Economic Crisis Requires Emergency Government Intervention

Testimony to the City Council of Boston Committee on State and Federal Government Relations Hearing, Dec. 4, 2000, by John Hoefle, Economics Staff, Executive Intelligence Review, *in support of: Resolution on Emergency Governmental Action To Reduce Oil and Natural Gas Prices.*

The resolution now before the City Council is essential to protect the general welfare of the citizens of the City of Boston, the State of Massachusetts and the United States. Without prompt action to reverse the takeover of heating oil, natural gas, and electricity supplies by speculators who charge whatever the market will bear, many people will find the cost of heating their homes prohibitive, and some will die. Energy is not an optional commodity, but a necessity of human life, an essential element of the infrastructure required to support human life. There is no need for anyone to freeze in the dark.

No 'Supply and Demand' Problem

The first point which must be understood is that there is no shortage of oil; there is plenty of oil in the ground and plenty of oil being produced. The price of oil has tripled over the last two years, even though the volume of oil produced has been rising.

If a shortage of crude oil is not driving up prices, what is? To answer this, one must look at the changing nature of the energy business, with spot-market price speculation replacing long-term contracts, combined with a dangerous consolidation in the industry. This process is not limited to the energy markets, either; similar consolidation is under way among commodity producers, and the privatization of other infrastructure areas such as water and sewer, is also increasing.

What is driving this change is the ongoing collapse of the global financial system. Especially since the near meltdown of the global financial system in 1998, the financial sharks have been looking for ways to get their hands on the income streams of ordinary people to keep their bubble afloat. The idea is to get a piece of each monthly electric bill, each heating oil bill, each water bill, by inserting themselves as middlemen between the producers and the consumers. That is the essence of deregulation.

Speculation and Consolidation

There has been a gigantic increase in speculative trading in crude oil futures contracts, on the New York Mercantile Exchange (NYMEX), and on the International Petroleum Exchange (IPE) in London. At present, a single contract for West Texas Crude trades 15 times, before it expires. Think of it this way: Over the last two years, for every new barrel of oil that was pumped onto the market, 325 new *paper barrels* of oil were traded.

What about the actual refining, distribution, and sales? A handful of integrated companies, and a small number of others, now dominate the oil and gas sectors, far more than in the famous days of the "Seven Sisters." In 1998, there were the mega-mergers: British Petroleum bought Amoco (and later bought Arco); then, Exxon merged with Mobil, and France's Total with Belgium's Petrofina (and later Elf Aquitaine), creating a new class of giant oil companies. Throw in Royal Dutch Shell and the merging of Chevron and Texaco, and you have a higher degree of concentration in the oil industry than ever before. Look at the relationship between the price of oil and the timing of the mergers: The price was driven down, causing a shakeout in the industry; then came the mergers, and the prices soared. Does anyone believe this is a coincidence?

The financial and political interests represented in this concentration of power, have seen to it in recent decades, that less domestic oil has been produced; the refinery base of the United States has been reduced, and in other respects, the nation has become more and more energy-insecure. This has just been "good business practice," in the view of those positioned to make a killing off control and speculation.

Crude oil refining capacity in the United States is now lower than it was in the 1970s. This artificial reduction in capacity is the excuse given for today's shortages of gasoline and heating oil. U.S. oil refinery utilization is up near 97%. This means that there is no reserve safety margin, which should be at least 15%.

Deregulation

The key policy shift which allowed this insanity to take place, was the implementation of Federal and state *deregulation* in energy, in recent years, along with *globalization*. The oil mega-mergers were all rubber-stamped by the Federal

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government. Why? You were told it was to "improve competition," or "lower prices to the consumer," or some other hoax. In fact, look at the BP-Amoco example. Their profits were up 94% in the third quarter this year over last. That's the point.

The story is the same for natural gas, and for electricity and other commodities. To date, some 25 states have so far fallen victim to some form of the deregulation swindle.

In this context, look at the Strategic Petroleum Reserve issue. When, this Fall, some oil was released onto the "markets" from the Reserve, intended to help the heating oil supply for New England, more fuel oil instead went to Europe. Under the deregulated, speculative markets, it got a better price there. Better for whom?

