The Law of Supply & Demand

The price of oil is determined by how much is available and how much the world wants to buy

Why Is Supply Up?

• Fracking and other new drilling technologies have nearly doubled the amount of oil the U.S. has produced in the last six years.

• OPEC, the cartel of oil-producing countries, decided in December not to cut back on oil production.

Why Is Demand down?

• People have bought higher-mileage cars that need less frequent fill-ups.

• Conserving energy at home has reduced the amount of oil needed for heating and cooling.

• Slower economic growth in China has reduced its need for imported oil.

The federal Energy Information Administration estimates that the typical American household will save $750 this year (2015) because of lower gas prices. Millions of people in the Northeast and Midwest depend on oil and propane to heat their homes. They’ll save an additional $750 this winter.

U.S. Oil Boom

Why have oil prices dipped so far and so fast? As with the price of anything, it has to do with the law of supply and demand (see box above). When the supply of oil increases or demand falls off, the price drops. On the other hand, when the supply shrinks or demand goes up, prices rise. In the last few years, the amount of oil being produced has surged. The game-changer has been American oil production, which has nearly doubled in the past six years.

The boom has been made possible by two new drilling technologies that have allowed the extraction of shale oil and natural gas once considered too difficult and too expensive to reach. The first is hydraulic fracturing, known as fracking. The process uses highly pressurized water, sand, and chemicals to force oil and gas out of shale rock formations. That’s why oil captured this way is sometimes called shale oil. The second is horizontal drilling. To retrieve oil, a drill goes down 100 feet or so, then turns sideways to extend a well out horizontally. This enables the extraction of oil and gas from a much larger underground area. Sometimes these areas are more than a mile wide.