A Long-Term Perspective on Grain Prices
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In the past year grain prices reached all time record highs. Volatility in grain prices is normal, so the question on everyone’s mind is whether grain prices will trend upwards over time, stabilize at a higher than historical level, or resume the 150-year downward trend (after adjusting for inflation) that had resulted from investments in agricultural research raising productivity faster than global grain consumption grew.

The forces which gave us last year’s explosion in commodity prices have been building for some time. Global population growth, which is adding about 78 million new mouths to be fed every year, is actually slowing down, but growth in global food consumption has been accelerating. An unprecedented rate of poverty reduction has occurred in developing countries, particularly in Asia. This has given millions of previously low income people enough purchasing power to include for the first time very much meat, eggs and dairy products in their diets. The resulting growth in feed grains consumption has been felt throughout the global grain markets.

At the same time that grain consumption was growing in developing countries, little was being invested in their agricultural development by their own governments, foreign aid, or private investors. Public investments in agricultural research were cut more than proportionately. Low world commodity prices made it difficult to get an adequate return on agricultural development projects, and hot new concerns like HIV/AIDS and the environment crowded agriculture off the international development agenda. With their farm sectors underperforming relative to their potential, developing countries came to depend on imports for more of their food supply.

As generous subsidies and historically high energy prices induced rapid expansion in biofuels production, the gap between global grain production and consumption widened further. On top of this tightening global supply-demand balance, Australia and several other countries experienced droughts that devastated their grain production.

Most countries whose governments had previously supported grain prices by buying surpluses, including the U.S., had switched to other means of providing support to growers, such as deficiency payments. With virtually no reserve stocks in government hands when the shortfall occurred, world grain prices started to edge upwards.

As world grain prices rose in 2007, a number of grain-exporting, low income countries imposed taxes or embargoes on exports of grain. This further tightened the world supply-demand balance, and the rise in grain prices accelerated. Media hype caused panic buying and hoarding by consumers and some governments around the
world, and grain prices exploded upwards to levels far higher than necessary to equilibrate world grain supply and demand. The final push up came with the widespread flooding and associated crop concerns in the U.S. in the spring of 2008. With a weak U.S. dollar, grain prices rose proportionately more in the U.S. than in other countries.

Global grain markets have settled down again, but prices remain higher than their historical norm. What is the most likely future long-term trend? This will depend on whether sufficient investment is made in agricultural research to raise productivity faster than growth in population, incomes and biofuels production increase global demand for grain.