The names and pedigree of the political and financial interests benefitting from the rigged markets, are identifiable. *EIR* has provided extensive documentation in the last six months. For here, suffice it to say that networks include, besides the well-known oil conglomerates: Enron in Texas, Duke Energy of North Carolina, and a network of others—all interconnecting with London-centered international financing. Right now, Enron executive Kenneth Lay is being mooted by the Bush transition team for Energy or Treasury Secretary. Gore's backers intersect the same interests.

Hyperinflation

In fact, the hyperinflation we are seeing in oil and gas, and also electricity, characterizes all essential commodities, and relates to the fact that in the domestic and international economy, basic economic activity has been parasitized by cancerous speculation and consolidation of ownership.

Figure 1 shows various kinds of energy price inflation. **Figure 2** shows the double-digit jump in residential electricity prices in California—the leading energy deregulation state. **Figure 3** shows, as of early Fall, the double-digit inflation in all kinds of commodities—metals, chemicals, fertilizers, etc.

The next figures demonstrate the fact that in the world "casino economy," the bubbles of speculation have reached the point of bursting.

The Nasdaq Composite (**Figure 4**) is now down about 50% from its peak, and shows every indication of heading lower, as the Internet mania disintegrates and the dot-coms reveal themselves to be dot-bombs. This one is not coming back. The price/earnings ratios are still, despite the drop, unsustainably high, and the phrase "down 90% from its peak" has become common when discussing the dot-coms.

Figure 5 shows the growth of derivatives. This is the mother of all bubbles, dwarfing the stock and bond markets in its ability to amplify millions of dollars of losses in one market, into trillions of dollars of losses across the board. Long Term Capital Management was the largest derivatives disaster to become public to date, but it won't be the last. The derivatives market is a ticking bomb. Compare its growth to the level of world trade in goods and the gross world product.

FIGURE 1

Energy Prices Take Off

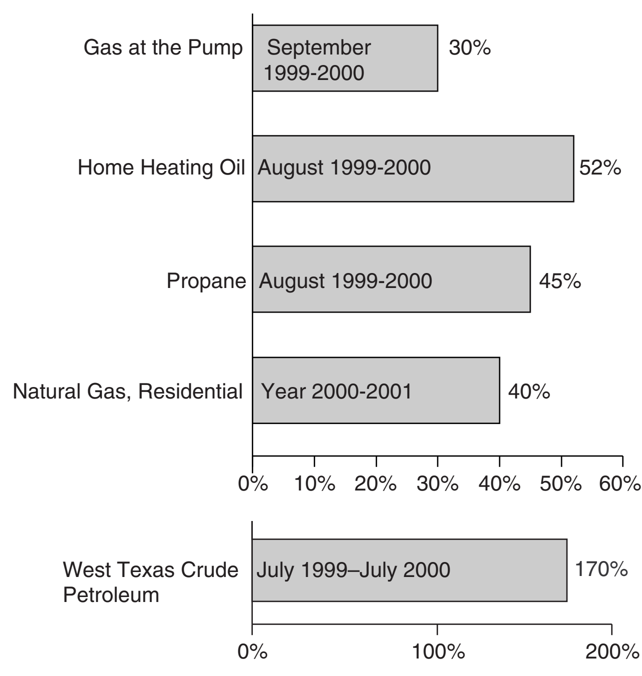
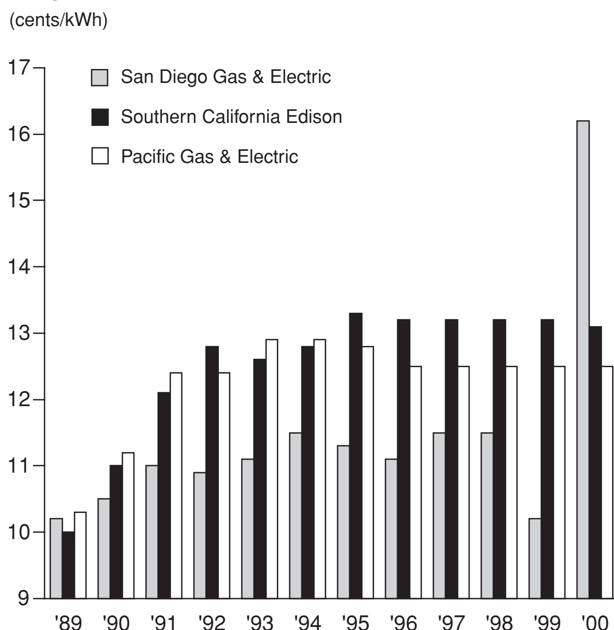


