

# **Agriculture as a Source of Fuel Prospects and Impacts, 2007 to 2017**

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## **Introduction**

For most of the period since 1978 when the first federal legislation to encourage ethanol production was enacted, U.S. agriculture served in a relatively minor role as a source of renewable fuels. Starting with the federal Clean Air Act of 1990 which mandated oxygenated gasoline in certain cities to improve air quality, ethanol and its petroleum alternative, methyl tertiary butyl ether (MTBE), provided the needed additive until MTBE came into disfavor for contaminating groundwater. In the past five years, ethanol production has nearly tripled, and biodiesel production has increased ten fold although at a much lower level than ethanol. As a result, this growth has recently elevated the prices of the major feedstocks of corn and soybean oil. Federal and state policies have encouraged this acceleration, prompted by a combination of (1) sharply rising energy prices, (2) increased dependence on supplies of crude oil from nations hostile to the U.S. or with unstable political structures, (3) growing environmental concerns including global warming, (4) issues related to balance of payments, (5) depressed farm prices and high farm program costs and (6) ongoing efforts to promote rural development.

Among the federal programs to support renewable fuels, blenders' tax credits amounting to about 50 cents per gallon on ethanol and \$1.00 per gallon on biodiesel (50 cents for non-virgin feedstock) have been particularly important. These provisions expire in 2010 for ethanol and 2008 for biodiesel. The Energy Policy Act of 2005 established a "Renewable Fuels Standard" (RFS) of 7.5 billion gallons for renewable fuels for 2012, a target which ethanol production alone will exceed by a wide margin. President Bush, in his State of the Union address on January 23, 2007, called for an enhanced RFS of 35 billion gallons by 2017.

## **Structural Change**

The advent of agriculture as a source of fuel as well as food and fiber represents a major structural change. Bill Tierney, Executive VP for Research and Marketing for John Stewart & Associates, recently projected that the capacity of ethanol plants existing and under construction would reach 13.4 billion gallons by 2009 compared with actual output of 4.9 billion gallons in 2006 (Tierney, 2007; Renewable Fuels Association, 2007). Adding planned construction, Tierney estimates that ethanol capacity could actually be as high as 20.7 billion gallons by 2009. Questions could be raised as to whether these plans will be executed and whether production will be at capacity. Assumed in this study is that ethanol production will equal the 13.4 billion gallon capacity in the 2009 crop year and increase linearly to 20.7 billion gallon by 2017.

Based on planned construction, biodiesel capacity could reach 2.0 billion gallons by 2008 compared to actual output in 2006 of about a quarter of a billion gallons (National Biodiesel Board, 2007). Because profits from biodiesel production from soybean oil have recently turned

negative, the presumption is that biodiesel production will increase to 1.5 billion gallons by 2010 and expand linearly to 2.0 billion gallons by 2017.

While these projections do not loom large in terms of total energy demands, they are very significant for U.S. agriculture as the source of feedstock supplies. Based on projections for 2017 in this analysis, ethanol would require about half of the corn crop and biodiesel about a fifth of the output of soybean oil, which, in turn, would comprise only about a third of the total feedstock for biodiesel. At 20.7 billion gallons, ethanol would represent about 15 percent of the gasoline used for transportation by volumetric measure and 10 percent in terms of energy. At 2 billion gallons, biodiesel output would approach 4 percent of the use of petroleum diesel for transportation.

### **Preparations for Generating Projections**

With such a dramatic increase in the demands for the product of U.S. agriculture over such a short period of time, measurement of the impacts challenges econometricians. For that reason, the procedure outlined in this paper is one of trial and adjustment draped with more than the usual sets of assumptions for 10 year projections. The analytical tool is an econometric/simulation model of U.S. agriculture called AGMOD designed to generate year by year projections (Ferris, 1991). The model includes major crop and livestock enterprises with an international sector for coarse grain, wheat and oilseeds. The international sector is aggregated into the major exporting nations, the European Union (15), and the rest of the world.

Special attention was given in this analysis to the significant change in the composition of the concentrate feed sector. The projections of ethanol production encompass the attendant increase in the production of the major livestock feed byproducts of corn gluten feed and meal from wet mills and of distillers' dried grain with solubles (DDGS) from dry mills. Almost all of the increase in these byproduct feeds will be DDGS. To model this rapid increase in the availability of mid-protein feeds, an approach outlined by Ferris was applied (Ferris, 2006). This involved the conversion of feeds to energy and protein equivalents and the construction of synthetic prices for energy and protein.

