404 Not Found

Dow Jones Reprints: This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit www.djreprints.com

See a sample reprint in PDF format. Order a reprint of this article now

THE WALL STREET JOURNAL.
WSJ.com

OPINION | Updated March 15, 2012, 7:24 p.m. ET

What's Behind Rising Gas Prices?

With so many ships trawling the crowded waters of the Persian Gulf, there is always the risk of an 'accident' or 'collision' with unintended consequences.

By DANIEL YERGIN

As in the 2008 presidential election—remember the chants of "Drill, baby, drill!"—rising oil and gasoline prices have become an issue in 2012.

But election-year politics aside, the forces driving up prices at the pump are very different today than they were four years ago. In 2008, it was primarily the surge in oil consumption in emerging markets, disruptions, and a belief that the world was running short of oil (the so-called peak oil crisis).

In 2012, the reason is mainly geopolitics. Last November, the United Nations declared that Iran was clearly developing nuclear-weapons capabilities. The West is responding with sanctions aimed at reducing Iran's ability to export oil, on which it depends for more than half of its government revenues, to get it to halt its nuclear-weapons program. Tehran has answered by conducting large naval exercises and threatening to close the Strait of Hormuz, through which passes some 35% of the world's oil exports.

Global oil prices and U.S. gasoline prices have both risen about 20% since mid-December. And all this is occurring in a world oil market that is already tight, tighter than it was last year, with no more than 2.5 million barrels of spare capacity. At least half a million barrels a day are currently out of the market because of disruptions in South Sudan and Yemen and civil war in Syria.

A market this tight would already be susceptible to upward price pressures. But the market is operating on expectations that supplies will become even tighter as new U.S. and European sanctions against Iran take effect and the risk of military conflict increases. Put simply, the oil market is reading the front page.

Given these circumstances, there's not much Washington can do in the short term to reduce prices at the pump. Indeed, the picture would look much worse were it not for the nearly 20% increase in U.S. oil output since 2008. More efficient permitting could get more U.S. oil fields up and running faster, but even then there are lead times. Moreover, new oil flows from Canada, North Dakota and elsewhere are hobbled by an outdated pipeline system.

The market is clearly responding to what it sees as dangers ahead. Still, charges of speculation and price manipulation are already being resurrected from 2008. This is nothing new. As early as 1923, Sen. Robert "Fighting Bob" LaFollette, chairing highly charged Senate hearings on gasoline prices, warned that if companies were permitted "to manipulate oil prices . . . the people of this country must be prepared, before long, to pay" the unheard-of-level of at least "a dollar a gallon." As it turned out, within a few years gasoline was as low as 10 cents a gallon.

In this election year, rising oil prices will inevitably raise the question about the purpose of the Strategic Petroleum Reserve:

Getty Images

Is it to be used as a tool for price controls? Or is it an instrument to counteract major disruptions that threaten economic growth?

The Strategic Petroleum Reserve has been tapped twice in recent years in cooperation with the 28-member International Energy Agency (IEA): in 2005, in response to Hurricanes Katrina and Rita, and in 2011 during the Libyan civil war. But now our strategic reserves and the entire IEA system may be called on to cope with what they were originally established for in the 1970s—a major disruption in the Persian Gulf. Given that possibility, there should be some caution about using our strategic reserves before it is absolutely necessary.

Europe's embargo is already forcing Iranian oil to be redirected and perhaps sold at a discount. Meanwhile, the stricter U.S. sanctions, which won't fully take effect until summer, will go one step further, likely reducing the volume of Iranian exports by shutting buyers of Iranian oil out of the U.S. financial system.

Existing sanctions are already causing difficulties for Iran's economy, as evidenced by the collapse in the value of its currency. The new U.S. sanctions will put much more pressure on Iran and its rulers. But will they also drive up world oil prices, allowing Iran to earn the same amount of money on smaller volumes? And will higher oil prices threaten U.S. and global economic recovery?

The answer depends on whether additional oil comes to market, replacing Iranian oil barrel for barrel. Saudi Arabia has its own version of a strategic petroleum reserve, in the form of spare production capacity, which could make up for most if not all Iranian exports. But this would leave the global oil supply with little or no spare capacity and thus unable to cope with any other disruptions. That would certainly make the oil market nervous.

New petroleum supplies could come into the market over the year from a variety of sources—from Iraq and Angola to Libya and Colombia. And notably, 300,000 barrels per day or more from the United States—primarily from North Dakota and Texas and from a rebound in off-shore production.

The other offset could come from reductions in demand. U.S. gasoline consumption so far this year is down over last year. China's new economic growth target of 7.5%—down significantly from the 10% or so of recent years—would mean lower growth in its petroleum consumption. Of course, a rebound in global economic growth would increase demand, not only in China but in the U.S., Japan and Europe.

Events are moving into uncharted waters in the Persian Gulf. In the face of intensifying economic pressure, Iran will have to decide whether to proceed on its current course or find a way to assure the international community that it will stop short of nuclear weapons. Meanwhile, with so many ships trawling the crowded waters of the Gulf, there is always the risk of an "accident" or "collision" with unintended consequences.

How all this plays out will be registered in global oil prices. And it will be no less clearly calibrated in the gauge at your local gasoline pump.

Mr. Yergin is chairman of IHS Cambridge Energy Research Associates and author of "The Quest: Energy, Security, and the Remaking of the Modern World" (Penguin, 2011).

A version of this article appeared Mar. 16, 2012, on page A13 in some U.S. editions of The Wall Street Journal, with the headline: What's Behind Rising Gas Prices?.

Copyright 2012 Dow Jones & Company, Inc. All Rights Reserved
This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our Subscriber Agreement and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit

www.djreprints.com