

## **‘Tackle volatility in oil prices’ to bring global economic growth**

The volatility of oil prices is ‘a fundamental barrier to stability and economic growth’ says a new study by the University of Oxford, published in *Frontiers in Energy*. It recommends a raft of measures to bring prices under control, saying the amount of speculative trading taking place in the oil derivatives market is a large part of the problem. It suggests the ‘behaviour of speculators compounds existing volatility’ and previously unrelated volatility is spilling over from the stock market to the oil market and vice versa. This has changed the nature of the oil derivatives market, driving it away from its original purpose of ‘hedging’ – a means by which businesses could protect themselves against price fluctuations, say the researchers from the Smith School of Enterprise and the Environment.

While the authors welcome the European Commission’s proposed Financial Transactions Tax on transactions in the oil derivatives market, they say the amount (pegged at 0.01%) is too small and therefore unlikely to deter speculators. It could even carry the risk of curbing hedging as an unintended consequence, says the report. They conclude that the planned EU tax for financial transactions is a good first step, but unlikely to be sufficient to cut out unnecessary trading.

In the study, Sir David King, Dr Oliver Inderwildi and Zoheir Ebrahim recommend a combination of policies to tackle both the supply and demand side of the oil industry. They highlight the importance of collective action, such as the strategic oil reserve administered by the International Energy Agency (IEA) that can effectively be used to reduce price volatility in times of crisis. The study says given the IEA’s projections of oil prices reaching at least \$215 a barrel by 2035, global cooperation is fundamental to the management and reduction of future price volatility.

‘In this regard, the IEA collective action framework, which mandates the maintenance of strategic oil reserves, has been highly effective on several occasions in reducing the extent of price volatility in the context of oil-supply disruptions,’ says the report. It recommends strengthening and expanding such frameworks to improve future market stability.

The study also suggests the introduction of new regulation to make it mandatory for major oil-reliant industries to maintain their own oil stocks, thereby insulating oil prices from sudden spikes during crises in oil-rich parts of the world.

Governments should provide incentives to businesses and companies investing in infrastructure that promotes alternative fuel and energy sources or that develop new greener energy provision, says the study. The authors note that additional unconventional fossil fuel resources obtained through processes such as fracking are due to come online over the next decade, suggesting this is ‘highly likely’ to keep resource prices at a relatively low level. It describes this development as ‘terrible news for the environment’, but ‘excellent news for the economy’ which will ‘buy us time for decarbonisation endeavours’.

To reduce the volatility of oil prices in the long term, the study says governments need to take charge of the ‘politically challenging task’ of removing subsidies on fuel, particularly in non-OECD countries where fuel subsidies are institutionalised. It says policies aimed at improving energy efficiency, such as the adoption of fuel-economy standards and government requirements for greater energy efficiency, provide a significant opportunity to reduce demand for oil.

Dr Oliver Inderwildi said: ‘Unconventional fossil fuel resources are a blessing at the moment as cheap fuel will support the global economic recovery. In the long term, however, we have to reduce our reliance on fossil fuels because of the great damage they are causing to the environment and the toxic economic effect of price volatility. This will require many measures, from extending the strategic oil reserves to the restructuring of derivative markets and large-scale investments in modern, energy efficient infrastructure.

‘Reducing our dependence on fossil resource should also increase the energy security of OECD countries and in the long term, as a knock-on effect, this would also be likely to improve relations in areas where there are geopolitical tensions. However, this can only be achieved if countries that depend on imports of resources like oil and gas take collective action.’

*For interviews or the full study, please contact the University of Oxford News and Information Office on +44 (0) 1865 280534 or email: [press\\_office@admin.ox.ac.uk](mailto:press_office@admin.ox.ac.uk)*

**Notes for Editors**

\*'Macroeconomic impacts of oil price volatility: mitigation and resilience' by Zoheir Ebrahim, Oliver Inderwildi and David King is published in the journal *Frontiers in Energy* on 28 January 2014.

\*An oil price shock is a manifestation of extreme volatility. For the purposes of the present study, which focuses on oil price volatility as opposed to shocks, it is reasonable to understand the distinction between both measures in terms of the size of price deviations. Acute deviations in oil prices, such as those seen in early 2008 are termed shocks, while relatively minor price deviations are referred to as price volatility.

\*The Smith School of Enterprise and the Environment is an interactive hub within Oxford University that engages with, educates and equips public and private enterprise with the solutions, knowledge and networks needed to address the major environmental challenges facing our planet.

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