The argument for de-sensitising the UK economy from oil through energy diversification is compelling

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Oil has long been the very life blood of the global economy, and its price fluctuations have in the past had significant economic implications. **Dan Bailey** *argues that the UK economy would benefit from not being so systemically reliant on an exogenous, unstable and finite resource. Capital investment projects designed to upgrade the UK's energy infrastructure would promote long-term economic and environmental stability and sustainability.*

It is commonly understood that the dominant modes of contemporary economic thinking are disproportionately concerned with so-called supply-side issues affecting productivity. In others words, concerned with the identification and weakening of barriers to production in order to promote economic health. Supply-side remedies in public discourse normally manifest themselves in terms of flexibilising the labour market, reducing corporation tax and 'cutting red tape'. Rarely is the finite supply of oil, and the potential macroeconomic effects of oil scarcity, mentioned as a primary concern.

Although it remains on the periphery of political discourse, oil constitutes a significant faultline running through the global economy, potentially conveying and amplifying its price fluctuations as it intersects with sectors such as the food and transport industries.

The free market, cornucopian perception is that the finite nature of oil is a particularly long-term supply-side issue which will be resolved through the innovativeness of the market economy. This deeply-embedded viewpoint holds that energy diversification remains too expensive (partly because the costs of carbon are not priced in) and that the market will respond to peak oil concerns as, and when, price signals guide the way. This has led to a series of short-term fixes including the controversial fracking of shale gas. Energy supplies seem to be guided by a bullish market logic rooted in notion of profit-led market efficiency that is responsive to short-term availability rather than long-term sustainability of supply.

In an age where supply-side issues are normally understood through the lens of the 'free market', it is ironic that when discussing the sustainable use of fossil fuels it is almost a non-market logic that we must adopt. To facilitate sustainable wealth cultivation in this case we must acknowledge the limitations of the market (or, instead, where the market fails to respect the limitations of the planet) and demand state action to ensure long-term economic and environmental stability.

That the historical volatility of oil price movements and their effects on Britain's economy has, thus far, not prompted significant policy change towards energy diversification can be seen as surprising in itself. Even in the short-term the UK economy could benefit from not being so systemically reliant on an exogenous, unstable and finite resource.

Oil price movements exerting a heavy influence on economic performance is certainly not without precedent. The appreciation of oil was complicit in the balance of payments deficits and 'stagflation' which induced the demise of the Keynesian paradigm in the 1970s, and peak production of North Sea oil in the 1980s was an enormous boon to Margaret Thatcher as this sector contributed up to 6% of GDP in her premiership.

It could also be argued that oil price movements played a (supporting) role in the economic implosion of 2008. As Colin Hay recognised the Anglo-liberal growth model was predicated upon the nexus of low inflation and low interest rates in order to maintain a booming housing sector and the affordability of household debt. The raising of interest rates in 2007 and 2008, intended to control growing inflationary pressures, exploded the housing and consumer bubbles and ultimately led to the financial crash. One of the primary inflationary pressures which policy-makers were responding to, however, was the appreciation of Brent Crude oil. The price of Brent Crude had risen from $18.71 a barrel in December 2001 to $132.72 in July 2008. This had created an inflationary headache for policy-makers which the Bank of England responded to.

Therefore, the sensitivity of the UK economy to oil has been pronounced in recent decades. Indeed, oil prices continue to hamper the economic recovery as acknowledged by the International Energy Agency. Oil price movements have long been correlated with economic performance. Oil is the very life blood of the global economy, and its accessibility has been central in securing centuries of rising living standards and underlying recent economic downturns. It remains surprising how invisibly the self-obsessed human economy is contingent on the future of our natural resources.

In the long-term, the argument for de-sensitising the UK economy through energy diversification is even more compelling. Whilst the systemic reliance on oil has left Britain vulnerable in recent decades to wholesale price rises and geopolitical shocks, in future years the inevitable culmination of our unsustainable exploitation of the natural environment will result in the declining availability of global oil.

Peak oil concerns have been around since the 1970s, but it remains the case current oil usage relative to discovery dictates that at some stage future oil supply will be unable to meet demand. Oil is ultimately a finite resource and, as Andrew Simms makes clear in his new book, a range of institutions estimate that we are either living through, or near, the peak of global oil production.

Global supply will eventually peak whilst global energy consumption continues to grow at approximately 2.5% per annum. These forces, compounded by financial speculation, will conspire to generate geological scarcity and price volatility, with dramatic consequences for the global economy. In short, the 250-year fossil fuel binge is almost over.

Such environmental developments could arrest an economic recovery even in its own terms. Policy-makers and academics consequently need to pose questions about what an economic recovery can sustainably be fuelled by. These are not issues that can simply be 'priced in'.

Calls for capital investment projects to establish renewable energy infrastructure have been muted since 2010, as the Green New Deal ideas have slipped from the political agenda. Yet the benefits of these capital investment projects, in combination with efforts to scale-up local energy micro-generation ventures, are manifold and respond to the holistic nature of the political economy challenges we face. They would create jobs, mitigate environmental degradation and help immunise Western economies from a significant structural vulnerability which has already contributed to the global economic slowdown.

The sustainability of energy is a potentially momentous supply-side issue and it needs to be part of our economic discourse in this period of re-construction. The Sustainable Development Commission have shown that there is great renewable potential in parts of the UK and that it is possible (even without resorting to nuclear power) to meet our energy needs in a low-carbon and sustainable manner. There are few policies which respond jointly to both our current economic and environmental predicaments, but capital investment projects designed to upgrade the UK's energy infrastructure would promote long-term economic and environmental stability and sustainability.

The initial costs of energy diversification have been politically unappealing to many, but the state's economic role should be concerned as much by long-term issues of energy stability and resilience as much as the short-term price signals of the market. Long-term strategic thinking centred upon sustainability, rather than profit, is needed from the state to acknowledge the limitations of the market in managing energy supply and the planet's biocapacity.

Note: This article gives the views of the author, and not the position of the British Politics and Policy blog, nor of the London School of Economics. Please read our comments policy before posting.

About the Author

Dan Bailey *is a PhD candidate at the University of Sheffield. His work focuses on sustainability and the welfare state from a political economy perspective. He is the Co-Editor of the White Rose Politics Review, and can be found on Twitter at @DanBailey85.*