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Book Review: Saudi America by Bethany McLean

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All books include a date stamp to place them in the proper context, and this one was released in September 2018. It is a quick read, only 131 pages, but tells an interesting story. The short story is questioning the argument that the U.S. is energy independent due to shale oil when the industry is not profitable. As borrowing rates increase it will be interesting to see this story play out. US prices to consumers are the lowest in the world for energy as most other countries have incented citizens to use less fuel by adding use taxes. If oil prices spike, some countries will revert to coal. This has ramifications on global warming.

In the United States there are a number of shale oil fields, ranging from North Dakota to Pennsylvania to Texas and Oklahoma. Technology continues to make it cheaper to extract the oil and gas from them, but frackers continue to pump as quickly as they can. This is because the industry is built on Wall Street loans that must be serviced. They make enough to pay the interest and roll the junk bonds over. If there were no leverage, owners would likely wait for costs to reduce and prices to rise.

The low rates that allowed this expansion during the Obama administration was due to actions by the Federal Reserve trying to pump liquidity into the economy. The jobs recovery over the last 10 years, and economic growth of the period, are mainly due to fracking, and eventually Obama may become known as the fracking President. A retrospective on the era should look at what the alternatives were for growth. Fracking may have been another type of stimulus and, like that from fiscal and monetary policies, will need to clear the system if it is not financially sustainable. Using up fossil fuels as quickly as possible for fuel may be financially feasible in the short run, but their use in chemical feedstocks mean that agriculture is also at risk until a new pivot is developed.

Aubrey McClendon was the face of the industry prior to his death in 2016. His financial life was a series of bubbles and crashes, and ended when he drove into a wall the day after he had been indicted. He was the CEO of Chesapeake Energy and part-owner of the Oklahoma City Thunder NBA franchise. Born into a well-to-do family, a relative had been governor/senator of Oklahoma and he married an heiress tied to the Whirlpool Corporation whose relatives included a cousin who chaired the Committee on Energy and Commerce as a Republican congressman and model Kate Upton. He was a born salesman, and some in NYC avoided taking meetings with him because otherwise they would invest. For years he bought up oil rights, and was ready when the technology advanced to make fracking commercially viable. Chesapeake ran on debt, and Wall Street loved McClendon for the fees, over $1 billion total, he paid them. Incentives for oil were based on revenue and production growth, rather than profit, so encouraged good money to be thrown after bad regardless of the oil price.

As with anything involved with oil and gas, Enron's name always seems to pop up and does so in this story. Enron Oil and Gas, spun off and now EOG Resources ($75 billion market cap), implemented the technology to be a fracking powerhouse. In 2014 Saudi Arabia attempted to flood the market with oil that was not economically sustainable. They miscalculated, not understanding that their own social contract with citizens required a high cost of oil to maintain the standard of living. This is especially true in Saudi Arabia, but also in Russia and Venezuela. When Russian oil is extracted their citizens will wonder what they have achieved with it, while Venezuela has already imploded. Norway is one country that recognized early on that fossil fuels were limited in supply and invested much of the proceeds to build infrastructure and be available in the future. This fiscal break-even price has risen in Saudi Arabia from $20 per barrel to nearly $100, so OPEC countries became more dependent on the high price of oil than even the frackers. President Trump signed an arms deal with the Saudis for $350 billion over 10 years, and I wonder if they will be able to pay for it.

Oil remains a geopolitical risk, and future wars will be fought over it and require its use. Oil companies should now be included with the defense sector, as they are likely to be driven by the same events. McLean talks about the impact on shale oil, similar to a light crude found in Africa, on Nigeria and other producers who previously were the source in the US. Asia has little oil of their own and is developing relationships with African countries they want to trade with. Many of these Asian countries are primary sources of trade partners for the US. Oil shipments are protected by the US military, indirectly increasing the cost by $50 billion annually but providing leverage over China and other potential combatants.

I recommend this book. It is a quick read and makes you think.

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