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The development of the oil price

Tilburg
April 27

The oil price in the longer term

by Wim Suyker

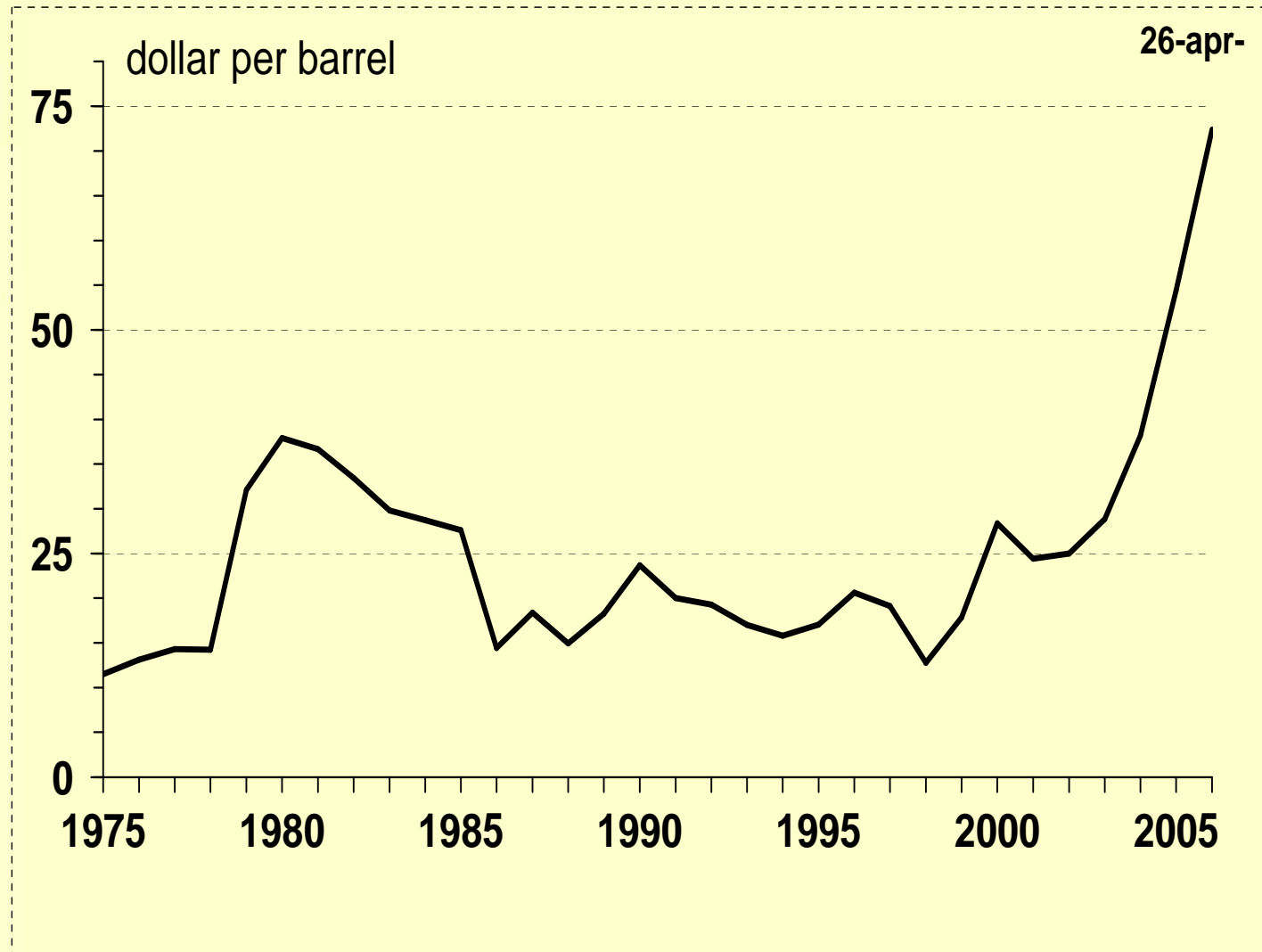
Programme leader at the CPB
(CPB Netherlands Bureau
for Economic Policy Analysis)

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Nominal oil price at record high

