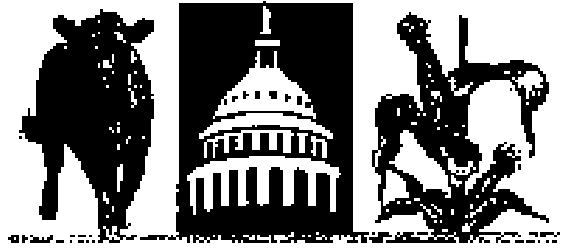


# ECONOMIC AND POLICY UPDATE

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### **Tobacco Yields Across the State**

Obviously, 2007 was not a typical tobacco production year for any area of Kentucky. According to the Kentucky Farm Business Management (KFBM) program records for 2007, wide variation existed across the state. Post buy-out Kentucky has also seen considerable shifts in tobacco production. Some areas have seen sharp acreage declines, while other areas, especially western Kentucky, have experienced increases in tobacco acreage.

Producers as a whole in 2007 experienced a severe drought that greatly affected production. The state average burley yield, according to KFBM, was 2343 lbs/acre. This represents a 6.4% decrease from 2006. However, producers in both the Ohio Valley and Lincoln Trail areas experienced an increase in production per acre. Decreases in the Pennyroyal and Bluegrass areas can largely be attributed to a more severe drought in those areas.

According to KFBM records, small producers (those farming less than 1000 total acres) tend to have higher yields. In 2007 small producers averaged 2543 lbs/acre. Interestingly, producers who crop 2000 acres or greater only averaged 2178 lbs/acre, and those cropping between 1000 and 2000 acres averaged 2346 lbs/acre. The pattern held for 2004, 2005 and 2006. Although small producers tended to produce more per acre, they were not able to affect the state average yield to a significant degree.

Dark Air production, like burley, also experienced a decrease for 2007. On average, per acre production decreased 17.5% or 592 lbs/acre to 2787 lbs/acre. Typically, dark air tobacco is thought of as a western Kentucky crop; however in recent years we have begun to notice some dark air production moving east. In 2007, Lincoln Trail area producers had a production increase of 2039 lbs/acre compared to 2006. This is a large increase, but represents a small number of producers in that area. As this area becomes more familiar with dark air production, others will begin to produce.

Dark Fire production, like burley and dark air, saw a decline in production in 2007. Although, producers on average saw a decline of 649 lbs/acre, several producers have increased dark fire acres. Not only have western Kentucky producers increased their total acreage of tobacco, they have also begun to shift to Dark Fire/Air types at the cost of burley acreage. Producers in several areas of the state have also invested large amounts of capital in Dark Fire/Air in hopes of increasing farm profits. Coming off two bad weather years that drastically reduced the profitability of grain crops and livestock, dark tobacco has looked much more profitable. (Evan Conrad)

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## Thanksgiving Dinner: Tighten the Belt & the Budget

It is no surprise that total food production decreased in 2008 due to high fuel, fertilizer, and labor costs. With food prices at an all-time high, many families are wondering what to do for the holidays.

In an August 2008 report, a Food Marketing Economist at Purdue University, Corinne Alexander, said that while grocery prices have been rising at a steady annual rate of 2.5% in the past, we experienced an increase of more than 7% from July 2007 to July 2008. Prices have continued to increase into the fall months and economists are not projecting a decrease any time soon. "We've seen reduced acreage of fruits and vegetables this fall and, as a result, food shoppers are seeing higher prices for both fresh and processed fruits and vegetables," said Alexander in a recent interview posted on the World Wide Ag Network at [http://www.worldwideag.net/index.php?option=com\\_content&task=view&id=2306&Itemid=328](http://www.worldwideag.net/index.php?option=com_content&task=view&id=2306&Itemid=328).

So, what to do? Alexander says that, while grocery prices are increasing at a rate of 7%, restaurant prices are only increasing at a rate of 4.5%. In addition, because of convenience, consumers are going to find themselves tempted to dine out more often.

On a more positive note, the USDA reports that turkey production is actually up more than 5% for the 2008 holiday season, and wholesale prices are expected to be reasonable. To entice consumers to purchase additional food items for their feast, it is likely that retail prices of turkey will remain modest.

In terms of fresh produce, retailers might experience a demand for more potatoes, onions, and canned items, as consumers find replacements for higher priced produce such as fresh asparagus, greens, and delicate fruit. (Tim Woods and Sarah Williamson)

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## The Future of Ethanol

There has been a lot of recent interest in renewable energy options in Kentucky. It seems

that many have recognized both the positive and negative impacts of the corn-based ethanol trend we have seen in the last few years. Corn growers have experienced nice returns while the livestock industry has been hit hard with higher feed costs. Recently, critics of corn-based ethanol have suggested that it takes more energy to produce ethanol than what we are saving by producing a cleaner fuel. Regardless of the pros or cons of corn-based ethanol, the Renewable Fuels Standard (RFS) mandates that we produce 15 billion gallons of corn-based ethanol by 2022. In 2008, we will have produced just under 10 billion gallons. Right now, things have calmed down with lower fuel prices and corn prices have returned to a more moderate level. However, to meet this RFS requirement, we can expect the corn market to exhibit more volatility in the future.

