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Perspectives



Why Energy Prices Will Stay Firm: The New Realities

It's hard to find anybody who likes what's going on in the post 9/11 world. But some of the forces unleashed by radical Islam's challenge will actually be welcomed in Washington, Moscow and Europe's disgruntled capitals. I'm referring to energy, in particular.

Ever since the 1970s, the industrialized economies have been kept hostage to wildly gyrating oil prices and, consequently, to a handful of corrupt potentates which ran the Saudi Arabian peninsula and the Persian Gulf. They dictated when output should rise or be curtailed, and by doing so boosted or choked off the vibrancy of the West's economies. To prevent retaliation, they spent hundreds of millions on lobbying Western politicians and bought sophisticated arms, fleets of private planes and luxury liners from the industrialists. Only a fraction of the swelling oil revenues were expended on improving the lot of the Middle East's mushrooming population. The result: a vast unemployed and impoverished young generation that rightly resents both their rulers and the Western powers that danced with them.

Am I suggesting that the events in the Middle East will reduce oil prices? Unfortunately not: ongoing political instability in the region makes for an environment in which supply disruptions are a constant threat, while burgeoning economic growth in many developing nations keep pushing up demand. What I'm saying is that energy prices would have climbed far more dramatically than they have, thanks to 9/11.

Corrupt Arrangement

The corrupt arrangement between potentates and their Western clients has not only been challenged, but is on the way out. The reason for this goes beyond America's attempt to bring the Middle East firmly under its hegemony. To at least as large an extent, it has to do with the aspirations of the resource-rich former republics of the Soviet Union. Nothing could please Russia, Kazakhstan or Uzbekistan more than the weakening of OPEC as an energy power or, even better, its breakup.

The reason energy prices will over time stabilize and in inflation-adjusted terms even fall is that the US and those who strive for a position to become tomorrow's key energy suppliers, temporarily have the same interests. The fact that the United States has achieved control of Iraq and has, by doing so, dramatically curbed the power of OPEC, only accentuates this reality.

Even so, the path towards a more stable energy supply situation will not be steady. Several issues could quickly unsettle the current supply-demand equilibrium and send oil and natural gas prices heavenward:

-Supply disruptions could at any time occur due to Al Qaida's bid to challenge US supremacy of the Middle East. It's not coincidental that several Western nations have once again placed Saudi Arabia on the list of countries too dangerous to visit. Strikes against oil installations throughout the region remain a key concern.

-Venezuela, the second largest supplier of oil to the United States, is in considerable turmoil. The current restructuring of the country's national oil company by Hugo Chavez will cause permanent damage to its standing as a reliable producer. That, together with Chavez's sympathy and overt support for Colombia's FARC rebel movement, raises the possibility of a reaction by internal forces, or Washington, or both.

-The nations leading the charge to displace OPEC as a meaningful energy cartel are themselves on an unstable trajectory. Russia, in particular, needs to overcome infighting between the nation's political establishment and its oligarchs, presumably through the introduction of unassailably solid property legislation. Before this can happen, the country will be unable to attract the tens of billions which are needed to bring its vast resources into production.

Unsavory and Volatile Mix

These factors make for an unsavory and volatile mix, which should keep energy prices firmly supported. At the same time, China and other Asian nations keep demanding an ever larger share of world oil supplies—all while the mainstream economies are finally growing and, by doing so, adding to demand as well.

It's not that long ago that the world expected America's invasion of Iraq to cause oil prices to collapse. So much for that! ☐

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