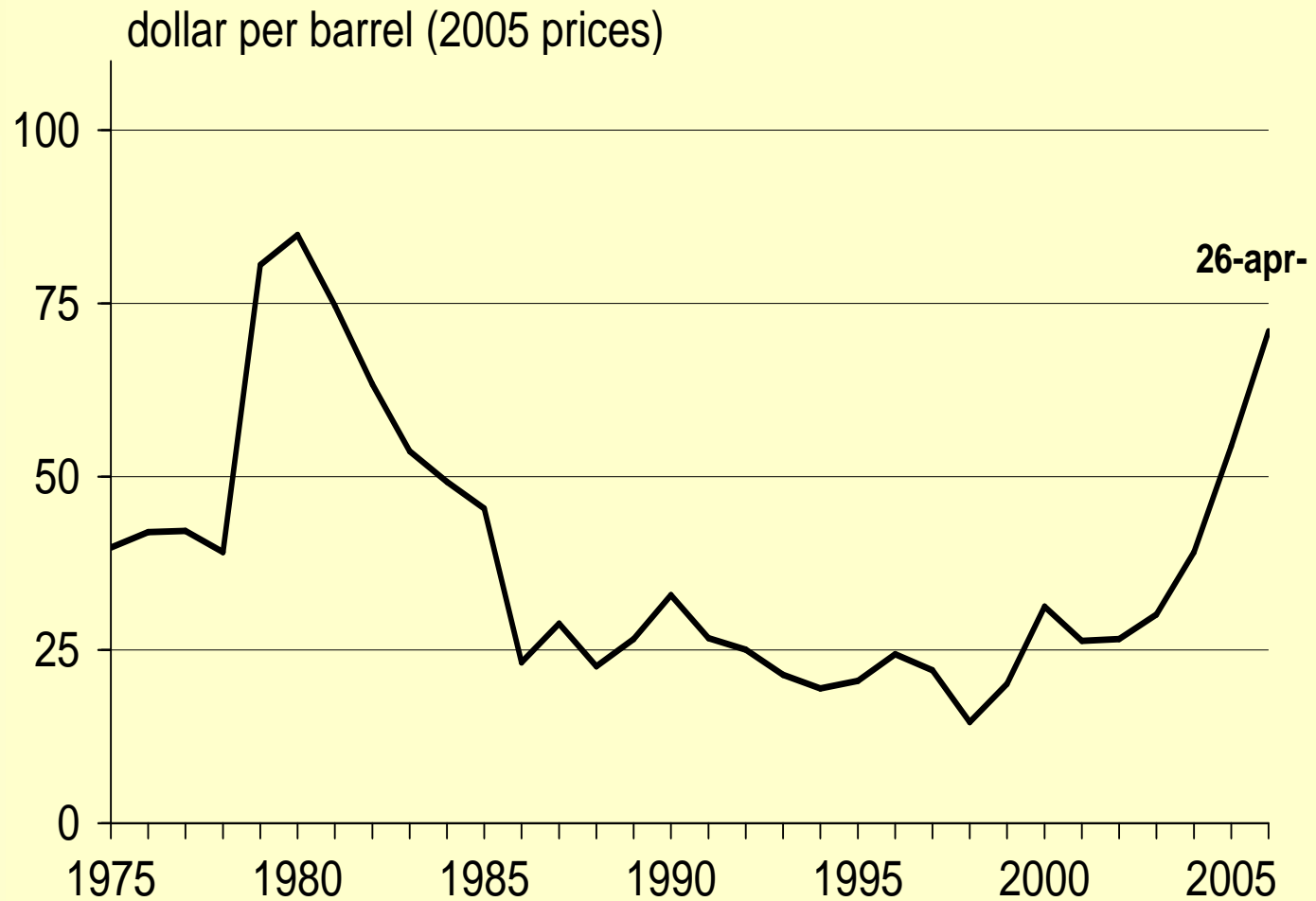


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Real oil price close to record high of 85 dollar per barrel in 1980



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Some proximate causes of the recent oil price rise



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-
- In the short run, prices can diverge from costs.
 - But not in the long run
 - As supply will react.

 - This also holds for oil.

 - Thus: The current oil price is less indicative than costs for oil prices in the future.

