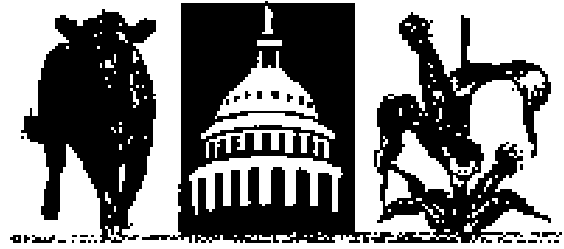


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High Sales and Income for U.S. Agriculture in 2008

With harvest season in full swing, it is clear this will be another record-setting year for U.S. agriculture. Although major crop prices have come down from earlier record-high levels, the index of prices received for crops is 40% higher than just two years ago. The unusual combination of high prices and generally good yields for the major crops, means USDA is projecting U.S. crop cash receipts this year at \$190 billion, an all-time record and a jump of 42% over last year.

On the livestock side, prices have not followed the dramatic recent upswing seen in corn, wheat, and beans, but livestock prices have improved since last winter and returned to the “strong” level of mid-2007. And with higher sales of most livestock products due to strong export demand, that means total U.S. cash receipts from the sale of beef, hogs, poultry, horses and other animals will be about

\$146 billion, an all-time record and up about 8% over last year.

As a result of a booming crop sector and good livestock performance, net cash income to agriculture this year in the US will be an all-time high of around \$100 billion – 16% higher than last year and more than 50% higher than the 10-year average.

In recent years, U.S. agricultural income has been split about 50-50 between crop and livestock receipts, but in Kentucky the situation is very different. In 2007, 76% of Kentucky agricultural income came from the livestock side, so the state’s total ag income will not be affected by crop sales as dramatically as was the case for U.S. agriculture this year. About one-fifth of Kentucky’s ag income comes from horse sales and stud fees. The early results from the fall horse sales indicate this may be a down year for thoroughbred prices, which will dampen growth in total ag income to the state. Thus, it is reasonable to expect that total ag income in Kentucky may only be modestly higher than last year’s \$5.3 billion.

Despite this very positive market performance in agriculture, there are concerns about profitability. Farmers are facing substantially higher input prices, almost across-the-board. Both land prices and cropland rental rates are up considerably in most regions, as producers compete for available cropland. Feed grain costs are squeezing dairy and livestock producers, especially as ethanol plants take more of the corn supply. An increase in fertilizer use worldwide – up 38% in China this year – has resulted in large increases in delivered prices for nitrogen, potash, and phosphate. Energy prices have moderated in the last two months but remain

much higher than two years ago. As a consequence, profit margins are being squeezed, especially for livestock producers.

We will need to keep our eye on what happens on both the revenue and input cost factors in 2009 to determine if a more serious cost-price squeeze will affect U.S. agriculture. (Craig Infanger)

U.S. Agriculture and International Trade

U.S. agriculture is a major beneficiary of international trade. The production equivalent of 25% of U.S. cropland moves into the export market. Nearly half of U.S. food grains (primarily wheat), 16% of feed grains (primarily corn), and 38% of oilseed production are exported. Feed grain exports as a percentage of production have declined in recent years, reflecting a significantly higher production level as well as higher ethanol production.

The U.S. Department of Agriculture recently released their fiscal year (FY) 2009 agricultural export estimates pegging U.S. agricultural exports at \$113 billion, down slightly from the \$114 expected this FY. But the past two year export figures are 37% above 2007 levels. Agricultural imports in FY 2009 are estimated to be up about 18% to \$83 billion. Agriculture is one of the few sectors of the U.S. economy to continue to show a trade balance surplus (exports-imports) which is forecast to be \$30 billion for FY 2009.

The value of the U.S. dollar (exchange rate) continues to be a major force behind expanded U.S. agricultural exports, even though the dollar has recently strengthened. The dollar remains weak compared to our major trading partners. A weak dollar makes U.S. exports relatively inexpensive in world trade. The weakening world economy will likely diminish US export growth next year. U.S. economic growth has slowed this past year as has most of the world. World economic growth is expected to be 2-2.4% next year, much higher than the 1 to 1.4% growth rate expected in the U.S.

The top five export destinations for U.S. agricultural products are Canada, Mexico, Japan, China and the European Union (EU-27) and these markets take about 70% of all U.S. agricultural

exports. Canada and Mexico are our top two destination markets with expected purchases of \$17.8 and \$17.1 billion, respectively (together they represent 30% of all U.S. exports). The passage of the North American Free Trade Agreement (NAFTA) was a significant factor behind rising U.S. exports to our North American neighbors.

