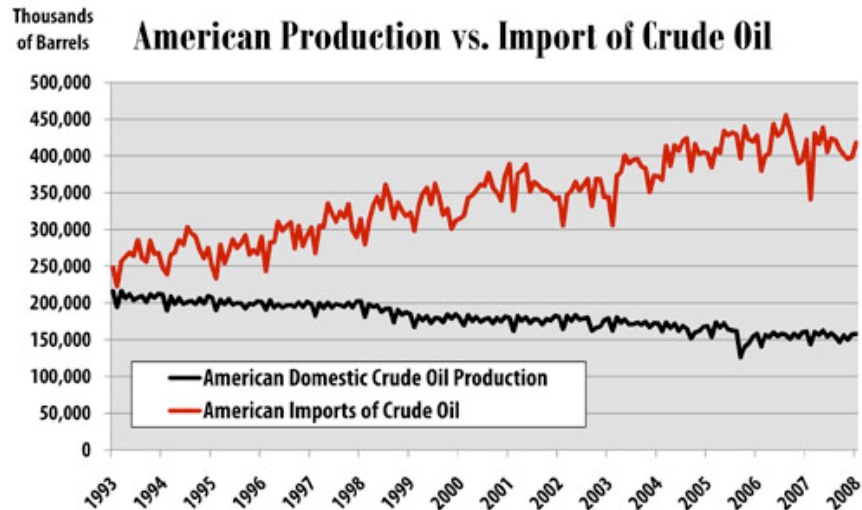


Securing the Insecure: U.S. Oil Imports

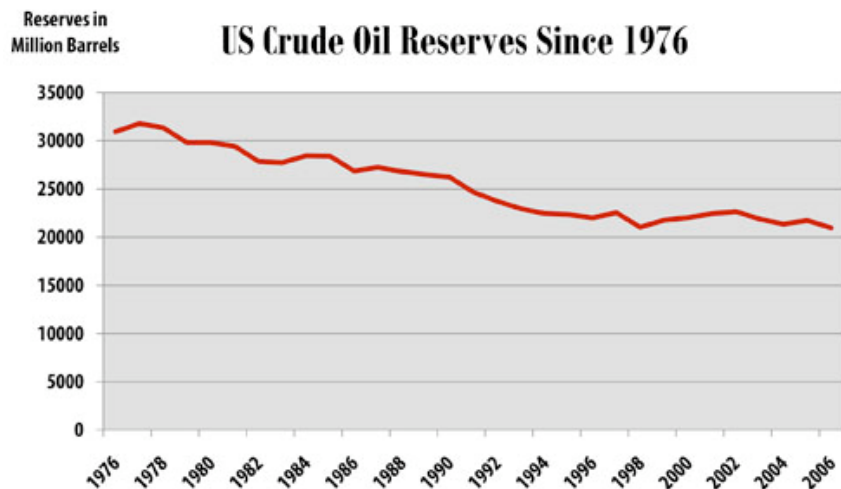
By: Marin Katusa

[Casey Energy Speculator](#)

Calls for national security to the contrary, America's appetite for energy is stronger than its caution. In the last 15 years, the United States has steadily increased its dependence on imported crude oil by some 60%. Part of the reason is declining production, as displayed in the chart below.

