Asinus Muses

Asinus has been musing on oil markets. Or more accurately, Asinus has been listening to better-informed people meditate, deliberate and pontificate about oil markets at the Oxford Institute for Energy Studies' first *Oil Day*. Do speculators spoil an otherwise-honourable institution? Would regulation ruin legitimate businesses? Are the dramatic ups and downs even a problem in the first place? The well-groomed look of the great and good who attended was evidence enough that the vagaries of the oil price have not forced too much belt-tightening in their personal cases. But then a criterion for being great and good is the ability to look beyond the demands of one's own paunch to the larger needs of society – the topic of the day.

And what are those needs? With oil bouncing from $147 to $33 to $80 in 15 months, it was widely agreed that less pronounced swings would be desirable. Widely, but not universally: Asinus spotted a loose but positive correlation between the amount of economics training a participant had and his or her equanimity with respect to oil's volatility. In Asinus's opinion this belies the mythic status of economics as a dismal science. At times it seems that economists, in fact, are bothered by very little, on the basis that everything has a perfectly good explanation even if we haven't spotted it yet. They seem to share the view that the Lord moves in mysterious ways, although the chap in question would be our friend the rationally optimising and forward-looking representative agent, rather than the big guy with the beard.

Why, on this view, might the grumbling be an over-reaction? Well, the oil price was high because the world and its demand for oil were growing fast. The oil price was low when it looked like the financial services sector had just delivered us back to the stone age. Now that confidence has returned, it is surely correct that oil is up again. Indeed, the futures curve has been rising, collapsing and recovering along with the prompt, suggesting that all was being driven by our friends the fundamentals.

But was it really the fundamentals? As after every great crash, certain observers have decried the shadowy figure of the speculator plying his evil trade at our expense. This shifty wretch allegedly fills his pockets with gold by betting against the side of the market composed of decent commercial producers or purchasers of petroleum, trying to make a living on the basis of true demand and supply fundamentals. (Asinus is interested to note that the financial market is perhaps the only arena in which fundamentalism is supposed to be the more honourable position.) Fortunately, it was unanimously agreed that this popular dichotomy is a confusion. If you enter the futures market you take a view on the price. If you are right you make money; if not, not. This simple logic determines the behaviour of all participants, commercial or financial, whether their core business is pumping oil, burning hydrocarbons, or shuffling bits of high-value paper. And those who have no more than little black boxes, betting simply on the numbers and the patterns they trace, or the positions of the stars, add no more than harmless daily noise.

Even if speculators are not the problem, many participants were not so content with the large swings in price. What should be done about them was a more difficult question. It seems there is one theme on which economists are reliably gloomy, and that is any attempt to try to do something about the imperfections that most of us perceive in the world. But in this case the economists were not alone: even if oil price swings are undesirable, many believed that attempts to regulate the price would be futile, disastrous or both. If energy markets are swept up in the anti-finance fervour of today's regulators, repentant at their former negligence, then smaller energy producers may find it impossible to raise money for legitimate investments. The sins of the banks should not be visited on the rest of us.

But on attempts to stabilise the oil price per se, a few radical voices stood out against the sceptics. Asinus has previously mentioned Robert Mabro's scheme, in which an Oil Price Committee, along the lines of the Monetary Policy Committee of the Bank of England, would manage the price with the support of the USA, Japan and Saudi Arabia. ENI have also come up with a scheme for stabilisation. Noting that spare capacity is required to manage the price, but that spare capacity does not pay, their plan involves all oil market participants paying a small tax to those who hold it to make it profitable. The thought of subsidising the Saudis may not have universal appeal – do they really need more 25-foot-long SUVs? But it can hardly be more galling than million-dollar bonuses to bankers in thanks for breaking the global economy.

Asinus, at least, (despite his economics training) can see the argument against the more sanguine view of the oil price. Indeed, it can be argued that the future's following of the prompt price makes a mockery of the notion that the market is engaged in 'price discovery'. In such circumstances allowing the futures price to guide our actions is like taking comfort in the fact that, when you turn to the right, your broken compass turns with you. The usual outcome in these circumstances is to walk in circles. As the more trigonometrically-minded will know, walking in circles on a moving path results in a sine wave. Throw in a couple of large whiskies and you get the oil price.

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