New study says high grain prices are likely here to stay

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An ethanol-fueled spike in grain prices will likely hold, yielding the first sustained increase for corn, wheat and soybean prices in more than three decades, according to new research by two University of Illinois farm economists.

Corn, an ethanol ingredient that has driven the recent price surge, could average $4.60 a bushel in Illinois, nearly double the average $2.42 a bushel from 1973 to 2006, said Darrel Good and Scott Irwin, professors of agriculture and consumer economics.

They say price swings stemming from weather or other market variables could send corn as high as $6.70 a bushel or down to $3, based on a review of market data dating back to the mid-1900s for a report titled "The New Era of Corn, Soybean and Wheat Prices."

"The extreme low prices in terms of the new era would have been considered awfully good prices in the old era," Good said.

Soybean prices could average $11.50 a bushel, up sharply from an average of $6.15 from 1973 to 2006, with swings from $8.20 to $19 a bushel. Wheat could increase to an average $5.80 a bushel, up from $3.24, dipping as low as $3.30 a bushel or as high as $10.15.

Although the forecasts are based on Illinois grain prices, Good says increases will likely be similar on a percentage basis in other grain-producing states.

Irwin says the study stemmed from concerns as farmers tried to get a handle on rising prices when markets turned volatile in the wake of the ethanol boom.

"There was frustration that they no longer had a frame of reference," Irwin said. "This is our first effort to try to provide some perspective on what might be high and what might be low, with all of the caveats about how difficult that is to do."

Agricultural economist Scott Irwin collaborated with Good on a study of grain prices, which stemmed from farmers' concerns of rising prices when markets turned volatile in the wake of the ethanol boom.

Research revealed just two earlier lasting increases in grain prices. The first came after World War II, when price controls were lifted and post-war rebuilding began.

The second lasting increase began in 1973, sparked by shifts in exchange-rate policies, massive grain purchases by the former Soviet Union and a period of escalating energy prices and more rapid inflation.

Good says the dawn of the new era mirrors the earlier ones, driven by the growth of ethanol and accompanied by higher inflation and production costs that have been permanently inflated.

The study forecast average prices for the new era based on increases between the World War II and post-1973 eras, which ranged from 79 percent for wheat to 134 percent for soybeans. It also accounts for fluctuations as the new higher prices take hold, setting a range of possible highs and lows based on data from the first five years of the earlier eras.

Irwin says the new price era could easily last two or three decades, sustained by corn prices that are now tethered to near-record gasoline prices because of ethanol.

"The key is what happens in our crude oil and energy markets," he said. "The risk on the downside is technological breakthroughs that would dramatically reduce oil consumption, lowering the whole price structure. If anything, though, the risk is on the other side. We likely are going to continually be bumping into demand for crude-oil production that we can't easily get above."

Good says new era prices would not be affected by a shift from ethanol to another fuel additive made from crops, such as switchgrass. Finite land available for production would continue to drive up prices for other grains, just as corn has raised prices for soybeans and wheat.

"We would have to steal land away from corn to grow a different energy-related crop, so now you have that competition again," Good said.

Irwin says food costs have likely seen the worst of the shift to higher-priced grain after posting 5 to 6 percent increases this year. But he warned that commodities account for just 20 percent of food costs, so prices could still rise to cover labor, transportation or other expenses.

Good and Irwin say Illinois farmers posted record earnings in 2007, and likely will again this year. But profits will ultimately dip back to historical levels of roughly $50 to $60 an acre as land and production costs rise to keep pace with new era prices.

"The real winners in this are landowners," Irwin said. "If history is any guide, we will see every ounce of the operating margin bid into land and cash rents."

Source: University of Illinois at Urbana-Champaign