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Why Oil Prices Will Keep Falling

New energy extraction technologies will overcome bad policies and geopolitical risks.

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The recent retreat in crude prices has surprised many experts, who were predicting steeply higher levels. The sanctions choking off Iranian exports and the ever-present elephant in the room—a possible shutdown of the Strait of Hormuz, where 20% of global crude traffic occurs—were pushing prices up.

Recently, however, an ensemble of unrelated factors—the Greek economic bailout, shale-oil fracking in the U.S., and the resurgence of exports from Iraq and Libya—have combined to push prices down. Is this a temporary relief that will falter with the first stress test? The answer is no.

The trend derives as much from the fundamentals of supply and demand as it does from the psycho-speculative forces that generate risk premiums ranging from $20 to $30 extra per barrel. A case in point is the Greek bailout, which offsets the anxiety premium raised by Iranian war games in the Persian Gulf by suppressing demand projections.

The invisible hand steadying global energy markets is the growing influence of modern technologies. So a case can be made for a relatively stable crude-price window—$80 to $120 a barrel for the next several years.

Yes, there could be unforeseeable global events and a price-spike response to them at the pumps. For instance, the stoppage of crude exports through the Strait of Hormuz would be highly disruptive, and anxiety over it would add more than $30 to the price of oil. On the other hand, there are workarounds that would preclude a sustained blockage.

Associated Press

An oil pump working in Sakhir, Bahrain

And even a price spike can have unintended consequences that ultimately lower prices. In the U.S., for instance, a price spike would give consumers an incentive to move toward non-crude alternatives, namely hybrid and electric vehicles. American transportation's slow transition to a more natural-gas-centric fuel will get a boost from supply disruptions.

Neither the Arab Spring nor the collapse of the Soviet Union was forecast by experts. Each simply happened. Who is to say when Iran or Venezuela will shed their handicapped status in petroleum production and produce more? The potential for more global supply to hold down prices is not insignificant.

Iran's current production capabilities are decades behind the rest of the oil industry. With their huge reserves of some 137 billion barrels, the Iranians have substantial room to increase production. Whether they do will depend on several factors, including U.S. sanctions and political will. Daily Iranian production

capacity of five to seven million barrels (double the current level) appears achievable. Iraq increased its daily production by 50% after the 2003 war began—to three million barrels today compared with two million barrels prewar. Libya's quick recovery and resurgence in crude exports since the chaos that brought down the Gadhafi regime is not the result of political stability or democratic reforms.

Some may argue that burgeoning middle classes in China and India will cause a sea change in the demand for oil, with the competition for fuel driving prices up. Not so. Consumption efficiencies will likely offset demand pressures. One game-changer is electric cars, which in essence allow nuclear plants or unconventional gas to fuel future cars via power grids.

The growing influence of modern technologies is evident everywhere. Net daily U.S. imports of petroleum have dropped by 50% to eight million barrels over the last five years. Imports are likely to shrink further in the coming decade due to an upsurge in domestic oil and gas supplies.

U.S. energy policy is moving in the right direction. The Obama administration's early message of disengagement from fossil fuels was the wrong approach to an important subject. The "all-of-the-above" energy strategy being publicized now is not only a contrast but well suited to the nation's energy needs.

The U.S. is on its way to becoming energy independent—a state that can be defined as, say, 90%-plus self-sufficiency—riding its advantage in unconventional oil and gas resources. The question is how fast will this happen.

Equating shale oil and gas resources with fracking—today's technical solution to releasing the oil—is disingenuous at best. The U.S. has abundant oil and even more massive gas resources. Fracking does not have a monopoly over future exploitation techniques any more than rotary phones did over the making of long-distance calls. What fracking and next-generation technologies do provide is an orderly transition to the post-petroleum era.

In the new world order, the U.S. can lead but not control the planet's energy outlook. Fracking and horizontal wells have given the U.S. an unmistakable geopolitical advantage while moderating the market swings. Both presidential candidates have a chance to accelerate U.S. energy independence. Ambiguity, policy vacillation and an overreach on uneconomical options (ethanol, wind) act as suppressants. But technology and market forces trump politics. The march is on.

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