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Say goodbye to cheap oil

By Paul Roberts, 3/27/2004

FOR THE tens of millions of American motorists patiently waiting for gas prices to come back to Earth, the news from the oil markets is not encouraging.

Government forecasters have reassured us that the unusually high oil prices we've seen since 2002 -- around $30 a barrel -- were temporary: As soon as global markets recovered from the mess in Iraq, oil prices would drop and gasoline prices would eventually follow. Yet nearly 12 months after "victory" in Iraq, oil prices are at an eye-popping $38 a barrel, or about $15 above the two-decade average, and some forecasters are offering a far less sanguine prognosis: The days of cheap crude are history.

What happened? In simplest terms, what we're seeing are the final months of a 25-year oil boom. That boom was sparked by the oil shocks of the 1970s, when sky-high prices touched off a feeding frenzy among oil producers. Eager to cash in on the good prices, oil companies and oil-rich states drilled thousands of new wells, built massive pipelines, developed fantastic exploration and production technologies, and generally expanded their capacity to find and pump oil.

This surge in capacity eventually brought prices down and helped buffer consumers from subsequent oil crises. When a disruption occurred -- for example, when Saddam Hussein knocked out Kuwait's huge oil fields in 1990 -- the world's other oil producers simply tapped their own surplus capacity and filled in the shortfall. Surplus capacity helps explain why oil prices since 1982 have averaged just $22 a barrel.

Now, however, the world's surplus capacity is disappearing. Many Middle Eastern countries lack the cash to expand production. Private oil companies are struggling to discover oil fields. Worse, even as industry worries about supply, global demand is growing far faster than predicted. And as everyone knows, when supply falls behind demand, prices head for the sky. Oil-price anxieties are especially acute among big energy users such as the United States, which burns a quarter of the world's oil production and whose economy is extremely vulnerable to price spikes. Indeed, nearly every severe global recession of the last 50 years has been preceded by a jump in the price of oil.

That's why every US president since Richard Nixon has sweated bullets to keep prices down -- mainly by bullying producers such as Saudi Arabia but also by helping oil companies develop new production capacity outside the Middle East. Both George Bush the elder and Bill Clinton worked assiduously with Western oil companies to tap new oil fields in the Caspian region.

That also explains why the current administration has so aggressively courted new allies in oil-rich (if democracy-poor) West Africa and Russia. And why White House strategists saw Iraq -- and the much-awaited "flood" of Iraqi oil -- as key to lowering world oil prices, bolstering the US economy and ending OPEC's 30-year stranglehold on the global oil market.

Sadly, Washington's cheap-oil strategy isn't working anymore. Hampered by terrorism and unrest, Iraqi oil production won't reach hoped-for levels for years. Political turmoil also has throttled oil booms in Russia and Africa. In short, the advertised wave of new oil that was to bring prices down hasn't materialized. Demand, meanwhile, shows every sign of increasing.

Barring the unexpected, oil prices have no place to go but up -- and the United States isn't well prepared for a high-cost oil future. It has made only feeble efforts to develop alternatives to oil or to improve fuel efficiency, especially in cars. And though some of this reluctance is cultural -- Americans like big cars and hate being forced to conserve -- the main factor is economic: Oil has been so cheap for so long that most consumers simply don't worry about the risks of relying so heavily on a single fuel.

And if US voters aren't worried about oil, US politicians aren't either. However, such complacence will soon be untenable. Despite the recent minuscule drop in gasoline prices, some forecasters believe prices will soon head back up and could crest at $3 a gallon by Labor Day -- well past the point, experts say, when even oblivious Americans, and their elected representatives, start to pay attention. And though some of that increase stems from gasoline refinery bottlenecks inside the United States, the price of gasoline is ultimately driven by the cost of crude, so attention must ultimately fall on the oil market.

Of course, few of us will take the market's hint willingly. Many will reflexively point the finger at greedy oil companies and nefarious "foreigners." But eventually, all of us may be forced to concede that the days of cheap oil are over and that the United States really does need an entirely new approach to energy.

Paul Roberts, author of the fortcoming book "The End of Oil: On the Edge of a Perilous New World" wrote this column for the Los Angeles Times.