

PolicyPennings by Dr. Daryll E. Ray

Do unusual price multiples signal a larger shift in acreage than expected?

Usually we are content to leave crop price comparisons to extension economists and the marketing services because they are on top of the technical issues on a day-to-day basis. But we have noticed some recent price trends that have piqued our curiosity and led us to wonder what will happen to soybean and wheat acreage in the coming years.

For the last 30 years, the price ratio between soybeans and corn has been about 2.5 to 1 (table 1). While there have been some years where this price multiple has not held, the decade price multiple for soybeans to corn has declined ever so slightly from 2.53 in the 1970s to 2.50 in the 1990s. On March 9, 2007, the price multiple was 1.83 and the USDA projections for 2007 show a price multiple of 2.0.

Table 1. Inter-crop price multiple for soybeans to corn and wheat to corn, 1990s, 1980s, 1970s, computed from March 9, 2007 Chicago Board of Trade nearest futures, and USDA Office of the Chief Economist projections for the 2007 crop year.

	70s	80s	90s	3/9/2007	OCE-2007
Soy/Cn	2.53	2.51	2.50	1.83	2.00
Wht/Cn	1.33	1.36	1.39	1.14	1.27

For wheat the price multiple in comparison to corn was 1.33 in the 1970s. Over the next two decades, it increased to 1.36 in the 1980s and 1.39 in the 1990s. On March 9, 2007, the price multiple, based on Chicago Board of Trade close for the nearest futures, was 1.14. USDA 2007 projections peg the price multiple at 1.27.

It is possible that the new price multiples signal a shift in the fundamental relationship between corn and the other two crops, soybeans and wheat. We certainly would not count that possibility out.

At the same time, we wonder if the price multiples will trigger a response on the part of farmers and induce them to shift more acreage than expected. Shifts in relative levels of production would lead to higher soybean and wheat prices and/or lower corn prices.

Based on the historic multiples, we would not be surprised to see even more corn acres and fewer soybean and wheat acres than currently

expected. If that were to take place, and in the absence of adverse weather and the presence of reasonably adequate quantities of nitrogen and other inputs, corn production could be significantly higher than projected, leading to a drop in corn prices and an increase in the price multiples for soybeans and wheat.

What does all of this portend for the 2007 Farm Bill? A greater than expected shift in acreage into corn could result in a significant drop in the price of corn. If this were to happen, the drop in the price of corn would result in a significant increase in the projected cost of the farm program over the next five years.

This would undoubtedly trigger a shift in negotiating positions of various players in the farm bill debate. With a drop in price, we could see farm groups placing a greater emphasis on a safety net than they would in a higher price scenario.

But that is only one of the polar extremes that is possible. As we have commented in previous columns, a perfect storm could develop this summer that could cause corn prices to explode.

In this case the perfect storm is defined by too few rainstorms resulting in greatly reduced corn yields combined with low stock levels and mammoth growth in ethanol demand. And that perfect storm could occur even if corn acreage increases beyond current expectations.

Then Congress would be confronted with a whole different set of issues. Not the least of which would be how to protect domestic and international demanders of US corn from sky-high prices in the future. One policy possibility sounds like "oil reserve" but with another word in place of oil.

Friends, we could be in for a wild ride in the coming months. As Yogi Berra says, "It ain't over till its over."

Daryll E. Ray holds the Blasingame Chair of Excellence in Agricultural Policy, Institute of Agriculture, University of Tennessee, and is the Director of UT's Agricultural Policy Analysis Center (APAC). (865) 974-7407; Fax: (865) 974-7298; dray@utk.edu; <http://www.agpolicy.org>. Daryll Ray's column is written with the research and assistance of Harwood D. Schaffer, Research Associate with APAC.

Originally published in *MidAmerica Farmer Grower*, Vol. 24, No. 11, March 16, 2007
Reproduction Permission Granted with 1) full attribution to Daryll E. Ray and the Agricultural Policy Analysis Center, University of Tennessee, Knoxville, TN; 2) Copy of reproduction sent to Information Specialist, Agricultural Policy Analysis Center, 309 Morgan Hall, Knoxville, TN 37996-4519