

The Future of the Global Oil Market

By Sarah A. Emerson

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Introduction

The price of crude oil has doubled in 2007 and is very close to \$100 per barrel. Net exporting countries have benefited from the windfall as they have accumulated “petrodollars.” In the meantime, however, the U.S. dollar has depreciated significantly in 2006 and 2007, so those petrodollars do not buy as much as they did two years ago. Indeed they buy about 25 percent less than they did in 2005.¹ Even so, with oil prices as high as \$100, the amount of petrodollars flowing into the global economy is enormous. Some estimates put that amount at \$4 trillion dollars as of the end of 2007.² So, the global oil market is resting on the three-legged stool of high oil prices, a weak dollar (in which most oil sales are denominated) and the unprecedented flow of petrodollars into investments around the world. At first glance, the numbers for each leg of the stool are striking: the oil prices are at record levels, the weak dollar is at record levels and the magnitude of the petrodollar investments is tremendous. At second glance, the stool appears to be relatively sturdy. The weak dollar cushions the impact of the high oil price, at least outside of the U.S., the petrodollars provide liquidity in investment which helps grow the global economy and the high oil prices encourage marginally more efficient consumption. In short, the status quo, as shocking as it seems to longtime observers of the oil markets, may be sustainable for some time.

There are concerns about this three-legged stool, however, that will ultimately lead to change. The high oil prices are a burden on oil consumers and the economies of oil consuming countries. The combination of high prices, geopolitical risk in and around oil producing countries and growing concerns about climate change will encourage consuming governments to rethink petroleum policies. The weak dollar is a concern for the U.S. economy because it makes imports very expensive, even as it promotes exports. In the meantime, investment dollars are coming from overseas and in some cases from countries not entirely trusted by the United States. Indeed, some analysts worry that growing control of the oil windfall by National Oil Companies (NOCs) of producing countries rather than the Integrated Oil Companies (IOCs) headquartered in consuming countries is a threat to the security of

¹ The Euro dollar rate was 1.1796 in November 2005 and 1.4672 in November 2007.

² “Oil Producers See the World and Buy it Up,” NYT, Wednesday, November 28, 2007, page A1

oil supply both in the short and long term. The trend towards resource nationalism in countries like Venezuela or Russia underscores this view.

So, in thinking about the future of the oil markets, one must consider how all of these issues will unfold. To that end, this paper examines recent trends in the global oil markets and especially factors that have lifted oil prices. It also discusses the rise of the NOCs in operating the global market as well as the policies of the consuming countries in regulating the individual markets that comprise the global market.

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During the 1950s, 1960s, and the early 1970s, oil prices were “posted” or set by the major integrated oil companies. Indeed, the volume of trade in crude oil spot markets accounted for only about 15 percent of international crude oil transactions. Moreover, spot transactions were possible only because the major oil companies needed to balance their own supply and demand, unloading small surpluses and covering minor deficits in the spot markets. The oil crises of 1973-74 and 1979-80 led to a threefold increase in prices, the adoption of fixed prices by OPEC, and the abandonment of fixed volume contracts between OPEC member countries and their customers. Higher world prices for oil stimulated non-OPEC production and cut global oil demand. As a result, in the market for the marginal barrel of crude (the spot market) prices fell below OPEC’s elevated and fixed price. Not surprisingly, independent refiners, traders and even the integrated majors bought more and more crude in the spot market. By the early 1980s, crude oil transactions at spot prices or prices tied to the spot market accounted for more than 50 percent of total international crude oil transactions.

Within OPEC, the role of swing producer in defense of higher prices became increasingly untenable for Saudi Arabia. Ultimately, Saudi Arabia abandoned this role, a market share war ensued and prices collapsed in 1986. Since 1986, almost all of the world’s oil has been sold bilaterally with transactions linked to some kind of market-based pricing, such as netbacks or formulas tied to spot, and more recently, futures prices.

...Gives Way to Market Forces

The emergence of spot and futures markets in oil has led to two decades of market forces as the organizing principle of the global oil sector. The deregulation of domestic oil industries and the liberalization of petroleum product pricing have proceeded all over the world as countries have opted to integrate into the large, transparent and relatively low priced global oil market. The view that market forces, rather than government policies, were best suited to allocate resources equitably was mirrored by the rise of Reagan-Thatcher laissez-faire conservatism of the 1980s and the eventual

collapse of the Soviet bloc by the early 1990s. The devaluation of the Russian ruble and the Asian financial crisis later in the 1990s showed the folly of policies that ran counter to market forces in global capital markets. More recently, the market-friendly approach adopted by the Bush White House and China's accession to the World Trade Organization (WTO) have again underscored the dominance of the "market."

