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## ECONOMIC NEWS UPDATE

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Call it the war of the State of the Union Address. As you read this, the final battle in that war is underway, with the winners to be determined on Tuesday when the President goes before a joint session of Congress and assorted dignitaries, and the nation, to report on the State of the Union. More important, he will lay out his plans for confronting the problems facing America.

Every policymaker, lobbyist, and legislator knows that if he can get the President to support, or even mention, or perhaps even hint at his pet idea in the course of the address, the probability of its implementation soars.

No one expects a major new initiative in policy in Iraq or in the war on terror. So the hottest battle in the war for Bush's ear will be over energy policy. No surprise. Nigeria is in turmoil, and its ability to maintain an assured flow of oil in doubt. Iraq is unable to restore its oil output to pre-war levels. Saudi Arabia's royals and China's communists have struck a new deal which is most probably missiles-for-oil, and has the added advantage to the Saudis of giving them a new friend to help them resist

pressure from the US to stop financing terrorists. Vladimir Putin has made clear that he views Russia's vast reserves of oil and gas as weapons in a new sort of cold war -- defer to me, or shiver in the winter.

Then there is Iran, home to some 12% of the world's oil reserves, and determined to take its place among the world's nuclear powers. Diplomacy having more or less run its course, and Iran's president Mahmoud Ahmadinejad had considered in Washington to be dangerous, all the American president's men are declaring Iran's acquisition of nuclear weapons to be "unacceptable", whatever that may mean.

If it means sanctions, the Iran's oil exports would be cut, a prospect that has driven crude oil prices back towards the \$70 level, and panicked European and US consuming countries. They should do a bit of arithmetic. Iran produces about four million barrels of oil a day, consumes about 1.5 million, and exports about 2.5 million. Experts with whom I have spoken say that in the short-term, removal of, say, half of Iran's 2.5 million barrels from the world's oil market (sanctions are never 100%

effective) would certainly send prices up. Best guess: \$80 per barrel. But in the longer term, the increased investment now underway in exploration and development will uncover sufficient new oil to make up for Iran's cutbacks. Remember: because there is no love lost between Iran and its Arab neighbors, the latter are unlikely to rein in their output to support an Iranian cutback, especially if it sends prices to levels that threaten to encourage the development of technologies that will free the West from its reliance on Arab oil.

Which neatly brings us back to the President's upcoming address. Proposals jockeying for inclusion in the President's address fall into three broad categories. First in line, and very congenial to Bush and vice president Dick Cheney, are those that call for relaxation of perceived barriers to domestic exploration. The President has tried repeatedly, and as often failed, to persuade congress to allow oil companies to drill in the Alaskan wildlife preserve. He would also like to see greater exploration for natural gas in the Rocky Mountain area, and more intensive exploitation of oil and gas reserves believed to reside off the Florida, California and other coasts.

He might get some of what he asks for, but my guess is that Alaska will remain off limits. No matter: domestic reserves, even if fully developed, are insufficient to make much of a dent in the nation's energy security problem.

The second set of options being put before the president consists of multiple subsidies, some overt, some hidden. The advocates of nuclear energy are calling for speedier plant licensing procedures, a resolution of the waste storage problem, government

support for reprocessing spent fuel, and a variety of other subsidies. The president will try to give them what they want, but due-process-of-law rules make it difficult to shorten licensing proceedings; the powerful leader of the Democrats in the Senate represents the state (Nevada) that contains the best potential waste storage facility (Yucca Mountain) and will fight to prevent its use; Yucca Mountain in any event would be at capacity in a few years; and nuclear power remains a rather expensive alternative to coal-fired generation.

Besides, until America replaces its fleet of 237 million mostly gasoline-powered cars, trucks, busses and motorcycles with fully or partially electric-powered vehicles, nuclear plants can't help meet the needs of the transport sector. So think tanks such as the Center for Security Policy are urging the President to mandate that every car made in America be capable of running on some combination of electricity and alcohol fuels. This will require "incentives" -- the polite word for subsidies -- for the manufacture and purchase of a new generation of vehicles and modification of the energy delivery infrastructure. Best estimates are that with gasoline in the \$2 per gallon range, these various alternatives to pure gasoline vehicles struggle to be economic unless somehow subsidized.

A third group of policy makers, which includes the former president of Resources for the future, and now Dean of the Eller College of Management at the University of Arizona, the widely respected Paul Portney, wants the President to announce that "the gas tax will be going up steadily for the foreseeable future to stimulate investment in all kinds of technologies

without anointing any particular ones". The proceeds can be used to lower the tax on wages. The President may buy into a version of that proposal, asking congress to set a tax on oil imports that cuts in only if crude oil prices fall below \$35 per barrel.

But, if history is any guide, little will come of any Presidential initiative. Congress is more concerned with restoring its scandal-ridden reputation (Republicans), and attacking the President (Democrats), than with the nation's energy security.

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