The Oil Drum: Europe
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

Countdown to $200 oil (3) - no gas tax needed...erm, right...

Posted by Jerome a Paris on May 8, 2008 - 8:59am in The Oil Drum: Europe
Topic: Demand/Consumption
Tags: $100 oil, $200 oil, gas tax [list all tags]

This story is part of my new Countdown to $200 oil series, which is the successor of my earlier, and now terminated by reality, Countdown to $100 Oil series.

As in previous years, I got my ass whipped in my latest attempt to suggest on Daily Kos that gas taxes should be increased, despite the fact that the place is completly dominated by Obama fans and Obama's solid stance against the gas-tax holiday.. Some commenters kindly called me a "rich elitist f*ck from Europe" (guilty on all counts, of course) for wanting to bankrupt poor Americans who cannot do without gasoline, preferably cheap, and are already struggling mightily.....

And that was despite my acknowledging upfront that a gas tax increase is politically deadly, and highly regressive, and my corresponding suggestion to make it part of a plan to (i) directly support those hardest hit by revenue transfers and (ii) use the money raised to invest in alternatives (public transport, renewable energy)

Of course, the fact that oil prices are reaching new highs almost every day these days might have given them pause for thought. As might this, which further underlines that this is not a short term phenomenon:

> Oil moves above $120 mark
>
> The entire WTI futures curve is trading well above the $100-a-barrel level with the longest dated contract for December 2016 up $1.57 to $110.55 a barrel on Monday, signalling the market's **consensus that $100 oil is here to stay**.

Oil prices are going in one direction only, and there's a very simple reason for that: market forces.

Market forces say that when demand is growing, prices will go up, which will encourage new supply to be provided, and some demand to be discouraged. But oil is a very atypical market right now:

- demand is growing in China and other places, as lots of people reach the income level that makes it possible for them to afford cars;
- demand is growing in oil-producing countries, as the oil bonanza of the recent few years brings them prosperity and massive growth in car ownership and economic activity;
- a number of countries, including those oil-producing countries that just have to dip in their production to fulfill demand, and many countries that try to support their citizens, further encourage oil demand via price controls or subsidies (their consumers are not subject to market prices and thus are directly unaffacted by them, even if their government are);
- meanwhile, supply growth, which used to be the easiest way to balance the market in the presence of strong demand growth, is no longer happening. Production has been flat for the

past 3 years and there are increasing doubts that it can increase in the coming years. Whether this is because of peak oil, because of lack of investment, or because of political games by oil-rich countries is essentially irrelevant: the fact is that supply is not responding to increasing prices.

With growing, and largely price insensitive, demand on one side, and flat supply on the other, something has to give. Price increases are not the only consequence: they have to bring about market equilibrium. And given the above constraints, it can happen only by causing demand to shrink elsewhere, ie in the US, Europe and the non-emerging parts of the Third World.

Oil importing countries in the poorer parts of the world are suffering mightily from higher prices, and limiting their consumption, but the overall volumes are too small to make a big difference. Letting Africa slowly die is not going to be enough,

Thus Europe and the US have to bear the brunt of demand reduction. But here's the problem: our demand is not very elastic either, and we either have to do without our cars, or be willing to pay a lot more than now for the convenience of driving them. But demand must shrink. So what happens?

Well, it's simple: prices have to go high enough to destroy demand. Given that we really don't want to do without our cars, the pain has to be bad enough to actually cause (undesired at lower prices) changes in behavior. Thus, VERY high prices.

One would expect such high prices to also bring online a lot of new supply, including from unexpected sources. It is happening a bit (biofuels being one exemple, coal-to-liquids another), but nowhere near the scale it's needed. It appears that demand destruction in the West is still, at current prices, the easiest way to actually balance the oil market, however unlikely that may seem, and however painful it is for us.

But given that Chinese demand is growing by 5-10% per year, and that Saudi, Iranian or Russian exports are dropping (as their production stagnates and their domestic demand continues to jump), we need to destroy yet more demand each year.

Thus, higher prices will happen. It's inevitable.

Well, there is an alternative, actually: shortages and rationing. Maybe that will create the urgency that the current situation seems unable to create yet.

And maybe we'll start having an energy policy that works, rather than one that does nothing and lets the poor gets slowly squeezed with no hope of any solution in sight.