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-
- Low price+low profitability = investment DOWN
 - High price + high profitability = investment UP.
 - This also holds for oil.
 - But adjustments lags are substantial!

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Underlying cause current high oil price: slow reaction of supply to prices

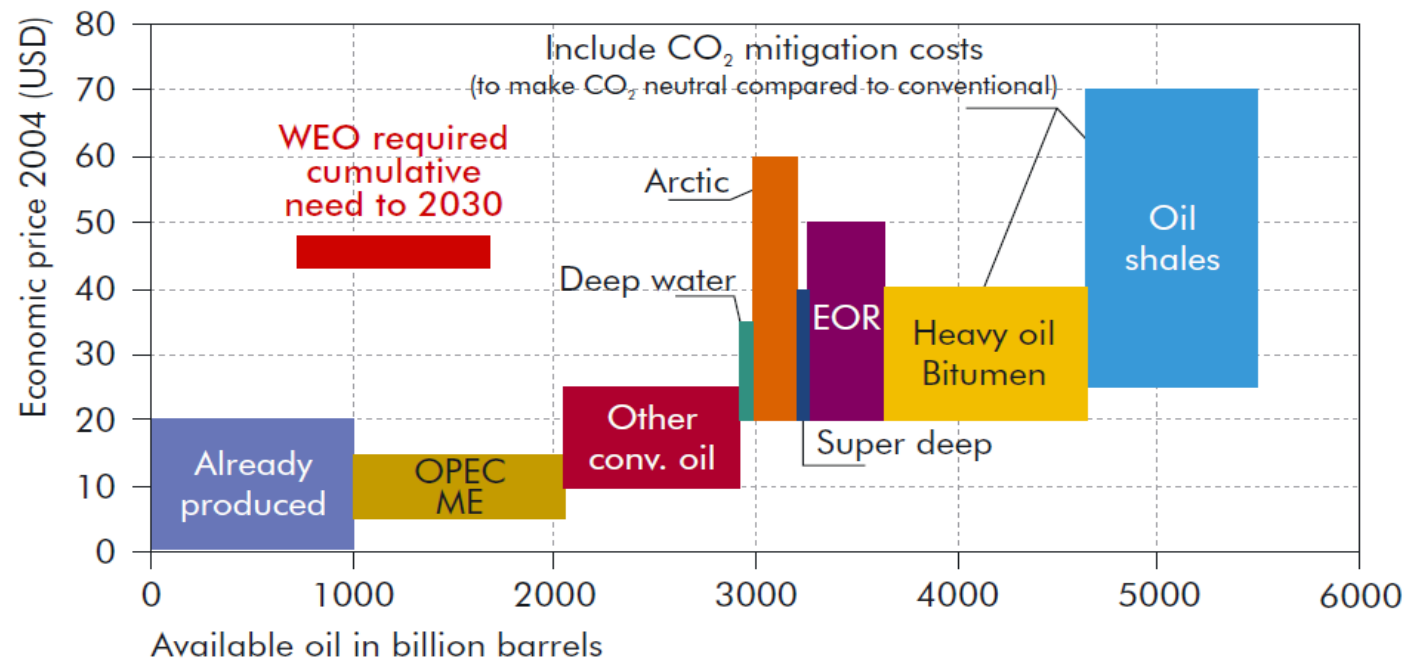
[1935]