The key assumptions involved in generating forecasts for 2007 to 2017, in addition to the aforementioned projections for ethanol and biodiesel production, were as follows:

1. Crude oil prices as measured by the U.S. Department of Energy's "composite refiner acquisition cost" will be \$5 per barrel below the New York Mercantile Exchange's futures quotes for light, sweet crude (basis, Cushing, OK) through 2012 and hold the 2012 level through 2017. The futures quotes were as of the closing of March 30, 2007.
2. The blenders' tax credits for ethanol and biodiesel will be extended through 2017.
3. The essence of the 2002 Farm Bill will be extended.
4. Macro-economic and demographic assumptions are in line with those of the U.S. Department of Agriculture and the U.S. Department of Energy.

To project ethanol and biodiesel prices, equations relating wholesale gasoline and diesel prices to crude oil prices provided the base. Ethanol prices were generated as a margin of 15 cents per gallon over wholesale gasoline prices (the average for 2005). Biodiesel prices were set at \$1.00 per gallon

over the energy equivalent of wholesale petroleum diesel prices. This was 92 percent of petroleum diesel prices plus the \$1.00 per gallon representing the blenders' tax credit.

While corn for grain is well established as the predominate feedstock for ethanol production, the future of soybean oil from the domestic crush is tentative. Nearly 90 percent of the annual output of soybean oil is consumed domestically as food, a demand which is expected to continue to grow. Exports have averaged about 1.3 billion pounds in recent years which, if diverted to biodiesel would provide enough feedstock for less than a fifth of a billion gallons. Other vegetable oils could be tapped; but their production is small compared to soybean oil, and their prices are normally higher.

Rising soybean oil prices would be reflected in soybean prices to farmers and encourage increased acreage. However, soybeans are crushed more for the meal than for soybeans. Even with the elevated prices on soybean oil forecast for the 2006 crop year, their value to processors would represent only about 40 percent of the returns with meal the other 60 percent. More important is the strong competition in prospect emanating from the relatively much higher margins from corn versus soybeans. Corn and soybean acreages overlap in major growing areas.

Since biodiesel can be produced from any vegetable oil or animal fat, recycled materials are candidates. This includes yellow grease collected from restaurants and institutions by rendering companies used mostly to add energy and palatability to livestock feeds and for export. Other candidates include inedible tallow, choice white grease and poultry fat, byproducts of the slaughtering industry. However, conversion of these sources to biodiesel involves higher processing costs. Also, the blenders' tax credit for yellow grease is half (50 cents per gallon versus \$1.00) that for "virgin" vegetable oils such as soybean oil, corn oil, cottonseed oil, canola oil, etc. and for animal fats.

In the wet milling of ethanol, food grade corn oil is a major byproduct. In dry milling, food grade corn oil can be produced if extracted ahead of the ethanol process. Alternatively, corn oil can be extracted from DDGS amounting to about 10 percent of the weight of the DDGS. However, the quality would not be food grade but would be acceptable for biodiesel production. To date, very little corn oil has been produced from either process. Because of the projected growth in ethanol from dry mills and the biodiesel requirement for feedstock beyond the availability of soybean oil and secondary sources, the presumption is that corn oil from DDGS will become a major venture in the next 10 years. Also, DDGS without oil features improved handling characteristics and is more suitable for dairy rations.

While market forces alone may not assure that the biodiesel industry can depend on domestic sources for feedstock, some satisfaction can be taken knowing that the soybean oil in soybeans normally exported would provide ample inputs along with the other named sources. The question is, "How can the biodiesel industry outbid foreign customers for U.S. soybeans?" This will be difficult because foreign demands for feedstock for biodiesel are also expanding along with growing markets for vegetable oils for food and oilseed meals as livestock feed.

### **Analytical Procedure**

A value from solving econometric models for long range projections is the feedback of information to the modeler. Often the initial runs of these models suggest that the forecasts are unrealistic or unacceptable. Such trial and error procedures are needed to pave the way for model improvement or the development of reasonable assumptions. This approach is being applied in this study because of the many unknowns involving the prospects for renewable fuels and new legislation.

After several trials, the following additional assumptions were employed:

1. The price of soybean oil was set at the level which would render the profit of biodiesel

production from soybean oil at break even for new plants, including a return to equity.

