policy pennings

∆ **Contact Dr. Daryll E. Ray**
at the UT's Agricultural Policy Analysis Center by calling
(865) 974-7407,faxing (865) 974-7298,
or emailing dray@utk.edu.
For more info, visit: www.agpolicy.org

It Is Hazardous To Predict The Future: More So If Half Of The Factors Are Ignored

DR. DARYLL E. RAY
Agricultural Economist
University of Tennessee

In times like these, it is good to do a reality check. We are being bombarded with prognostications that make major crop farmers smile and livestock farmers cringe.

The future that is being described is one of tight crop supplies and elevated prices. Crop agriculture, they tell us, is slated to finally move to the promised land of lucrative market-generated incomes (plus $5 billion in direct payments).

And, livestock farmers' frowns are also projected to turn into smiles – eventually. The current financial pain of livestock agriculture will fade as livestock numbers are sufficiently adjusted so higher livestock prices will more than cover higher feed costs.

This future is a very appealing place. So what is behind all this optimism?

Basically it's all about demand. Ethanol is, of course, part of the story.

Ethanol's appetite for grain-based feedstock has been a primary force in corn demand growth over the last two years, no question about that. And as US land resources shifted to corn and away from soybeans and other crops, prices for other crops increased markedly as well.

So will ethanol sustain the long-term profitability of crop agriculture? Not really – and it is only one of several factors that have influenced crop markets in the last two years. The ethanol effect will continue to be an influence on major crop agriculture for a few years, but then demand for grain-based ethanol will level off, no longer exceeding the growth in production

Most of the optimism about long-run agricultural demand is based on anticipated changes on the international scene.

One of these changes is the increase in incomes in developing countries, especially China and India – a growing middle class.

Another major anticipated change in the international arena is the successful completion of the Doha round of the World Trade Organization (WTO) negotiations. With the possible exception of the EU, each and every country seems to think that its agriculture will benefit from a successful Doha round as long as all other countries hold up their end of deal.

This is particularly true for the US. With the guarantee of market access, commodity groups, farm organizations, and the Administration are betting a large chunk of otherwise potential government payments that ever-increasing exports resulting from the growing Chinese and Indian middle classes will increase US farm income and make those payments unnecessary.

In recent years, China and India's incomes have been growing – often at double-digit pace. In fact, that income growth is typically given as an important reason for recent, as well as future, increases in commodity prices.

This winter – at a commodity outlook meeting near you – expect to see graphs showing recent income growth in China and India and graphs of US exports of certain farm commodities to China.

Before turning to the long-run effect of China and India, let's consider their recent impact on US agricultural demand. While China and India have experienced rapid income growth, trade data suggest that US agriculture has benefited relatively little.

China exports more corn than it imports, US soybean exports to China have increased but Brazil has captured the lion's share of the growth in world soybean exports, most of the US poultry exports to China are chicken parts for which there is no lucrative market in the US, and China continues to produce more of other meats than it consumes.

India as an importer of major agricultural commodities is currently a non-starter. Mentioning India in a discussion of factors positively affecting current-period US agriculture demand and prices is at best distracting.

It would be wrong to think that the recent increases in incomes in China and India are a major cause of the US demand and price increases of the last couple of years. But what about in the future? Well, it's a maybe at best.

"It is a maybe at best" because of what is missing in the unbridled optimism of agriculture's future. As we said earlier, the optimism is all about demand. Virtually without exception, discussions of what lies ahead for agriculture say nothing about future supply prospects. Focusing on demand growth and ignoring supply growth makes for a very upbeat presentation.

But what if – in a short few years – supply exceeds demand, as we suspect it will?

To us, the opportunities and motivations for increasing wor-ldwide supply have never been greater. Yes, even greater now than in the go-go times during the high price period of early seventies when Japan invested money to speed Brazil's soybean research along and when the EU and many other countries stepped up yield-enhancing agricultural research and solidified food self-sufficiency objectives. Farmers, who experienced that period, will never forget the ferociousness of the ensuing impacts on crop markets and farmers' balance sheets during the 1980s.

The opportunities and motivations, several years in the future, for supply to outstrip demand are greater than they were even in the 70s. These include:

1. The globalization of agricultural input suppliers. Most-to-many countries now have access to the wares of Monsanto, Pioneer, John Deere, Cargill and similar multinational suppliers of agricultural inputs and services.

2. These worldwide agricultural input supplies are conduits for advancing agricultural yields and productivity. New technologies are no longer limited to the domain of the US and other "developed" countries. Even after discounting some of the more optimistic yield projections, it is clear that agriculture is in for continued impressive yield advances in the years ahead.

3. There is more agricultural land out there after all. For years, it was popular to say that they are not making any more Iowas. But now we find there are hundreds of millions of acres of savannah land in South America and Africa that could be used to raise crops. All that is needed to open up this land is the equivalent of $5 to $7 corn.

4. The above provide the opportunities for exporters and importers alike. The major motivation to increase output for exporters is profit and for importers it is food security.

Food security and food sovereignty are front-burner issues once again. But this time these issues are being fueled not only by high commodity prices, and the riots they generate, but also worries about how WTO might affect food security and sovereignty in the future.

China is buying/renting agricultural land in Africa. Saudi Arabia is renting agricultural land in Thailand. Japan dutifully (no pun intended) imports rice from the US, stores it for a while and then disposes of it in hog troughs.

As we move through time, there may be many countries that will be saying in effect: Regardless of WTO rules – and abide by them we will try – but, when push comes to shove, nothing trumps domestic sovereignty over our food.

As we see it, when possible supply responses of export competitors and import customers to high prices are considered – in addition to the demand considerations usually talked about – the range of possible price and income possibilities widens considerably. ∆