

The Drill

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ENERGY INDEPENDENCE

The good, the bad and the ugly

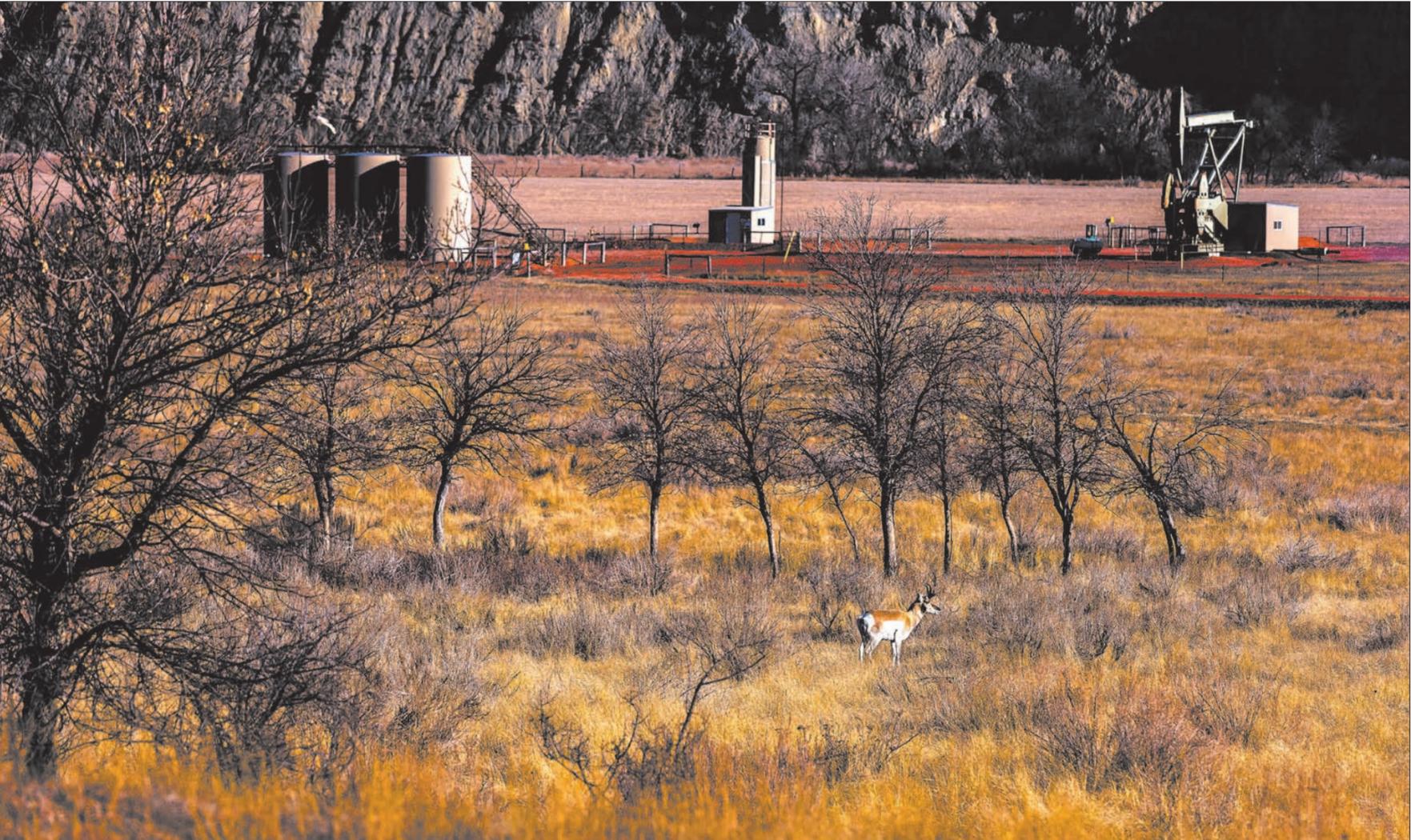


Photo by Jason Hallmark

An antelope stands in the North Dakota Badlands not far from an oil well site 18 to 25 miles north of Medora.

TORONTO — As some apparently inexplicable behavior illustrates (say, being a die-hard fan of the Chicago Cubs), humans are profoundly territorial creatures.

According to evolutionary psychologists, this is because for approximately 90 percent of their time on this planet, modern humans belonged to small groups that were constantly fighting each other over the possession of land and resources. Deep down, most people's behavior is not all that different from that observed on Animal Planet's "Meerkat Manor."

As recent events in the Ukraine remind us, sometimes the other tribe is still out there to get us. By and large, however, Harvard psychologist Steven Pinker demonstrates in his book "The Better Angels of our Nature" that we are living "in the most peaceful time in our species' existence," a relatively blessed state of affairs made possible through ever greater international trade and the worldwide exchange of ideas and culture over the last few centuries.

More than two centuries before Pinker, the French philosopher Montesquieu had similarly observed: "Commerce is a cure for the most destructive prejudices; for it is almost a general rule, that wherever we find agreeable manners, there commerce flourishes; and that wherever there is commerce, there we meet with agreeable manners. ... Peace is the natural effect of trade."