One major question as we enter FY 2009 is the status of the World Trade Organization (WTO) so-called "Doha" round talks which collapsed at the end of July in Geneva, Switzerland. The talks on trade liberalization have been off and on for the past seven years and the discussions deal with all trade issues including agriculture. Discussions appeared to reach an impasse over agricultural trade issues when China, India and the U.S. refused to make major concessions to the developing countries of the world over agricultural subsidies. While some U.S. farmers and farm interests argue that U.S. agriculture needs trade protection, most economists (including me) would argue that most of U.S. agriculture has been a huge beneficiary of the trade liberalization the world has witnessed over the past several decades. The *Wall Street Journal* in a July 31 editorial summed up the trade talk situation very well by asking whether the current trade talk impasse is just a temporary setback or do they mark the end of post WW II free trade? (Larry Jones)

Greater Risk for Agricultural Producers

The economy seems to be reeling from various risks and uncertainties hitting it from all directions. Agriculture is also experiencing greater risks as well. Parts of our industry have been doing well as a result of the ethanol boom. Other parts have not been enjoying the same success.

Grain farmers have been enjoying historically high prices the last couple of years which has created relatively good economic results. These high crop prices have resulted in increased feed costs which has created economic stress for our livestock producers. The initial period of high crop prices two years ago has been followed by economic adjustments and dramatically higher input costs. These economic adjustments have greatly increased the risk facing our agricultural producers.

The production risks our producers face are basically the same as they have always been, weather, disease, and various pests. However, the economic loss that may result from these risks is greater as a result of the much higher costs of production. This same argument applies to the risks facing livestock producers.

Crop production costs are also expected to increase dramatically again during the 2009 production season. Farm management specialists at the University of Illinois and Purdue University forecast the variable costs of producing corn, soybeans, and wheat to increase 30 to 40 percent next year. Again, these increased production costs will result in even greater risks facing our producers.

An Unfamiliar Risk

In addition to the greater production risk farmers are facing, there is a new or at least unfamiliar risk they may have to manage. Agriculture seems to be experiencing a market failure with Chicago Mercantile Exchange's (CME) wheat futures contract. During the current marketing year the wheat futures contract price and cash market price did not converge, as expected. The result has been wheat cash market prices as much as \$2.50 less than expected based on the futures contract price.

Speaking to the North Carolina Feed Industry Assn. recently, Randy Gordon, Vice President of the National Grain and Feed Assn. stated that, *“At the last meeting of the CME, they publicly admitted for the first time their wheat futures contract is broken. It’s been a long time coming, but they now admit the problem that grain buyers have warned has been happening over the past couple of years.”* There is also fear that the same thing may happen to the corn and soybean futures markets.

Should these developments prove the “undoing” of the futures market, it will effectively remove two widely used risk management tools. It will no longer be possible to do traditional hedging or forward contracting, both of which have historically been important tools used to manage market price risk. This will make the management of price risk much more difficult for our farmers.

Additional Risks

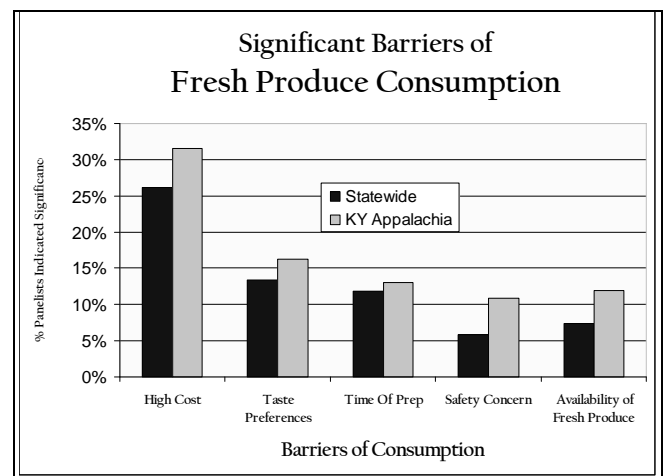
There are other risks our producers should not overlook as they consider these normal production and market risks. They must also be concerned with currency levels and exchange rates since they have such a dramatic impact on oil prices, energy costs, and other agricultural input costs. Farmers must become familiar with a new farm bill and how it may affect their farm business. Conditions in our general economy also raise questions about what will happen to interest rates and inflation.

Implications of Greater Risks

Producers should be aware of all the changes taking place and how they can impact their farm business and the management of that business. They must be ever vigilant in their management of risk in their farm business. One of the primary risk management tools producers should consider is the use of Crop Insurance. All farmers should also become familiar with and comfortable using the new farm bill in the management of their farm business. (Dick Trimble)

Price is Primary Barrier to Produce Consumption

During a recent survey conducted by the Kentucky Food Consumers Panel, participants were asked to indicate the significance of certain barriers to consuming more produce. In all categories, more panelists living in Appalachian counties indicated the respective barriers as being significant, compared to panelists statewide.