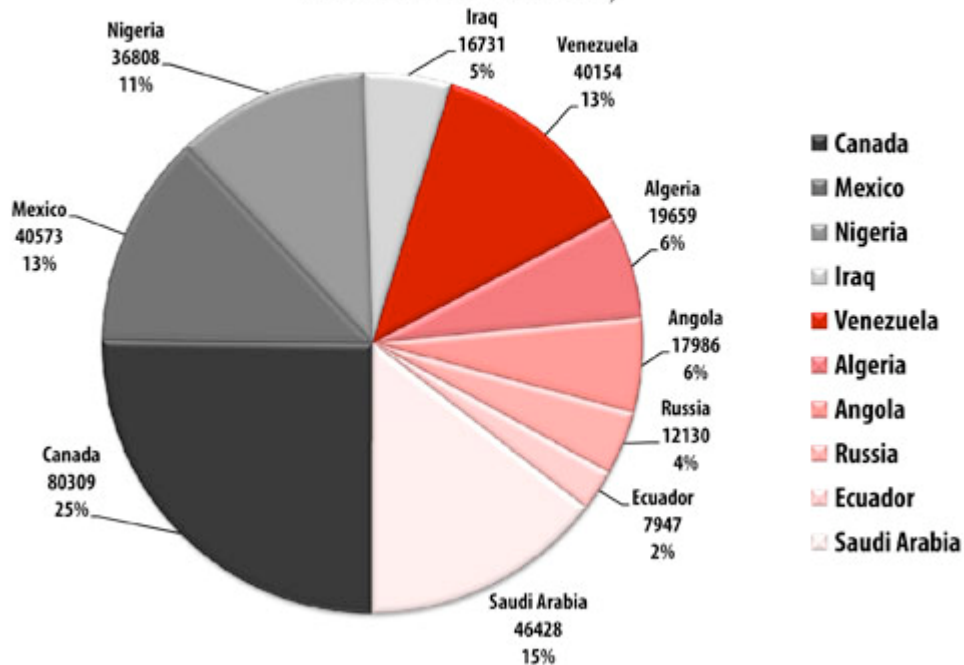


Declining production has been matched by the country's declining reserves. A decline that comes against the backdrop of increasingly extraordinary efforts to turn things around, including deep-sea drilling far off the coast in the Gulf of Mexico. Put simply, regardless of America's strategic concerns over energy security, any large increase in domestic production or reserves is unlikely.



To a superpower that imports nearly 70% of its oil, it's more than a mental exercise to evaluate the reliability of its sources. Any economic or geopolitical risk with the potential to disrupt supplies could have a destabilizing and even devastating impact on investment markets and the economy. In the pie chart here we've separated the countries exporting crude oil to the United States into three categories: friendly, potentially hostile/hostile, and unsure/neutral.

Countries Exporting Crude Oil to the United States (in Thousands of Barrels)



Those countries portrayed in black and gray are the allies, countries that have usually shown a willingness to work in concert with the United States on numerous issues. These countries are Canada (geographic proximity), Mexico (geographic proximity), Nigeria (much improved relations over the past 15 years) and Iraq (very close ties with the United States, for obvious reasons).

Countries depicted in shades of red are countries that are either openly hostile or have previously been hostile with the United States: Venezuela (Hugo Chavez... say no more), Algeria (issues remaining from Algerian Civil War), Angola (U.S.-funded anti-government rebels), Russia (lingering Cold War effects) and Ecuador (the new president is a friend of Chavez). We list Saudi Arabia as a wildcard, with the potential to go either way.

Adding up the numbers, a bit less than half of U.S. imports are from countries that are either politically unfriendly or have the potential to be. Now let's take a closer look at the "allies" of America, since even they have problems providing a stable stream of oil.

The Allies, Such As They Are

In the last 15 years, Canada has taken honors as one of the top crude oil exporters to the United States. However, conventional reserves of crude oil in Canada are in decline, and the only reserves that Canada has in abundance are the oil sands, which are expensive and difficult to extract.

Furthermore, Canada already consumes 90% of the crude oil it produces, and this number is growing. Finally, the Canadian dollar currently puts a great hamper on the growth of Canadian exploration companies: they have to pay their costs in Canadian dollars, but sell their commodities in American dollars, an unfavorable arbitrage.

Mexico has less of a currency conundrum than the Canadian exploration companies, but they face a much larger problem – their reserves are dropping quickly, with little ability to replace them. For example, production at Cantarell, one of the world's largest oil fields, is conservatively estimated to fall to half of its 2003 peak by the end of 2008.

This problem is exacerbated by Mexico's increasing domestic consumption. Its population already consumes 60% of its crude. Mexico, and its rapidly dwindling resources, could become a net importer of crude oil in the near future. (Jeffery Brown's Export Land Model estimates that this reversal will occur no later than 2014... six short years from now.)

Nigeria, the African continent's largest oil exporter, has impressive oil reserves. Unfortunately, the country is marred by not only the misappropriation of oil funds but also the ethnic clashes between the Ibo, Housa and Yoruba tribes. The multinational oil companies are either stuck in the middle or contributing to the mess, depending on your point of view. Ongoing supply unrest mean that Nigeria is less than a reliable source of crude.

Iraq contains large known fields, and the potential for more large fields yet to be discovered. As long as the United States maintains a strong presence in the area, it should continue to provide a steady supply to the United States. A long-term presence, however, is very much in doubt. And, should the U.S. leave, the direction of Iraq's flow of oil could change overnight. So, a big question mark here.

The Axis

Countries such as Angola, Algeria and Ecuador are obviously willing to sell to America now – as they need the money they'll sell to the highest bidder. But at the same time they have been ramping up their production and exports to other countries. As time goes on, however, these countries may begin to pick and choose to whom they sell such an increasingly precious commodity.

This trend is evident in Venezuela, a more mature oil-producing country, which, under the leadership of Hugo Chavez, has already begun to reduce exports to the United States. The Exxon Mobil suit against Venezuela is the latest, but far from the last jab in the sparring going on between America and Venezuela. The bad blood, combined with increased international competition for Venezuela's oil increases the possibility of a Venezuelan oil embargo on exports to the United States.

Russia has the potential to possess one of the most abundant sources of crude oil on the planet. But the tap-twisting that Russia has recently pulled with its natural gas exports strongly suggests it sees its energy as a tool for gaining geopolitical power, as the Europeans are discovering.