FIGURE 2

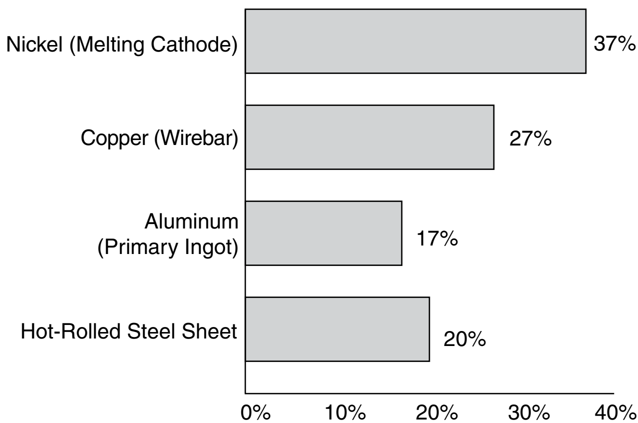
California Residential Electricity Rates, July 2000



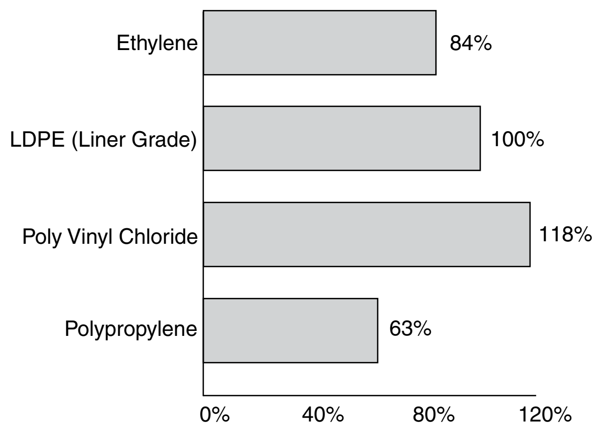
Source: California Electricity Options and Challenges, Report to the Governor, August 2000.

FIGURE 3
U.S. Price Inflation Is 3.5%?

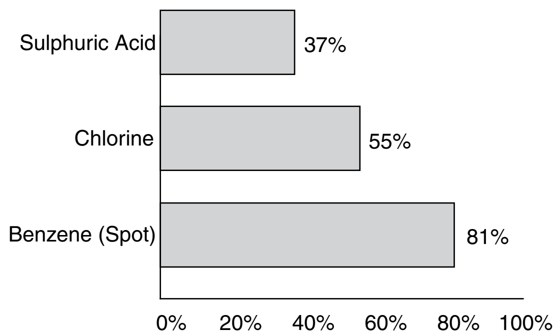
Metals Inflation Surges, May 1999 to May 2000



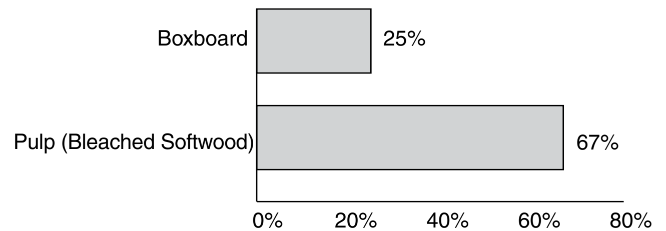
Plastics Inflation Surges, May 1999 to May 2000



