Ferguson: Energy Matters

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Food and Energy Markets

What a sheltered life we lead! My local newspaper is fond of reporting the plight of folks faced with the need to feed $4 gasoline into their 2-ton vehicles. Meanwhile, riots have broken out in poor countries around the world over the skyrocketing price of basic food. The problem of feeding my car pales in comparison with the problems Egyptians, Filipinos, Pakistanis, and others have feeding their families.

Rich countries are being blamed for using human food such as corn to make ethanol for vehicles. As loyal readers may remember, many months ago I also expressed my dismay in a column entitled *The Price of Tortillas*.

It may just be my Quaker heritage, but I agree with the Indian and Turkish finance ministers that the use of food crops for vehicle fuel is appalling. A "crime against humanity," as one put it.

The diversion of grain from the food supply into biofuels is not the only reason global food prices have nearly doubled in the last three years, a senator from Iowa quickly pointed out. There has been drought in Australia, a major exporter of grain. The Chinese are increasing their consumption of grain-fed meat, for example.

In my opinion, however, the biofuel craze and food riots are symptoms of the same phenomenon—the increasing price of crude oil. [The NYMEX price closed at a new record high of $114.93 per barrel (!) on 16 April.]

Experts estimate that about as much energy is used to grow corn as the energy corn provides. Fertilizer, farm equipment, irrigation, drying, and shipping are all energy intensive. The price of oil is nearly $20/MMBtu (a barrel of oil is about 5.8 MMBtus). Natural gas is about $10/MMBtu.

According to my calculations, the current price of corn is about $15/MMBtu of food energy (about 3 bushels of corn.) I don't see how the price of corn can fall unless the price of oil declines significantly. As you know, I don't see that happening any time soon.

The *Wall Street Journal* reports that economists are warning countries not to respond to the food crisis with actions that "distort market prices." That advice is all well and good for economists in ivory towers but must sound awfully arrogant to folks without enough to eat.

These same economists ignore the fact that oil prices are already "distorted" by dysfunctional oil markets, as I commented in this space last week. They continue to tout the sanctity of markets when the most important market of all—the oil market—is broken.

I fully expect countries increasingly to hedge their exposure to food and energy markets by entering into bilateral agreements tantamount to international bartering. Reversion to old-fashioned barter as a means of trade may dismay dogmatic economists, but when people can't afford food to eat something must be done.

One of the more creative responses to the food/energy problem came from Ukraine, which reportedly offered Libya a quarter million acres on which to grow grain in return for consideration in energy deals. Brazil is talking to Egypt. China is dealing with New Zealand and talking to Australia.

According to the *Journal*, economists are flummoxed. No one appears to have a solution for the current unsustainable dilemma. The World Bank proposes to lend Africa $800 million to expand agriculture, a mere10 percent of what is spent globally for oil products in *one day*. The U.S. spends over $1.3 billion *daily* for petroleum imports. Ending subsidies for biofuels would increase global food supplies somewhat, but wouldn't solve the fundamental resource problems.

The world needs to begin to grapple with the fact that supplies of crude oil are limited, a fact with profound implications for all of us.

Unless by some miracle global crude oil supplies rapidly increase, oil prices will continue to climb. Modern agriculture has become so energy intensive that market prices of grain and other food will also increase.

Nothing I can see on the horizon—except the unlikely prospect of much more oil—has the ability to prevent the current mess from getting worse.

Over the past year I have been pondering the broader implications of global oil supply limitations and associated price increases. It's not a pleasant prospect. Rich nations will muddle through and the poorer will not.

That's the trouble with markets—the rich get all they can afford and so do the poor.

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Opinions expressed by DrF are not necessarily those of any organization with which he is affiliated.