Meanwhile, financial institutions have become important participants in the futures markets, buying and selling paper barrels of oil. Futures markets and the liquidity provided by speculators have transformed the global oil market from one dominated by month-to-month pricing to one driven by minute-to-minute pricing. A striking example of the influence of speculation in the futures market on short-term price direction has been the impact of the net position (long or short) of the non-commercials (non-hedgers) on the price of WTI on the NY Mercantile Exchange (NYMEX).³

It is not just the existence of spot and futures markets and the political preference for unfettered markets, however, that has allowed the market to reign in oil. Over most of the last 20 years, the global oil market has been characterized by over supply. The capacity to produce oil has significantly exceeded demand. Nominal prices have been flat and real prices have fallen.

The Era of Market Forces May be Coming to an End

Now as we face the next 20 years, the era of "market" as the primary organizing principle may be coming to an end. Market forces are under attack from many sides. This is, in part, due to the state of the physical market itself. Years of relatively low oil prices have supported oil demand not only in the transportation sectors of the industrialized countries, but also in the power generation, industrial and now chemical and transportation sectors of the developing world. Global oil demand has caught up with the capacity to produce oil. The spare capacity held by OPEC has been reduced to a bare minimum. That cushion will not be replaced overnight, unless something distinctly slows oil demand growth.⁴

In the meantime, with low consumer prices for much of the last two decades, refining has been a fairly low margin business, discouraging investment except in countries where refiners are at least partially protected by government policies such as price subsidies or import controls. In sum, both global crude production and global refining are capacity constrained relative to the previous two decades.

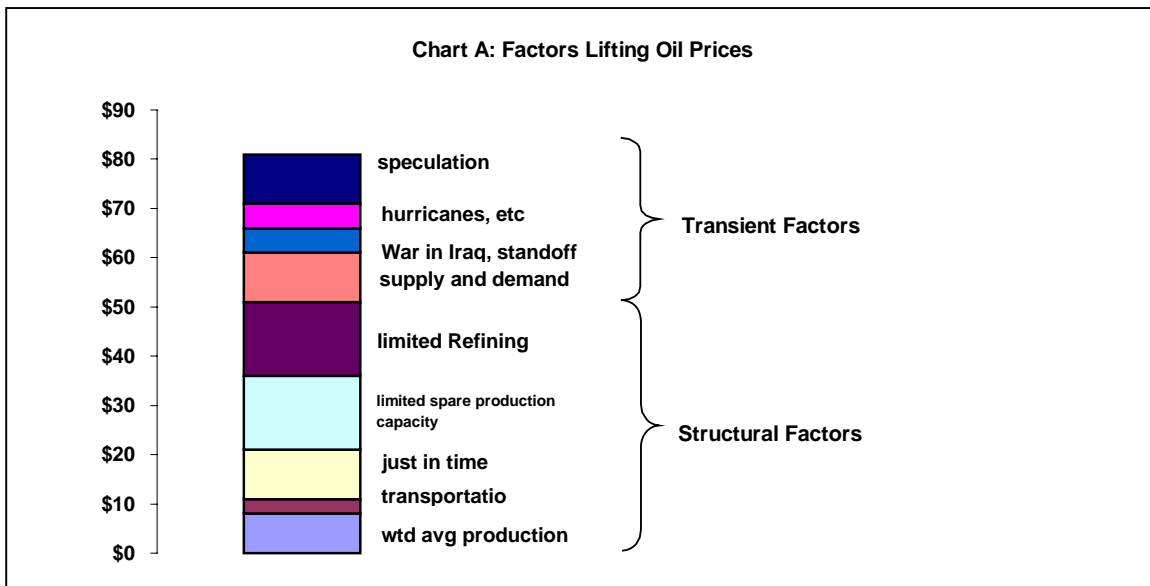
³ A chart comparing the net long position of the non-commercials with the price of WTI is included in the Appendix

⁴ A global balance that compares global oil demand with global supply is presented in the Appendix. Spare production capacity is held by OPEC and is presented graphically later in the text in Chart C.

But that is only part of the physical market story. The market impact of the capacity crunch has been intensified by government efforts to protect the environment. Policies to cut polluting emissions have led to fuel specification changes that have chipped away at the profitability of refining by forcing refiners to focus on investments to refine predominantly medium sour crude into clean low sulfur transportation fuels rather than investments to expand capacity. These refining investments have barely kept pace with demand for cleaner products, so the global market for clean products is supported not only by tight distillation capacity but also limits on the upgrading and desulphurization capacity available to make cleaner and lighter fuels.