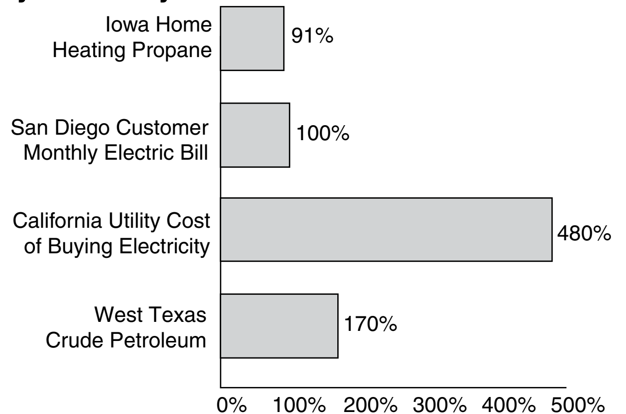
Chemicals Inflation Surges, May 1999 to May 2000



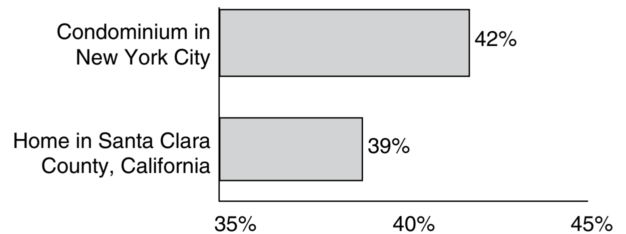
Pulp, Paper Inflation Surges, May 1999 to May 2000



Energy Price Inflation Surges July 1999-July 2000



Housing Price Inflation Surges, 2nd Quarter 1999-2nd Quarter 2000



Agricultural Inputs: Fertilizer Price Surges, May 2000-June 2000

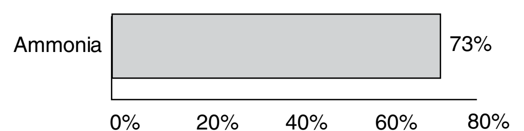


FIGURE 4
Nasdaq Composite

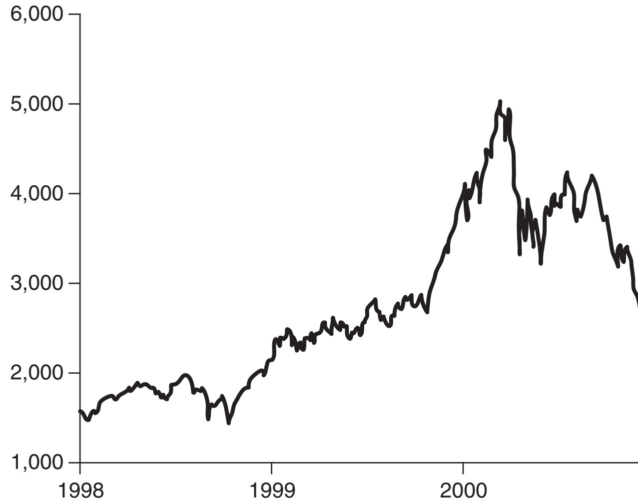
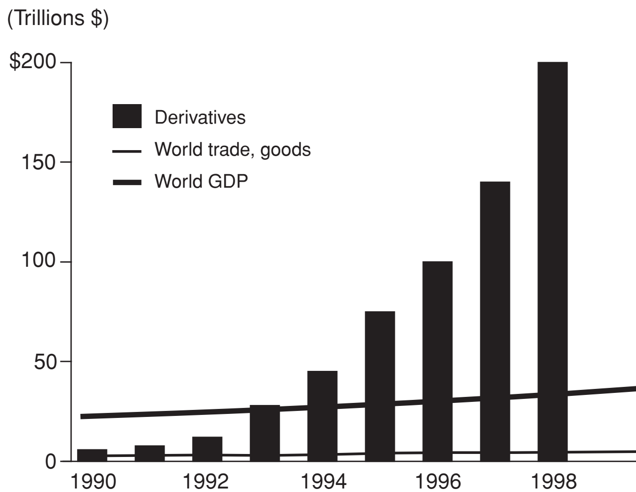
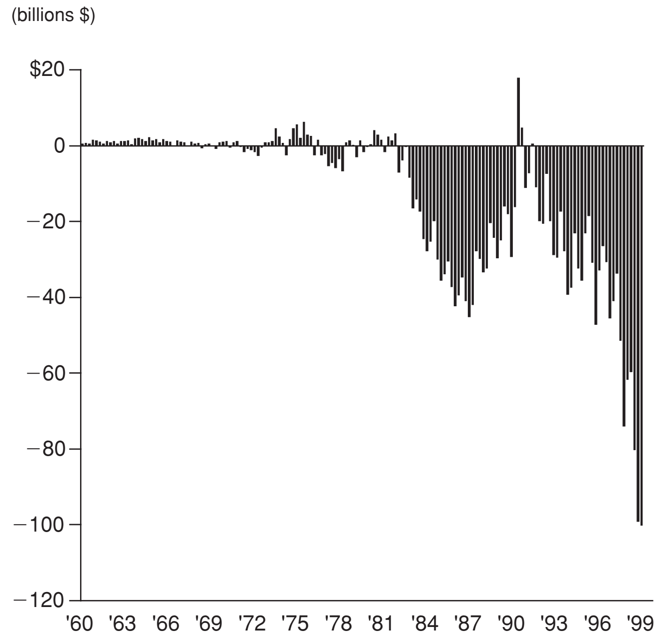