The Wildcard

Even though the Saud family and the United States have enjoyed a relatively stable relationship, rising tensions in the region and increasing Islamic militarism could potentially trigger another oil embargo such as in the 1970s, particularly if Israeli-Palestinian troubles remain unresolved. We can thus see both sides of the coin. On the one hand, Saudi Arabia could be the American bastion of supply over the next few decades; on the other, through its power in OPEC, it could increase the price of crude oil even more. The overthrow of the Saud family, dourly predicted for years, would in all likelihood be unfavorable to U.S. oil supplies.

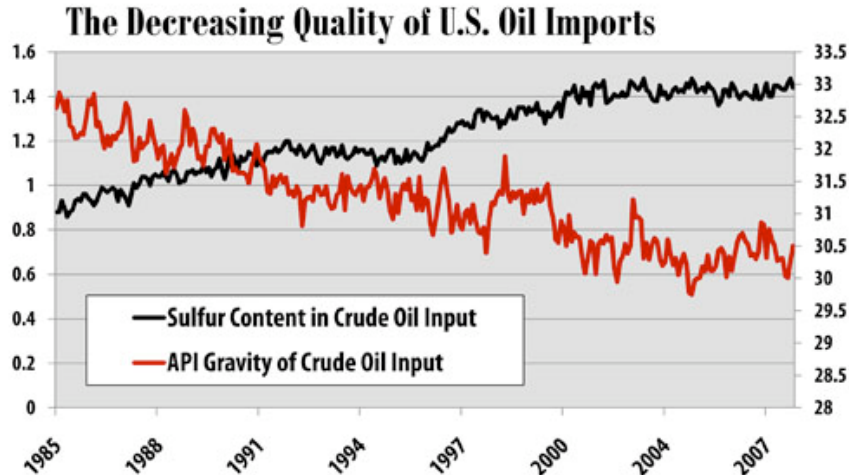
So What's the Solution?

The squeeze on supply is only getting worse as the ascendant economies of China and India ramp up their demands for oil. At some tipping point, exporters unfriendly toward the United States will be happy to sell their oil to these growing markets. So where can the United States expect to turn instead?

What about the former Soviet Republic countries (the "-stans")? Offsetting their vast potential and anti-Russian leanings is their geographical proximity to China, which is increasingly eager to exert as well as secure power. In any case, the possibility of finding a new significant reserve of light oil in most of these countries is unlikely.

There is, however, a much better solution – a proven and plentiful resource in an area friendly to the United States and in geographical proximity: the heavy oil fields in Alberta. While available in abundant supply, it is not without its challenges. That's because heavy oil is more viscous, more dense (low API gravity), and often has contaminants such as sulfur; it's usually purchased at a discount to light oil due to its increased cost to pump and transport.

The United States already uses heavy oil in some of its refineries, and increasingly so:



Canada could ramp up its heavy oil production relatively easily, since the reserves in the country have already been proven. Transportation of this fuel is also less of an issue since Canada is quite stable politically, and can easily construct new pipelines or twin their existing ones (to reduce the costs) to pump much-needed crude oil into the United States – provided the price is right.

The Opportunity

Why is heavy oil suddenly so much more popular? The main reason is that the demand for heavy oil from the refineries around the world is beginning to outstrip the supply of heavy oil. BP Inc, for example, is investing \$3.8 billion to upgrade its Whiting Heavy Oil Refinery outside Chicago, in large part to handle more heavy oil from Canada; and countries like China, India, Syria and Saudi Arabia are also beginning to build more heavy oil refineries.

This shows that the United States is beginning to use more heavy oil in its refineries, and is willing to pay a premium for a source of oil in a safe and friendly country.

So how do we profit? A logical answer would be to buy into prospective heavy oil companies, those that are cheap producers with good potential upside. Unfortunately, with oil prices well over \$130 per barrel, most producers come with a very high premium attached. These companies will begin to correct once they are unable to economically replace their current production with new reserves or when the impending American recession gains traction.

Therefore, we should be looking for well-cashed-up companies that can withstand difficult capital market conditions and has their operations in a jurisdiction that stands to benefit from America's crude oil shortfall, and increasing reliance on heavy oil.

The world of energy is changing forever... and not just the prices at the pump. Peak Oil is changing everything about the energy markets... including where to invest. But where do you look for investing inspiration in this brave new world of Peak Oil?

Well, the editors at Casey's Energy Speculator have put together a special five-part course, ***Understanding Peak Oil, and How to Profit From It***. In it, you'll learn all about the phenomenon that's reshaping the world. And you'll also discover the best places to make money in this quickly changing energy market. *The course is absolutely free.* It couldn't be easier to get started. Simply [click here](#) now, and you'll be on your way in seconds.