

## ECONOMIC NEWS UPDATE

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### **Peak Oil Panic is Not the Same as Peak Oil**

There are more misunderstandings about the oil market than perhaps any other. In America, drivers are fuming and politicians are demanding explanations because gasoline has hit about \$3.50 per gallon. That's less than half the price being paid by motorists in most industrialized countries. High to us is low to them. Then there are the oil refiners. Relative to the \$120 price of crude, \$3.50 for gasoline is so cheap that their margins have virtually disappeared. So "high" in Cambridge, Massachusetts and Oxford, Mississippi is "low" in similarly named cities in the UK, and "high" for motorists is "low" for refiners. It depends where you live, and at which point in the supply chain you find yourself.

But assume that prices are "high", which indeed they are by historic standards. We are mistaken when we think these "high" prices are causing inflation. High oil prices can force consumers to spend more on gasoline and heating oil, at the expense of other purchases. Ask any suffering restaurateur or clothes retailer if you doubt that. But high oil prices can't trigger a rise in the general price level -- inflation -- unless someone pumps

money into the economy so that, to use an oldie but goodie from the economists' lexicon, there is more money chasing the same amount of goods. If you want something to blame for inflation, don't look at oil prices, look at the billions the Federal Reserve Board's monetary policy gurus and their confederates at the US Treasury are pouring into the economic system. The cost to taxpayers of saving the financial services sector from ruin is not only making good any collateral the Fed has accepted that might prove worthless, but the run-up in the rate of inflation.

Another myth: we are running out of oil. According to WorldPublicOpinion.org "majorities in 15 of the 16 nations surveyed around the world think that oil is running out.... Only 22 percent on average believe that 'enough oil will be found so that it can remain a primary source of energy for the foreseeable future.'" Those majorities who think we are running out of oil include 76% of the American citizens polled. Luckily, they are wrong.

Production of oil is being constrained by several forces, none of them due to God's failure to put enough of the black gold under our feet. Several

countries that are important sources of supply are in political turmoil, and unable to bring to market the oil they are currently capable of producing. Think Nigeria, where security problems have shut down about 20% of the nation's 2.5 million barrels of capacity, and discouraged new investment, and Iraq, where political paralysis and terrorists have kept production at less than half of its potential. Other countries will not develop the reserves of oil known to lie under their territories.

Russia has made it clear that foreigners who invest in its oil industry might be playing a game with Vladimir Putin known as heads I win, tails you lose. Find nothing and you lose your money; find substantial reserves and the state squeezes you until your shareholders' pips squeak. Only companies at least 51% owned by Russians -- read FOPs, Friends of Putin -- are allowed to look for oil in the new, difficult areas in which it is to be found. Little surprise that Russian oil output dropped in the first quarter of this year.

Mexico's President Felipe Calderon wants revive Petroleos de Mexico (Pemex), the world's third-largest oil producer by contracting with foreign companies to introduce modern methods of extracting more from existing fields and finding new ones. But legislation is stalled by left-wingers who have seized and are sleeping at podiums in both house of congress.

Saudi Arabia's royal family has announced that it will not expand capacity. Abdullah Jum'ah, CEO of the kingdom's oil company, says that high prices don't mean the world needs more oil because such market signals are "imperfect", and Ali Naimi, the kingdom's energy minister, has announced that there are no plans to embark on a new

round of expansion. The oil is there, but with current production yielding about \$120 per barrel, there is no incentive to find more, especially since new production might drive down prices as demand for oil from the slowing American economy drops.

Venezuela's oil industry can only be described as a mess. President Hugo Chávez's cronies are inadequate substitutes for the technicians they have replaced, so production is falling, while foreign investors are reluctant to trust hundreds of millions in exploration dollars to a regime that treats contracts as the first step in a negotiation.

Here in America, Congress alternates between calls for "energy independence" and refusals to allow drilling in what it considers environmentally sensitive areas in Alaska and offshore California and Florida. There's more, but you get the idea. There is a lot of oil out there to be found and produced, not even including the vast reserves in Canada's tar sands. We might have reached the age of peak panic about oil supplies, but not of peak oil.

One thing we think we know about the oil business *is* correct. High oil prices and the greenhouse gasses produced by using oil have important geopolitical consequences. These \$100+ prices have led to a massive flow of wealth, and hence power, from consuming to producing countries. If oil were still priced at \$20 or even \$40 per barrel Russia would not have the wherewithal to revert to its bullying foreign policy, and America's banks would not be going hats-in-hand to Arab capitals in search of new capital. If gasoline prices had not closed in on \$4 per gallon in the US, thousands of SUVs and small trucks would not be sitting,

unsold and unloved, on dealers' lots. If oil had not pierced the \$100 per barrel level, and was not seen as a pollutant, the current enthusiasm for super-expensive nuclear power would not have reached a fever pitch. And if oil did not produce so-called greenhouse gasses when propelling cars and heating homes, there would be no massive subsidies for ethanol production, acreage would not be diverted from growing food to growing fuel, and the current run-up in food prices would be less steep, and food riots would not be breaking out around the world.

So oil indeed matters. But not in the ways we most often think.

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