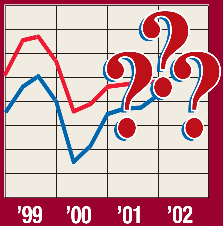

Major U.S. energy policy problems remain

George S. Littell, Partner, Groppe, Long & Littell, Houston

Basic flaws in the energy policy of the U.S. federal government became apparent in 2001. The outlook for 2002 is that they will become more troublesome.

It *did matter* who won the presidential election in November 2000. The Executive Order of May 18, 2001, states that:

> " . . . it is the policy of this administration that executive departments and agencies shall take appropriate actions *to the extent consistent with applicable law,* to expedite projects that will increase the production, transmission, or conservation of energy." (emphasis added)

As embodied in applicable law, energy policy has two basic elements: 1) Rely upon imports of crude oil and refined products for the supply of petroleum; and 2) Rely on natural gas as the fuel supply for new electrical generating capacity.

The important premises for the policy can be described as: 1) Other nations will be willing to increase production and invest in refining at low prices; and 2) The U.S. has a vast remaining resource of natural gas that can be produced at low prices. The appeal of these premises is that other policies—foreign affairs, improving the environment, saving the wilderness, etc.—can be pursued without conflict with energy policy. The problem is that neither premise is correct.

As time passes, it is becoming clearer that Venezuela's election of December 1998 was an important event in the history of the oil business. The policy of "growth and expansion" in this OPEC country was the central issue, and it was rejected. OPEC continues to have problems with controlling the price—due mostly to bad data and even worse forecasts—but the objective is firmly established. It is also becoming easier to achieve over time, as there is less competition from non-OPEC producing countries.

As non-OPEC output peaks and begins to decline, the industry's center of gravity continues to swing toward the Middle East. As it does, the vital interest of the U.S. is to assure access to oil in that region. At times, it seems that foreign policy is designed to exclude the U.S. from the region. Iraq, Iran and Syria are already actively hostile. The "war on terrorism" could easily achieve the same condition within Arabian Peninsula nations.

Twenty years ago, the Powerplant and Industrial Fuel Use Act—an important element of the Carter administration's energy plan—restricted the use of natural gas in new electrical generating plants. The ensuing expansion of plants to use coal and nuclear fission reduced the demand for gas faster than the supply of gas declined. Consequently, industry experienced the "take or pay" problems of the 1980s that finally convinced the government that regulating natural gas prices was poor policy—in practice, as well as in principle.

The theory that U.S. natural gas production can be increased indefinitely provided the justification for repealing the "take or pay" law in 1988. More than a decade later, gas production is still less than it was in 1973. This is true, despite a huge subsidy to producers from the tax credits for tight gas, coalbed methane, etc. If it were not for increased imports from Canada, the U.S. would have experienced high gas prices well before 2000.

The underlying trends in the natural gas market are increasing demand and reducing supply. Wide swings in gas prices are a consequence of deregulation—there is no OPEC in the gas business. Over time, they can be expected to occur around an average that keeps increasing, absent some change in the underlying trends.

It remains to be seen how much damage will be done before the premises for energy policy come under serious scrutiny. When such scrutiny occurs, reasonable energy policy may:

- Tax heavily the consumption of refined products, as do other industrialized countries
- Promote the use of nuclear fission to generate electricity.

Policies for the environment, land use, foreign affairs, etc., all have their defenders for reasons that do not consider energy. They will not be changed easily. Oil and gas producers, and the service industry, hope that they will not be changed at all.

Turmoil and confusion are helpful to my business, thus 2002 is shaping up to be a good year. It is possible that reason will prevail some day and make oil and gas prices a dull subject. I will bet against that happening any time soon. WO

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__George S. Littell__ has been a partner of the firm, Groppe, Long & Littell, since 1976. Over the last 20 years, this firm has accurately predicted price and supply & demand movements, including the sudden jump in crude prices to $20/bbl by mid-1999. Successor to a firm founded in 1955, Groppe, Long & Littell is based in Houston.