PolicyPennings by Dr. Daryll E. Ray

High priced oil

As this column is being written, crude oil prices end the week at near record highs of $56.72 per barrel. While seasonal issues like cold weather and the demand for heating oil have some impact on the day-to-day pricing of the market, the long term price pressure is driven by more fundamental forces. The first force is the growth in the demand for oil by the world's two most populous countries, India and China. The second is the wellhead production capacity of the world's crude oil suppliers.

While OPEC recently agreed to increase the production quotas of its member states by a half a million barrels a day, market analysts are concerned that this increase may not be large enough to meet the worldwide growth in demand. Much of this increase, however, may come in the form of heavy sour crude which is in less demand than low-sulfur light sweet crude. That would leave refiners competing for limited quantities of the more desirable oil, keeping the pressure on prices.

If Rodrigo Rato (the Managing Director of the International Monetary Fund) is correct farmers may have to contend with higher energy costs for the coming crop year. In a recent statement, Rato said, "The world will have to adjust to high oil prices for at least the next two years due to a combination of strong demand and supply constraints."

Reading about the potential for high energy prices this coming growing season got us to thinking about the potential impact these prices may have on farmers and the farm economy. Given the structure of crop markets, there is little chance that crop farmers will be able to pass on the increased costs on to the purchasers of their products. Barring an adverse-weather or disease driven price spike, higher energy costs most certainly will result in lower margins and lower profitability for crop farmers who are dependent on diesel fuel and energy related fertilizer supplies.

To cope with increased energy costs, farmers will be looking for ways to reduce field passes. Increased fertilizer and chemical costs may induce some to increase their dependence on precision agriculture so that the chemicals are concentrated on the areas of the field with the highest yield potential. If Asian Soybean Rust proves to be a problem this year, farmers will have to wrestle with the cost of each fungicide application versus the potential loss if they don't spray.

Higher energy costs will increase the transportation costs, not only for the commodities they sell, but also for the products that they purchase: farm chemicals, seed, fertilizer, and even the parts they need to repair their equipment. It would not be surprising to see the basis for commodities increase as local elevators factor in the increased transportation costs to get the grains and seeds to the terminals. If this year sees a wet fall, producers will have to balance out the costs of drying fuel with the losses that could be encountered leaving the crop in the field days or weeks longer in an attempt to bring the moisture level down before harvesting it.

Higher fuel prices may give corn and soybean farmers a reprieve in one area, the importing of those commodities into the Port of Wilmington. Higher priced fuel will increase the cost of shipping these commodities from South American ports, giving growers closest to Wilmington a potential advantage. The scale of the advantage will, in part, depend on the differential impact of energy costs on various transportation modes.

It is possible that the higher energy costs could tilt the playing field on horticulture and floriculture crops like green peppers and roses. The increased cost of airfreighting these commodities thousands of miles may be greater than the increased costs of shipping these products within the US by ground. Locally produced horticultural products likely will be less affected by fuel prices than products that are shipped in from Central and South America.

It seems almost certain that higher energy prices will put significant pressure on crop farmers in the short-term. In the coming weeks we will be looking at various scenarios for the medium- to long-term. Increased energy costs have the potential to make the 2007 farm policy debates an even higher stakes game than it already is.

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