2. All of the exports of soybean oil were diverted to biodiesel production.
3. One third of the output of yellow grease, inedible tallow, choice white grease and poultry fat was used for biodiesel.
4. Corn oil was extracted from one half of the production of DDGS.
5. Presuming that the intent of renewable fuels legislation is to grow the feedstock domestically, the balance of the requirements for biodiesel production was acquired by retaining soybean exports. The needed increase in crushing of soybeans in the model was the main “over-ride” of AGMOD.

Projections on production of yellow grease were based on a study by the National Renewable Energy Laboratory which sampled 30 randomly selected metropolitan areas and found an average production of about 9 pounds per capita annually (Wiltsee, 1998). Past production of inedible tallow, choice white grease and poultry fat was obtained from the U.S Census Bureau (U.S. Census Bureau, 2005). Projections were tied into AGMOD’s forecasts of beef, pork and poultry production..

## **Results**

The results from the analysis are contained in Tables 1 to 3 on pages 7 and 8. As shown in Table 2, crude oil prices are projected to hold near \$60 per barrel. This is the base for the estimates for gasoline and diesel prices which in turn determine the prices on ethanol and biodiesel at wholesale. Deducting processing costs from ethanol prices and assuming conversion rates will

Table 1. Projections of Selected Corn, Feed Grain and Soybean Variables plus Total Harvested Acres and Farm Land Values for 2007 to 2017