FIGURE 5
Growth of the Bubble: Derivatives Versus GDP and Trade, Worldwide
(Trillions $)



Sources: World Bank, *EIR.*

FIGURE 6
U.S. Current Account Balance, 1960-99
(billions $)



Source: U.S. Department of Commerce.

Derivatives aren't investments, they're bets, and Wall Street is the largest casino in the world.

Figure 6 tracks the U.S. current account deficit. The great U.S. economic boom has been based upon debt, with record levels of borrowing by corporations and households. The United States went over $3 in debt for every $1 increase in GDP in the 1990s. This debt can't be paid, and even making the interest payments requires hundreds of billions of dollars a year in capital flows from other nations, as the current account deficit shows. If this inflow stops, the bubble pops.

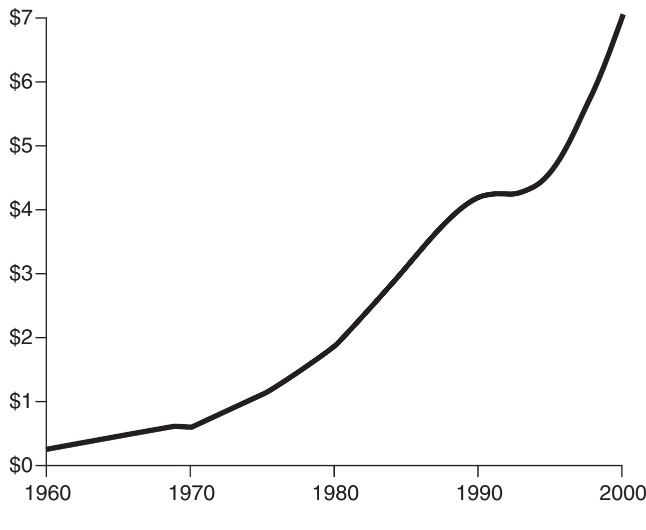
What has been the Federal Reserve's and U.S. Treasury Department's response on this? Besides lying, that inflation is "mild and under control" (a mere 3.5%, so we were told), they have been pushing liquidity to keep the bubbles inflated. **Figure 7** shows the take-off in money supply—M3. In particular, world oil is traded in dollars, so the demand for dollars plays into the Alan Greenspan bubble world. More and more money is required merely to roll over outstanding claims.

If Greenspan quits pumping money into the system, it will collapse in a deflationary spiral. But if he keeps the money pump going, he'll trigger hyperinflation. Either way, the current system is dying. The real question is, what type of system will replace it. Will it be a system which protects the general welfare of the population, or will it be a system which attempts to protect the financial system at the expense of the people? That is the question before us, and the secret reason for the imposition of energy speculation.

