

Oil

Opinion

Why we should beware the dawn of cheap petrol

Paul Stevens

The crash in crude oil prices has huge implications for geopolitics, climate change - and even our pensions

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It's been many years since the motorist had such a warm feeling at the petrol pump. Whoever thought they would be able to fill the car at prices as low as 90p a litre? Take advantage; fill up that tank. But don't delude yourself that this is an unalloyed benefit. Instead be aware of the dynamic that has delivered cheap petrol to your tank, and of its serious implications.

How did we get here? Since June 2014, the price of crude oil has fallen by over 70%. The reason is supply and demand, and the economics of oil markets. From the start of the Arab spring uprisings in Tunisia in January 2011, oil producers in the Middle East and north Africa sought higher oil revenues to keep people off the streets and out of the squares. That required higher oil prices - which for some time they managed to achieve. From 2011 to June 2014, prices averaged at \$97 a barrel. The shale gas revolution in the US also had an impact. Production there increased by almost 5m barrels a day between 2008 and 2015 - unprecedented in the history of the industry. You don't need a Nobel prize to realise that high prices in a market so oversupplied with oil were simply unsustainable.

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Future British production is also in doubt.' Photograph: Murdo Macleod for the Guardian

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However - and this is crucial - it is a much lower price compared with the last 10 years, when prices averaged \$85 in real terms. It is trading at a price that few are accustomed to.

So what should you be thinking as you fill your tank? In short, that lower prices in the UK mean good and bad news. You reap the benefit of the former; the price of petrol has fallen from about £1.40 a litre in 2011 to £1 and less in January this year. This is not as much as the fall in crude prices because of the fixed amount taken in tax. Of the price of oil products to the final consumer in 2014, more than 60% went as tax to the UK government. Nonetheless, lower prices put more money in consumers' pockets with beneficial effects to the economy.

In the good old days, when financial markets had some understanding of economics, lower oil prices would have also boosted expectations for growth and pushed up share prices. In today's world of economic illiteracy and “irrational exuberance”, this is no longer true. Globally, falling oil prices are now seen as bad news for stock markets.

Production of shale oil in the US increased by almost 5m barrels a day between 2008 and 2015, unprecedented in the history of the industry.' Photograph: Shuli Hallak/Corbis

Future British production is also in doubt. It will rely on existing platforms and pipelines, which are ageing and reaching their sell-by date, or investment in new infrastructure, which is unlikely to appear in this lower price world. The industry body Oil and Gas UK has said that less than £1bn is likely to be spent on new projects this year, as opposed to the £8bn spent on average every year over the past five years. British oil that is not produced in the next five to 10 years may never be produced.

Think too of what it means around the world, for already there are dramatic reductions in investment in conventional oil production. In January the commercial intelligence analysts Wood Mackenzie estimated that \$400bn of projects have been postponed or cancelled. This involves 68 that account for 27bn barrels of reserves, equivalent to the combined reserves of Norway, UK, Mexico and Oman.

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Assuming oil demand continues to grow, as the consensus argues, this lack of investment is very serious for an industry where the natural depletion of oil fields requires producers to run to a stand still. Over the next decade it is possible we'll have an ever-tightening market, leading to instability and the threat of price shocks. There will be problems for large oil companies in this lower price world as their share values fall. And if you wonder if this matters to you, just remember the pensioners who depend on stock market valuations for their pensions. In February 2015, before the price collapse really started, oil firms accounted for more than 13% of the value of the FTSE 100 share index.

Another source of concern is what lower prices mean for the drive to replace fossil fuels and offset the march of climate change. Suddenly, renewables begin to look relatively more expensive, and this could undermine the progress made last year at the Paris climate change talks to reduce burning carbon.

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But what should really occupy your thoughts is the geopolitics of oil. The price wars have contributed to poor relations between Saudi Arabia and Iran. Apart from any other consideration, this makes any agreement over ending the war in Syria distant, with potentially devastating consequences for the stability of the region.

To find an earlier period of such instability in the Middle East you need to go back to 1918 - the end of the first world war and the collapse of the Ottoman empire. To be somewhat parochial, what this might mean for the flow of desperate refugees and migrants to Europe beggars belief. Furthermore, a consequence of many oil producers facing serious economic problems is that countries as diverse as Venezuela, Nigeria, Angola and Algeria, to name but a few, will face serious internal political dissent as their governments, short of revenue, find they no longer have the funds to buy off their populations.

Human suffering, political unrest, delayed climate change action; surely it is worth thinking about all this when we fill up with cheap petrol?

● This article was amended on 29 February 2016. It originally said that rising oil prices were now seen as bad news for stock markets, but that should have been falling oil prices.

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