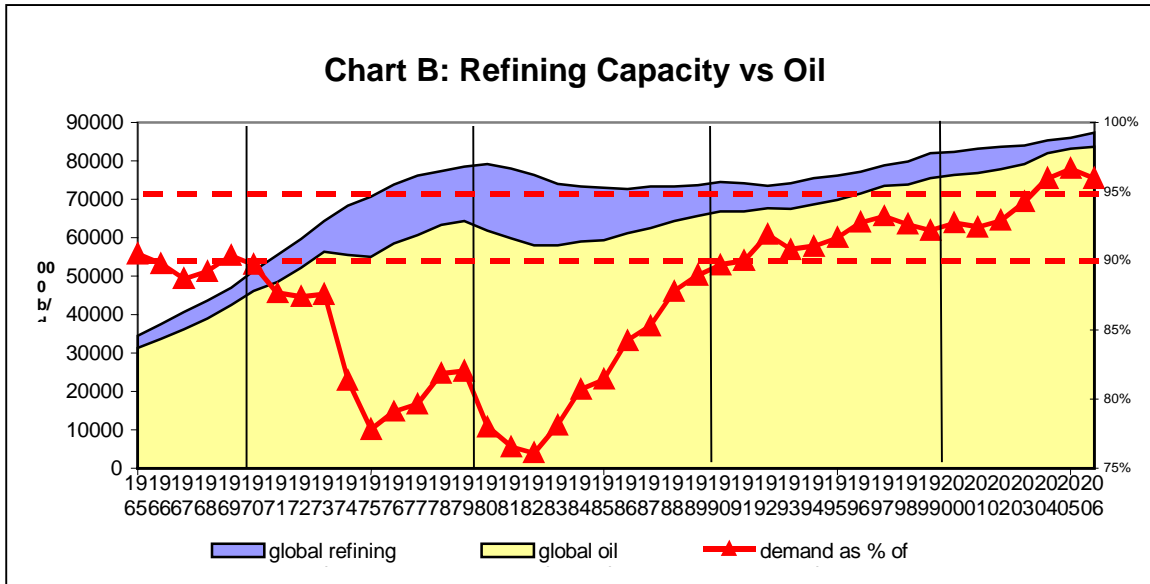
High Oil Prices

In thinking about the factors that have led crude oil prices from \$30 to almost \$100, some are structural factors that will take years to change. Others are more transient factors that change almost daily. As shown in the chart A, the structural factors include basic items such as weighted average production costs and transportation, but they also include supply chain factors such as the preference for just in time inventories, limited refining capacity and thin spare production capacity.⁵ These supply chain factors are not easily or quickly changed and they have made the current era of pricing a departure from the previous 20 years when companies carried a lot of inventory and there was significant spare refining and production capacity.

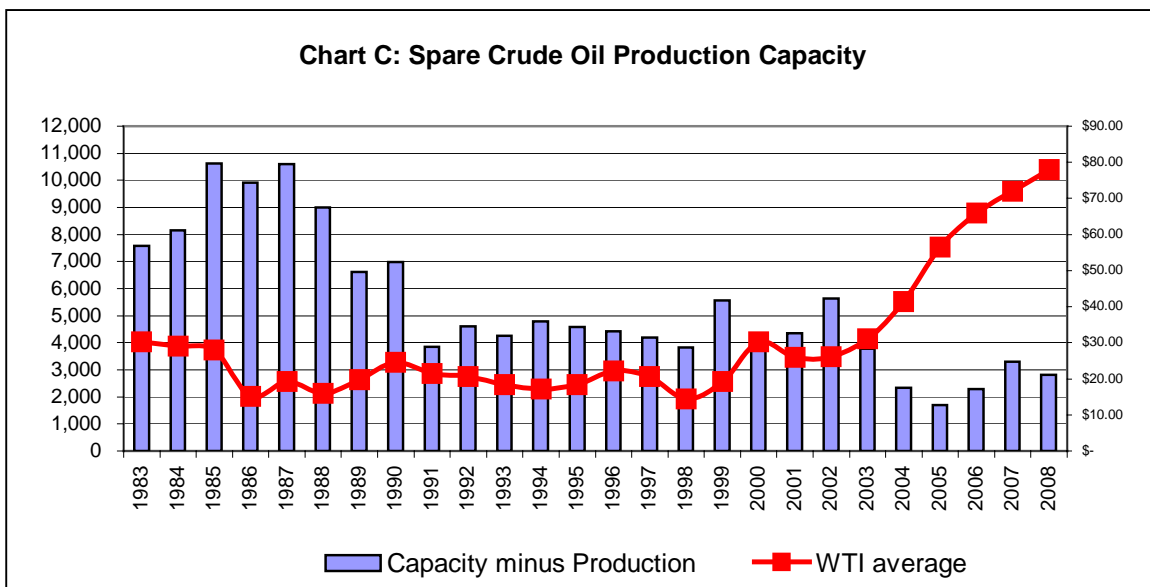


⁵ The values in this chart are the judgment of the author.

Charts B and C illustrate the elimination of spare capacity in both refining and crude oil production. In the case of global refining capacity, since 1990, the global utilization rate (here defined



as global demand/global capacity) has exceeded 90 percent, but since 2004 has exceeded 95 percent.⁶ 2004 was a remarkable year because oil demand grew very quickly around the world, but especially in the U.S. and China. Indeed, China’s demand growth was extraordinary. Even though China’s oil demand growth has slowed since then, that one-year spike drew a great deal of attention. China’s



⁶ Data for chart B is based on the BP Statistical Review and ESAI’s own database

growth will continue on a steady pace, but is unlikely to return to 2004 levels. In any event, the enormous increase in oil demand in 2004 led to a commensurate increase in crude oil production, especially in OPEC countries.⁷ That jump in output eliminated a significant volume of spare capacity. Since then, some spare capacity has been rebuilt as some new fields are brought on line in OPEC countries and as global oil demand has slowed down distinctly in 2005-2007. Indeed, oil demand growth in 2005 through 2007 has averaged about 1.2 million b/d whereas oil demand in 2004 was roughly 3.0 million b/d on the back of the Chinese surge.

