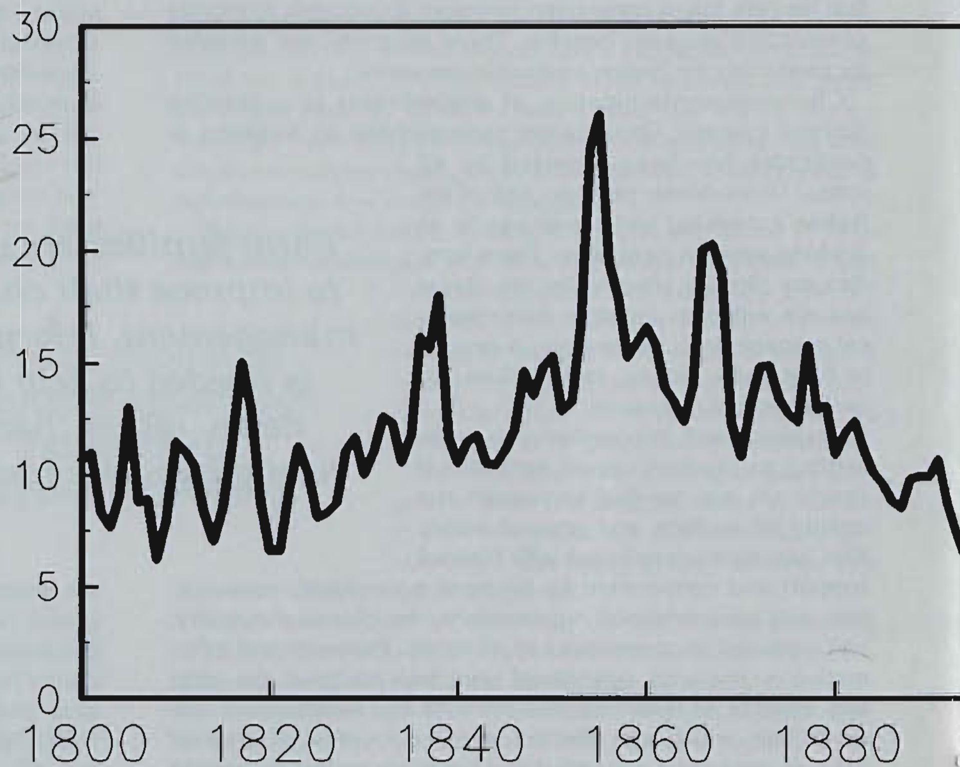
Real Prices Received b

— by Clark Edwards —

◆ When world food markets were growing rapidly during the 1970s, people became concerned about longrun food shortages and higher real food prices. Some of these concerns are surfacing again this year as the severe drought in the United States is reflected in reduced world supplies of grains and oilseeds. However, when world food markets collapsed during the early 1980s and food surpluses again appeared, people became concerned about longrun excess capacity and the prospect of declining real prices received by farmers. Through the muddle, a third and apparently more reasonable view emerged. Although shortrun changes in real food prices can be relatively large, the longrun pressures either up or down are not great and the changes are too close to call. The best bet according to this view is to predict that the real food price will *not* change in the long run regardless of how volatile it is in the short run or how wide the swings are in the intermediate run.

Of these three views, history supports the one which says farmers likely will continue to experience cost-price squeezes, as they have for more than a century.

REAL WHEAT PRI



Prices for crops are higher this year, mostly—but not only—because the drought reduced production. In fact, prices had begun to rise before the drought became apparent. Farmers are right in thinking that higher prices improve their incomes. This year prices have risen enough to hold up the value of crop production despite lower yields, and have helped keep net cash income near or slightly above last year's record. For example, the price of wheat is up about 16 percent from last year, and production is down about 13 percent.

Income Depends on More Than Price

Over the longer term—several decades—prices received are seen to be only part of the income story. Income per farm grows through adoption of technology and expansions in farm size, too. For example, wheat yield per acre is about three times what it was in the 1930s, and wheat acres per farm growing wheat are about ten times what they were. Increasing productivity and growing farm size are helping wheat farmers to make more money even though the real price of wheat—the purchasing power in terms of consumer goods and services, of a bushel of wheat—is lower than during the depression of the 1930s.

Productivity, size, and price are, of course, related. In fact, over the longer term, the tendency for farm output to grow through increasing farm productivity and size helps supplies grow as fast or faster than demand, and maintains downward pressure on real prices.

