LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

One of the more hotly debated issues today centers on the price of oil—why prices are so high and who is responsible. Many place the blame on large U.S. oil companies or on OPEC, while others claim it is the fault of speculators bidding up the price to generate profits for themselves. Since some speculators operate in the U.S., it has been fairly easy for Congress to hold hearings regarding their impact on the price of oil. There have been numerous calls to increase the margin requirement which would drive these *bad* speculators out of the market. People forget oil is not just traded in New York. It is traded in London, Dubai, and other places around the world. If margin requirements were increased in the U.S., speculators would simply trade in one of the other markets—so the whole idea of raising margin here is moot. Speculators do serve a purpose in the commodities markets, and we agree they can influence price—but only for a short period of time. Once it becomes clear that fundamentals don't warrant the current price of a commodity, producers will begin to sell the commodity into this artificially-inflated market and drive the price back down.

The impact U.S. oil companies have on the global price of oil can easily be discounted as they are not large enough—in a global context—to significantly affect the oil market. ExxonMobil, the largest U.S. oil company, is dwarfed by the foreign government-owned/sponsored monopolies in South America, Asia, and the Middle East. There is even a question as to Saudi Arabia and OPEC's ability to control prices to the extent they have in the past. Saudi Arabia claims it will be able to meet incremental demand for years to come. However, OPEC's estimate of reserves—over 250 billion barrels—has not changed for 20 years despite production of over 3 billion barrels per year and no new major fields being discovered since 1968.

Oil production is declining around the globe. Norway, Mexico, the U.K., and the U.S. have seen their collective production fall by 2.5 million barrels a day in less than 3 years. Prudhoe Bay peaked in 1989 at 1.5 million barrels per day and is now producing less than 300,000 barrels per day. Production at Mexico's Cantarell Field, the world's third-largest oil field, is falling at the fastest pace in 12 years while North Sea oil production peaked in 1999 and has declined by 1.2 million barrels per day in the last 3 years. Obviously, the production trend is not good and with little additional supply to show after 40 years of searching with the best technology available, one must wonder how—even in a stagnant global economy—energy prices could not help but remain high or even increase.

But as we all know, the global economy is far from stagnant. Economic growth of China and India has put a strain on resources world-wide. These two countries are estimated to consume 9.4 million barrels of oil per day, while producing only 4.5 million barrels. As for annual per capita consumption, China consumes 1.8 barrels per person and India consumes 1.0 per person. By contrast, the U.S. annually consumes 25.6 barrels per capita.

Since oil is priced in U.S. Dollars (USD) around the globe, any change in the relative value of the dollar to other currencies will have an impact on the dollar price of oil. From January 2000 to July 2008, the price of oil went from $22 per barrel to $142 per barrel—while the USD has declined by 38.5%. Simple math tells you that almost $55 of the price increase is due to the weakness of the USD. Oil today would be about $87 per barrel without the dollar impact. Obviously then, part of the blame for high oil prices should be placed on the weak USD.

In summary, it appears to us that the main cause for high oil prices has to do with supply and demand of the actual product and not from speculation or manipulation. The actual blame for high oil prices should be placed on (1) the demands of China, India, and other third world countries in the process of industrializing, and (2) U.S. consumers and their Congressmen in Washington D.C. The U.S. has not had an energy policy—other than one of cheap oil—for over 30 years. We have depended on other countries to supply us with oil, while failing to develop our own supplies from coastal waters and areas of Alaska. The U.K. and Japan consume no more oil than they did in 1973. Even Brazil began an energy policy of alternatives and conservation in the 1970s. Now that the dollar is weak and we must depend on others, we are paying high prices for our lack of vision. Unfortunately, we have no Plan B.

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