APAC Agricultural Policy Analysis Center

The University of Tennessee

PolicyPennings by Dr. Daryll E. Ray

When framing a farm bill, betting on "high" prices may be a long shot

One of the significant influences on the shape of a farm bill is the economic condition of crop agriculture in the period leading up to its adoption. The 1996 Farm Bill was enacted during a period of prices that were significantly higher than they had been for more than a decade. Wanting to believe and with experts' assurances that $2.60 to $2.80 corn was the future of agriculture, farmers supported the market-oriented reforms of Freedom to Farm. Doing so meant giving up floor prices, and acreage setasides in exchange for planting flexibility, decoupled AMTA payments, and LDPs.

Two years later, when prices hit the skids, Congress authorized Emergency Payments to keep most farms afloat. Emergency payments were paid four years, 1998-2001. By 2002, Congress was ready to end Freedom to Farm one year early, clearly in response to the four-year trough of low crop prices. The low prices were taken into account by Congress as the legislators included the Counter-Cyclical Payment program as a way of institutionalizing the Emergency Payments.

The assumption that the short-term, current conditions will hold into the foreseeable future shapes the type of policies that policy advocates and policy makers alike consider relevant. This tendency is reinforced by the baseline projections that policy makers use to examine the impact of various policy proposals. The baseline projections are usually the result of extrapolating the current, short-term trends into the long-term future.

At present the nearby month futures price of corn is double what it was just before harvest last fall. The press is abuzz with talk of 70 or 80 new corn-based ethanol plants in the construction or planning phase. The carry-over level of corn is projected to plummet this year and some are talking about a conflict between food and fuel.

USDA's newly released10-year "Agricultural Projections to 2016" show $3.30-$3.75 corn prices for the whole period. The projections are based, in part, on a continuation of present agricultural and ethanol policies. Certainly if prices remain in that range for the next 10 years, the implications for farm policy are quite different than if the bubble bursts and prices drop below the loan rate once again.

Looking at some of the details of USDA's projections we note that exports are far more realistic than they have been in the past. Their export projections are virtually flat, beginning at 2.2 billion bushels, dropping slightly for a couple of years and increasing to 2.25 billion bushels in 2016. Projections in that range are far more consistent with the actual pattern of corn exports for the last quarter-century than we have seen in baselines over the last 10 years.

Corn-based ethanol demand grows faster than corn production, an honor bestowed on exports in the past. Corn for ethanol use increases from 1.6 billion bushels in 2005 to 4.35 billion bushels in 2016. To meet the needs for ethanol plants, USDA projects that corn planted acreage will increase by 7.4 million acres in the 2006 crop year, an additional 3 million acres in 2008 and 1 million acres in 2010 for a total of 90 million acres of corn.

Because of the strong ethanol demand, the USDA baseline shows the ending year stocks-to-use ratio hovering between 4.5 percent and 5.5 percent for the 10 year period. This contrasts with a twenty-year range from 8 percent to 19 percent with a couple of years above 20 percent and 1996 at 4.6 percent.

Never before have corn stocks been that tight for such an extended a period of time.

Over the last 40 years, a decrease of 1 percent in the year-ending stocks-to-use ratio has resulted in a little over a 3-cent increase in the price of a bushel of corn. In the new baseline, a decrease of 1 percent in the stocks-to-use ratio triggers a 20-cent increase in the price of a bushel of corn. Granted the demand expansion may be of an unprecedented sort, but the change in relationship between stocks and price is huge.

We would be mighty wary of basing the new farm bill policies on these projections.

The last time we wrote a set of farm bill policies based on high prices and growing demand we were sorely disappointed, and the costs to the US Treasury exploded. The 1995 season average corn price was $3.24 and Congress enacted Freedom to Farm. Two years later the season average corn price was $1.94 and emergency payments were needed.

In this time of high corn prices, we hope that calm heads will prevail and Congress will adopt a farm bill that will work just as well in times of sub-$2.00 corn prices as it will in times of $3.00 plus corn prices. What we need is a "policy for all seasons."

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.

Originally published in *MidAmerica Farmer Grower*, Vol. 24, No. 8, February 23, 2007