UNIVERSITY OF ILLINOIS EXTENSION

WEEKLY OUTLOOK

A joint publication of the Department of Agricultural Economics, College of Agriculture, Purdue University, West Lafayette, Indiana, and the Department of Agricultural and Consumer Economics, College of Agricultural, Consumer and Environmental Sciences, University of Illinois at Urbana-Champaign.

AUGUST 21, 2000

PROSPECTS FOR CONTINUED LOW PRICES STIRS POLICY DEBATE

Prospects for record large corn and soybean crops suggest that the two year period of extremely low prices will continue for a while longer. In the near term, pricing and marketing decisions will be centered around the use of the marketing loan program. Specifically, producers will be occupied with deciding when to establish loan deficiency payments, how much of the crop to store unpriced, and whether or not to take advantage of large premiums for post-harvest delivery.

With marketing moving to the back burner, more attention is being focused on government programs and proposals for policy change. A number of "plans" are being proposed from a variety of sources. Many of the proposals are without merit and/or are very short term in their approach.

The history of crop prices in the U.S. suggests that high prices are an exception and that low prices are the norm. The U.S. and world has the capacity to produce more crops than can be sold at high prices for an extended period. Efforts to increase demand can and have been successful, so that more product can be sold at higher prices. These efforts, however, tend to be gradual and demand has not improved faster than productivity gains, so prices general remain low. This is the primary reason that U.S. crop policy has historically had a supply control component.

Some writers appear surprised that the current extended period of low prices has not resulted in a voluntary supply reduction on the part of U.S. or world producers. The reason that has not happened, of course, is that prices (prices plus government payments in the case of some countries) continue to exceed the variable cost of production. Budgets based on farm records in Illinois, for example, show that the out of pocket costs for producing corn may vary from about $1.20 to $1.50 per bushel. All non-land costs may vary from $1.80 to $2.40 per bushel. For soybeans, the out of pocket costs may range from $2.10 to $2.50 per bushel, while all non-land costs may range from $3.90 to $4.70 per bushel. If price plus payments exceed out of pocket costs and contribute to fixed costs, production will continue, at least for a while. Current loan rates that are above the variable cost of production, along with highly subsidized crop and revenue insurance premiums, tend to encourage production.

Even though production is not discouraged, low prices result in low or negative incomes for many producers due to the high cost of renting or paying for farm land. Again, budgets for Illinois show an “equivalent rent” cost of land ranging from $.85 to $1.00 per bushel for corn and $2.00 to $2.80 per bushel for soybeans. Over time, low prices and low incomes would likely result in lower land costs (values), bringing the cost of production in line with the market price. However, the short term impacts of land price devaluation are not generally acceptable, so the government has made additional income payments to producers in each of the last two years and will likely do so again this year.

The effect of additional government payments, then, is to support land values (costs) and keep the total cost of production well above the normal market price. Since payments go to producers, there continues to be keen competition to own or rent land, driving values higher. The capitalization of government payments into farm land values has been documented by a number of academic studies and is generally understood by farmers and many in government. However, there appears to be some emerging frustration on the part of policy makers that government payments drive up the cost of production which require more government payments to support incomes during periods of low prices.

While the capitalization of government payments into land values may be rational economic behavior, it creates a policy dilemma – discontinuing or reducing payments could create widespread financial stress, while continuation of large payments prevents the downward adjustment in costs that appears to be needed. Expecting crop producers not to bid up the value of land is like expecting hog producers not to expand production when hog prices are over $50 – it doesn’t happen. The upcoming policy debate should be interesting.

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