In the immortal words of another French thinker of the time, Voltaire: "Go into the (Stock) Exchange in London, that place more venerable than many a court, and you will see representatives of all the nations assembled there for the profit of mankind. There the Jew, the Mahometan and the Christian deal with one another as if they were of the same religion, and reserve the name of infidel for those who go bankrupt."

Unfortunately, at the first sign of political and economic trouble most people are spontaneously inclined to put the brakes on international trade and to increase local production of critical things such as food and energy. This stance often has dire consequences. As the old saying goes, if goods don't cross borders, armies eventually will.

Less dramatically though, these policies typically deliver lower standards of living (after all, no one would bother moving good over long distances if they did not provide better and cheaper alternatives to local productions) and greater insecurity (for instance, promoting "food security" through increased local production essentially amounts to putting more of our agricultural eggs in one regional basket, a recipe for disaster when droughts, floods and other unavoidable natural calamities strike).

Energy security is no different. Policies in this respect typically involve a combination of reduced dependence on any one foreign supplier by increasing their number, ramping up domestic production and reducing overall demand through energy conserva-



By Pierre Derochers and Hiroko Shimtzu
For The Drill

tion measures. While none of these things are inherently bad when they occur spontaneously (such as when new profitable local energy sources are developed), they are counterproductive when they occur solely as a result of government subsidies, mandates or barriers to trade, as the history of U.S. energy markets abundantly illustrates.

More than a century ago, the U.S. was the most important oil producer in the world with significant drilling operations in regions such as the Midwest, Texas and California. The country's only serious global rival back then was Russia whose large oilfields around the Caspian Sea — in what is now Azerbaijan — had been developed largely at the instigation of Robert and Ludvig Nobel, brothers of the better-known Alfred (of Nobel Prizes fame).

In later decades though, the rapid development of the American economy and the discovery of gigantic petroleum reserves in the Middle East, Venezuela, Canada and other places turned the U.S. into a net importer.

Greater dependence on foreign imports was not problematic until the energy crisis of the early 1970s that prompted President Richard Nixon to launch the Project Independence, the goal of which was to make the U.S. self-sufficient. Similar policies were later embraced by many politicians. As many readers know, one of the main goals of the Obama administration was to create millions of well-paid, abundant, stable, unionized (with full benefits), healthy, environmentally beneficial and geographically dispersed "green jobs" in everything from electric cars to wind turbines. Unfortunately, overturning the laws of physics and economics proved more challenging than herding free-range and grass-fed

unicorns. Try as they might, no visionary policymaker found a way to convert the green job Kool-Aid into an affordable, convenient and reliable energy drink.

But while green schemes were falling apart, production of the much-maligned hydrocarbons soared to such an extent that, according to the U.S. Energy Information Administration, American crude oil imports peaked in 2005, while in 2013 the country became the world's top producer of petroleum and natural gas, surpassing Saudi Arabia and Russia. Of course, the sheer size of the U.S. economy means that its petroleum consumption still depends for about 40 percent on imports of crude oil and petroleum products, but BP's Energy Outlook now forecasts that the U.S. will produce 101 percent of its energy needs by 2035, making the country de facto energy independent.

While such forecasts should be taken with a grain of salt, the possibility of an energy "Independence Day" is now, for the first time in several decades, eminently plausible. This type of self-sufficiency is desirable, for it rests on superior local alternatives to those that the rest of the world could provide.

If history is any guide, however, something completely unexpected could emerge in energy markets in the coming two decades and foreign alternatives might again become more desirable. If that was the case, the U.S. would be ill advised to cling to less desirable local alternatives. As was the case before the fracking boom, energy security would be best achieved not by reducing the physical volume of imported oil, but by diversifying supplies and letting creative people in the private sector come up with better alternatives.

Risk Management 101 tells us to diversify our investment portfolio. The same is true from the perspective of energy consumers and national governments. If energy security is the goal, then strengthening energy interdependence the world over is the way to achieve it. The more suppliers you depend on, the more secure you will be. As Andy Grove put it, out true goal should be energy resilience through adaptability and substitutability. In fact, resilience is one of the best features of market processes as individual buyers and sellers can adapt, each in their own way, to changes in supply and demand conditions conveyed through market prices.

World markets not only deliver cheaper and better goods, but they also make countries and consumers more secure and resilient. Now, as in the past, for most of the world more energy security means less energy independence. The US is now in the unique position of benefitting from a significant local energy boom and should enjoy it while it lasts. But this should not detract from this greater truth.

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FEATURED WESTERN NORTH DAKOTA AUCTIONS

HOME AUCTIONS - 8 Newly Constructed Homes - Minot, ND

June 25, 2014 - 1:00 p.m. (CT)

Location: On-Site: 3000 11th St. NW - Minot, ND
(Inclement Weather Location: International Inn - Minot, ND)

Newly constructed houses ranging in size from 1,136 to 2,165 Sq. ft. with different floor plans all located in the rapidly expanding NW area of Minot, ND. Homes all have easy access to Hwy 83 and Burdick Expressway. All homes are subject to prior sale. Contact Pifer's for more information or view all information at www.pifers.com!

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