| Item                            | Unit       | Year   |        |        |        |        |        |        |        |        |        |        |        |        |       |
|---------------------------------|------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|-------|
|                                 |            | 2004   | 2005   | 2006   | 2007   | 2008   | 2009   | 2010   | 2011   | 2012   | 2013   | 2014   | 2015   | 2016   | 2017  |
| <u>Corn</u>                     |            |        |        |        |        |        |        |        |        |        |        |        |        |        |       |
| Harvested Acreage               | Acres      | 73.6   | 75.1   | 70.6   | 80.5   | 81.6   | 84.7   | 85.6   | 82.2   | 82.4   | 82.1   | 81.9   | 82.2   | 82.1   | 82.7  |
| Yield                           | Bu/Acre    | 160    | 148    | 149    | 153    | 154    | 156    | 158    | 160    | 162    | 164    | 166    | 168    | 170    | 172   |
| Production                      | Mil. Bu.   | 11807  | 11112  | 10535  | 12275  | 12607  | 13242  | 13559  | 13185  | 13381  | 13486  | 13623  | 13829  | 13975  | 14230 |
| <u>Feed Grain</u>               |            |        |        |        |        |        |        |        |        |        |        |        |        |        |       |
| Production                      | Mil MT     | 319    | 299    | 280    | 325    | 339    | 358    | 369    | 359    | 370    | 374    | 376    | 384    | 388    | 394   |
| <u>Utilization</u>              |            |        |        |        |        |        |        |        |        |        |        |        |        |        |       |
| Feed                            | "          | 166    | 163    | 158    | 149    | 144    | 141    | 143    | 139    | 139    | 142    | 141    | 141    | 141    | 142   |
| Ethanol                         | "          | 34     | 41     | 55     | 79     | 114    | 128    | 136    | 143    | 150    | 157    | 164    | 171    | 178    | 182   |
| Other Domestic                  | "          | 40     | 41     | 41     | 42     | 42     | 42     | 43     | 43     | 43     | 43     | 43     | 44     | 44     | 44    |
| Exports                         | "          | 51     | 60     | 62     | 54     | 50     | 47     | 45     | 43     | 36     | 34     | 32     | 29     | 30     | 30    |
| Ending Stocks                   | "          | 59     | 55     | 22     | 28     | 19     | 22     | 27     | 21     | 26     | 26     | 25     | 27     | 25     | 23    |
| Corn Farm Price                 | \$/Bu.     | 2.06   | 2.00   | 3.20   | 3.21   | 3.66   | 3.56   | 3.35   | 3.62   | 3.44   | 3.46   | 3.55   | 3.46   | 3.61   | 3.71  |
| Corn Gross Margin <sup>1</sup>  | \$/Acre    | 209.26 | 157.36 | 309.75 | 308.54 | 377.44 | 363.17 | 334.29 | 382.35 | 355.54 | 361.35 | 378.91 | 366.33 | 394.25 | 413.3 |
| <u>Soybeans</u>                 |            |        |        |        |        |        |        |        |        |        |        |        |        |        |       |
| Harvested Acreage               | Acres      | 74.0   | 71.3   | 74.6   | 66.7   | 68.8   | 68.4   | 69.2   | 72.2   | 72.5   | 73.4   | 74.0   | 74.3   | 74.8   | 74.6  |
| Yield                           | Bu/Acre    | 42.2   | 43.0   | 42.7   | 42.0   | 42.4   | 42.8   | 43.2   | 43.6   | 44.0   | 44.4   | 44.8   | 45.2   | 45.6   | 46.0  |
| Production                      | Mil. Bu.   | 3124   | 3063   | 3188   | 2802   | 2918   | 2928   | 2990   | 3148   | 3191   | 3257   | 3317   | 3359   | 3413   | 3432  |
| Crush                           | "          | 1696   | 1739   | 1780   | 1706   | 1697   | 1818   | 2004   | 2050   | 2094   | 2116   | 2143   | 2177   | 2206   | 2279  |
| Exports                         | "          | 1097   | 947    | 1100   | 1070   | 1104   | 1219   | 928    | 762    | 917    | 1012   | 1026   | 1022   | 1026   | 1006  |
| Ending Stocks                   | "          | 256    | 449    | 595    | 465    | 426    | 159    | 150    | 242    | 266    | 240    | 232    | 236    | 261    | 252   |
| Farm Price                      | \$/Bu.     | 5.74   | 5.66   | 6.45   | 7.86   | 7.91   | 8.68   | 8.66   | 7.96   | 7.79   | 7.93   | 8.05   | 7.99   | 8.03   | 8.09  |
| Gross Margin <sup>1</sup>       | \$/Acre    | 172    | 165    | 192    | 246    | 246    | 280    | 281    | 252    | 248    | 255    | 262    | 261    | 264    | 269   |
| <u>Soybean Oil</u>              |            |        |        |        |        |        |        |        |        |        |        |        |        |        |       |
| Production                      | Mil. Lbs.  | 19360  | 20393  | 20165  | 19382  | 19300  | 20709  | 22846  | 23407  | 23927  | 24218  | 24547  | 24971  | 25329  | 26201 |
| <u>Utilization</u>              |            |        |        |        |        |        |        |        |        |        |        |        |        |        |       |
| Biodiesel                       | "          | 177    | 384    | 1690   | 1414   | 1138   | 1370   | 3508   | 3787   | 4073   | 4347   | 4624   | 4902   | 5184   | 5601  |
| Other                           | "          | 17439  | 17955  | 17360  | 17483  | 17921  | 18140  | 18427  | 18639  | 18834  | 19008  | 19225  | 19473  | 19727  | 20004 |
| Imports                         | "          | 26     | 35     | 30     | 200    | 200    | 200    | 300    | 300    | 300    | 300    | 300    | 300    | 300    | 300   |
| Exports                         | "          | 1324   | 1153   | 1500   | 1000   | 1000   | 0      | 0      | 0      | 0      | 0      | 0      | 0      | 0      | 0     |
| Price, Decatur, IL <sup>2</sup> | Cents/Lb.  | 23.0   | 23.4   | 30.0   | 32.9   | 30.4   | 31.3   | 30.6   | 30.4   | 30.2   | 30.2   | 30.2   | 30.1   | 30.1   | 30.0  |
| <u>Soybean Meal</u>             |            |        |        |        |        |        |        |        |        |        |        |        |        |        |       |
| Production                      | Mil. Tons  | 41     | 41     | 42     | 38     | 38     | 40     | 44     | 45     | 46     | 47     | 47     | 48     | 49     | 50    |
| Feed Utilization                | "          | 34     | 33     | 34     | 32     | 28     | 26     | 26     | 25     | 26     | 26     | 26     | 26     | 26     | 26    |
| Exports                         | "          | 7      | 8      | 9      | 6      | 9      | 14     | 19     | 20     | 21     | 21     | 22     | 22     | 23     | 24    |
| Price, Decatur, IL <sup>3</sup> | "          | 183    | 174    | 200    | 237    | 250    | 285    | 287    | 253    | 246    | 253    | 259    | 256    | 258    | 261   |
| Acres Harvested <sup>4</sup>    | Mil. Acres | 210    | 207    | 202    | 208    | 210    | 215    | 220    | 223    | 225    | 226    | 228    | 229    | 229    | 230   |
| Price of Farmland <sup>5</sup>  | \$/Acre    | 2315   | 2698   | 3037   | 3163   | 3210   | 3429   | 3665   | 3973   | 4271   | 4522   | 4753   | 4977   | 5223   | 5471  |

