



Oil Market: Lower Gas Prices not the Only Reason to be Thankful

When news from Vienna arrived on Wall Street early Thanksgiving morning that OPEC wasn't going to cut its production quotas to stabilize crude oil prices, [those prices immediately fell even further](#), touching lows not seen in four years. West Texas Intermediate briefly touched \$70 a barrel while Brent crude was close behind, at \$73.



Oil hit a high of \$147 a barrel in July 2008, so Thursday's drop represents an astonishing 52-percent decline in just over six years. This coincides with an 80-percent increase in crude oil production by the United States over that same period. As economies around the world struggle to regain their footing, thanks to failing Keynesian policies, the demand for crude remains about where it was 10 years ago. With flat demand and increasing supply, it was only a matter of time before prices started to fall.

American consumers are benefiting enormously, with gas prices dropping significantly below \$3 a gallon, which is saving them an estimated \$150 million every day. But that's just one reason to be thankful this day.

The drop is exposing OPEC for the ghost of Thanksgiving past that it is. Years ago its crude oil production of 30 million barrels per day gave it clout in the world market, enough to influence oil prices worldwide. During the oil crisis in the mid-70s, speed limits were reduced to 55 mph, and drivers waited hours in line to fill up their cars on odd- or even-numbered days. The government put in place regulations forcing power plants to use coal rather than oil, and prohibited the sale of American crude oil abroad.

Oil producers in OPEC have engaged in straight-line thinking in a curvilinear world for years, planning their state budgets around a predictable flow of revenues from the sale of their crude reserves. But some of the more unfriendly producers in that cartel are facing overwhelming budget deficits, and it's highly likely that they will get worse for the foreseeable future.

For instance, Libya — headed until recently by the terrorist Moammar Gadhafi — needs crude prices at \$185 a barrel to fund itself. Iran — presided over by Supreme Leader" Ali Khamenei — needs \$133 a barrel to fund itself.

Vladimir Putin's Russia isn't in much better shape, needing (according to Goldman Sachs) \$101 a barrel



Written by [Bob Adelman](#) on November 27, 2014

to fund its militarist adventures around the Black Sea. With crude near \$70 a barrel, Russia's budget deficit is running \$100 billion a year, not including the \$40 billion it is spending in the Ukraine. Reflecting those deficits, the Russian ruble has lost nearly 40 percent of its value so far this year.

The benefits to the American consumer continue to build:

- Plastics cost less, reducing food packaging costs and hence food prices. Electric bills are continuing to decline, reflecting the shrinking cost of energy.
- The American dollar continues to strengthen against foreign currencies, allowing consumers to purchase more for less from foreign companies.
- The cost of living continues to decline for the consumer as well, while interest rates remain low. This is showing up in increased auto sales and the home building sector, to say nothing about the economic explosions taking place in oil-producing states such as North Dakota and Texas.

One would be hard-pressed to find any disadvantage to the current decline in the price of oil. On Wednesday, however, a small Norwegian oil drilling company, SeaDrill, which concentrates in off-shore drilling, lost nearly one-quarter of its market value after it announced it was suspending its dividend to conserve cash. It's a highly-leveraged company whose strategy often works well if prices for oil advance, allowing loans to be paid down out of those increased revenues. But leverage, as SeaDrill and possibly other highly-leverage companies in the American oil patch are finding out, is a two-edged sword. If oil prices drop too far and stay down too long, the effect on marginal producers with high costs could be fatal.

That's the other half of any bubble: Eventually reality sets in, prices revert to the mean, and the market stabilizes. While investors are focused on the nose-bleed prices of stocks, few are looking for a bust in the oil patch. Most are happy to see lower oil prices benefiting consumers while giving America's enemies serious heartburn. More to be thankful for this Thanksgiving Day.

A graduate of an Ivy League school and a former investment advisor, Bob is a regular contributor to The New American magazine and blogs frequently at www.LightFromTheRight.com, primarily on economics and politics. He can be reached at badelman@thenewamerican.com



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