Energy shock inevitable

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Governments were distracted in 2009 and 2010 by the global financial crisis and a slackening of energy demand. They were also distracted by the need to respond to very difficult climate-change negotiations in Bali, Copenhagen and Cancun. They may have been lulled into a false sense of security about the future supply of oil.

In the short term, the International Energy Agency's emergency oil stocks regime is there to manage supply shortages and, in the long term, substitute fuels will be available from a diversity of sources. In the meantime, inter-fuel substitution will remain inelastic, costly and slow.

Airlines, shipping companies and trucking firms are particularly vulnerable to the risk of disruption to their businesses. It is not just the transport sector that could be affected by an oil crisis. Mining operations, such as iron ore and coalmining, that depend on a continuous supply of liquid fuels, would also be exposed. Major public services, including police, ambulances, fire brigades and waste collection, would be affected and, if the reliable supply of transport fuels to the navy, army or air force of any country were to be threatened, national security concerns would arise.

The real culprit is the increase in global energy demand – principally, accelerating levels of urbanisation and industrialisation in the rapidly developing economies of Asia – without adequate counterbalancing on the supply side. Because oil supply is exposed to uncontrollable geopolitical risks, such as war and terrorism, and the possibility of arbitrary production constraints, importing countries may today be more vulnerable to an oil crisis than ever before. Oil is the most strategically important commodity in the world. There are limits to which consumers of strategically important commodities can or should expose themselves to the risk of market disruption.

The oil market as now structured will possibly fail at some point. Each country must develop its own country-specific response to this excessive oil-dependency problem. At the very least, this will entail further diversification of all fuel types and all sources of each fuel, and greater investment in more efficient, low-carbon technologies, including electric vehicles.

The most exposed economies are those with the highest levels of oil import dependency and relatively low levels of indigenous oil resources.

These are Japan (100 per cent dependent), Korea (100 per cent), India (76 per cent), the United States (61 per cent) and China (56 per cent).

The largest importer by volume is the United States, which in 2009 imported an incredible 11 million barrels every day of the week.

Australia is in a unique situation where, despite its 40 per cent oil import dependency, it is the world's largest exporter of coal as well as a major exporter of liquefied natural gas and uranium. This underscores the fact that energy security issues are not confined to oil. An energy green paper is being prepared in Australia but its finalisation has apparently been delayed by the need to further study how energy and climate-change policies can be reconciled.

For decades, the oil and gas industry has lobbied governments to accelerate investment in upstream development and refining capacity by providing investors with competitive fiscal and regulatory regimes. However, the principal oil-producing countries have mostly not followed this advice. Those with national oil companies have preferred to keep their resources under state ownership. Most have wanted, understandably, to retain as much as possible of the value of the resources. Resources nationalism is alive and well.

With many producer governments not allowing foreign investment in the oil sector, and with 10- and sometimes 20-year lead times for new project development, these unilateral policies are no longer enough to stave off a 21st century oil crisis. There may be no need for panic but there is a need to reassess the systemic risks inherent in the current arrangements.

Innovative market restructuring should be explored: supply chains may need to be reviewed; greater cross-border collaboration involving supply-side and demand-side participation may need to be negotiated; greater levels of vertical integration may need to be promoted; and risk management safeguards may need to be more explicitly factored into commercial arrangements.

Governments, for their part, will need to consider and adopt policies that promote and facilitate, not impede, the

adjustment process.

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