

# Quality Asset Management

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## Could High Oil Prices be Good?

*By Gil Hanoch, October 26, 2004*

Oil prices are rising every day and it is hard to see the end of this trend. The problems in Iraq, Russia and Venezuela combined with the growth in China and India lead to decreased supply and increased demand. It seems like the world is running out of oil, which might bring world economies to a halt. Will it?

The current demand for oil surpasses the supply, but the world is not running out of oil. Oil is a commodity with cyclical behavior. History is full of examples where supply did not keep up with demand, and people believed that the inflated prices would never go down - but they did.

During 1973-1974, oil prices quadrupled in less than 6 months, and reached higher prices than today, when adjusted for inflation. What was the result of the peak in prices?

- More fuel-efficient cars
- Better insulation in homes
- Improved energy efficiency in industrial processes

In the 80's and 90's, prices went back to the long-term historical average of around \$20 a barrel, measured from 1869 until 2003. What happened to these energy efficiency improvements after the drop in oil prices? They stayed with us and will continue affecting the world throughout the future.

Can you think of possible scenarios resulting from today's situation? We have gas-guzzling SUVs that will gradually be replaced by hybrid electric cars. In the longer term, hydrogen operated cars will turn one of the most abundant resources in the world into energy. The Environmental Protection Agency (EPA) will establish stricter rules for energy efficiency.

Like any problem that caused stock markets to go down in the past, there is no question of whether there will be a solution to the energy problems in the world - only *when* it will be. And the bigger the short-term problem, the stronger the long-term solution.

I would like to give special thanks to Jim Williams at WTRG Economics. I could not have compiled this article without his generous help and his detailed article Oil Price History and Analysis. Note that an updated version of his article is expected soon.

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