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Energy Independence: Obama Embraces the Department of Nutty Ideas

By Steve H. Hanke
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Ed. note: Steve H. Hanke, our newest contributor, is a Professor of Applied Economics and Co-Director of the Institute for Applied Economics and the Study of Business Enterprise at The Johns Hopkins University in Baltimore; a Senior Fellow at the Cato Institute in Washington, D.C.; a Distinguished Professor at the Universitas Pelita Harapan in Jakarta, Indonesia; a Senior Advisor at the Renmin University of China's International Monetary Research Institute in Beijing; a member of the National Bank of Kuwait's International Advisory Board (chaired by Sir John Major); a member of the Financial Advisory Council of the United Arab Emirates; and a columnist at Forbes magazine.

In the past, Prof. Hanke taught economics at the Colorado School of Mines and the University of California at Berkeley. He served as a Senior Economist on President Reagan's Council of Economic Advisers in 1981-82; as a State Counselor to the Republic of Lithuania in 1994-1996 and to the Republic of Montenegro in 1999-2003; and as an Advisor to the Presidents of Bulgaria in 1997-2002, Venezuela in 1995-96 and Indonesia in 1998. He played an important role in establishing new currency regimes in Argentina, Estonia, Bulgaria, Bosnia-Herzegovina, Ecuador, Lithuania and Montenegro. He has also advised the governments of many other countries, including Albania, Kazakhstan and Yugoslavia. In 1998, he was named one of the twenty-five most influential people in the world by World Trade Magazine.

Dr. Hanke is a well-known currency and commodity trader. Currently he serves as Chairman of the Richmond Group Fund Co., Ltd., a global macro hedge fund located in Richmond, Virginia. He is also Chairman Emeritus of the Friedberg Mercantile Group, Inc. in Toronto. During the 1990s, he served as President of Toronto Trust Argentina in Buenos Aires, the world's best-performing emerging market mutual fund in 1995. Prof. Hanke's most recent books are Zimbabwe: Hyperinflation to Growth and A Blueprint for a Safe, Sound Georgian Lari. Dr. Hanke and his wife, Liliane, reside in Baltimore and Paris.

Every president since Richard Nixon has asserted that we are sitting ducks for those who brandish the oil weapon. To keep the evildoers at bay, the government must adopt policies that ensure our energy independence. Like his predecessors, President Obama is worshiping at this altar. And why not? How many elections have been lost by blaming foreigners for an impending crisis?

Despite their cynicism about politicians, most people actually believe that mineral resources, including oil, are doomed to disappear. It's obvious: Start with a given stock of provisions in the cupboard, subtract consumption and eventually the cupboard will be bare.

But what is obvious is often wrong. We never run out of minerals. At some point it just costs too much to produce them profitably. In the 19th century, the big energy scare was in Europe. Most thought Europe was running out of coal. That doomsday scenario never materialized. Thanks to a plethora of substitutes, the prices that European coal could fetch today are far below its development and extraction costs. Consequently, Europe sits on top of billions of tons of worthless coal.

Once economics enters the picture, the notion of fixed reserves becomes meaningless. Reserves are not fixed. Proven oil reserves, for example, represent a warehouse inventory of the expected cumulative profitable output, not a fixed stock of oil thought to be in the

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ground.

When thinking about oil reserves, we must also acknowledge another economic reality: Oil is sold in a world market in which every barrel, regardless of its source, competes with every other barrel. Think globally, not locally. When we do, the dwindling reserves dogma becomes nonsense. In 1971, the world's proven oil reserves were 612 billion barrels. Since then the world has produced approximately 990 billion barrels. We should have run out of reserves fourteen years ago, but we didn't. In fact, today's proven reserves are 1,354 billion barrels, or 742 billion barrels more than in 1971.

How could this be? Thanks to improved exploration and development techniques, costs have declined, investments have been made and reserves have been created. The sky is not falling.

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