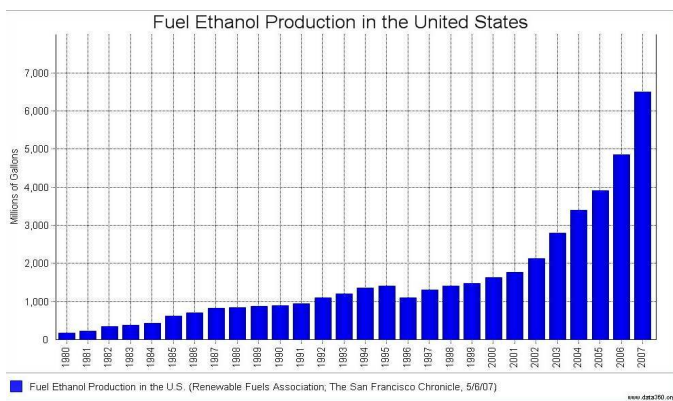
In addition, the RFS states that 21 billion gallons of ethanol should be produced using cellulosic residues. In the future, we are likely to see switchgrass, sugarcane, sweet sorghum, algae, and wood as inputs into ethanol production. Tennessee has recently broken ground on a switchgrass ethanol blending facility. Meanwhile, Dupont says it has created the technology to convert biomass into ethanol; it just needs enhancement for large-scale production. If this is a profitable venture for producers, Kentucky could contribute pasture and hay ground towards growing switchgrass for ethanol. There are some plots in Kentucky that have already started experimenting with switchgrass production.

Let us look at what may happen if switchgrass becomes a viable alternative. We will likely be taking land out of hay, which would mean limited hay supplies and cause the price of hay to rise. So again, the livestock industry looks like it will take a hit if switchgrass becomes prominent, which is likely. However, the federal government has funneled a lot of money into researching and producing cellulosic based ethanol. Thus the incentives are there for both agricultural producers and ethanol plants, regardless of the impacts across the entire economy.

At the present, we are clearly experimenting with many alternative fuels until we learn what is most viable. Eventually, different areas of the country are likely to produce ethanol based on their

comparative production advantage so that transportation and storage costs are minimized.

For example, Texas might grow sugarcane partially for ethanol. Iowa might focus on growing corn for multiple uses including ethanol. Kentucky would likely provide a mix of switchgrass and wood. The ethanol plants will then locate near these resources. Along the way, we will need research to show how ethanol can be transported to the coasts, where the majority of our population lives. We also need to determine ways to better manage our water use in ethanol production. Currently, switchgrass is the “greenest” biofuel. However, all other crops used to produce ethanol are big water, pesticide, and fertilizer users. It seems therefore that we are a long way from biofuels being the answer to higher fuel prices, lower greenhouse gas emissions, and reducing our dependence of foreign countries for resources. (Alison Davis)



makes the point clear that Americans have adopted a changing mindset toward debt and the use of credit in our society.

The recent “credit crunch” has created heightened awareness regarding the levels of debt carried by the average consumer. Debt is viewed as a necessity in many American households, with uncollateralized debt, such as credit cards, often used to bridge the gap. Identifying the rationale behind saving and borrowing decisions is instrumental in understanding why people may accumulate debt. Family goals, as well as anticipated future income and past experiences are all factors in determining saving and borrowing decisions.

One of the most commonly cited reasons individuals provide for using credit cards and other forms of credit is to establish a credit score. During the 1990s mortgage lenders transitioned from traditional underwriting to using an automated statistically generated score. The most commonly used score is FICO, developed by Fair, Isaac and company. A credit score measures a person’s creditworthiness based on their history of debt repayment. A logical consumer may believe small debt, such as credit cards, is necessary to build a FICO score; thus improving their ability to qualify for home or vehicle loans where debt may be a necessity. The trend toward automated underwriting has been scrutinized, placing a large emphasis on credit and limiting the influence of two traditional components of manual underwriting, collateral and repayment ability. Nonetheless, today almost all conventional loans are underwritten using automated scoring; however, an individual can still find financial institutions that offer manual underwriting.

