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29 June 2005

Oil prices have reached new heights, topping \$60 per barrel, and possibly won't stop there! Faced with this apparently relentless climb, we ask ourselves three questions: **Do such high oil prices hurt the economy? What causes such high prices? And what can we do about it?**

Do such high oil prices hurt the economy?

Obviously yes. The IEA and the IMF rang the alarm bell a year ago and the message was largely ignored due to continued robust growth in the US and in China. Today, everybody recognises that the risk for the world economy is significant. President Bush has dubbed it "a foreign tax on the American dream". He is absolutely right, but he could add that it is a tax on the world dream of more prosperity and less poverty. And the poorer the country, the higher the burden.

What causes such high prices?

Many compounding factors are in play: lack of available capacity across the oil supply chain in production, refinery upgrading and transportation infrastructure; surging demand in emerging economies; apparent insensitivity of consumers to the price signal; uncertainties related to the weather (hurricanes) or to politics (Iran, Iraq, Venezuela, Nigeria); and increasing activity in the commodities markets. It is not very useful to blame any single player in the game. What is now required is for each player, and in particular for each government, to act as needed.

So, what can be done about it?

First, more oil must be brought onto the market, a decision resting mainly with OPEC. Several OPEC ministers or officials have recently suggested that there was no need for

more oil, as the bottleneck was in refining capacities. I do not share this view - even if it is difficult to increase refining throughputs, it is useful to have more oil in commercial stocks ahead of uncertain times, and the structure of the market, in contango (meaning that forward prices are higher than current prices), should eventually encourage this.

Second, the oil market needs more capacity, both upstream and downstream. That cannot happen overnight, but all governments can take immediate measures to improve the attractiveness of investment in the oil sector. OPEC governments should announce clearly their programmes and schedules for new capacities, consuming and producing countries should review and streamline investment regulations in refining. And operators need to continue to invest to meet growing demand.

Third, a demand response to the high price signals. Governments in all consuming countries have now put energy efficiency as a top priority on national agendas. Energy ministers of the IEA countries committed on May 3rd, 2005 “to reinforcing [their] efficiency efforts”. There is now an urgent need for implementation.

More oil, more investment, more energy efficiency - that is how market forces should react to market signals. However, sometimes this reaction is slow. If it does not happen soon, with government impetus when needed, it will happen later, more painfully.