



**FUNDAMENTAL FACTS REGARDING OIL**

First , oil ( petroleum ) is a non – renewable natural resource . All natural resources are scarce and non – renewable natural resources even more so . For example , trees are a natural resource , but when harvested they can be replaced . Oil can not be replaced .

Second , oil is the most used energy production resource .

Third , oil must be refined ( processed ) to be useful . Oil is used to make gasoline and many other products .

Fourth , the United States has not built a new refinery to process oil in over 40 years . The supply stream of gasoline and other oil based fuel products has been , and will remain , very tight . Any disruptions to the supply stream ( due to natural disasters like hurricanes or potential global conflicts / wars ) will cause a shortage and the price of the fuel products to rise rapidly .



Fifth , EVERY product or service that a United States consumer purchases is dependant on oil based products to get into the hands of the consumer . One example to illustrate this , everything that is used to transport a product to its point of sale ( trucks , airplanes , ships , etc . ) uses oil based products to get it there .

Sixth , the overwhelming majority ( 70 % ) of the world’s oil reserves are located in the Middle East .

Seventh , production of oil ( pumping it out of the ground ) is geometrically less expensive in the Middle East than in other parts of the world .

Eight , the overwhelming majority of the oil that is produced is NOT produced by the oil companies that you may be familiar with ; Exxon Mobil , Chevron , Shell , etc. The majority of the oil is produced by governments of countries . In addition , these governments are not democratic governments . They are totalitarian governments either in the form of monarchies or dictatorships . These governments have also formed an organization , called a cartel ( we discuss these further in chapter eight ) , under which they cooperate to control production and prices ( this type of organization is illegal in the United States ) . The name of the cartel is the Organization of Petroleum Exporting Countries ( OPEC ) . The oil companies buy the oil from OPEC , refine / process it into various products ( see the chart above ) , and sell it to distributors / retailers ( most gasoline stations are franchises – more about how franchises work in chapters eight and nine ) .

## *BASIC ECONOMICS AND GEOPOLITICAL FACTS*

*Prior to the early 1990's , over two thirds of the world's population lived under a communist or socialist economic system .*

*History has shown by statistical fact that communist and socialist economic systems are both less productive ( in terms of output ) and efficient ( in terms of costs ) than a capitalist system .*

*History has shown that during the 1900's , nations that were based on capitalist economic systems achieved the highest standards of living , highest levels of growth , and highest levels of productivity .*

*Based on the indisputable fact that a capitalist economic system is a more productive and efficient economic system , it will consume more energy resources to produce goods and services . Socialist and communist systems will not consume as much and will waste energy resources .*

*In the 1990's the most populous countries in the world began their switch from communism or socialism to capitalism . The effects have been dramatic . For example , over the last 19 years the world has seen the greatest increase in the overall global standard of living than any other time in recorded history . In putting capitalism in place over the past 19 years these former communist and socialist countries have jumped to top of charts in annual growth and now rival older capitalist societies in terms of productivity .*

*Now with over 98 % of the world's population working within a capitalist economic system , the demand for energy ( oil ) to fuel the system has skyrocketed . The demand has been growing , and will continue to grow , exponentially ( " rule of 70 " ) .*

## *SUPPLY AND DEMAND AS IT RELATES TO OIL*

*All resources , and therefore goods , are scarce . Oil , being a non – renewable natural resource is very scarce .*

*The value we assign to resources and goods depends on its utility ( usefulness ) to us . The more important the utility , the more valuable the resource or good is to us .*

*As long as there is an abundant supply ( enough for everyone's purposes ) of a valuable resource or good , then there is no real competition to acquire the resource or good . As a result , the price of the resource or good will remain low . However , if there is not an abundant supply , competition for the valued resource will arise . This competition will generally take two forms , competition using force ( war ) , or by willingness to pay ( bidding on price ) .*

*No modern society can survive , for the foreseeable future , without oil . It is a true need , a must have to survive . The supply of oil is limited and well identified . The demand ( competition ) for oil is now going through the roof . Simple equation > limited and declining supply of a critical resource + rapidly rising demand for the critical resource = ↑ prices ( or conflict = why we continually have conflict in the Middle East - By the way , it is not about religion , its about who controls the most valuable resource in the world ) .*

## MISTAKES MADE BY THE UNITED STATES

*With the collapse of socialism and communism it was very clear to the educated person , or the person who has an interest in what is going on in the world , that the demand for oil would skyrocket . It has , and the price of a barrel of oil has been on a steady climb since .*

*Common sense dictated that our government public policy should have been to encourage investments in renewable alternative energy sources and to increase our refining capacity in the short term . We still have not done this . Why ? Our politicians have been exploiting the ignorant public for their personal purposes .*

*Let me start with the action that would have helped in the short term , increasing refining capacity . In the short term if we could refine more oil ( assuming that OPEC would also increase production to match our demand requests ) , we would be able to increase the supply of the oil based products in the short term and keep the prices down . However , understand that this is not a viable long term solution . Nothing changes the fact that the amount of oil will rapidly continue to decrease and the demand for it rapidly continue to increase .*