## Tackling the Credit Crunch: Saving and Borrowing Decision Factors

To many, the Monopoly board game could be considered as American as apple pie. Created in 1934, over 200 million sets of Monopoly have been sold. Most children have played the game – counting out Monopoly money, fighting over game pieces, and receiving the infamous jail sentence. Parker Brothers recently released Monopoly Brand Electronic Banking Edition, with a Visa debit card replacing the multi-colored Monopoly money. The toymaker touts that you can “wheel and deal your way to fortune even faster using debit cards instead of cash! All it takes is a card swipe...” Although this is somewhat of a light-hearted example, it

The notions of self-concept or self-image are important for many Americans, supporting the stereotype of “keeping up with the Joneses.” A person inclined to make purchases to support their self-image or that of their family may be more likely to accept or use debt to maintain this lifestyle.

A lack of self-control has also been highlighted as a reason people may borrow money. A consumer exhibiting self-control understands the constraints of their financial budget and resources, including available credit, and therefore spends accordingly.

Individuals with self-control problems find it difficult to associate a time value with money; therefore, they perceive their current costs are much higher than the potential of future gains.

Liquidity preference, or preferring to keep cash on hand, is potentially a confounding explanation of debt assuming behaviors. Typically, people assume debt due to lack of assets or income to support consumption. However, the concept of liquidity preference suggests an individual may prefer debt as opposed to using liquid assets, such as checking, savings accounts, and certificate of deposits, etc., to finance consumption. Liquidity preference may be

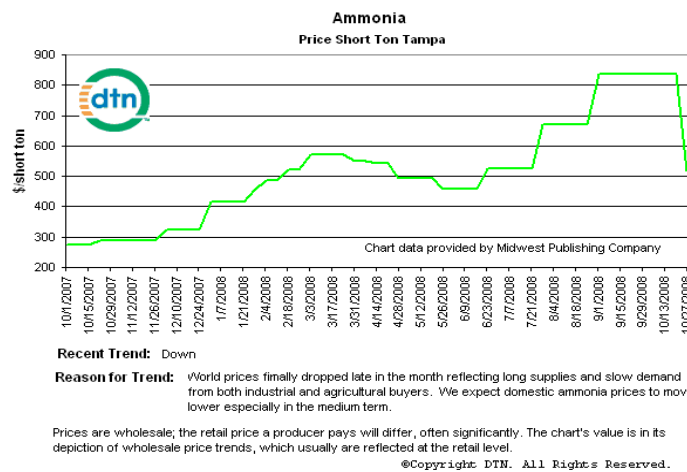
used as a means of self-control, assuming a credit line has a ceiling. The ceiling would ensure that spending was in fact limited. Additionally, maintaining liquidity provides a certain level of liquid assets acting as a security or emergency fund in instance of unexpected events. Furthermore, a large portion of family expenses require cash or check payments, such as utility bills and rent or mortgage payments. Using credit to finance monthly consumption ensures the cash assets necessary to pay other bills. (Jennifer Hunter)

## The Blinking Game

Fertilizer prices increased dramatically through the first eight months of 2008, significantly increasing production costs for Kentucky grain and forage producers. Urea for example, increased from \$.60/unit in March to \$1.20/unit in August. There were many livestock and hay producers that questioned the profitability of spring nitrogen applications this spring given the price in August. The possibility that this price would be doubled next spring has caused much anxiety. Corn growers using 160 units of N, 60 units of P, and 60 units of K had overall fertilizer costs of about \$140/acre in the spring of 2008. That same amount of fertilizer would cost about \$230/acre at the height of the market this summer, for a total increase of \$90 per acre.

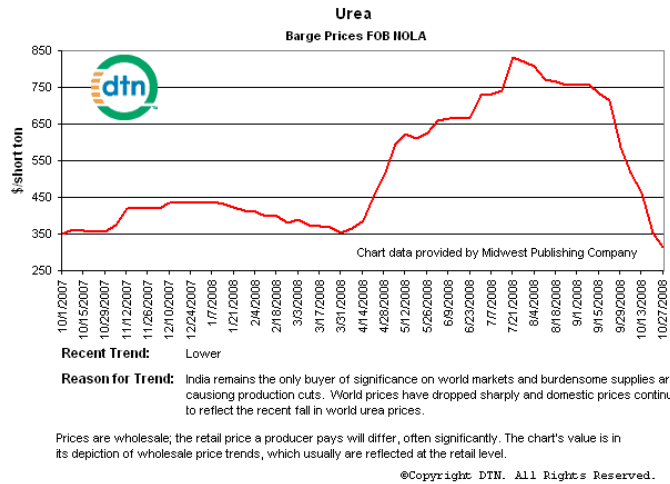
Luckily, however, fertilizer prices look like they are poised to dramatically decrease in the next 1-3 months. Figure 1 shows the wholesale prices of anhydrous ammonia from late Oct. 2007 to late Oct. 2008. Notice how the price increased through the year and peaked in late September at just over \$800/ton. The last two weeks of October, however, the price dropped like a rock to around \$500/ton wholesale, or about a \$300/ton decline.

