

1/5/2009

MID-EAST PEACE & THE PRICE OF OIL

Energy is the life blood of our civilization and the lowest cost energy is oil. Our problem is that lowest cost oil is controlled by "totalitarian" governments. These governments control huge quantities of very cheap oil and profit from creating conditions that threaten to interrupt the supply of oil.

Even a short interruption in the flow of oil can have a catastrophic effect on our economy, so any threat of interruption of the oil supply causes the price of oil futures to soar. Soaring oil prices create huge profits for the oil producing "totalitarian" governments. The tactic of causing conditions that threaten to interrupt world oil supply has been successful in increasing the price of oil from less than \$20.00/barrel at the end of 2001 to over \$140.00/barrel by the middle of 2008. Unfortunately, the oil controlled by these totalitarian governments cost much less to produce than the oil resources controlled by relatively free governments.

The major cost of producing oil is the capital expense required to convert the resources to oil reserves (cost of drilling the well). Once the capital investment is made, it can only be recovered by harvesting the oil. If the decision to make that investment is based upon an artificially high price and the conditions that created that price are removed and the price of oil drops such that the company cannot service the debt, the company will go bankrupt and lose control of its property. This is very close to what happened in the 1970's energy crisis. Who in their right mind would invest in a business that has a competitor that has the power to destroy the business?

Are we really being victimized by the manipulation of oil prices by foreign powers? Look at the record. Oil was selling for less than \$20.00/barrel near the end of 2001. Oil prices started to rise with the attack on the World Trade Center. Prices rose \$30.00/barrel by early 2003, but then dropped to \$20.00/barrel just before mid 2003. It became evident in late 2002 that the U.S would invade Iraq. The price of oil began to rise but dropped back to \$20.00/barrel on initial military success. Hostile relations between Iraq and Iran were a

restraint on both countries. When Iraq's military capacity was eliminated, Iran was free to create problems in the area. Using ever increasing oil revenue, Iran funded insurgent activities in the Mid-East. When oil prices declined, Iran would test rockets with the capability to reach oil tankers in the gulf or have various quasi military groups attack Israel. Each attack or saber rattling reversed the falling oil prices. By mid 2008 the price of oil reached almost \$147.27/barrel on concern over Iranian missile tests. When concerns over the missile test subsided, the price of oil dropped back to almost \$35.00/barrel.

Guess what happened? Hamas, a group of criminals funded by Iran, declared an end to the truce with Israel and stepped up rocket attacks. To defend itself from the rocket attacks, Israel attacked Hamas, and oil prices increased to over \$45.00/barrel. Can there be any doubt why we pay so much for oil?

The purpose of our government is to protect us from the initiation of force both foreign and domestic. Our government has not protected us from those who use force to steal our wealth by manipulation of oil prices. How can our government protect us from the aggression of these "totalitarian" governments?

First, look at the facts.

1. The natural order of consumption of natural resources is to consume those with the lowest recovery cost first. To do otherwise would be to artificially increase the cost of the resource.
2. The "Strategic Petroleum Reserve" has been ineffective in protecting us from artificial surges in oil prices.
3. The baseless restrictions on development of domestic natural resources are aid and comfort to our enemy, enhancing their ability to manipulate prices.
4. The ability of OPEC to manipulate oil prices makes it very unlikely that private companies will convert oil resources to reserves in a quantity to destroy the "totalitarian" government's monopoly power. Even if they tried, the low cost of Mid-East oil available to the "totalitarian" governments would make the effort futile.
5. The use of force by these totalitarian governments to manipulate the price of oil can only be defeated by the use of force.
6. In our society, the government has a monopoly on force.

7. Over the last ten or so years the use of military force has been ineffective in maintaining a stable source of energy.
8. As long as the "totalitarian" governments have access to vast unearned wealth of manipulated oil prices, there will be no peace in the Mid-East.
9. Conventional military force does not offer a long term satisfactory solution.

The solution to the problem is to create a "Strategic Petroleum Production Reserve" instead of the "Strategic Petroleum Reserve". The United States has enough fossil fuel resources to last well over a hundred years. The problem is that these resources will cost much more to convert to reserves and harvest than Mid-East oil. Mid-East oil is not now and will never be available at stable and reasonable prices as long as it is a monopoly controlled by "totalitarian" governments.

The fossil fuel resources of the United States are oil, coal and shale oil and are adequate for well over 100 years usage. Following the doctrine of consumption of the natural resources in the order of lowest recovery cost, these resources would be developed when the "cheap Mid-East" was depleted. If the monopoly exercised by the "totalitarian" governments could be broken, the natural order of the consumption of natural resources could be restored.

How do we solve the problem? The government should create the "Strategic Petroleum Production Reserve" by contracting with oil companies to convert our fossil fuel resources to reserves and maintain these facilities so that production could be started when oil prices reached a predetermined level. Part of the contract would allow for continuing research to reduce the cost of conversion of shale oil and coal to petroleum products. The cost of the project could be paid for by using the "stimulus package" (makes a lot more sense than the "bridge to nowhere" or congressional earmarks), release of the "Strategic Petroleum Reserve". Limited production and a small tax on imported oil (even with the tax, the oil would cost less than we pay now) would be used to pay the maintenance and research cost. As the cheap Mid-East oil is depleted, the oil price level that triggered "Strategic Petroleum Production Reserve" activity would increase. The value of the "Strategic Petroleum Production Reserve" would increase with the increased trigger price.

Eventually, cheap Mid-East oil would be depleted and "Strategic Petroleum Production Reserve" would come "on line" and produce much of the world's energy requirements. When "Strategic

Petroleum Production Reserve" comes on line; companies managing the facilities will repay the initial cost of the project. Remember, any money repaid to the government would come from the users of the energy. In the meantime we would all enjoy a price of energy based upon cost and reasonable profit, not monopoly force.

Today, a reasonable price to trigger the "Strategic Petroleum Production Reserve" production would be around \$22.50 a barrel with a \$2.50/barrel tax on imported oil. I may have guessed a trifle high on the trigger price.