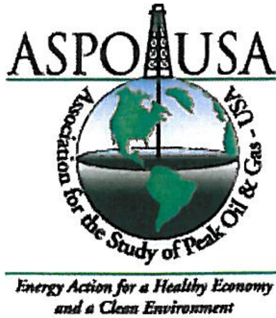

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Commentary: Peak Oil and the Current Economic Opportunity

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(Note: Commentaries do not necessarily represent ASPO-USA's positions; they are personal statements and observations by informed commentators)

The run-up to Peak Oil was a major factor in the current economic crisis, and the changes emerging from the crisis may help us deal better with the challenges of the coming decade.

The financial problems that emerged in the summer of 2007 led to the collapse of Baer Sterns in March, the nationalization of Fannie Mae and Freddie Mac, and a cascade of subsequent events, policies, and impacts that continues as this is being written. The nature of the crisis started from the fact that the large financial institutions – banks, hedge funds, pension funds, and such – have created and used a lot of securities that are either mispriced or hard to value. They've taken a lot of home loans that are "sub-prime" (the borrowers had little income or wealth compared to the loan size; there was too much loan-to-value; future payments would be beyond the borrowers' ability to pay, etc), put them together into large packages (mortgage-backed securities, or MBS), secured high ratings for the bonds (higher than the component loans justified), and sold them to domestic and foreign lenders/investors looking for high, secure yields. At the same time, another industry was created selling "insurance" on whether these or other loans might default, and the resulting "credit default swaps" were unregulated. As long as the system worked, it worked well – as long as we kept clapping, Tinkerbell lived. The models used by the regulators, the rating agencies, and the borrowers and lenders assumed that the past records of defaults would continue. The old patterns failed, and now no one knows how much anything is worth or how big the losses will be.

Yet while all these financial instruments were being created, there were plenty of voices pointing out that American home prices would peak in 2005 or so, and that the quality of loans was declining rapidly. According to the October 15, 2008, Washington Post, sub-prime mortgages made up 8.0 to 8.6% of all mortgages from 2001 to 2003, but 18.5 to 20.1% from 2004 to 2006. The dollar value of subprime MBS rose from $121 billion in 2002 to $401 billion in 2004 and about $500 billion in 2005 and 2006. Why the big jump in junk?

The US balance of payments deficit has grown rapidly during this decade, and one of the big drivers of that has been the rising cost of imported oil and other petroleum products. In 2002 we spent $102 billion importing oil, but that figure rose to $300 billion in 2006, and to $328 billion last year. Those imports (along with Jim Kunstler's salad shooters and all the other things we buy) had to be financed, to the tune of $2 billion a day by last year. We convinced the Chinese, Japanese, and many others that our MBS were safe because they were sorta guaranteed (wink, wink) by Freddie Mac and Fannie Mae. We needed the oil, so we needed product to sell to finance our "addiction." Our suppliers wanted bonds, the government deficit wasn't large enough, so we created an endless supply of MBS to sell. Nobody – the government, the American people, the Wall Street crowd, mortgage brokers, home builders – wanted to take away the punch bowl, or look too closely at what was being produced. Rising oil import volumes multiplied by rising prices contributed to the crisis we are now experiencing.

Those who understand the Peak Oil concept anticipate that the aftermath of the current peak (whether that occurred globally in 2005 or will happen in a few more years doesn't matter much) will be long-term pressure on the productive capacity of our economy, both from high prices and absolute supply constraints. The climate crisis is equally imminent, since many believe that current greenhouse gas levels are already high enough for major impacts. Mitigation efforts for both aspects of the energy crisis should have begun in earnest years ago. We hope it is not too late.

The acute nature of the current financial crisis, and the radical responses so far, actually give me three reasons for optimism in the energy area.

First, Americans (and people in other energy-intensive areas) have just experienced a real "shock and awe" event that has shaken their confidence to the core. If the earlier bail-outs had worked before the stock market collapsed, the problems would have been attributed to technical issues nobody understands, or simply to "Wall Street greed," much like the Enron collapse of several years ago. Now we have experienced the sharpest one-year drop from a market high in history (worse than 1929-30), the worst week ever, and retirement plans have lost a third or more of their values. The costs of easy credit, easy living, loose regulation, and investment speculation have been talked about forever, but now they've hit us in the gut. We're angry, scared, and more ready to change than ever before.

Second, I assume that the steps that have been taken will solve the credit and liquidity emergency that threatens to bring down the global economy, or that we'll keep trying until we solve it. Catastrophe has been avoided (I hope), but the US and Europe still face a nasty recession, according to the experts, possibly the worst one since the 1970's, or even since the 1930's. The silver lining in that cloud is that energy use should decline, giving us more energy resources to work with later. The post-peak decline curve will be shallower than if we hit Peak Oil at full speed.

Third, we have begun a radical restructuring of the global financial system. The days of free-wheeling high-leveraged investment banks and hedge funds are over. This led to high incomes for some, but a breath-taking destruction of investment capital we are still trying to measure. With tight resources and lots to do in the decade ahead, we have neither the time nor money to waste on "creative finance." The government may not sit in the banks' board rooms, but Congressional oversight will help guard against the abuse of the public's investment.

The challenge of running a partially-socialized finance system is huge, and the track record is not good. However, we have the opportunity to change rules and incentives to encourage longer-term outlooks and more responsibility. We can restore an understanding of the value of social investments on a par with private investments. Our community can work to figure out ways to include depletion, emissions, and life-cycle resource requirements into pricing decisions. These changes make it possible that individual and collective capital decisions will increase for the kind of efforts that we hear about at the ASPO conferences and read about in the many books, articles, and blogs on the energy and climate challenges.

In the Twentieth Century we finally figured out how to create a system to maximize the exploitation of cheap resources, through loosely-regulated multi-national corporations. Unfortunately, we perfected the system just as the cheap resources were disappearing. We do not have a model for how to optimize the use of scarce resources in a non-growing economy. The current crisis creates the opportunity and the incentives to begin addressing that problem.

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