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THE WALL STREET JOURNAL.
WSJ.com

OPINION

JUNE 2, 2011

Future Oil Supplies Can Lower Prices Today

We benefit now from more exploration, even if it takes years for new product to reach the market.

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Every time there's a run-up in gasoline prices, our policy makers respond with two measures: (1) investigations of market manipulation and (2) proposals to increase the tax take on oil and gas companies. Today is no exception.

The political popularity of these tactics is hard to resist, but neither one will likely drive down prices or even increase revenues. The government has found no wrongdoing by the oil companies in any of the major oil price run-ups, and the effective tax rate on oil companies, 39.8% according to the Tax Foundation, is the highest among all industries.

There is, however, a strategy open to the Obama administration that could yield both lower prices and higher revenue from oil and gas companies. To undertake this strategy, the president will have to retreat from his war on petroleum.

In world oil markets, prices are determined not only by what is happening to current production, but also by the expectations that buyers and sellers have about future production. In the 1973-74 Arab oil embargo, for example, oil prices quadrupled overnight even though little oil was lost from the market. Instead, buyers and sellers expected that the growth in oil production in the region would be substantially curtailed as a result of the likely nationalization of Persian Gulf oil fields.

Crude oil prices shot up at the outset of the 1979 Iranian Revolution, and again when war broke out between Iran and Iraq the following year, although in neither case did the amount of oil supplied to the market decline by much. But buyers and sellers understood that expectations about the growth of new production from both Iran and Iraq were shifting downward. Unrest in Libya, combined with expectations of continued turmoil throughout the Middle East, is certainly contributing to the current run-up in oil prices.

Nevertheless, many analysts deny that quickly opening our borders to imports from Canadian oil sands, more access to the petroleum resources in Alaska, expanding oil and gas leasing in new offshore and onshore provinces on federally owned lands, and deepwater drilling in the Gulf of Mexico will make a difference. The supplies will reach the market too far in the future to help us with prices today, or the amount will be too small to matter. This is too simplified a view of the oil market.

If we open up more North American resources for development, we may very well shift long-term expectations on domestic supply and receive the benefits of lower prices even before the supplies come to market. We may even get some pleasant surprises, such as what we recently experienced with the shale gas revolution. New discoveries of shale gas, and breakthroughs in the technology of extraction, have pushed down natural gas prices between $4-$6 per thousand cubic feet (mcf) over the last three years. These lower prices have saved American consumers over $50 billion a year, according to data from the federal Energy Information Agency.

I will leave you with a statistic: If we can alter the long-term price of crude oil by $20 a barrel—let's say to $80 instead of $100—the savings in our import bill alone would be $100 billion per year. This would immediately foster economic growth. That means more jobs, a better return on capital, higher corporate and personal income taxes paid, and government revenues from bonus bids and royalties from petroleum development.

Unlike costly programs for electric cars and renewable fuels, an aggressive petroleum development strategy will generate large and sustainable additions to both domestic employment and government receipts.

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