What is the most burning and urgent single energy challenge in today’s world and how do you think governments and businesses should effectively address them?

Firstly the most burning and urgent energy challenge should be determined. To determine it, World Energy Issues Monitor of World Energy Council was used. The World Energy Issues Monitor is based on an annual survey that is completed by energy leaders from nearly 80 countries that are member of WEC and 1045 energy leaders like ministers, chief executives and experts attended to 2015 survey. With using the Issue Monitor, challenge that has high impact, uncertainty and urgency was determined as energy prices / volatility.


Oil price volatility’s determinants are supply-side but its impact is demand-side. To reduce oil price volatility (OPV), both supply-side and demand-side policies should be implemented. Supply-side preventative policies should focus on stabilization of production of oil because throughout history OPV has raised largely because of supply-side oil disruptions. Oil prices are low for now but IEA project that oil prices per barrel will reach about $215 by 2035. For this reason, a global cooperation is vital. Within this context, IEA suggests maintaining of current oil reserves. Beside these, another preventative response to OPV may be that companies and industries which make production heavily oil powered, should maintain individual oil reserves to avoid shock from OPV.

Even if supply-side managing policies are implemented ideally, it can only minimise the OPV. To prevent OPV, a combination of both supply-side policy and demand-side policy are needed. Demand-side policies should prioritise that reducing dependence on oil with reforms of tax and subsidy, increasing industrial energy efficiency and diversification in energy industry. Institutionalised subsidies in non-OECD countries have augmented global dependence on oil and provided a little contribute to reduce oil consumption.

There is big dependence on oil in transportation, reforms of tax and subsidy should strike innovation and transportation. Effective policy reforms which are about energy efficiency standards should be achieved. Facilitating alternatives of energy sources and renewable energy sources are to be one of main goals of the governments. Alternative fuels like bio fuel, gas, non-carbonised electric that can be substitute of fuel in transportation should have financial backing before they can become economically viable.

A system which can identify traders and their current locations should be improved to prevent speculations. Improvements in both physical and financial information systems of oil market would reduce market uncertainty and price volatility by improving accurate and homogeneity of oil prices expectations.

Governments should respond to low oil prices. After a sustained period of price of Brent oil per barrel over $100, oil prices have fallen sharply in third quarter of 2014. Policy response to low oil prices depend on a set of complex factors. These factors include fiscal and external buffers, inflation, exchange rate regime, output gap and terms-of-trade shock.

For oil exporters, circumstance of low oil prices has decreased their incomes. Oil exporters should adjust their policies for low oil prices but how quickly? Pace of the adjustments
depend on fiscal and external vulnerability of those countries. In period of high oil prices, countries which are member of Gulf Cooperation Council like United Arab Emirates, Saudi Arabia, Kuwait and Qatar accumulated large fiscal and external buffers. Also Norway has one of the largest buffers around the world. So these countries can use their buffers to a smooth transition and reduce demand of low oil prices gradually. Also monetary policy should find a right balance between vulnerability and domestic cycle.

Countries with fixed exchange rate regime were impacted by negative term of trade shock. A flexible exchange rate regime may helpful to implement policy response. Also in countries with large buffers, monetary policy should be kept tighten to control inflation expectations and capital outflow. Medium-term fiscal deficits may challenge despite the large buffers. Therefore pace of adjustment should be gradual in line with size of external and fiscal buffers.

But countries which oil export has large share in their income and have not large fiscal and external buffers should adjust policies immediately. Also for those countries a flexible exchange rate regime may be helpful to adjust policies. Those countries already have not large buffers, in case of fixed exchange rate, the countries may have to use their financial resources to maintain current peg.

Oil exporters should adjust their policy to low oil price. This new policy should facilitate to economic growth. Also these adjustments should strike growth in non-oil private sector. In low oil price environment and in countries which have low income, energy adjustments should provide reliable development and growth.

After low oil price shock generally oil importers have made a profit or gained a windfall. For this reason, main question is to be how the windfall should be used. The lower oil prices have increased household incomes of countries which are oil importer. If oil importers have vulnerabilities, those countries should use saving from the windfall for their buffers and slowing decrease in demand of oil. Also the low oil price environment is an opportunity to strengthen monetary policy framework of countries which are oil importer. Besides monetary framework, somewhat windfall can be used for social investments.

If an oil importer country has not vulnerabilities and inflation risk, this country may have negative output gap. In that case, all of the windfall can be spent for increasing domestic demand to oil. Also low oil prices give an opportunity to consider energy taxes.

Oil importer countries which have external and fiscal vulnerability should use their saving from the windfall to implement more sustainable fiscal position and decrease public depts. Emerging countries can spend the saving from the windfall to education, tax cuts and infrastructure.

Companies also should respond to oil prices and volatility. To maintain energy managing in an uncertain oil world, three major areas which can provide flexibility to strengthen their financial position should be focused on.

1-Financial flexibility: Companies should learn how they can manage imbalance between a new level of cash gain in low oil price environment and their internal and external obligations. Strategy of the financial flexibility should include optimising capital structure of the company, refinancing certain loans and restructuring balance sheet.
Also the flexibility should ensure that tax and corporate structure are analysed for maximum benefit, cash balances are optimized and capital performance of the company becomes strong. Reviewing dividend structure of the company and making sure of that cash flow of the company is sufficient to different price levels and maintain current pay-out levels at various price levels. If appropriate, the company divest business units or assets to raise amount of available cash.

2-Portfolio flexibility: Determining which assets have insufficient performance or can be divested are required. The low oil price environment is time to optimize overall portfolio of the company by restricting capital allocations away from high-price and lower-return projects. Companies with strong balance-sheet may acquire challenged business or focus on growth in their core market, the low oil price environment may provide opportunities.

3-Operational flexibility: Executives should have sufficient knowledge about break-even prices, marginal prices and use that knowledge to strain levels of operational capital. Delivering project capital on time and on budget is very critical in this environment.

Companies should restructure their business model according to low oil prices besides this, negotiate with their supply chain and suppliers to reduce expenses and maintain efficiency. Weathering this challenged period may provide opportunity to earn greater success when prices rebound.

While every company can gain benefit with financial, portfolio and operational flexibility, low price environment hasn’t impacted equally every company. Largest oil companies already hedged their fiscal structure for low oil prices; impact of this crisis wouldn’t be too big. BP stated that its business was rebased for low oil prices. Also national oil companies hedged their structure for the circumstance but national oil companies may encounter political pressures. Except these companies, smaller ones which hedged insufficiently for low oil prices may be financially straitened in case of an extended period of low oil price.

Retaining talents in the oil industry would be a problem if low oil price stays low. Key people of the companies may be moved to core assets; also new talents would be required for future.

Consequently, low oil price and volatility is one of the most critical energy issues in today’s world. Basically to reduce impacts of the volatility and price, governments and companies should focus on fiscal flexibility. By hedging fiscal structure, both companies and governments can weather this environment.

Gurkan Hayirtas

References

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