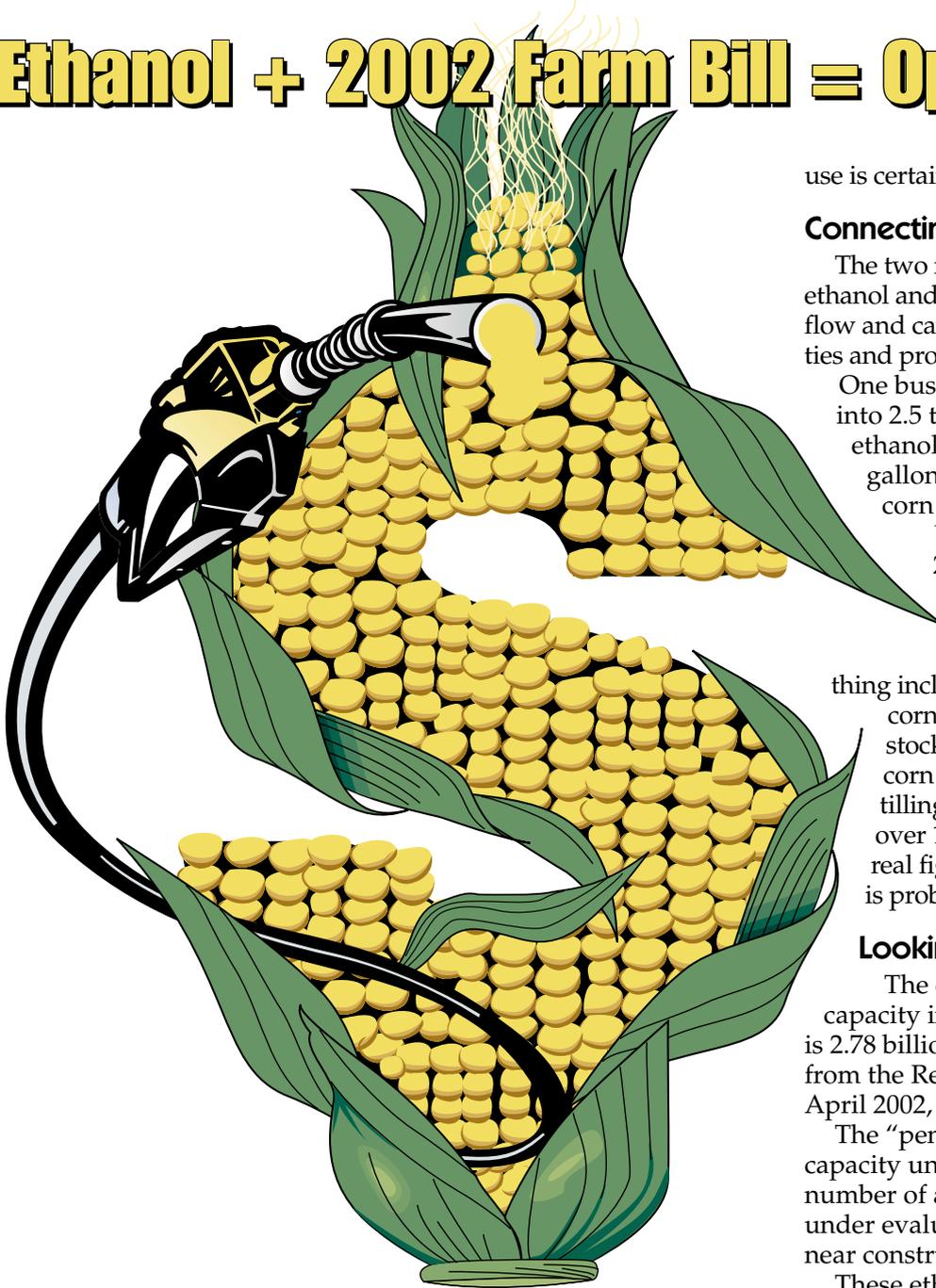


# Ethanol + 2002 Farm Bill = Opportunities



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**S**avvy traders constantly watch for opportunities — between ethanol and the new farm bill, they will have a lot to monitor.

Congress has crafted a new farm bill that significantly enhances the safety net for grain and oilseed producers. The House and Senate have also passed separate comprehensive energy bills that appear poised to dramatically raise ethanol production. But even if not mandated by Congress, ethanol

use is certain to climb in the years ahead.

## Connecting the two

The two may appear unrelated, but ethanol and the farm bill will impact grain flow and can create grain trading opportunities and problems.

One bushel of corn can be fermented into 2.5 to 2.7 gallons of ethanol. In 2001, ethanol production totaled 1.77 billion gallons, most of which came from corn or related grains.

Under the Senate version of the 2002 energy bill, production would reach 5 billion gallons by 2012. Although ethanol can be fermented from anything including corn to grass clippings, corn will likely be the dominant feedstock. Assuming just 70% would use corn or other grain as a feedstock, distilling 5 billion gallons would require over 1.3 billion bushels of grain. The real figure would likely be higher (70% is probably low for a corn percentage).