The other factors included in chart A are more transient factors, which may have a shorter life span than structural factors. They include short-term developments in supply and demand, geopolitical events involving oil-producing countries like Nigeria, Iraq, Iran and Venezuela, supply chain mishaps like pipeline explosions or hurricanes hitting refining facilities. There is also speculation when non-commercial traders buy crude oil either as a short-term speculative investment or a hedge against something else like inflation. Each of these categories of factors has different impacts. Under the supply and demand developments, some factors have more lasting impact. The previously mentioned oil demand surge in 2004 was driven, in part, by a sudden acceleration in China's oil use. That was really a one-year phenomenon, although China continues to post healthy demand growth. Another example is the start up of a new oil field or a warmer or colder than normal winter. The rest of the transient factors are largely surprise events that are generally difficult to predict, but also relatively short lived. Regardless of the severity or duration of the threat these transient factors pose to the supply of crude or products, their impact on prices can be tremendous because of the absence of spare capacity in the global supply chain. This is well known by speculators who are inclined to "buy" oil at the first news of an actual or potential supply interruption.

Will Market Forces Bring Oil Prices Down?

In response to these oil market realities, a pure market economist might contend that high oil prices will spur conservation and temper demand growth while encouraging investment in crude oil production. The result will be more supply and less demand and oil prices will fall signaling the end of the current cycle. At current prices, even development of the least conventional sources of liquid hydrocarbon production (i.e., gas and coal to liquids and tar sand, shale and bituminous deposits) is affordable. In short, conventional oil gets a boost from the traditional investors and oil sands, bitumen,

⁷ Data for chart C comes from ESAI's own proprietary database. ESAI maintains a country-by-country database of supply, demand, inventories, refinery operations, crude production, production capacity for crude oil and each petroleum product for the entire world. All of ESAI's market analysis is based on a bottom-up approach to analyzing supply and demand at the national regional and global level.

oil shale, biodiesel, and other alternatives get a boost from the entrepreneurs. The current boom cycle comes to an end, the market equilibrates and prices fall.

The mean reversion, market equilibrates view of today's prices, however, does not yield an accurate characterization of where we go from here. Given that many of the factors that have led to \$100 oil are structural ones, the amount of investment in new production of oil (or alternatives) and the demand restraint required to re equilibrate the market is substantial. Moreover, the players in the market, whether they are national governments or private companies, are either changing altogether or developing new attitudes towards oil.

Governments May Not Think So...and May Intervene in Markets

In today's market, oil supply disruptions are perceived to be more likely and more difficult to counteract. The recent strength in oil prices is, in part, because they have internalized the energy security concerns highlighted by the War in Iraq and terrorist attacks in and outside of the Middle East. Civil unrest in Nigeria, the standoff between the U.S. and Iran over nuclear weapons, and tensions between the Bush Administration and President Chavez of Venezuela underscore historical concerns about the security of supplies. In a well-supplied market, the consequences of a supply disruption can be managed through alternative supplies. In a capacity constrained market, however, every disruption has more severe consequences. These energy security concerns have moved energy higher on the public policy agenda in many countries.

Higher oil prices have also lent perhaps undeserved credence to the claim that the volume of conventional oil production is at or very close to its peak. Pinpointing the year in which conventional oil production peaks or plateaus is unnecessary and far too contentious an exercise. What matters is that alternative liquid hydrocarbons like syncrudes from oil sands or bitumen and alternative fuels from biomass and agricultural crops will increasingly become part of the liquid fuel mix over the next few decades. The expansion of ethanol in the U.S. gasoline pool is an early and instructive example of the trend towards greater volumes of non-traditional hydrocarbons or non-hydrocarbons in the petroleum product pool. This trend will become more widespread.

Regardless of the veracity of the "Peak Oil" argument, it has raised a red flag about the long-term supply of conventional oil and its adequacy for meeting oil demand. This has led the major stakeholders, including producers, consumers and government regulators to rethink the alternatives. In some countries, especially those without oil production, the government response to these concerns is likely to be more conservation. Regulations that improve efficiency and reduce consumption seem almost inevitable in some countries. Likewise, countries with dwindling oil production, which are

becoming bigger and bigger net importers are pursuing policies to secure foreign supplies. Meanwhile, all net oil-importing countries are considering changes to their energy mix if their resource endowments allow.

