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This paper is part of a series of papers on a notion of the new oil order. And the new order really relates to two things. On the one hand the shale revolution, primarily in North America, which has resulted in a significant increase in both oil and gas production North America using hydraulic fracturing. So this is Harold in an era of fossil fuel abundance, such that we now have an abundance of oil and gas on global markets. And at a particular price, we have an oversupply, which makes it more difficult for OPEC For example, to manage global supply and hence the price So on one hand, we have fossil fuel abundance.

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On the other hand, the second factor is we have a growing global consensus around the need to address climate change as reflected in the Paris agreement in 2015. And the subsequent IPCC report on 1.5 degrees, which makes quite clear that limiting warming to two degrees was going to result in lots of negative impacts. And so the idea of the Paris Agreement is to try and constrain global warming to less than two degrees and as close to 1.5 degrees as possible.

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In parallel with that ambition, we have also seen a rapid fall in the cost of renewable energy, wind and solar and a falling cost in electricity storage, and the growth of renewables in the overall energy mix of the of the global system, but also with some interesting regional variations. To take these two processes as one we have a situation of oversupply of fossil fuel production at a time when there's a growing conviction about the need to reduce fossil fuel consumption to address climate change as the energy system is the single largest source of greenhouse gas emissions. And so, cop 24 cook the committee of parties is passed. of this process of neat of meeting to agree progress on the Paris Agreement. And it was then followed by cop 25 in Madrid where we were supposed to agree the rulebook behind the Paris Agreement. Unfortunately, that beating didn't go particularly well, and seem to get bogged down in the minute I made limited progress. And so great hopes were being placed on cop 26, which was going to take place this November, in the UK, where the ambition was that we should be ratcheting up

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the targets. We had initially agreed with the Paris agreement in 2015. But that too, has been postponed. So we're kind of in limbo, in terms of progress on the Paris Agreement. And the big question out there is what happens when we eventually get the other side of the COVID-19 pandemic in terms of our conviction to address climate change. So the combination of oversupply fossil fuels and The desire to reduce fossil fuel consumption poses particular challenges to two economies that specialise and rely on the export of oil and gas, and hence in your order, and hence the focus on Russia and Saudi Arabia.

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This paper was published last summer, but even then, there was sufficient evidence to suggest that it was getting increasingly difficult for OPEC as the organisation of Petroleum Exporting Countries to manage supply of oil to to balance supply and demand to keep the price at a level that they considered to be acceptable.

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And the problem was that where they were able to constrain OPEC production, all it did was push the price up, which further encouraged production in the United States. And so we've seen in recent years, a rapid surge in production from the United States. And so we have three countries dominating your sector, Russia, Saudi Arabia and the new kid on the block. Is it worth it? The US and OPEC was having to manage and reduce its own production to keep prices at a particular level. And that was simply encouraging more shale gas production. And to make this work, OPEC had called on a number of non member states to also participate in production cuts, and Russia was one of those. And so he sort of fast forward to what has happened more and more recently, OPEC was meeting in March to try and agree a further set of cuts because it was already evident there that the COVID-19 pandemic was starting to impact on demand. And Russia refused to accept any further cuts. Their response from Saudi Arabia was to was to say it was going to flood the market with oil result was the oil price crashed.

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End of OPEC plus for the moment at least, but most recently, we have seen the full impact of COVID-19 Become starting to become a parent with concerns of you could see 20 30% more decline in global oil production, with oil prices plummeting. And so, in the last few days, actually in the middle of April, we have seen OPEC plus meet again. And OPEC plus agree further cuts deeper cuts than Russia walked away from earlier. And we've also seen within the context of G 20. President Trump trying to orchestrate a wider deal to try and reduce production to try and hold up the price in part to protect the US oil industry. So these are unprecedented and uncharted territories in terms of cooperation between oil producing states, but what we really don't know are two things. One is what is the full depth of demand destruction that's going to be caused by COVID-19. The next big challenge is running out of physical storage, nowhere to put The oil and actually having to stop production of oil. And the second unknown, of course is how long this will last and what the trajectory will be coming out of the pandemic in terms of future oil demand. And so there's a bait about whether or not we will actually get back to the level of oil demand that we saw prior to the pandemic and whether in fact, the pandemic will, will mark a point of peak global oil demand and oil demand will continue to to plateau and perhaps fall thereafter. And that, of course, has longer term implications for oil producing economies. So we chose Russia and Saudi Arabia because they are the two largest oil producing exporting states. Russia is a major gas producer as well. So it is the largest energy exporter, but also because of their geopolitical significance in terms of relations with the rest of the world. And they also represent two quite different types of Petro state.

