Tulane University

Don't Blame Big Oil for Gas Prices

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Last week, top executives from the five largest U.S. oil companies were called to Capitol Hill to answer questions from lawmakers about the surge in prices and record profits that their respective companies have recorded. Their response? “It's not our fault.” Tulane energy expert Eric Smith agrees.

Eric Smith of the Entergy-Tulane Energy Institute says higher international demand is the cause of high prices at the pump. (Photo by Paula Burch-Celantano)

High oil and gas prices have been in the news for many months, and while it may be easy for many American consumers to point the finger at big oil, we should start looking closer to home for the causal factor, says Smith, a clinical professor of finance at the A.B Freeman School of Business and associate director of the Entergy-Tulane Energy Institute.

“We are thinking like we have plenty of oil and gas, and while we may have more than most, we have a lot less than we used to,” Smith says.

The floundering economy, coupled with record gas prices, is forcing U.S. demand to slack off a bit, but Smith says that won't necessarily result in lower prices for the nation's consumers.

“The rest of the world's demand is not static. Brazilian, Russian, Indian and Chinese economies are growing at greater than 6 percent per year, and their demand for oil and gas is growing faster than that. ”

Here in the United States, there is a public outcry for energy companies, as well as the federal government, to fix the problem. The political response is to put more money toward renewable energy sources, but that won't solve the immediate problem, Smith says.

“If you think in 15 years, you're going to be off of hydrocarbons, you won't. The best wind turbine system is twice as costly as the best hydrocarbon alternative, and the best solar systems are twice as expensive as that.”

Smith says that there is no arguing about the record profits recorded by big oil, but for a long time they were not breaking records, they were trying to break even. Their returns given the monumental amounts of capital invested are good, but not great.

“We are the only country that beats up on our domestic energy companies,” Smith says. “We should not be intent on punishing these companies. If we want them to diversify their resources to minimize our risk, we should consider using the carrot and not the stick.”

He says the price risk comes with a volatile market, which, in turn, is due to relatively low production capacity, worldwide.

“In the last few years we are running with a very small margin to compensate for problems. One bump anywhere in the world and the price goes up.”

Proof of that is clear; the price of crude oil surged to a record level of more than $112 a barrel Wednesday (April 9), before retreating and settling slightly lower after a government report showed lower-than-expected supplies.

With the upcoming presidential election there is a tendency to politicize the issue, but Smith believes the nation is on the verge of an energy crisis that will straddle party lines, and force politicians to look at tapping domestic oil reserves that have been subject to longstanding moratoria.

“We will reach a point where Democrats and Republicans, on a bipartisan basis, will call for the opening of some of these areas, not because the oil companies ask for it, but because the voting population insists on it,” Smith adds.

Even so, there still will not be enough new production to erase our dependence on foreign oil. As a result, the average American should expect to continue to take it on the chin and in the wallet, at least in the intermediate term.