Finally there is the environment. Efforts to reduce emissions and clean up fuels, especially transportation fuels, will continue around the world. But behind those efforts is a far bigger environmental issue for the global oil sector: reducing greenhouse gas (GHG) emissions.

In sum, the continued dominance of the “market” as the organizing principle of global oil is under attack by two overriding concerns: energy security and the environment. One could argue that these challenges have always existed, but it seems clear that the absence of “spare” capacity in production and refining has dramatically underscored the energy security issue while growing consensus on climate change has transformed the environment issue. With this in mind, market regulation in the petroleum sector is far more likely in the next two decades than in the last two.⁸

Producer vs Consumer

A greater willingness to question or intervene in markets is complicated by an emerging divergence between producers and consumers with regard to their medium term outlook on oil markets. On one side, there are the consuming countries, the IOC’s headquartered in those countries and the IEA. On the other side, there are the producing countries, the NOC’s from those countries and OPEC. Even though the producer-consumer dialogue has improved communication between the two sides, there is still significant distance between their views of the future. In the simplest terms, OPEC worries about demand destruction and the penetration of alternative fuels in the oil markets in the name of energy security and the environment and the IEA worries there will not be enough investment to generate enough oil to meet strong demand in countries like China. Both organizations are careful not to highlight this fundamental difference, but one can see it in their projections of supply and demand. As Table 1 shows, the two sides have subtle but still significant differences in their views on medium term demand growth

⁸ The recent signing of the 2007 Energy bill into law already signals more government intervention in the U.S. oil sector as it raises CAFÉ (fuel economy) standards to 35 mpg by 2020 and calls for 36 billion gallons of alternative fuels used in transportation fuels by 2022.

Table 1: Comparison of IEA and OPEC Demand Projections

Million b/d	2005	2010	2015	2030
IEA demand	83.7	91.1	98.5	116.3
OPEC demand	83.3	89.7	96.5	117.6
Avg Annual Growth (IEA)		1.5	1.5	1.2
Avg Annual Growth (OPEC)		1.3	1.4	1.4
Sources: OPEC World Oil Outlook 2007, IEA Medium Term Oil Market Report July 2007, OMR Annual Statistical Supplement				

In the period from 2005-2010, which is half over, the IEA's demand growth projection averages 1.5 million b/d to OPEC's 1.3 million b/d. At first, this seems like a trivial difference, but over 5 years, that difference equals 365 million barrels. In the period to 2015, IEA continues to see faster demand growth than OPEC. Notably, over the long-term from 2015 to 2030, the IEA sees oil demand growth slowing down and OPEC does not. So the two organizations get to a very similar end point in 2030, but the IEA sees a more rapid growth in the medium term followed by slower growth whereas OPEC sees more gradual growth in the medium term and little slowdown after that. To the degree that these are different views of the next 5-10 years, they mirror the producing countries' concerns over demand destruction and the consuming countries' concerns over capacity investment.

The Rise of New Oil Companies

Beyond the subtle but important differences between the IEA and OPEC views on oil demand, there are other indications of the changing nature of the divide between producers and consumers. Twenty years ago, when there was significant spare capacity in the global supply chain, the IOCs acted as the lubricant that kept the oil market operating efficiently. As integrated companies, the private companies that comprised the majors and sub-majors, such as Exxon, Mobil, BP, Chevron, Texaco, and Shell understood the entire supply chain from production to transport to refining, distribution and retail. Moreover, with the help of periodic OPEC production decisions, they managed the surplus in the system to help the market equilibrate.

Today, the stretched global supply chain and the unique resource endowments of the National Oil Companies (NOC) of the Persian Gulf countries give the latter enormous market power at the beginning of the global supply chain. The Persian Gulf NOCs are very different from the major private oil companies whose business is far more heavily weighted towards refining and marketing and the other end of the supply chain (see Table 2).

Table 2: Company Assets at either end of the Supply Chain (in mmb/d)

2004	Crude Production	Refining Capacity	Refining as % of crude production	Petroleum Products Sold	Petroleum Products as % of crude production
Saudi Aramco	8.6	2.5	29%	2.3	27%
NIOC	3.8	1.5	39%	1.4	37%
KNPC	2.3	1.1	48%	0.9	39%
Exxonmobil	2.6	5.7	219%	8.2	315%
BP	2.5	3.9	156%	6.4	256%
Shell	2.3	5.2	226%	7.6	330%
Chevrontexaco	1.7	2.1	124%	3.9	229%

note: refining capacity includes shares in JVs and products sold include a comparable portion of output from JVs , Source: Source: ESAI and OPEC

By necessity, the private, vertically integrated major oil companies, such as Exxonmobil, BP, Shell and Chevrontexaco in the table above, wield their market power by operating in many different petroleum product markets as well as the global crude oil market. Even though crude oil production is the most profitable part of their business, the fact that these companies are net short crude oil forces them to pay very close attention to the realities of environmental regulation, refining technology and crude oil availability in every country in which they have refining or retail operations. Indeed, in light of these changing regulatory realities, the recent strategy of these companies has been to embrace technologies that squeeze oil from sand, liquefy gas or coal and sequester CO₂, while expanding their fuel portfolios to include gas to liquids and bio-fuels. They are transforming from oil companies to energy companies or even to energy technology companies as they attempt to optimize the opportunities of technological innovation and minimize the risks of regulation at the end of the supply chain.