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So we're interested In the relationship between the sort of the nature of reliance on oil exports or oil rent, and the sort of the political economy of the two countries and their plans for the future. So if you look at look at Saudi Arabia, Saudi Arabia is your classic Petro state or rent your stake, wholly dependent on the export of oil and the revenue generated by oil. And yet Saudi Arabia in recent years has come to realise that they need to prepare for the world beyond oil. And so they have something called their 2030 vision, which is a programme of reforms to try and diversify the Saudi economy to develop what they call the non oil sector to make themselves more resilient and less reliant on oil. assuming of course, that climate change will eventually result in significant permanent structural demand or destruction. The other problem they face is they have a very young population And that needs to be employed. And so part of this is also about creating a non oil sector that can employ young Saudis. And so they have a bold plan. And that plan is to be financed during the 2020s with revenues from the export of oil, which, of course is a problem, because they don't have the revenues they were counting on. And so at the moment, what we call the social cost of oil, that is the oil price the Saudi government would need to balance the budget is around $80 a barrel plus, and they've already spent about half of their of their foreign currency reserves, some $500 billion trying to prop up their budgets since the previous collapse in your price in 2014 15. So the question for Saudi Arabia is, you know, how will they maintain this social contract which is based on all revenue in the state distributing that revenue and increasingly bringing about my well diversified economy, which provides meaningful jobs. If they fail to do that, of course, there are serious social and political consequences. Russia, on the other hand, is is a different kind of Petro state in the sense that it's not as dependent on oil revenues. And so to share its GDP. It's got a much more diversified economy. But the real weakness in Russia is the extent to which the Russian government is dependent on revenues from from oil and gas, oil more than gas. And so no 3040 plus percent of revenues in Russia, for the Russian government come from the export of oil and gas, in fact, too, but since 2014 15, they have been really quite fiscally conservative. Understanding that having a social cost of all around 80 to $100 a barrel is simply not sustainable. So they've actually responded by cutting government expenditures, cutting social welfare. And so the at the time the crisis struck, their social cost of war was around $42 a barrel. But what Russia doesn't have is a vision for the future that is preparing them for the time beyond oil. Quite the opposite, that their energy strategy, which has only recently been approved, five years late, is all about developing more hydrocarbons and exporting them to external markets.

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And so there's a real question mark here about the viability of Russia's economic model going forward to the 2020s, which is now in stark relief when we think about what if we have posts post COVID 19, a period of more a longer period of a very low oil price and then falling oil demand. What does that mean economically for the Russian state? What does it mean for the future of Russia as leader President Putin, who on the on the eve of this crisis have promised to use a sovereign wealth fund to spend a lot more money on social programmes and who's trying to bring about constitutional reform to extend this period in power? So if we sort of step back from the, the details of social costs of oil and future oil prices, and what are the implications of this are that the ability or not of producer economies of rentier states to manage this new oil order, the energy transition has critical geopolitical consequences because it results in social unrest, say, within Saudi Arabia because of the breakdown of the social contract with the ruling elite. That is, that is a major source of instability in the Gulf, equally if Russia fails to develop a sustainable economic model, and there's growing political dissatisfaction and social unrest in Russia, that, again, is not a happy, happy, separate set of circumstances. And it's difficult to predict how President Putin and his ruling elite might respond to that exact sort of situation. And so, not withstanding the crisis that we're in at the moment Which is really the sort of the the future and fast forward in terms of the scale of fossil fuel demand destruction.

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What we're suggesting is that actually, the process of economic transition is a geopolitical challenge that needs to be managed. And that we should be looking very carefully at how states like Russia and Saudi Arabia, and others are able to manage a move away from their reliance on fossil fuel rents, like Saudi Arabia has a clear plan. Russia doesn't. And we must start to think about what that means geopolitically in terms of the relative stability of those economies, and the consequences of that both for their near neighbours, but for the wider geopolitics of the energy system. The questions that I'm thinking about now in the context of the research that we're doing around the energy transition and Petro states is what is going to be the nature of recovery. If we look at the lessons from 2008 financial crisis What we're seeing now is a much more significant reduction in fossil fuel consumption and a much deeper cutting greenhouse gas emissions as a consequence. But what we saw in 2008, was a very rapid rebound. And it was only a matter of less than two years before we were back on the path of growing carbon emissions that we would have been on had there not been the crisis. So the question really now is how are how are we going to recover? And in particular, in terms of those two dimensions that I talked about, on the one hand, what recovery mean for the availability and price of oil? Are we going to be in a period of continued low level demand? No, might not demand in the transportation sector recover in quite the same way where we have a different attitude to international airline travel or you know, going into physically work and so on and so forth, which might impact on fossil fuel demand and dust price? But secondly, what will what will Our attitude towards the Paris Agreement and that desire to reduce fossil fuel consumption be, we could have two types of response, I think what one we could, we could parallel what we did in 2008. Which would be to try and prompt a kind of quick and dirty recovery, where we put aside environmental constraints and consumers of fossil fuels to get the economy back on track. Or we could return to those promises of, of clean growth of a green New Deal, and see recovery as an opportunity to drive home. The desire to decarbonize economies, develop renewable sectors, and so on and so forth. And so there's have a green recovery. And that green recovery, again, impacts on fossil fuel demand. So I think this is the main there are calls for environmental groups at the moment not to give up on climate change agreements and on desires to green recovery, the things like the green new deal in the US and a similar vision of the European Union. So I think No, these things have decisions that are made in the next six to 12 months to try and deal with the immediate crisis will again have a longer term implications. We don't want to find ourselves at the end of the 2020s in a situation where achieving the Paris Agreement is all been impossible. So

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I think that that is a critical concern moving forward.