

Policy Pennings by Dr. Daryll E. Ray

Ethanol demand and the CRP

In a time of large federal deficits, budget cutters see the elimination of the Conservation Reserve Program (CRP) as a potential place they can save as much as \$1.6 billion a year. At the same time, agribusinesses have several reasons for clamoring for the end of the CRP. On the one hand they recognize that when it comes to CRP acres, farmers spend little money on seed, fertilizer, farm chemicals, machinery, and repairs. On the other, agribusiness processors depend upon an abundant supply of inexpensive grains and seeds and CRP acres do not add to that supply.

The growth in the ethanol industry, which presently uses corn as its primary feedstock, has provided both groups with a marketable rationale for calling for the virtual elimination of the CRP.

Well over a year ago, researchers here at the Agricultural Policy Analysis Center, University of Tennessee (APAC), began to study the effect of the elimination of the CRP on crop prices and government payments.

The study carried out by Dr. Daniel De La Torre Ugarte and Chad Hellwinckel was funded by a grant from the American Corn Growers Association, Pheasants Forever, National Farmers Organization, American Agriculture Movement, Association of Fish and Wildlife Agencies, Theodore Roosevelt Conservation Partnership, Wildlife Management Institute, and Environmental and Energy Study Institute.

The result of this study is an APAC publication, "Analysis of the Economic Impacts on the Agricultural Sector of the Elimination of the Conservation Reserve Program," which is available online at <http://www.agpolicy.org/crp.html>.

In the time between the inception of the project and the final report, the USDA rolled over the renewal of expiring CRP acreage for time periods of up to five years, and the price of oil spiked, radically increasing interest in ethanol production.

Because one of the foci of the study was the impact of the elimination of the CRP on crop prices, the temporary renewal of CRP acreage simply alters the years in which the price impacts are felt, but not the magnitude of the price change. To account for the increased demand for ethanol we used the February 2006 USDA baseline which was the latest published baseline available at the time the study was released.

The APAC study estimates that if CRP contracts are eliminated as they expire, 37 percent of today's 34.7 million CRP acres, or 12.6 million acres, will return to crop production by 2015. Seventy-one percent of returning acres, or 9 million, will grow corn, soybeans and wheat.

"With additional CRP acres coming into production, corn prices would be 31 cents below current expectations with wheat prices experiencing a 63 cents per bushel decline. Soybean prices would suffer from a 90 cents per bushel drop" said Daniel De La Torre Ugarte.

"These lower prices are the trigger that brings about a nine year \$33 billion increase in farm program spending," De La Torre Ugarte continued.

Instead of saving \$1.6 billion a year or \$14 billion over the nine years of the study, the elimination of the CRP would trigger a net increase in government costs of over twice that amount.

According to De La Torre Ugarte, "As of April 1, 2006, 34.7 million acres of farmland had been converted from crop production to soil, water and wildlife conservation uses under the Conservation Reserve Program.

In addition to protecting highly erodible watersheds, protecting and providing new habitat, and reducing pollution, the CRP has reduced supplies of crops that would have been produced on that land if it had not been placed in the CRP. APAC simulations indicate that significant reductions in CRP acreage will have major impacts on crop production crop prices, net market income for producers, and government payments."

From our perspective a far wiser policy would be to allow the increase in corn acreage to respond to any ethanol-driven price increase. In addition to bringing in acreage from other crops, rising prices would undoubtedly convince some farmers to convert existing pastureland into crop production when it would be profitable to do so. Once these additional acreages are drawn into production, then and only then in our view, should the USDA's CRP renewal and extension rules be slanted to bring the least highly-erodible acreage back into production.

To us a couple of things stand out. First, the reason that most CRP crop acreage became eligible for the program was because it was declared to be erodible, often highly erodible. For that reason, it would seem that the CRP would be the last place to look for additional crop acreage, a last resort.

Secondly, this is not the first time in which a promised-land of high prices and the need for all-out production have been dangled in the view of eager farmers. But history has not been kind – by the time full production is achieved the need for the increased output has waned and prices plummet.

It is important to remember that corn, while the current dominant ethanol feedstock, will eventually play second fiddle to cellulose as an ethanol feedstock. Cellulose comes in many forms, some agricultural, some not. Exuberance is fun, but let's hope it does not get too irrational.

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