Precedents and Initiatives

This collapse process must be stopped. There are precedents and initiatives. The U.S. precedent is straightforward. Before the era of the last 30 years of floating exchange rates

FIGURE 7
Flooding the Markets with Money
(M3 money supply, monthly, trillions $)



(started in 1971), speculation, deregulation, and globalization, there were stable government-to-government commitments for energy, production, and trade. That approach can be resumed.

In September this year, Lyndon LaRouche issued a memorandum on steps to resume the traditional policy of government-to-government commitments. This would side-track the speculators, and also create the context to set priorities for refining and distribution. This memorandum (attached as an appendix) has been widely circulated in Organization of Petroleum Exporting Countries (OPEC) nations and elsewhere.

On Sept. 27 and 28 in Caracas, Venezuela, the OPEC nations held "Summit II," the first heads-of-state meeting in 25 years. The issue was raised of longer-term commitments between oil-exporting and oil-importing nations. Point 9 of the Sept. 28 twenty-point final communiqué stated the resolve to "actively seek new and effective channels of dialogue between oil producers and consumers." The Venezuelan government offered to commit oil and refined product to New England states directly—an offer rejected by Secretary of Energy Bill Richardson, who said that it would interfere in "free" (i.e., rigged for cartels) markets.

On Nov. 17-19, in Riyadh, Saudi Arabia, the Seventh International Energy Forum, a group originally established following the catastrophic rise of oil prices during the 1990-91 Gulf War, was convened. On the eve of the Forum, the Arabic daily *Al-Arab International* (from London) ran the policy proposal, "Wanted: Oil for Technology Program for All Arab Nations," saying that the Riyadh gathering would be "an appropriate opportunity for opening a dialogue on this issue between the two sides, the mostly industrial consumer nations and OPEC." On the scourge of speculation, OPEC Secretary General Alí Rodríguez, in an interview on Nov. 17 with France's *La Tribune,* said that speculators in oil futures have "created a market that did not really exist, adding up to $8 to the price of each barrel of oil. There were days, on which more than 150 million barrels—that is, double the world's demand, were negotiated on the markets" by speculators.

The most strategic action in the direction of energy stability to date, is the 20-year energy-for-technology pact reached this Fall, between Russia and the European Union. On Sept. 25, German Chancellor Gerhard Schröder and Russian President Vladimir Putin met, and specified the value of long-term government-to-government oil trade. Russia, with one of the world's richest sources of untapped oil and natural gas, would gain from receiving high-tech capital inflows from western Europe, to the mutual benefit of all.

U.S. State and Local Initiatives

These recent international actions show that there is motion in the direction of mutual-interest relations among nations on the question of energy, and potentially in other vital areas. The so-called energy "markets"—based on speculation and cartels—are blowing out, whatever we do. Therefore, linking up the initiatives of citizens in the United States with international motion, is critical at this turning-point period.

There are initiatives in other states that are of note in this respect.

Nevada: In September 2000, the state put a stay, and stopped in its tracks, pre-scheduled deregulation of energy supplies, given the electricity disaster evident in California, and other deregulated states. State Sen. Joe Neal (D-Las Vegas) was instrumental in mobilizing this anti-deregulation move, utilizing *EIR* documentation, and the Lyndon LaRouche policy proposals.

Pennsylvania: On Oct. 12, a group in the General Assembly introduced House Resolution 618, to "Memorialize the President and the Congress of the United States to take emergency action to reduce oil prices."

California: On Nov. 21, the Public Utility Commission voted to call on the Federal Energy Regulatory Commission to impose price caps on electricity, because electricity prices in the state are not "just and reasonable," because the "market is dysfunctional" because of extensive "market power."

Pass the Needed Resolution

Action by the Boston City Council, in providing leadership in responding to the energy crisis, is urgent for the citizens of the Commonwealth and region, and also as encouragement for other states and even nations to act, before hardship and chaos worsen to an impossible stage.