Meanwhile, the NOC's are beginning to look and behave more like the old fashioned IOCs. They are investing in refining capacity to move their market power downstream. They have access to significant reserves in their home countries (i.e., Saudi Aramco, KNPC, PdVSA, Petrobras, etc) or they are out seeking access to oil reserves (CNPC, CNOOC, ONGC).⁹ Beyond the formal NOC's there are also a growing number of private companies that behave like NOC's or national champions. Lukoil (Russia) or Kazmuniagaz (Kazakhstan) may fall into that category. As the NOC's account for

⁹ NOCs control 77 percent of global proved oil reserves, according to the Baker Institute's study on the *Changing Role of National Oil Companies in International Energy Markets*, April 2007

ownership of a greater and greater share of the remaining conventional oil reserves and as they invest downstream through the supply chain, they are becoming more critical players in the oil markets.

This worries some market observers who are concerned that an NOC will always have to balance its corporate objectives with the national objectives of its government. The Baker Institute's recent study on *The Changing Role of National Oil Companies in International Oil Markets* points out that "NOCs have non-commercial objectives....[that] tend to interfere with the firms ability to produce at a technically efficient level and maximize the overall value that could theoretically be obtained from their oil resources."¹⁰

The Baker report also asserts that these NOCs help their governments pursue foreign policy goals, perhaps to the detriment of the market or consumers.¹¹ The pursuit of foreign policy goals by NOC's is a two-edged sword. If the Saudi government asks Saudi Aramco to produce more oil to benefit the economies of its consuming country allies that is a benefit to consumers, but if the Iranian government asks NIOC to withhold oil from the market due to differences over its nuclear policies then that harms the consumer. In either case, the oil market's anticipation and understanding of national oil company behavior is complicated by their pursuit of national objectives. A related point is made in the Congressional Research Service's (CRS) report on *The Role of National Oil Companies in the International Market*.¹² The CRS report suggests that it is not just important that National Oil Companies do the bidding of their government owners, but that they can collude through organizations like OPEC. This gives them even more market power when compared with the IOCs that are under tight anti-trust controls. Both the Baker report and the CRS report suggest that the NOCs may not make the investments needed to expand production capacity to meet demand, "If the national oil companies do not undertake investment...and their governments exclude the international oil companies from developing reserves in their countries, the world oil market could be supply-constrained in the future, and prices might be higher..."¹³

The scope of this paper does not provide for a detailed discussion of the differences between IOCs and NOCs and thus the implications of the rise of the NOCs, but there are certainly common perceptions (or misperceptions) of the differences between the two and they are summarized in Table 3.

¹⁰ Baker Institute report, Introduction and Summary Conclusions, page 4.

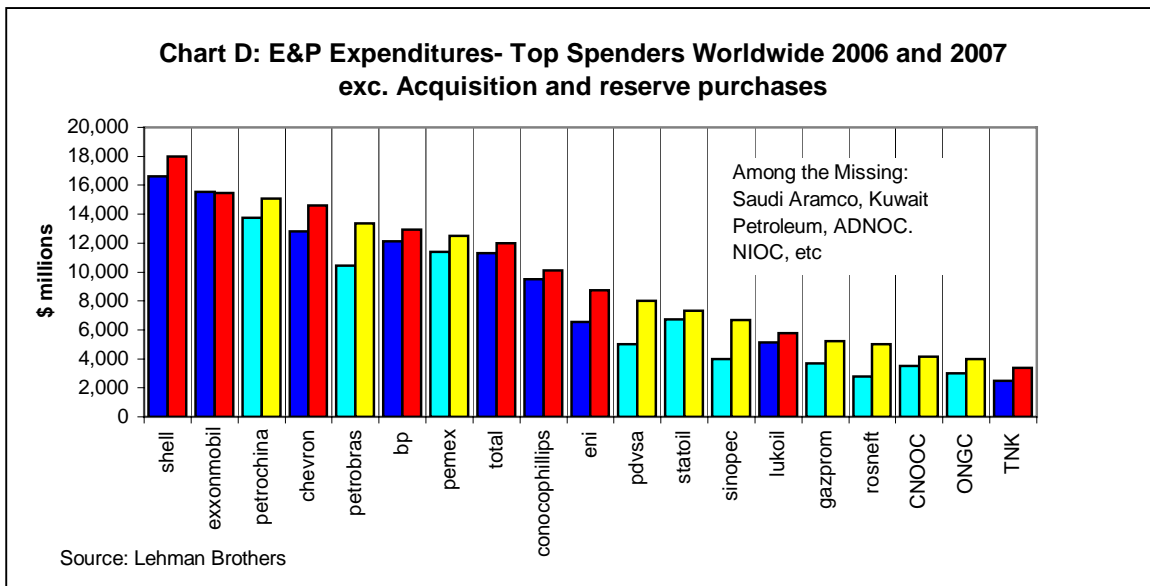
¹¹ Baker Institute report, Introduction and Summary Conclusions, Page 10-12

¹² The Role of National Oil Companies in the International Market, CRS, August 21, 2007, page 5.

