The Lingering Effect of Food Versus Fuel

The Renewable Fuels Association (RFA) this week released a report on the ongoing "food versus fuel debate" entitled, *"Corn Prices are Plunging, … So What about Retail Food Prices?"*

Not surprisingly, RFA used every trick in the book to understate the true cost of the Renewable Fuel Standard (RFS) to consumers, citing:

- The cost of corn in a box of corn flakes, …. Indeed, according to the National Corn Growers Association, about 8 percent of the weight in a box of corn flakes is corn. A pound of broiler meat, however, takes between 1.5 to 2 pounds of corn to produce.

- The annual average food inflation rate from 2008-2012 of 2.88 percent, … which includes all foods, such as vegetables, fruits, rice, baked goods, coffee, wine, peanut butter, and sugar which contain no corn. Poultry and red meat, however, which rely on corn as a feed ingredient averaged 3.58 percent over this time, with annual highs of 10 percent for beef in 2011, 8.5 percent for pork in 2011, and 5 percent for poultry in 2008.

A press release with the report states, ethanol critics,

> *immediately blamed high corn prices and ethanol for food price increases. However, these same critics remain suspiciously quiet now that corn prices have dropped, but retail food prices aren't dropping along with them.*

But make no mistake, "food versus fuel" under the RFS was real and today's high prices and the inflationary pressures on the poultry, meat, livestock and dairy industries which are impacting consumers through high retail prices is the lingering effect of the RFS. Moreover, even with the proposed reduction in the RFS for 2014, consumers are just one bad crop year away from starting this viscous cycle all over again.

What the RFA Report Missed

RFA states that "grain prices have completely collapsed over the past two years" – citing the July average corn price of $3.80. For a point of reference, the average price of corn prior to the RFS was $2.05 cents, which adjusted for inflation today would be about $2.50 cents.

According to RFA's press release issued with the report,

> *retail food prices of dairy, pork, poultry, eggs, and beef have remained steady or continue to increase. The report concluded, "… fluctuations in corn prices do not significantly affect consumer food prices."*

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Such a conclusion can only be compared to the proverb of the blind men describing the elephant; the one who felt the tusk concluded the elephant is smooth, the man who touched the leg described an elephant as a rough tree trunk, the man who touched the tail described the elephant as similar to a rope, the man who touched the ear likened an elephant to a fan.

RFA blindly looked at only corn prices as the key driver of retail poultry, meat, dairy and egg prices. They did not consider the full impact of the RFS.

Indeed, the price of any commodity – whether ethanol or meat - is a function of many factors. The price of inputs and their impact on cost of production is but one of those factors. Price is also driven by demand and available supply. RFA has conveniently factored out the key variables which determine the price of poultry, meat, dairy and eggs to rationalize the RFS.

Demand

Demand for poultry has been increasing last year and this year. For example, domestically, despite increased production in 2014 over 2013, carryover stocks at the end of the year of are projected to shrink according to USDA's August WASDE report. This is a sign of strong demand.

USDA's Cold Storage report for July shows that total poultry supplies in cold storage were at 1.106 billion pounds, down 14 percent on the year. Chicken is down 13 percent. (Beef and pork and were down 21 and 3 percent respectively). Higher demand leads to higher prices when supply is static or decreased.

Compare increased broiler demand to the demand for ethanol. Ethanol demand is determined by total fuel use and by the RFS. By both measures, demand has dropped, as have ethanol prices since their peak. While broiler demand is growing both domestically and globally, ethanol demand is essentially capped.

Supply

Why is broiler production below normal trends? The implementation of the RFS, which mandated the diversion of corn into fuel and away from feed, significantly raised the cost of poultry production which lead to decreased production. Indeed, poultry companies have incurred more than $44 billion in higher actual feed costs due to the RFS. Consider, for the 10 year period from 1996 to 2005, broiler production increased at an annual rate of about 3.5 percent on average. Since the RFS went into effect in 2006, annual average production increases were less than 0.8 percent with two years of absolute decreases. By comparison, ethanol production grew at an annual average rate of 17.625 percent under the RFS.

Year	**Percent Change in Production**	
	Broilers	***Ethanol***
2006	0.4	24
2007	1.9	35
2008	2.1	43

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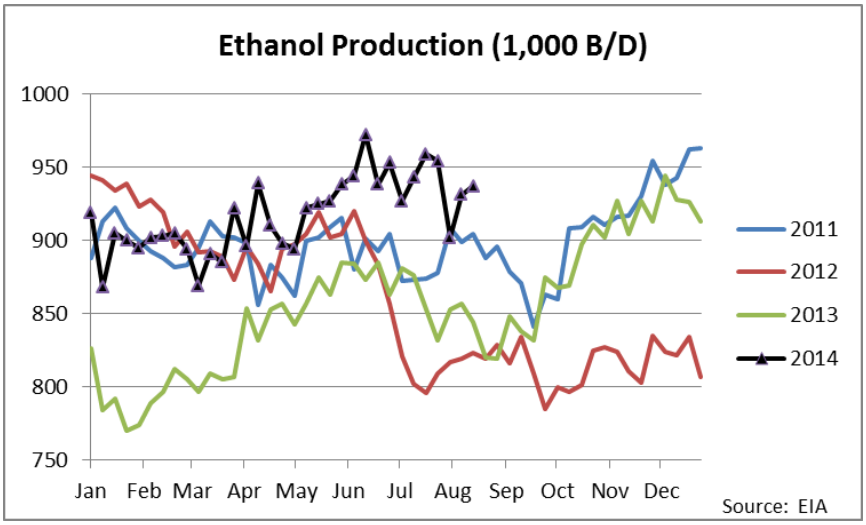
2009	-3.9	17
2010	3.9	22
2011	0.8	5
2012	-0.4	-5
2013	2.1	1

Source: NCC, RFA

During the RFS years, at least a dozen chicken companies have ceased operations, filed for bankruptcy, or have been acquired by another company. Two more chicken companies so far this year have been acquired by other companies. This slowdown in production took its toll not only on commercial broiler meat consumption, but also on the breeding stock – the grandparent stock and parent stock of chickens that produce the chicks that are raised for commercial broiler meat production. It can take up to a year and a half to rebuild these stocks to a size sufficient to increase the supply of commercial broiler chicks (for pork and beef the cycle is even longer). The production and breeding stock for broilers bore the brunt of high and volatile corn prices for seven years under the RFS. The current drop in corn prices so far into 2014 can't change the production cycle on broilers.

Compare broilers' production cycle (and the longer beef and pork cycle) to ethanol. Ethanol's production cycle is about a week or less. It is much easier for ethanol companies to adjust supply to demand. However, despite a reduction in fuel consumption and a reduced RFS, ethanol companies continue to expand production. The chart below shows this year's ethanol production trending upward from the past three years.



Conclusion

The RFS has disrupted the grain and oilseed markets and left a lasting impact on the meat, poultry, livestock, dairy and egg industries that has not yet worked itself out of the market. Even this year with a record corn crop of more than 14 billion bushels, and a reduced RFS, ethanol will consume a projected 36 percent of the corn crop and will sell most of its production to a captive base of refiners and blenders who are required by law to use ethanol per the RFS. There is no similar "annual protein standard" that guarantees a certain level of

consumption for chicken, pork, or beef like the RFS guarantees a bottom-line demand for biofuels. In fact, since the RFS has been in place, annual per capita consumption of meat and poultry has gone down about 8 percent. That is the food versus fuel situation.

There is renewed and strong consumer demand for proteins, and corn prices have dropped from their recent record highs, as long as the inflexible RFS is in place, consumers are only one drought away from another food inflation setback to the family budget.