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THE COST OF OWNING CORN AND SOYBEANS

AS A RESULT OF THE RECENT RAPID DECLINE IN GRAIN PRICES, farmers are becoming quite reluctant to sell corn or soybeans. Many prefer to own the grain, anticipating that prices will be higher later in the marketing year. The question then arises, How should ownership be maintained?

Because of the current high rate of interest, it is very expensive to store grain. Many producers are asking if they should sell the grain for harvest delivery and maintain ownership by buying an equivalent amount of grain in the futures market. On the surface, this alternative seems attractive. The cost of owning the futures contract is quite low, a small commission fee and interest on margin money. However, the real cost is considerably higher than the sum of those two items. When cash grain is replaced with futures, the producer gives up any gain in the basis that would accrue to him if he stored the grain. Producers should carefully examine all the costs of each method of ownership.

An Illustration. On October 1, 1981, the price of corn in central Illinois was about $2.40. The cost of storing that corn from harvest (October 1) until June 1 includes extra drying and shrink required for stored corn over harvest-delivered corn, interest on the value of the corn, and direct storage expenses.

Assuming a 1.3 shrink factor and a drying cost of 1 cent per point of moisture removed, the cost of reducing the moisture level from 15.5 percent to 14.5 percent is 4.1 cents per bushel. At 18 percent interest, the cost of holding $2.40 per bushel corn for 8 months is 28.8 cents. If the corn were stored in commercial facilities, the storage costs would total about 19.5 cents per bushel. The total cost in this example is 51.4 cents per bushel. If the corn were stored in on-farm facilities, the out-of-pocket storage costs would be significantly less than 19.5 cents, reducing the total cost accordingly.

To replace the corn with futures, the producer pays a direct cost, commission fee plus interest on initial margin, of about 2.5 cents per bushel. Interest costs could be higher if the price declined and additional margin money were required.

In addition to the direct costs, the producer should consider the potential basis gain he forfeits by selling the corn. On October 1, July 1982 futures closed at about \$3.24. Since the cash price was \$2.40, the July basis was 84 cents. That is a relatively wide basis, reflecting the depressed cash prices and the large spread in the futures prices stemming from the high interest rates. Over the past four years, the July basis around the first of June has averaged about 25 cents, ranging from 23 to 28 cents. The producer is giving up about 59 cents in potential basis gain. Adding that figure to the direct cost brings the total cost of owning futures up to 61.5 cents per bushel, which is 10 cents above commercial storage costs and 20 to 25 cents above on-farm storage costs.

If the same assumptions are made for soybeans, the calculations show that the commercial storage cost would be 91 cents and the cost of owning futures \$1.03 per bushel.

Although replacing cash grain with futures seems attractive at current low grain prices, it is actually more expensive than storing the grain. Because of the weak basis and large spreads, a substantial premium must be paid for futures. Both methods of ownership are expensive. Perhaps the more important question is, Should ownership be maintained?

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