

High prices remain on the agenda

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Large increases in both oil and gas prices in 2002 were helpful to poor-but-honest analysts. We forecast more of the same in 2003.

As 2002 comes to an end, the U.S. federal government energy policy continues to have two basic elements:

- Rely on natural gas as the fuel supply for new plants to generate electricity.
- Rely upon imports of crude oil and refined products for the supply of oil.

The premise for the first element is that the U.S. has a large, remaining resource of natural gas that can be produced at low prices. It began during the “gas bubble” of the 1980s as gospel (good news) from Enron and the Bureau of Economic Geology.

Crude oil production in the U.S. reached its peak in 1970 and continues to decline. Peak production of natural gas was in 1973. The gas bubble was the result of reduced demand for gas—both from increased efficiency and from more use of coal and nuclear fission—rather than any increase in supply. Sluggish E&P activity is consistent with a premise that the remaining gas resource is small.

Federal officials will eventually conclude that a 30-Tcf/year gas market in the U.S. is not, and never was, a possibility. Energy policy has already resulted in the loss of much of the capacity to make ammonia and methanol in the U.S. With no change, olefins and petroleum refining are next on the list, to be followed by automobiles and other manufacturing.

Approval of a site for spent nuclear fuel in 2002 may, in retrospect, turn out to be the first step toward a new policy. An optimist can hope that 2003 will turn out to be the year that a nuclear reactor is ordered for a plant to be built in the U.S., most likely at Clinton, Illinois. It makes no sense that nuclear plants can be built and operated elsewhere in the world, but not in the U.S.

A premise for the second element of energy policy is that other nations will be willing to increase oil production and invest in refining at low prices. The appeal of such premises is that other policies—foreign affairs, saving the wilderness, etc.—can be pursued without conflict with energy policy.

Bush administration foreign policy has proven to feature uncritical, unlimited support for Israel. There is no war on terrorism, nor can there be. Terror is not mindless violence, but rather a means to an end.

Since it was created in 1948, Israel has survived three wars with its neighbors, with support from the U.S. Making the costs of U.S. support unacceptably high (as the costs of preserving the Republic of Vietnam came to be) is what the opponents of Israel have to do for their cause to prevail. The socialist/statist ideology of the Baath parties that rule Iraq and Syria has nothing in common with the Shia Muslim theocracy in the Islamic Republic of Iran, the Sunni Muslim theocracy established briefly in Afghanistan, or the monarchies of the Arabian Peninsula. Opposition to Israel is the only common ground for all states in the Middle East except Turkey, which considers itself part of Europe.

Iraq (rather than Iran) may be attacked, because it is weaker after

11 years of sanctions. Attacking Iraq will not end terrorism against the U.S., because Iraq is only one of the sources. If there is a war with Iraq, the important issue for oil markets is what follows—does the invading army leave or does it stay?

If that army leaves, there are two general possibilities. One is that Iran, Syria, and Turkey intervene and divide the territory. The other is a civil war that ends with a new party in control of the central government. Its leader may well be more able and ruthless than Saddam Hussein.

If that army stays, a stream of U.S. casualties can be expected. That has been the experience of U.S. troops in Lebanon, Saudi Arabia and Kuwait, as well as Israeli troops in Lebanon. Iraq's neighbors cannot expel the army any more than North Vietnam could do so in 1965-1975. It is just a far more accessible target than the U.S., itself.

Events may follow the script from 1991-92, with a war in Iraq followed by a new U.S. administration in 2004 amid a recession brought on by high oil and gas prices. The other possibility is that reason prevails, and pursuit of a compromise in the conflict over Israel begins. Either way, the Chinese curse, “May you live in interesting times,” applies.



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 has its offices in Houston.