The Pig-Cycle: A Rejoinder

By R. H. COASE and R. F. FOWLER

IEA cost estimates of conventional oil: substantially below current prices

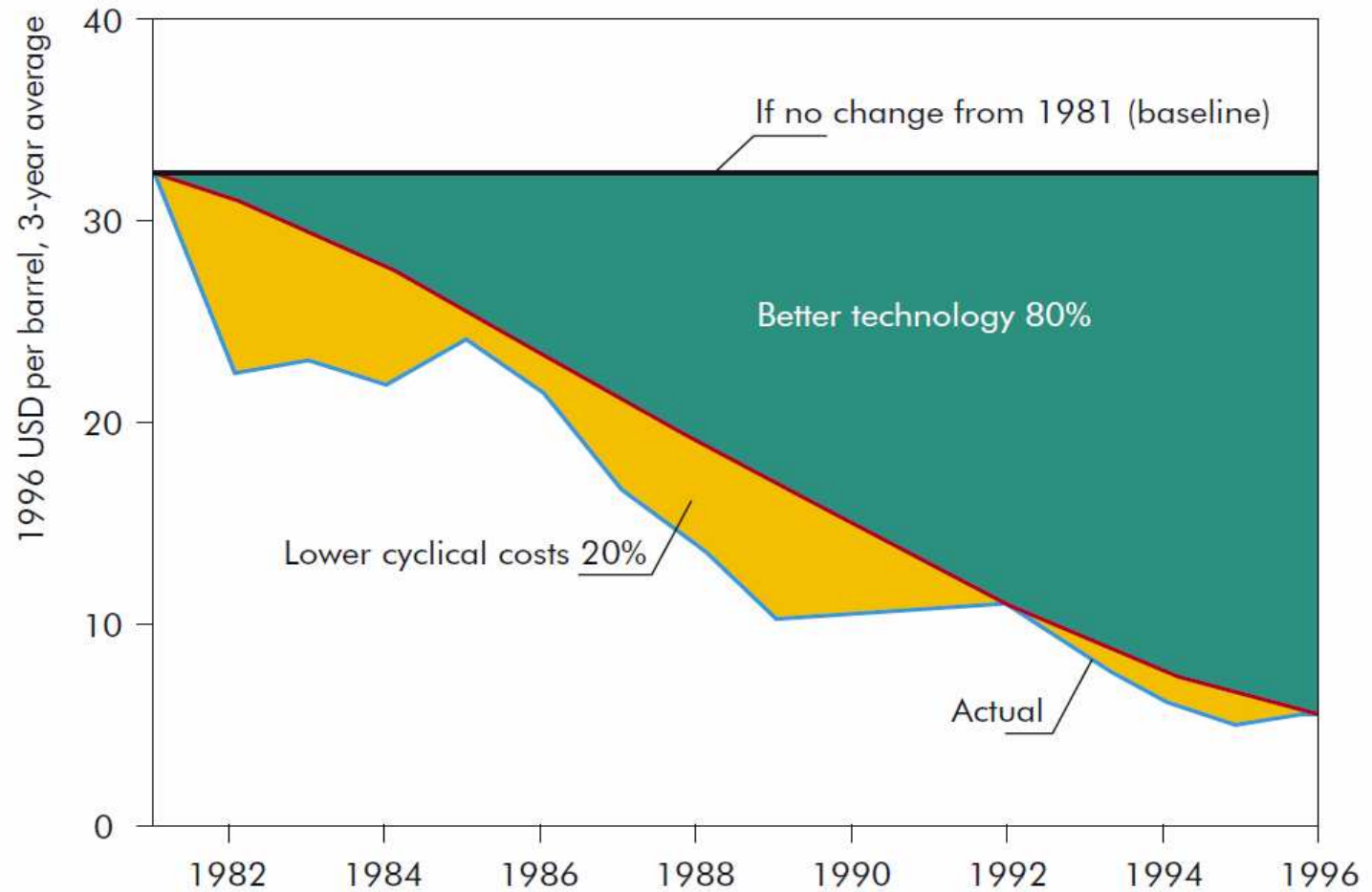
Figure ES.1 • Oil cost curve, including technological progress: availability of oil resources as a function of economic price



The x axis represents cumulative accessible oil. The y axis represents the price at which each type of resource becomes economical.

Costs are falling due to rising productivity

Figure 2.5 • Technology impact on costs for offshore USA



Should we believe the IEA estimates of low oil costs?

- Certainly not.
- One should assess the estimates critically. Such an analysis should not be biased by objectives. One should check whether estimates are theoretically and empirically plausible. One should cross-check with other reliable sources.
- The CPB's conclusion after doing so:
- The oil price is likely to drop to 25-35 \$/b in the long term.

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Thus, we concluded that building very large wind parks in the North Sea is currently economically unviable.



