

PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

Where is the safety net?

There is no safety net

It could be worse than we thought. With record corn production in a year with heavy spring rains and late planting problems, the price drop in recent weeks suggests that corn demanders see the crop-reducing effects of 2012 drought as an aberration—since apparently improved seed genetics successfully protected 2013 corn production from moderate drought and planting problems.

Compared to the 2012 corn crop, the November WASDE reports record production, increased crop utilization—both domestically and internationally—and the year-ending stocks increasing by nearly 1.2 billion bushels of corn. The result is a projected season average corn price received by farmers of \$4.50 per bushel for the 2013 corn crop, a drop of \$2.93 per bushel from a year earlier.

For most farmers, even on the most productive land, \$4.50 is getting frighteningly close to their cost of production—and for some-to-many land costs would not be covered. This leaves little margin on the downward side before things get really scary.

And scary it might be. While recognizing that we are talking about the outer edges of the US corn belt, on November 18, 2013 DTN Ag Policy Editor Chris Clayton reported that “DTN’s market tracker shows corn for delivery selling as low as \$3.17 a bushel in northeast Montana.” He also said, “DTN’s Market Tracker shows corn prices below \$3.70 in parts of the eastern Corn Belt, notably throughout parts of Michigan and Ohio. Farther west, prices throughout North and South Dakota are hitting lows below \$3.40 a bushel in some places with prices averaging more around \$3.50 a bushel.”

Can it get any worse? We think that is a distinct possibility.

Consider the following scenario, suppose that: 1) the USDA has underestimated the corn crop by 100 million bushels and 2) it has also overestimated domestic and export consumption by 200 million bushels. And, as we have further considered the November WASDE numbers, those possibilities seem very real.

If that scenario comes about, total use would decline to 12.750 billion bushels and the 2013 year-ending stocks for corn would increase to 2.187 billion bushels, resulting in a year-ending corn stocks-to-use ratio of 17.2%.

The last time we saw the year-ending stocks-to-use ratio at that level was 2005, just before the ethanol boom took off. The price was \$2.00 per bushel. As unlikely as that price may be, given today’s produc-

tion costs, that price would be devastating. Even if the price fell to \$3.00 because of forward contracting and other pricing strategies, the effects would still be devastating.

Worse yet, suppose the 2014 corn crop adds 500 million bushels or more to the year-ending corn levels, \$2.00 could actually be a possibility. Remember 1998-2001, the LDPs and emergency payments?

We have had a reader argue that “Corn price is now based on its energy value not just on the supply and demand of corn for feed, which has helped hold up the plateau for corn.” To that we would argue “Why didn’t the feed value of corn hold up prices in the 1998-2001 period?”

The answer is that cattle feeders captured the value of the below the cost of production of corn. They had no incentive to pay more than the market demanded and neither do non-farmer-owned ethanol plants.

This reminds us of a discussion Harwood had when he took a conservation class at Ohio State. The professor was getting the students to think about balancing the competing demands for use of dams on Ohio Rivers: flood protection and recreation.

Those wanting flood protection argue for low water levels while recreation users want higher water levels. To which Harwood said, “Why can’t you have both.”

The professor responded, “If you have maximum water levels for recreation users and heavy rainfall and a flood comes, the reservoir might as well be filled with concrete!” There is little remaining room to hold the additional water, he explained.

For the 2013 crop year, WASDE projects that 4.9 billion bushels of corn will be used for ethanol production, a level that we have generally seen since 2010. With ethanol not continuing to consume 500 million extra bushels of corn each year, the 5 billion bushel mark for ethanol production is like water in a full reservoir; it is the same as concrete and any extra corn is like additional water flowing over the top of the dam—existing stable demand provides little or no protection against a flood of additional production and lower prices.

Coming back to what could happen next year if corn production in 2014 outstrips utilization causing year-ending stocks go up by another 500 million bushels, further depressing prices. Revenue insurance would provide very-little-to-no protection against production costs—because the level of insured revenue would be based on the percentage of a very low price.

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That leaves some income from LDPs and the hope for \$10-\$15 billion in emergency payments, especially if direct payments are taken away.

Perhaps writing a farm bill in a year of declining prices will persuade legislators to provide farmers with an adequate safety net. It would be even better if they designed the farm program based on the fundamental characteristics of crop production: the low price elasticity of supply, the low price elasticity of demand, the tendency for supply to grow faster than demand, and the fixity of resources.

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