Opinion

To fight new global perils, we must beef up the UN

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Oil is too important to leave to market forces

A six-point plan is needed to see off the latest threat to the economic stability of the world

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Towards the end of last year, as financial panic about the global credit crunch reached its climax, I wrote that a taxpayer-backed "plan B" would soon be needed to the save the world banking system. If financial markets failed to clear up the sub-prime mortgage mess by the end of the first quarter, the consequences would be so horrific that governments would have no choice but to step in.

This government-backed plan B was implemented in late February and early March with the rescue of Bear Stearns and the nationalisation of Northern Rock. As a result, the credit crunch is no longer a big threat to the world financial system, even though its painful impact on the British and European economies has only just started.

As the banking crisis has eased, however, a far greater danger has emerged to global prosperity: the price of oil. It looks increasingly as if this is another challenge that cannot simply be left to market forces. So is it time for a government-led plan B to curb the price of oil? I believe it is — and there are growing indications that world political leaders are starting to think along these lines.

The present oil boom looks reminiscent of the housing bubble, the dot-com bubble, the Japanese share bubble and all the financial bubbles before that. It started with a genuine and important structural shift in the world economy — the growth of China and the decline in non-Opec oil production — but financial markets have magnified this beyond all reasonable bounds.

But another more important aspect of the oil boom is now attracting political attention: An oil price above $100 a barrel is an enormous danger to the world economy. It threatens to reignite global inflation, wreck development plans in China and other emerging countries and magnifies geopolitical risks by redistributing some 7 per cent of global GDP, roughly $4 trillion per annum, from the stable societies of America, Europe and developing Asia to potentially hostile regimes. These regimes then leak this money to Wahhabi fundamentalist madrassas, communist insurgencies in South America and mafia activities from former Soviet states.

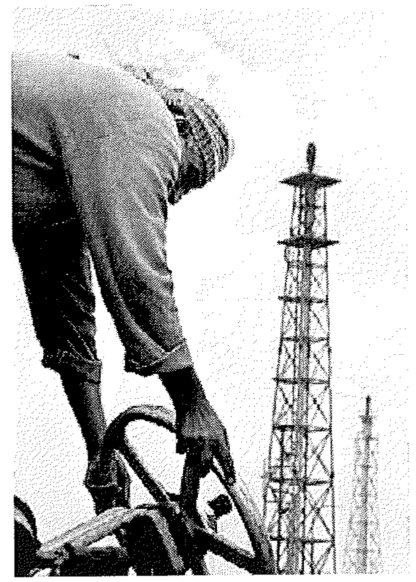
As politicians and voters start to grasp this, pressure is mounting for something to be done. As a result, a series of energy-related summits has recently been announced, starting with an emergency meeting of oil producers and consumers in Saudi Arabia and culminating in the G8 leaders' summit in Japan in July. What, then, might a Plan B to reduce oil prices consist of? And could it possibly work?

The second question can be answered by a leap of imagination: suppose first that China and other developing countries, which now account for all of the growth in global oil demand, stopped insulating domestic consumers and industries from high global oil prices. They could do this, without immediate hardship or political unrest, by abolishing all their energy subsidies. To soften the blow to consumers, they could raise domestic prices over a period of three to five years. Once prices reached global levels, they could gradually introduce European-style energy or carbon taxes to limit oil dependence, control pollution and encourage industries to adopt energy-efficient technologies, perhaps even leapfrogging Europe and the US.

This may seem wishful thinking, but in the past few weeks, Indonesia, Malaysia, Taiwan and India, have announced measures along these lines. The world is now waiting for China to recognise that it too has an overwhelming self-interest in becoming energy efficient — and that raising domestic energy prices is the best way to achieve this.

Secondly, suppose that the EU agreed to a minimum level of petrol and diesel taxes across Europe, set by each country within 10 or 15 per cent of the highest level at present prevailing in the EU (which, depending on exchange rates, is in Germany or Britain). By reducing tax competition, such a policy would remove a main gripe of lorry drivers and transport companies in countries with high energy taxes. This minimum energy tax could be raised by 3 per cent above the rate of inflation each year.

Thirdly, suppose that the US, Britain, Norway and other non-Opec oil producers reduced — or abolished — oil production taxes and royalties on any extra new oil produced in their territories. This would create powerful incentives for oil companies to extract every possible barrel from existing oilfields.



Oil at above $100 a barrel is a huge danger to the world economy

Fourthly, suppose that either of the main US presidential candidates announced firm targets for achieving energy independence — for example, that US oil imports, already roughly static, would be reduced by 5 per cent every year.

This target could be met by setting energy or carbon taxes — refundable to consumers through income tax cuts — at whatever level was required.

Fifthly, suppose that revenues from steadily rising petrol and diesel taxes in Europe and America were earmarked wholly or substantially to subsidise non-oil or zero-carbon energy sources.

Finally, suppose that financial regulators in America and Britain curbed commodity speculation and discouraged long-term investment in oil by financial institutions. The most important of these changes, proposed in the recent Senate hearings, would close the loophole that allows investment banks, such as Goldman Sachs, to enjoy the same privileges as oil producers in commodity markets.

Regulators and politicians are starting to recognise that investment by pension funds in commodities is detrimental to the interests of the world economy because commodities are not productive assets in the same way as company shares and that investors who buy commodities serve no social purpose, as they do when they buy government bonds.

Would such a six-point plan have any effect on global oil prices? "Market fundamentalists" — who believe that today's stratospheric prices reflect an imbalance between supply and demand — would presumably claim that announcing higher taxes on oil in the future would reduce the price only once these taxes were imposed.

My guess, however, is that the sort of Augustinian programme suggested above — raising prices to consumers but not just yet — would have an immediate and powerful effect on prices, especially if the tax measures were matched by restrictions on speculation and financial investment.

This could, of course, be wrong. But there is only one way to find out.

The oil-consuming nations have to agree on a plan B to cut oil prices, just as they agreed on a plan B to ease the credit crunch. And they have to do this within a matter of months. With the outlook for the global economy deteriorating almost daily, the time to let market forces solve the energy crisis is running out.