## Looking at capacity

The chart shows current ethanol capacity in key states (total U.S. capacity is 2.78 billion gallons). These figures are from the Renewable Fuels Association as of April 2002, but there is more to the story.

The "pending" category in the table is capacity under construction. But there are a number of additional projects that are under evaluation, on the drawing board or near construction.

These ethanol plants warrant serious attention. First, they'll significantly alter regional grain movement. Second, the plants also produce feed byproducts that will compete with other feeds such as soybean meal. One bushel of corn, dry-milled into ethanol, will also produce about 17 pounds of distillers dried grains-soluble (DDGS). Dry-milling 50 million bushels/corn will produce 7,600 tons/DDGS that will have to find a home.

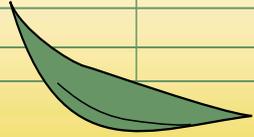
Locating so much ethanol capacity in Nebraska, Minnesota and the Dakotas may seem logical, but it poses significant chal-

allenges and will pose problems at times. Crop failures do occur, and it will be very costly to supply those remote plants then. The cheapest corn basis is in those states, so supplying a South Dakota plant with Midwest corn would raise the cost. Locating plants in those cold, upper-tier states also increases the supply of DDGS feedstuffs away from the largest livestock areas.

But even without a crop problem, the plants will consume much of the current ending corn stocks in those upper-tier states. South Dakota has carried over only 50 to 80 million bushels of corn in recent years — years of big surpluses. South Dakota has 45 million bushels worth of new ethanol capacity under construction. When these plants are all running, they would consume 20% of South Dakota's typical production and theoretically wipe out the state's

Ethanol Production Capacity — key states 					
million gallons/year (mmgy)					
State	Nbr. Plants	Feedstock	mmgy	MM Bu. corn (active)	MM Bu. corn pending
Iowa	13	Corn	247	34	59
Iowa-ADM	2	Corn	na	na	15
IL	3	Corn	1,168	426	
IL-ADM	1	Corn	na	na	0
MN	13	Corn	340	128	0
MO	2	Corn	41	16	
ND	1	Corn	na	na	8
NE	8	Corn	409	146	45
SD	8	Corn	210	34	
WI	3	Corn	59	55	4
	<b>54</b>		<b>2,474</b>	<b>839</b>	<b>131</b>
All Other	21	All Sources	304		
			<b>MM Gal.</b>		

*Last Updated: April 2002*  
*Source: Renewable Fuels Association*



surplus stocks. And more plants have been announced.

### Ethanol changes corn flow

In reality, ethanol production would supercede the movement of corn to other states or for export. To the extent South Dakota already uses its corn production within the state, the ethanol plants would have to battle the other users to get the corn. Another possibility is for corn to move northward (or westward) into South Dakota. In either case, the basis will be what allocates supply to where it's most needed.

The table only shows 8 million bushels of new capacity pending for Nebraska, but several more plants are on the way. Nebraska has carried over 170 to 280 million bushels of corn in recent years, so the impact there will be less dramatic. Wisconsin is another state that could face difficulties allocating corn supplies. There are several

more plants on the drawing board, and the dairy industry is growing as well. (At least that's good for disposing of DDGS.)

Sharp traders will study the potential impact of ethanol construction on these regional grain flows, basis values and freight

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opportunities. Truck-only grain elevators may suddenly find themselves no longer at a disadvantage to unit-train shippers, for example. Small-unit, short-haul rail move-

ment may be another result.

### Impact of the Farm Bill

But where does the Farm Bill come in? Regardless of the provisions in the final bill, the bottom line is clear: More money will flow to the farm economy, and a much larger percentage will be guaranteed and predetermined rather than via disaster payments.

As long as prices stay below loan levels and crops are large, producers will likely become even more stubborn marketers. The return of the Target Price concept will establish new benchmarks in many producers' eyes.

There could easily be a tendency to hold off marketing when prices are below these new *higher* thresholds. Producers will receive:

1) loan deficiency protection to loan rate on actual production;

2) a fixed payment each year on 85% of program acres X program yield;

3) extra, "counter-cyclical" payments when prices are below the Target Price (paid on 85% of program acres times program yield); and

4) the opportunity to update their program acreage and yield numbers.

Target prices have been finalized. The prices are \$2.60 on corn, \$3.86 on wheat and \$5.80 on soybeans.

Any tendency of producers to raise their price 'benchmarks' can translate into an overall stronger basis when selling is light due to low prices, and even more pressure on basis when selling does occur. That spells greater basis volatility over the course of the crop year and opportunities for sharp traders!

It's too early to draw absolute conclusions, but approach 2002-crop merchandising with a fresh eye. A lot of new factors are on the scene. Old basis benchmarks may lead you astray. **EG**

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