The high cost of produce was the most significant barrier of fruit and veggie consumption,

both in Appalachia and statewide. Due to increasing fuel prices, it is likely that produce prices will continue to increase. As a result of higher fuel costs, 65% of panelists reported an increase in preparing meals at home. As consumers are purchasing more food to prepare, and looking for more cost efficient options, the opportunity for local producers to gain market share is growing rapidly. (Tim Woods, Wuyang Hu, and Sara Williamson)

Mechanical Drying vs. Air-Drying for Corn

Kentucky grain farmers face a dilemma each year in deciding when to start harvesting corn. An early harvest results in grain that has a high moisture content and high drying costs. Foregoing this early harvest means extending the harvest season and results in higher stand losses. Determining the optimal balance is often difficult because of the many counteracting factors that enter into the decision. The price of corn and the price of fuel are two of the main factors, but additional repairs, maintenance, and labor costs of running the dryer also affect the decision.

The most difficult factor to estimate, but potentially the most important, is the expected losses incurred by leaving the crop to dry in the field. These typically range 2 to 8 percent above those seen with a timely harvest. Stand loss can be estimated using the following method: If you delay harvest by X weeks, you will extend the harvest period by Y weeks. What stand loss level would you expect at this later date compared to current losses? Even if it is not the same field that actually gets harvested at this late date, this is the method that should be employed. As an example, say that by not harvesting during the last week in September you will extend the harvest from November 7th to November 14th. You then estimate what your stand loss would be on November 14.

To evaluate this year's harvest situation, let's look at a representative example¹. We will use corn

priced at \$5/bu and LP gas priced at \$2.30/gallon. If we assume a potential corn yield of 150 bushels per acre and a harvest loss 5 percent above our current loss, we are expecting a loss of 7.5 bushels due to the harvest delay. The value of this corn left behind in the field is \$37². The total cost of drying is \$35 for removing 5 points of moisture per bushel. Thus in this situation, there is a very slight advantage to drying the corn.

In contrast, if the corn is harvested at 25% moisture, and dried 10 points, and all other assumptions remain unchanged, the cost of drying increases to \$57, which is \$20 more than the value of corn left in the field. In this situation, it would take a corn price of \$7.72/bu before it would pay to mechanically dry the corn. However, there is a definite value in having corn safely in the bin, especially with weather uncertainties.

In an exceptionally good drying season, weather related delays and stalk diseases are few, so harvest losses might be no more than 2 percent above normal levels. In this case, field drying would be the least cost option for all yield levels and corn prices evaluated in the table.

If we have hurricane related weather and/or high disease pressure, harvest losses can be 8 percent or more above normal losses. In this case and with the assumptions above, harvesting and drying the crop is now about the same as letting the crop air dry. Thus, any losses above 8 percent would favor mechanical drying over air-drying. A spreadsheet is available to compare specific drying costs with harvest losses for different yield levels and corn prices at www.bae.uky.edu/ext/Grain_Storage. (Sam McNeill and Greg Halich)

¹ An important assumption we make is that the farmer has considerable storage capacity connected to the dryer, and that this grain would typically go into storage until later in the season. In other words, we are assuming no additional transportation costs in drying the grain.

² This value is adjusted downward slightly because you would normally incur hauling costs to the elevator on this grain if it was harvested.

Air Drying Corn with Loses vs. Mechanical Drying						
Low excess harvest loss: 2%						
Expected Yield (bu/ac)	Harvest Loss (bu/ac)	Value of harvest loss (\$ /ac) by Corn Price (\$/bu)			Total Cost to Dry 5 or 10 Points	
		\$4.50	\$5.00	\$5.50	5	10
100	2.0	\$9	\$10	\$11	\$24	\$38
150	3.0	\$13	\$15	\$16	\$35	\$57
200	4.0	\$18	\$20	\$22	\$47	\$76
Medium excess harvest loss: 5%						
Expected Yield (bu/ac)	Harvest Loss (bu/ac)	Value of harvest loss (\$ /ac) by Corn Price (\$/bu)			Total Cost to Dry 5 or 10 Points	
		\$4.50	\$5.00	\$5.50	5	10
100	5.0	\$22	\$24	\$27	\$24	\$38
150	7.5	\$33	\$37	\$40	\$35	\$57
200	10.0	\$44	\$49	\$54	\$47	\$76
High excess harvest loss: 8%						
Expected Yield (bu/ac)	Harvest Loss (bu/ac)	Value of harvest loss (\$ /ac) by Corn Price (\$/bu)			Total Cost to Dry 5 or 10 Points	
		\$4.50	\$5.00	\$5.50	5	10
100	8.0	\$35	\$39	\$43	\$24	\$38
150	12.0	\$53	\$59	\$65	\$35	\$57
200	16.0	\$70	\$78	\$86	\$47	\$76
<i>Assumptions: LP gas at \$2.30/gallon. Total costs associated with mechanical drying are \$.047 per bu-pt when removing 5 pts and \$.038 per bu-pt when removing 10 pts.</i>						

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