*Why haven't we built any new refineries ? The reason is that it has not been in the interests of our politicians . Here is how it works . First , understand that the politician , like anyone , wants to keep their job and will do close to anything legal ( many also do the illegal ) to keep it . Unfortunately the American public has not held the politicians accountable to also do what is in the best interest of our country . Why has the public not done this ? Many believe it is the result of the complacency we have developed enjoying the highest standard of living in the world ( possibly also a result of the creeping expansion of our welfare state ? ) . Many also believe that it is a result of an ignorance of basic economic concepts and geopolitical issues that has developed among the public ( possibly as a result of our rising high school drop out / failure rates ? ) .*

*Secondly , consider the situation that the politician is faced with . No community in the United States wants a nasty looking refinery in its backyard . Despite the economic benefits ( lower fuel prices in the short term , new jobs , etc. ) , our citizens regularly tell the politician that if they vote to permit a refinery to be placed near their homes ( environmental laws and regulations require the politicians involvement ) , they will vote them out of office . As a result , no political office holder has had the courage to champion this cause .*

*What about the long term ? Why hasn't the government encouraged investments to help us transition to some renewable energy source for our most used fuels ? Is there a practical renewable energy source that could be used ?*

*Yes , for ground transportation fuels , there are two alternative technologies that could have been developed a long time ago . One is battery power and the other is cellulosic ethanol ( made from organic waste ) . Why wouldn't our political leaders have encouraged investment in these technologies ? Because the oil companies , whose business is threatened by these other fuel sources , have made sure the politicians do not support the technologies to develop these . They have done this by contributing large sums of money to the politicians' election campaigns ( the classic " quid pro quo " ) .*

*By the way , battery power works . Just check out what Project Better Place is doing in Israel , Holland , and now Hawaii . Project Better Place is a start up company that has raised the most venture capital of any start up company in history . <http://www.betterplace.com>*

*As for ethanol , note that I said cellulosic ethanol which is made from organic waste . What about making it from corn or other agricultural products ? Making it from the corn or other agricultural products would be a major blunder . And it is a blunder that our political leaders seem very interested in making . To understand this all you need to do is watch a short subject video presented by Reason TV at the following site - <http://reason.tv/video/show/462.html>*

#### *WHY DID THE PRICE OF GASOLINE FLUCTUATE SO WILDLY IN 2008 ?*

*Yes , we saw wild swings in the price of gasoline during 2008 . However , do not get too comfortable with \$ 1.80 per gallon prices . The facts about oil have not changed . It is still a scare , non – renewable resource and the long term supply of it decreases every day . No country is turning to communism and the global demand for oil is going to continue to increase . It took the United States over 200 years to reach the consumption levels we are at today and we have only 15 % of the population size of China and India individually . Once they get all their population involved in their new capitalist economies their demand for oil will have increased exponentially .*

*OPEC believes that a fair price for a barrel of oil , based on normal current global demand levels , should be between \$ 90. and \$ 100. This would roughly make the price of gasoline to be about \$ 2.40 and \$ 2.75 a gallon .*

*The over \$ 4.00 per gallon gasoline pricing we saw in 2008 was caused by speculators driving up the price of oil to the \$ 150. per barrel level late in 2007 and early in 2008 . The speculation was driven by three things ; a couple of years of “ white hot ” exponential growth by the Chinese and Indian economies , fears over supply disruption based on potential expanded military conflicts in the Middle East , and expectations for continued supply disruptions based on bad hurricane seasons in North America .*

*During the first four months of 2008 the United States and the European Union managed to convince OPEC to increase production to help lower the price of oil . This did not cause , but set the stage for the huge drop in prices that we saw by year end .*

*The wild swing down to the \$ 1.50 per gallon gasoline pricing , based on a \$ 45. barrel of oil , by late in the year was the result of a “ perfect storm ” . Since the summer , record levels of oil were being supplied to the market in an effort to bring down pricing . This worked as the price of a barrel of oil began the decline to OPEC’s target level . However, by mid - Fall there was a panic over potential damage to the global economy due to the crash of the financial markets and a number of important industries ( automobiles for example ) in the United States . The panic brought global economic growth and production to a halt and this began to drive up the unemployment rate. The panic was so bad that many people were talking about a depression .*

*As business activity slowed down , and unemployment rose , the worldwide demand for oil naturally declined a bit ( 6 % to be exact ) . Now oil companies had much more oil than was previously being consumed and the price of a barrel of oil began to fall below OPEC’s target price . Therefore , by November in an effort to flush out the over supply and eventually stabilize / raise price for the longer term , the oil companies lowered the price of a gallon of gasoline and OPEC began to cut back production . This is why gasoline prices are going back up here in January 2009 . How fast gasoline prices will go up to reflect OPEC’s targeted level for a barrel will generally depend on*

*how fast a global economic recovery takes place ( assuming no outside factors such as wars , natural disasters , etc. ) .*