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U.S. Oil Production Will Soon Overtake Saudi Arabia's

Fatih Birol, head of the Paris-based International Energy Agency (IEA), told a congressional committee last week, "What we see is a result of the shale revolution [fracking]. The U.S. is becoming the undisputed leader of oil and gas production worldwide. [U.S.] oil production is growing very strongly and will continue to grow. We think that this growth is unprecedented [both in the] size of the growth and the pace of the growth."

In 1973, Saudi Arabia punished U.S. citizens with an oil embargo in retaliation for the U.S. government's support for Israel during the Yom Kippur War. It could do so because it held the biggest hammer: Saudi Arabia controlled the world's largest reserves of crude oil and the kingdom. Within months, the price of oil quadrupled in the United States, resulting in shortages and rationing. Gas stations were closed, and when they reopened they were forced to restrict gasoline purchases to "odd" and "even" days depending upon their customers' license plate numbers. The federal government imposed "double-nickel" (55 mph) speed limits on highways, and experimented with "daylight saving" time in order to reduce the impact of the embargo.

Those days are long gone and not likely ever to return. Saudi Arabia and its OPEC cartel are slowly being reduced to bit players in the global energy market. Saudi Crown Prince Mohammed bin Salman saw that coming more than two years ago when he announced the kingdom's "Saudi Vision 2030," a plan to diversify his country's economy away from its dependence on oil and gas revenues. He created a "sovereign wealth fund" to invest in various schemes and projects to expand public service sectors such as healthcare, education, infrastructure, recreation, and tourism. Part of the plan was to take advantag of the country's unique geographical location as a central hub connecting Asia, Africa, and Europe.

To do all of that, the crown prince needed money — lots of money — to transform his country and move it away from its dependence on oil and gas revenues. In April 2016, he announced that he would be offering for sale up to five percent of his oil company, Saudi Aramco, hoping to raise an initial $500 billion, as the company was estimated to be worth $10 trillion. But with the decline in oil prices, his country's stagnant oil and gas production, and the coming of age of the fracking revolution in the United States, estimates of the real marketable value of Aramco have continued to drop. The latest estimate is that the company is worth about $2 trillion, with the sale of that five percent (if it happens at all) generating a paltry $100 billion.

It's been two years since that announcement, and the offering continues to be delayed. The latest delay is pushing the public offering of shares into the second half of 2018.

All of which raises a question: What happened to rebalance the equation against Saudi Arabia in favor of the United States? What happened was George P. Mitchell. A son of poor Greek immigrants (who entered the U.S. legally in 1901), Mitchell served in the U.S. Army Corps of Engineers during World War II. After the war he joined his brother Johnny in starting an oil exploration business in Houston.

Fast-forward to the late 1970s. Mitchell was using company resources to explore ways of getting more natural gas out of shale formations at such a rate that his board of directors and investors were getting nervous. It took almost 20 years and the threat of near-bankruptcy before Mitchell and his company's engineers finally developed the magic formula of techniques and materials to extract gas, and then oil, from shale.

In 2002 Mitchell sold his company, Mitchell Energy & Development Corporation, to Devon Energy Corporation for $3.1 billion.

Why couldn't Saudi Arabia have done the same thing? Why did it wait until the issue became an existential threat with the development of fracking in the United States?

Part of the answer has to be the culture. In Saudi Arabia, the country's vast reserves — some 360 billion barrels of recoverable oil, at last count — belong to Aramco, i.e., the government. What is the incentive then for an entrepreneur to risk his capital, his time, his reputation, and his energy to try to find a way to squeeze more production out of those reserves?

In the United States, the culture is vastly different. The oil in the vast Permian Basin (which lies under west Texas and eastern New Mexico), for example, belongs to the people who successfully negotiate the land leases and then develop it. They take risks with their own money (and that of other people — investors) and spend themselves into exhaustion both physically and financially in the hopes of striking it rich. If they succeed, they get to keep what they have reaped. If they don't, they eat their losses and perhaps return for another go at it in the future. It is the peculiar, some say unique, mixture of limited government intervention, the enforcement of contracts at law, and the exhilaration that comes from success, that drives people such as George Mitchell to change the world.

It was thus inevitable that the United States, given that peculiar culture, would eventually become the "undisputed leader" of the world in energy development. It has an unfair advantage over every statist economy on the planet. All it took was time, and George Mitchell, to soon relegate Saudi Arabia to second place.

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