**Figure 1**

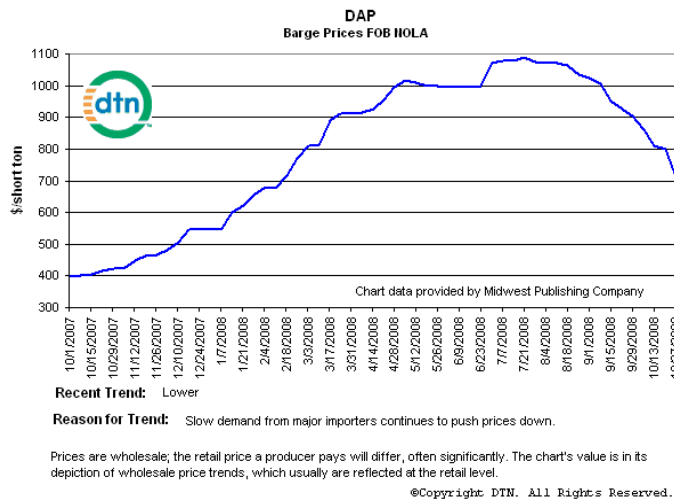


Figures 2 and 3 show wholesale prices for urea and DAP during this same time period. Urea peaked at over \$800/ton but dropped to under \$350/ton by late October, for a \$450/ton decline. DAP prices reached nearly \$1100/ton in August but dropped to nearly \$700/ton by late October, showing a \$350/ton decline in wholesale price.

**Figure 2**



**Figure 3**



Potash is the one fertilizer that has not shown a dramatic decline in wholesale prices as seen in Figure 4.

**Figure 4**

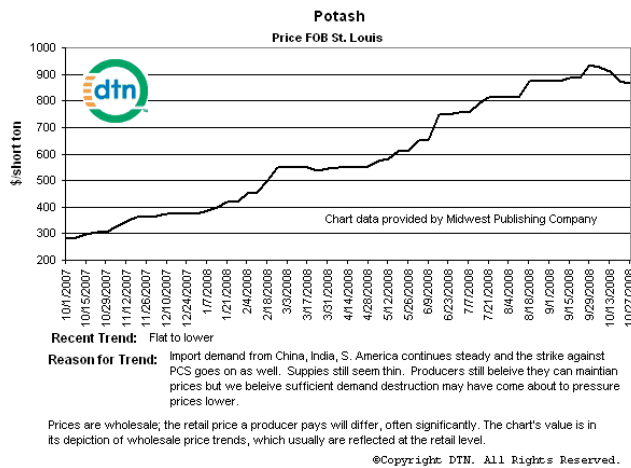


Table 1 shows the impact that these wholesale prices are starting to have at the retail level in the Midwest. As seen in this table, there are tremendous price variation among the retailers surveyed for anhydrous ammonia (\$500/ton), urea (\$430/ton), DAP (\$430/ton), and potash (\$218/ton). It is my understanding that retailers on the

high end of these ranges likely bought product when the market was near its peak, and those near the bottom of these ranges likely bought product in the last few weeks. In other words, they are pricing based on what they bought the wholesale fertilizer for rather than what the market is/may currently bear. However, high-priced retailers will likely have a hard time selling their product, particularly if customers start shopping around on pricing. If the fertilizer market continues downward or stabilizes, these retailers will likely have to eat the loss at some point. Will producers wait these prices out until spring, or will the high-priced retailers lower prices? Who will blink first? (Greg Halich)

<b>Table 1 – Midwest Fertilizer Prices (Retail) 11/7/08 per ton</b>					
State	DATE	POTASH	UREA	DAP	ANHYD
Iowa	11/3/2008	\$900	\$590	\$1,050	\$980
Iowa	11/5/2008	\$900	\$600		
Indiana	11/5/2008	\$860	\$620		\$1,190
Missouri	11/4/2008	\$799	\$450	850	
Missouri	11/6/2008	\$950	\$605	890	\$750
Nebraska	11/6/2008			820	\$1,050
Ohio	11/5/2008	\$772	\$475		
S. Dakota	11/3/2008	\$990	\$880	1220	
Wisconsin	11/3/2008	\$948	\$880	1250	\$1,250
<b>Max</b>		<b>\$990</b>	<b>\$880</b>	<b>\$1,250</b>	<b>\$1,250</b>
<b>Min</b>		<b>\$772</b>	<b>\$450</b>	<b>\$820</b>	<b>\$750</b>
<i>Source: DTN Online</i>					

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