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graphic look at key economic figures

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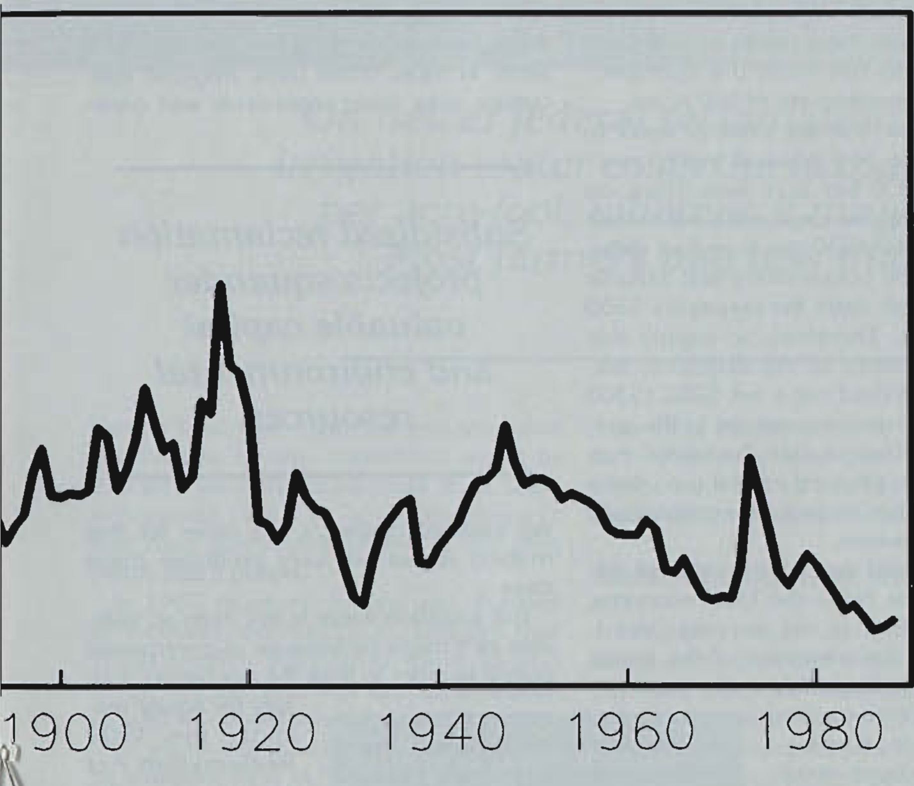

Wheat Prices Show Longrun Decline

The accompanying chart shows real wheat prices since 1800—actual prices adjusted for inflation using the consumer price index. Many important economic events can be seen in this price history. Rising prices reflect growth in domestic and export demand from the beginning of the 19th century to the Civil War, capped by prices reflecting food shortages during that war. From then on—for more than a century—U.S. agriculture has shown a capacity to grow faster than its markets, and real wheat prices have trended downward, with cycles from wars and depressions.

The agricultural depression of the 1920s, following World War I, is discernible in the chart, as is the further downward pressure on prices during the Great Depression of the 1930s. The World War II peak was well below that of World War I, which, in turn, was well below the Civil War peak. The real price fell from its World War II high during most of the 1950s and 1960s; there was a gradual downtrend in the nominal price and inflation picked up, particularly after 1965.

It is also apparent that the price was less volatile during the 1950s and 1960s than before or since. The 1950s and 1960s were years of massive Government programs. These programs boosted the domestic price above the world price and supported farm incomes. One effect of these programs was to reduce price fluctuations. The downtrend in real wheat prices during the 1950s and 1960s reflects policy adjustments to bring domestic prices closer to the declining world prices and to reduce accumulated farm surpluses.

Exposure of the domestic wheat market to world trade during the world food crisis of the 1970s drove nominal wheat prices to an historic high and reintroduced wide annual fluctuations. Even so, the real price of wheat at the 1973 peak was below the World War II peak. During the early 1980s, real prices fell as export markets shrank.

The price edged up again this year and last as recovering exports reduced stocks. Prices were pushed further because of the drought. Even so, the real price of wheat is well below what it was at the depth of the depressed 1930s, and lower than it has been since Revolutionary times.

What Can History Say About The Future?

Wheat is an important staple in the world food supply and it is a substitute for other foods as well as for livestock feed. So let us consider the price of wheat deflated by the consumer price index as a proxy for real farm and food prices.

Those who think prices received will rise relative to prices paid by farmers in coming decades, either from economic forces or from Government intervention, are calling for a fundamental change in the longrun trend. The same goes for those who expect little change in longrun food prices.

It would appear more reasonable to expect farmers (and help them when the farm sector comes under stress as it did early in this decade) to continue to find ways to make a living in the face of a continued longrun cost-price squeeze, as they have done for over a century. C