slid for two years and stayed in the tank for four years. Could that happen again?

If it does, the Senate's Average Crop Revenue program will protect farmers on the first year down, and to some extent the second and third years. By the fourth year, the average of three years of low prices will offer farmers little protection—certainly less than the protection of the Counter-Cyclical Payments under the current program.

The last time we made a major change in farm programs (1996) it ended up costing us an extra $10 billion a year in LDPs (Loan Deficiency Payments), MLGs (Marketing Loan Gains), generic certificates, and Emergency Payments.

Before finalizing the farm bill, Congress needs to investigate whether the provisions it adopts will work just as well when prices are low for extended periods of time as they do on those occasions when prices are high.

Daryll E. Ray holds the Blasingame Chair of Excellence in Agricultural Policy, Institute of Agriculture, University of Tennessee, and is the Director of UT's Agricultural Policy Analysis Center (APAC). (865) 974-7407; Fax: (865) 974-7298; dray@utk.edu; http://www.agpolicy.org. Daryll Ray's column is written with the research and assistance of Harwood D. Schaffer, Research Associate with APAC.

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