<sup>1</sup> Gross margins over variable costs <sup>2</sup> Crude, degummed <sup>3</sup> 48 percent protein <sup>4</sup> Total harvested acres of coarse grain, wheat and soybeans <sup>5</sup> Corn Belt states

Table 2. Projections of Variables Related to Renewable Fuels for 2007 to 2017

| Item                                 | Unit      | Year  |      |      |      |      |      |       |       |       |       |       |       |       |       |
|--------------------------------------|-----------|-------|------|------|------|------|------|-------|-------|-------|-------|-------|-------|-------|-------|
|                                      |           | 2004  | 2005 | 2006 | 2007 | 2008 | 2009 | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  |
| <b>Energy Prices</b>                 |           |       |      |      |      |      |      |       |       |       |       |       |       |       |       |
| Crude oil <sup>1</sup>               | \$/Brl.   | 37    | 50   | 60   | 60   | 64   | 64   | 62    | 62    | 61    | 61    | 61    | 61    | 61    | 61    |
| Wholesale gasoline <sup>2</sup>      | \$/Gal.   | 1.29  | 1.67 | 1.97 | 1.94 | 1.91 | 1.92 | 1.87  | 1.86  | 1.85  | 1.86  | 1.87  | 1.88  | 1.89  | 1.89  |
| Wholesale diesel <sup>3</sup>        | "         | 1.19  | 1.74 | 2.01 | 1.95 | 2.06 | 2.07 | 2.02  | 2.01  | 2.00  | 2.01  | 2.01  | 2.02  | 2.03  | 2.03  |
| Ethanol <sup>4</sup>                 | "         | 1.69  | 1.80 | 2.56 | 2.09 | 2.06 | 2.07 | 2.02  | 2.01  | 2.00  | 2.01  | 2.02  | 2.03  | 2.04  | 2.04  |
| Biodiesel <sup>5</sup>               | "         | 2.09  | 2.83 | 2.86 | 2.79 | 2.90 | 2.90 | 2.86  | 2.85  | 2.84  | 2.85  | 2.85  | 2.86  | 2.86  | 2.87  |
| Yellow grease <sup>6</sup>           | Cents/Lb. | 14.1  | 13.2 | 18.5 | 18.8 | 18.8 | 18.9 | 18.2  | 18.7  | 18.3  | 18.3  | 18.5  | 18.3  | 18.6  | 18.8  |
| <b>Biodiesel Feedstock</b>           |           |       |      |      |      |      |      |       |       |       |       |       |       |       |       |
| Soybean oil                          | Mil. Lbs. | 177   | 384  | 1690 | 1414 | 1138 | 1370 | 3508  | 3787  | 4073  | 4347  | 4624  | 4902  | 5184  | 5601  |
| Other virgin oil                     | "         | 0     | 0    | 0    | 368  | 410  | 427  | 437   | 445   | 453   | 461   | 469   | 475   | 481   | 490   |
| Animal fat <sup>7</sup>              | "         | 0     | 0    | 0    | 3461 | 3443 | 3454 | 3473  | 3494  | 3509  | 3537  | 3563  | 3587  | 3611  | 3631  |
| Corn oil from DDGS                   | "         | 0     | 0    | 0    | 0    | 3432 | 3866 | 4103  | 4339  | 4575  | 4810  | 5045  | 5282  | 5515  | 5638  |
| Total                                | "         | 215   | 699  | 1882 | 4293 | 6705 | 9116 | 11520 | 12065 | 12611 | 13156 | 13701 | 14246 | 14792 | 15360 |
| <b>Biodiesel Returns<sup>8</sup></b> |           |       |      |      |      |      |      |       |       |       |       |       |       |       |       |
| Yellow grease                        | \$/Gal.   | -0.11 | 0.61 | 0.73 | 0.15 | 0.27 | 0.26 | 0.22  | 0.24  | 0.20  | 0.22  | 0.21  | 0.20  | 0.20  | 0.18  |
| Corn oil from DDGS                   | "         | -0.06 | 0.76 | 0.70 | 0.31 | 0.35 | 0.36 | 0.33  | 0.33  | 0.32  | 0.31  | 0.30  | 0.29  | 0.28  | 0.27  |
| <b>By-Product Feed Prices</b>        |           |       |      |      |      |      |      |       |       |       |       |       |       |       |       |
| Corn gluten feed <sup>9</sup>        | \$/Ton    | 53    | 55   | 77   | 79   | 87   | 90   | 88    | 86    | 83    | 84    | 86    | 85    | 87    | 89    |
| Corn gluten meal <sup>9</sup>        | "         | 268   | 274  | 305  | 322  | 332  | 376  | 382   | 339   | 334   | 344   | 352   | 351   | 354   | 359   |
| DDGS <sup>10</sup>                   | "         | 75    | 87   | 110  | 90   | 98   | 106  | 104   | 99    | 95    | 97    | 99    | 98    | 100   | 102   |