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Further reading

- CPB en ECN, Windenergie op de Noordzee, Een maatschappelijke kostenbatenanalyse, 2005, www.cpb.nl
- IEA, World Energy Outlook 2005
- IEA, Resources to Reserves, Oil&Gas Technologies for the Energy Markets of the Future, 2005
- CPB, Four futures for Energy Markets and Climate Change, 2004
- Kingma en Suyker, Veel gestelde vragen over olie en de wereldeconomie, CPB Memorandum 95 en 104, 2005, www.cpb.nl

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Thank you!

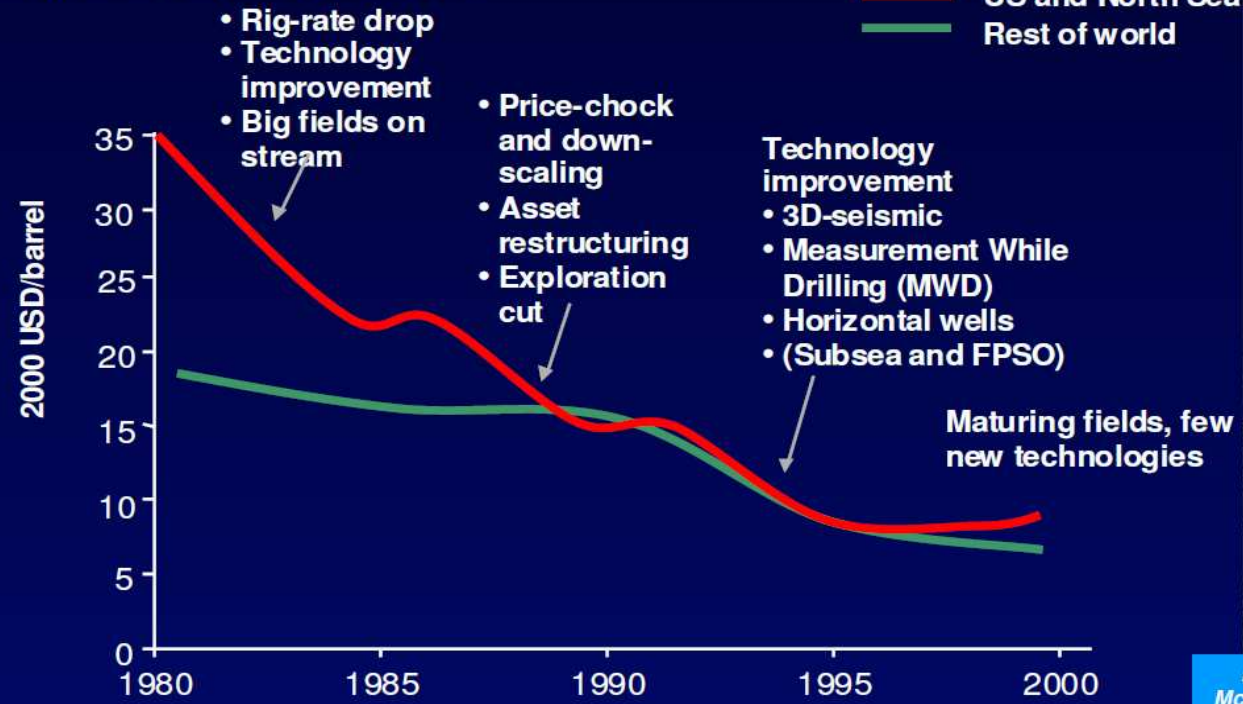
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Cost-curve development

Finding, development and lifting cost



Ref.:
McKinsey
study

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My propositions for the debate

1. Policy goals and analysis of energy issues should not be mixed.

Policy goals and analysis should not be mixed. This also holds for energy issues. Policy makers should set the goals (high income per capita, energy security, preventing climate change etc.) and should have the willingness to let analysis lead where they may. With a cold heart and a clear mind, researchers should analyse the feasibility of proposed policy measures and their costs and benefits.

2. The oil price will drop in coming decades.

In the short run, prices may diverge from costs. In the long run, they will converge as supply will react. This also holds for oil. Thus, with costs estimated at around 25 dollar per barrel, the oil price will drop in the longer term.

3 As the oil price will fall, many alternative energy programmes will not be economically viable

World oil-price developments in the coming decades are not expected to render wind energy and other alternative energy programmes economically viable in the absence of changes in climate policy.