Rodney's Take

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Trading Flexibility for Cost in the Energy Sector

Companies and countries are disassembling parts of the global supply chain and reconfiguring it like a giant erector set. We learned during the pandemic that relying almost exclusively on one source for goods or computer chips can be disastrous, particularly when those sources don't share your world view. We've made a concerted effort over the last two years to diversify our supply lines and even to bring some manufacturing back home, even though it will be expensive because our costs are higher than those of our current suppliers.

The lessons we learned about manufacturing and supply lines during the pandemic were just a warmup compared with what Western Europe is dealing with today as it tries to build energy inventory ahead of winter. The pipeline Nord Stream 1 sits idle as German and British businesses shut down because they can't afford to buy electricity to operate. Governments don't know if enough natural gas will be available to heat homes this winter, much less to keep commercial sites operating.

To reduce their reliance on Russia and Vladimir Putin, Western European countries are leasing floating storage regasification units (FSRUs) and building liquefied natural gas (LNG) import facilities. These efforts won't replace Russian natural gas this winter, but they will allow these countries to receive LNG from a variety of sources in the years to come, which could benefit both suppliers and clients.

Iran, which has some of the largest natural gas reserves in the world, would love to get out from under sanctions and start sending gas to Europe. Both the U.S. and Qatar are increasing their natural gas production for export, while perennial enemies Lebanon and Israel are working on maritime borders so that they can extract natural gas from a large field in the area. As more importers build import facilities or install FSRUs, more producers will develop liquefaction capabilities. There's no doubt that dealing with LNG is much more expensive than manipulating natural gas that arrives via pipeline, but LNG import facilities have the incredible attribute of being able to accept supply from any ship. If you end up in a spat with your current supplier, you can contract with another one. As Germany and other nations are learning, that flexibility can be worth every penny.

But the war in Ukraine won't last forever, and Vladimir Putin won't always lead Russia. At some point, Germany will have Nord Streams 1 and 2 delivering natural gas from Russia and will also have LNG import facilities that can accept supply from anywhere. It will be interesting to see if Germany throttles back LNG in favor of gas arriving through pipelines because of the difference in cost, or if it maintains a balance between the two to have a choice of suppliers.

Other countries busy constructing LNG import facilities are tethering themselves to more-expensive energy in exchange for the same thing, flexibility. As LNG supply increases and the crisis in Europe subsides, the price of LNG for export will fall, although it will never be as cheap as gas delivered by pipelines. Just like our initiatives to bring home semiconductor chip manufacturing and other production, countries committing to more LNG are trading cost for control. They will pay more for energy but have more say in where it is sourced. The problem is the same. Governments never pay for such decisions, consumers do, through lower standards of living. We'll find out in the months and years ahead if populations agree that the increased costs of living are worth it.

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