<sup>1</sup> Refiner acquisition cost, composite of domestic and imported <sup>2</sup> Refiner prices for resale <sup>3</sup> Refiner prices for resale, No. 2 <sup>4</sup> Rack prices, F.O.B. Omaha  
<sup>5</sup> Upper Midwest, Jacobsen's Biodiesel Bulletin <sup>6</sup> Illinois, Jacobsen's Biodiesel Bulletin <sup>7</sup> Includes yellow grease <sup>8</sup> Over variable and fixed costs <sup>9</sup> Illinois points <sup>10</sup> Lawrenceburg, IN

Table 3. Projections of Livestock Variables for 2007 to 2017

| Item                           | Unit      | Year   |        |        |        |        |        |        |        |        |        |        |        |        |        |
|--------------------------------|-----------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
|                                |           | 2004   | 2005   | 2006   | 2007   | 2008   | 2009   | 2010   | 2011   | 2012   | 2013   | 2014   | 2015   | 2016   | 2017   |
| <b>Livestock Production</b>    |           |        |        |        |        |        |        |        |        |        |        |        |        |        |        |
| Beef                           | Mil. Lbs. | 24650  | 24787  | 26258  | 26786  | 26758  | 27162  | 27575  | 27821  | 27860  | 28066  | 28178  | 28282  | 28420  | 28514  |
| Pork                           | "         | 20529  | 20705  | 21075  | 21682  | 20754  | 19902  | 19262  | 19147  | 19254  | 19499  | 19807  | 20000  | 20158  | 20228  |
| Broiler                        | "         | 33699  | 34986  | 35369  | 35516  | 35756  | 35815  | 36005  | 36332  | 36744  | 37213  | 37706  | 38196  | 38677  | 39164  |
| Turkey                         | "         | 5383   | 5432   | 5612   | 5704   | 5825   | 5884   | 5929   | 5981   | 6044   | 6106   | 6166   | 6215   | 6255   | 6294   |
| Egg                            | "         | 7443   | 7509   | 7572   | 7600   | 7741   | 7800   | 7862   | 7941   | 8034   | 8137   | 8248   | 8361   | 8475   | 8593   |
| Milk                           | "         | 170900 | 176900 | 181800 | 183918 | 187645 | 188623 | 189072 | 190389 | 191979 | 194097 | 197011 | 200151 | 203099 | 205444 |
| <b>Livestock Prices</b>        |           |        |        |        |        |        |        |        |        |        |        |        |        |        |        |
| Choice steers <sup>1</sup>     | \$/Cwt.   | 84.75  | 87.28  | 85.41  | 92.78  | 89.05  | 87.51  | 86.18  | 85.54  | 86.51  | 86.68  | 87.97  | 88.65  | 89.07  | 89.97  |
| Barrows and gilts <sup>2</sup> | "         | 52.51  | 50.05  | 47.26  | 46.89  | 50.70  | 56.72  | 62.07  | 64.10  | 64.78  | 64.12  | 63.37  | 63.05  | 62.93  | 63.43  |
| Broilers <sup>3</sup>          | Cents/Lb. | 74.1   | 70.8   | 64.4   | 74.0   | 70.7   | 77.1   | 83.0   | 87.3   | 91.3   | 94.3   | 97.7   | 100.8  | 104.1  | 108.0  |
| Turkeys <sup>4</sup>           | "         | 69.7   | 73.4   | 77.0   | 78.8   | 76.9   | 81.6   | 85.7   | 88.3   | 90.5   | 91.9   | 93.9   | 96.0   | 98.3   | 101.0  |
| Eggs <sup>5</sup>              | Cents/Doz | 82.2   | 65.5   | 71.8   | 91.1   | 73.4   | 78.7   | 83.3   | 86.1   | 88.5   | 89.8   | 91.3   | 92.4   | 93.6   | 95.3   |
| Milk, average farm             | \$/Cwt.   | 16.05  | 15.14  | 12.90  | 15.36  | 15.37  | 15.46  | 15.65  | 15.88  | 16.19  | 16.68  | 16.73  | 16.61  | 16.42  | 16.29  |