¹³ Ibid, page 11.

Table 3 Actual or Perceived Differences between IOCs and NOCs	
IOCs	NOCs
Struggle with reserve replacement	Own significant reserves
More refining than crude production	More crude production than refining
Looking for more reserves to develop	Building refining for domestic demand and export
Vision embraces some alternative fuels	Vision embraces resource nationalism
Maximize shareholder value	Pursue national interests
Efficient firm	Inefficient firm
Less investment in upstream	More investment in upstream

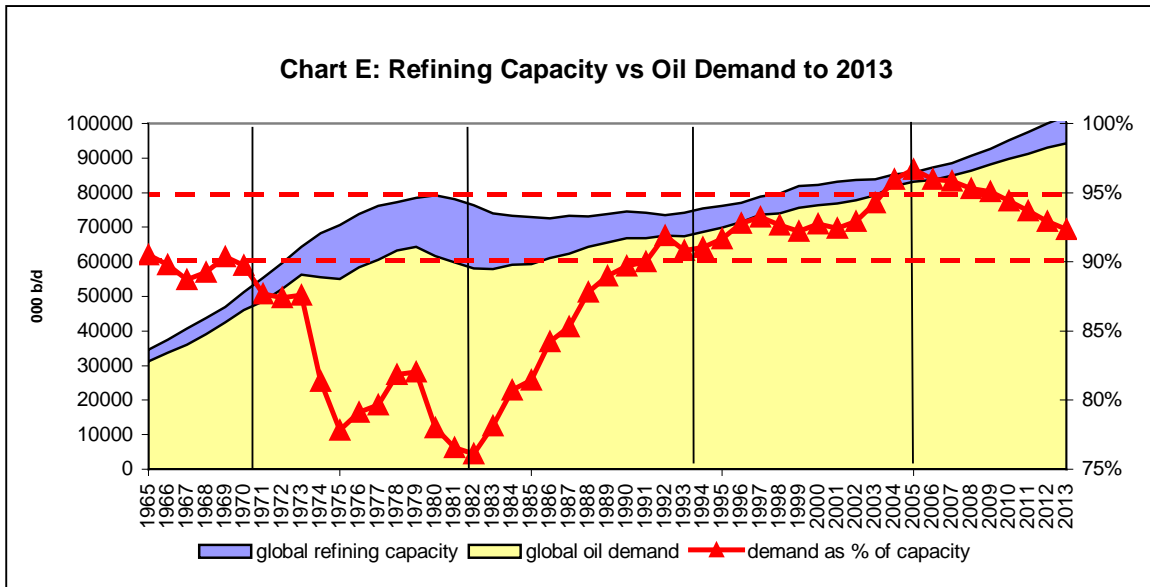
One of the best indications of the changing composition of the global oil industry is the collection of companies who are making significant exploration and production expenditures. Lehman Brothers biannual survey of E&P expenditures presents a useful snapshot of who is spending and how much.¹⁴ It is important to note, however, that their data do not include the large NOC's in the Persian Gulf. As shown in chart D, of the top 19 E&P spenders in 2006 and 2007, ten are national oil companies. Of that ten, 3 are Chinese, 3 are Latin American and 2 are Russian. It is almost impossible to determine if this level of investment is enough to ease the crude production capacity crunch, especially when the Persian Gulf companies are not included, but it appears that high oil prices are having a significant impact on the spending and investment decisions of oil producers. Indeed, estimates of the petrodollars that are flowing into investment around the world are striking (the