<sup>1</sup> Nebraska, Direct, 1100-1300 lbs. <sup>2</sup> National Base, Live equiv 51-52% lean <sup>3</sup> Wholesale, 12-city average <sup>4</sup> 8-16 lbs, Eastern Region <sup>5</sup> Grade A large, New York, volume buyers

improve toward 3 gallons of ethanol per bushel of corn, the farm price of corn resulting in this projection set averages about \$3.40 per bushel, near the breakeven level for new dry mill ethanol plants (Table 1). Ethanol processing costs were based on a USDA 2002 survey and adjusted by input price changes following (Shapouri and Gallagher, 2005).

The price of soybean oil was established by deducting biodiesel processing costs from the projected biodiesel prices assuming a conversion rate of 7.5 pounds of soybean oil per gallon on biodiesel. Biodiesel production costs were derived from a “process model” of the USDA’s Eastern Regional Research Center and adjusted for subsequent changes in input prices (Haas, et al, 2005). The price of crude, degummed soybean oil at Decatur, IL was thereby established at about 30 to 32 cents per pound for the 2007 to 2017 period as the breakeven feedstock cost for biodiesel production (Table 1).

Because of the importance of corn to the agricultural economy, corn prices heavily impact the entire livestock feed sector along with production and prices of livestock and competing crops. While gross margins per acre increase on soybeans in the projection period over recent levels, the gross margins on corn escalate much more. Consequently, major shifts of soybean acres to corn is contemplated in the 2007 to 2009 crop years (Table 1). This compounds the problem of generating increased supplies of soybean oil and other virgin vegetable oil for biodiesel production. The result is reflected in Table 2 under the subtitle Biodiesel Feedstock. With animal fat representing a major share of the feedstock in the early part of the projection period, corn oil from DDGS could reach the level of soybean oil in the later years..

The attractiveness of animal fat (including yellow grease) and corn oil from DDGS as feedstock for biodiesel is reflected in the section under Biodiesel Returns in Table 2. Also note under Energy Prices, that the prices on yellow grease are projected to be about two-thirds of the prices for soybean oil. Positive returns are projected for biodiesel production from both animal fat and corn oil from DDGS. The implicit price for corn oil from DDGS is the midpoint between (1) the per pound price of DDGS (about 5 cents) plus the extraction costs and (2) the price of soybean oil -- a split between the cost for corn oil leaving the ethanol plant and the prevailing feedstock input price for the biodiesel plant. However, competition would eventually bid up prices on yellow grease and corn oil from DDGS to breakeven levels. Pretreatment costs for yellow grease were obtained from a study at Iowa State University (Canakci and Van Gerpen, 2001) and extraction costs for corn oil from DDGS were derived from research at the Michigan Biotechnology Institute International (McCalla, 2006).

To provide for both the expanding use of soybean oil as a food and as a fuel and to ensure that the feedstock requirement for biodiesel would be met from domestic sources, AGMOD’s initial solution was overridden by increasing the domestic crush and reducing exports of soybeans. By 2017, this represented about 700 million bushels, a third of the domestic crush. With domestic feeding of soybean meal already diminished by the competition from the byproduct feeds of ethanol production, the combined impact was to increase substantially the exports of soybean meal. This, plus the increase in ethanol byproduct feeds, pressured the high protein feed market internationally and domestically. However, the predominance of the strong corn market more than offset the increased supplies of the mid and high protein feeds as reflected in Tables 1 and 2.

Even though the strong corn market pulled acreage out of soybeans for a few years, the longer run impact on the combination of all coarse grain, soybeans and wheat was for a substantial acreage expansion. This amounted to a 28 million acre increase between 2006 and 2017 (Table 1). Presumably about a third would come out of the Conservation Reserve Program. The elevated returns to cash crops will also extend the secular rise in farmland prices. Cornbelt farmland values could rise from the \$3000 per acre level to \$5000 in the next 10 years (Table 1).

As shown in Table 3, livestock production and prices will obviously depart from scenarios sans expanding renewable fuels. While the USDA's baseline projections of February 2006 reflected a moderate increase in renewable fuels (8.5 billion gallons of ethanol from corn by 2015), the projections in Table 3 reflect 20.7 billion gallons by 2017 (USDA, 2006). In general, livestock production will be lower and prices higher. Specifically, the major impacts are the reduced production of pork and broiler meat production, but more than offset by higher prices, a reflection of the inelastic demand for these products. In any case, the livestock and food industries have legitimate concerns about the rate of expansion in the construction plans for renewable fuels, particularly for ethanol.

### **Caveat**

As might be noted, some of the assumptions in this analysis may seem extreme such as the phasing out of soybean oil exports and restricting exports of soybeans. Alternatively, options could be explored in which the feedstock for renewable fuel production could be imported. The projections do provide a perspective on the volumes which would be involved. In any case, the econometric models such as AGMOD allow analysts to quickly evaluate alternative scenarios.

### **What About Cellulosic Ethanol?**

We conservatively assume in our projections that production of cellulosic ethanol either from agricultural residues or from dedicated energy crops such as switchgrass will be small even by 2017. Though cellulosic ethanol is considered the best biofuel alternative for reducing crude oil imports and greenhouse gas emissions, commercial feasibility of cellulosic ethanol on a large scale remains a formidable challenge for a number of reasons (Collins, 2007).

While significant progress has been made in various unit processes such as pretreatment, hydrolysis, enzyme production, fermentation and distillation in the conversion of cellulosic feedstocks into ethanol, major technical uncertainties remain, such as effective hydrolysis of recalcitrant cellulose, fermentation of pentose sugars, system integration, commercial scale up and overall process optimization. A number of potential technical pathways are still competing for dominance. No commercial facilities or fully integrated demonstration plants which are necessary to prove technical and economic viability and to secure financing are currently operational. Capital requirements for cellulosic ethanol plants are much higher than for corn-ethanol dry mills. The estimated capital costs per gallon of annual capacity of ethanol ranges from \$2.85 (Aden, et al, 2002) to \$5.44 (McAloon, et al, 2000) for cellulosic plants compared to a range of \$1.05 to \$3.00 for corn ethanol plants and \$0.20-\$1.00 for expansion of existing plants (Shapouri and Gallagher, 2005).

Expert opinion is that biomass conversion facilities will need to be large (5,000 to 10,000 tons per day) to be economical, and the configuration of appropriate supply chains for biomass and logistics of harvesting, storage and transport remain unresolved. Significant new investments will also be necessary in harvesting and storage infrastructure. Sokhansanj and Wright estimate that biomass refineries using 508 million tons of biomass will require investments of \$31 billion in baling and harvesting equipment and \$10.6 billion in storage structures (Sokhansanj and Wright, 2000). Further, energy crop production and investments in conversion facilities suffer from the classic "chicken and egg" problem. Farmers are unlikely to grow biomass in large enough quantities unless there is an assured market, and investors are unlikely to invest in conversion facilities until adequate feedstock supplies are assured. Growing dedicated energy crops, such as switchgrass, is not attractive at current yields of 4-5 tons per acre and significant improvements in yields through breeding and research are necessary. The projected higher

returns for corn production and potential revenues from corn stover, if cellulosic ethanol were to become commercially viable, will only exacerbate the problem.

Hence we assume in our projections that the contribution of cellulosic ethanol will be minor even by 2017. Following a similar logic, the early release version of the Annual Energy Outlook 2007 from the U.S. Department of Energy projects that cellulosic ethanol will contribute less than 2 percent of total fuel ethanol produced in the US by the year 2030, despite a projected quadrupling of fuel ethanol output between 2007 and 2030 in the reference case (Energy Information Administration, 2006). Similarly a recent University of Tennessee study analyzing the economic and agricultural impacts of ethanol and biodiesel expansion assumes that cellulosic ethanol becomes commercially viable by 2012; but initial feedstocks will be forest and mill wastes; and dedicated energy crops will become primary cellulosic feedstock only by 2017 (La Torre Ugarte, et al, 2006).

The U.S. Department of Energy (DOE) announced on February 28, 2007 that DOE will invest up to \$385 million for six biorefinery projects over the next four years to help bring cellulosic ethanol to market (U.S. Department of Energy, 2007). The total investment in these facilities including industry cost share is more than \$1.2 billion. These plants use a variety of cellulosic feedstock such as urban yard and wood waste, wheat and barley straw, corn stover, switchgrass, wood residues and woody energy crops. When fully operational by 2011, these biorefineries are expected to produce about 130 million gallons of cellulosic ethanol per year. Technical and commercial success of these DOE funded plants and several other proposed plants will be a critical first step in the future commercial development of the cellulosic ethanol industry. However, we expect that cellulosic ethanol production will continue to be relatively minor through 2017.

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