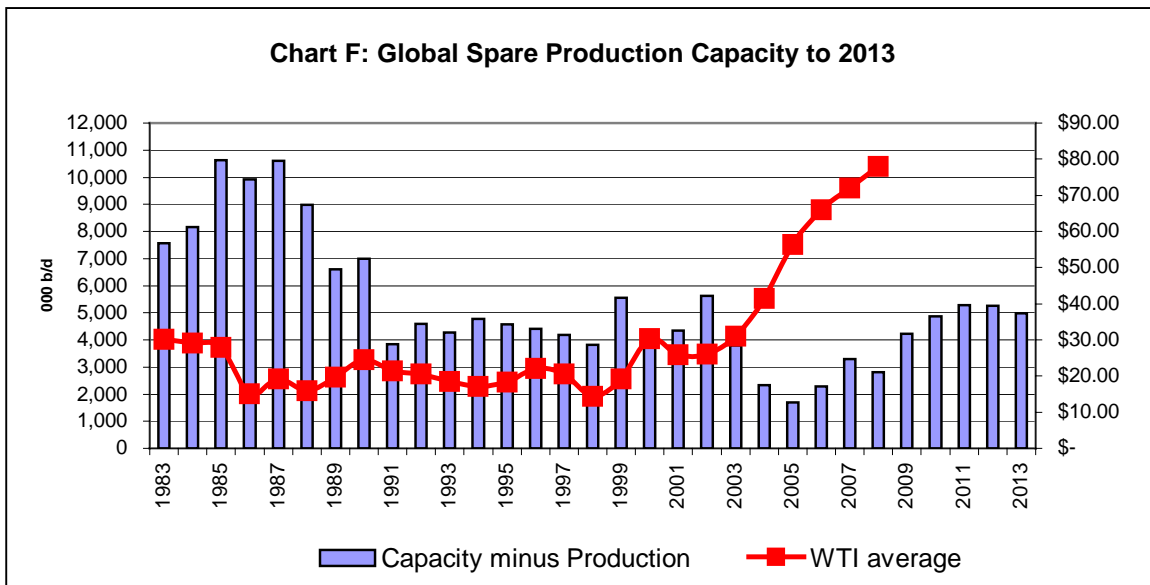
¹⁴ The Original E&P Spending Survey – Midyear Update, Lehman Brothers, June 2007

aforementioned \$4 trillion). Some of that investment is going into oil production and refining. The exact number of dollars going back into oil is uncertain, but substantial.

Where Do We Go from Here



It is difficult to look very far out when examining the structural factors shaping oil prices today, but one can say something about the next 5 years or so with some confidence. As described earlier, the two most important structural factors contributing to high oil prices are tight refining capacity and limited spare crude production capacity. But investment is underway and in the medium term those problems will ease. Charts E and F are projections of Charts B and C presented earlier.



Based on ESAI's analysis of global expansion of refining capacity and production capacity, both improve. The refining capacity projection indicates that the global utilization rate should fall below 95 percent. This is still a high number, but more consistent with the 1990s when oil prices were lower. The production capacity projection is more speculative because it encompasses many countries with declining oil fields and a handful of countries with expanding production. All of the spare capacity is held in OPEC and the view in Chart F is probably optimistic in magnitude but accurate in direction.

Beyond 2013, the picture is much more difficult to draw because the structural tightness in the global supply chain never disappears. It just improves and deteriorates depending on the ebb and flow of investment and demand. With that in mind it is difficult to imagine a return to \$30 crude oil. At the same time, \$90-100 crude oil will be hard to sustain. In short, market equilibrium is much more loosely defined and probably refers to a price range of \$50-\$80 with more potential to break above that range than below that range.

Conclusions

The last two decades of deregulation and reliance on market forces as the defining principle of the oil markets has run its course and, on the margin, regulation is moving back into the oil patch. The confluence of high prices, limited upstream and downstream spare capacity, instability in producing countries and concerns over climate change are encouraging coalitions that endorse change in energy policies. Whether it is in the name of environmentalism, national security, resource stewardship or mercantilism, many different political and economic interests are looking for a change to the regulatory status quo. Slowly their efforts will gain ground in countries all over the world.

At the same time, in an environment of high oil prices, resource nationalism is encouraging the rise of national oil companies and national champion private companies who have access to oil reserves within the border of their countries and diplomatic and financial support from their governments to pursue oil reserves in other countries. Some of these countries will be more successful than others and some will operate more like private companies than others, but all will have a government shareholder with an agenda that goes beyond profit maximization, so corporate decisions will not be as easy to anticipate as they have been with the major IOCs.

In sum, governments on both the producing and consuming sides of the global oil market will take a bigger role in the global oil markets in the next 20 years than they have in the last 20 years. The future direction of the global oil market will not be driven entirely by either consuming government regulation or the rise of the NOCs, but how today's structural supply chain challenges and environmental objectives are met will certainly be influenced by decisions made by consuming and producing country governments and their national or champion oil companies.

In the meantime, the global oil market remains perched on a three-legged stool of high oil prices, a weak dollar and huge flows of petrodollars into investments around the world. This stool has been fairly steady over the last several months, but it does not represent a status quo that will satisfy most governments. The high oil prices, in particular, are a direct concern for consuming governments and an indirect concern for producing governments if they see consumers turning to conservation and alternatives. The weak dollar is a concern for U.S. consumers and must make oil producers worry about inflation in their economies. Consuming governments will be compelled to take action to protect their economies. Producing governments will invest to broaden their oil price windfall and, in the process, perhaps take the edge off high prices. But it will take time to effectively slow demand growth and increase supply growth. Moreover, slower demand and faster supply will not be smooth and not commensurate, especially as governments take a bigger role in markets. So the stool may rock, but remain upright for some time. Oil prices will eventually moderate (and the stool will topple), but prices will remain volatile and unpredictable as the steps taken by governments unfold.