



Pathfinder Energy Alert

From Black Gold to Bronze

Declining trend in world energy prices and its policy implications for Sri Lanka.

Changing Energy Landscape.

The Foreign Affairs journal published by the US Council on Foreign Relations is a ‘highly’ respected newsletter in spite of its partiality towards broader US security interests and its animosity towards rival countries such as China, Iran, Russia and the like. In its December 2012 volume a detailed description of how the current energy map of the ‘world is being redrawn’ has been vividly analysed.

The fundamental premise of the article is that during the next 5-10 years the current predominant prices of energy, such as petroleum and natural gas, will decline reducing the annual revenue of major oil and gas exporting countries, including Saudi Arabia, Russia, and other Middle Eastern countries. The key driver behind the changing landscape has been identified as technology breakthrough in drilling and extraction from shell gas formations. This change in technology has made the energy production process less complex and relatively low-cost. The latest technology and processes termed as *hydraulic fracturing* and *horizontal drilling* has led to remarkable progress in producing relatively cheap large volumes of energy. Initial concerns regarding the impact on the environment and water supplies have largely been addressed.

Emerging Petroleum and Natural Gas Supply Glut.

According to the Foreign Affairs article authored by Aviezer Tucker hydraulic fracturing has resulted in creating a substantial supply glut of natural gas in the United States. As a result of this supply increase, the price of natural gas in the country has experienced a dramatic decline to a quarter of what it was in 2008. ‘The low price has prompted changes throughout the US economy including projected retirement of 1/6th of US coal power generation capacity by 2020, the conversion of hundreds of thousands of vehicles from gasoline to compressed gas and the construction and repatriation from China of chemical, plastic and fertilizer factories that used natural gas as both raw material and fuel by 2025.’ These developments in the US alone will have far reaching economic implications beyond its shores. These effects are likely to be greatly amplified around the world as the new “fracking technology” is expected to unlock massive supplies of oil and gas.

The PF wishes to focus in this Economic Alert on the possible impact on broader Middle East and Asia with specific reference to strategic direction of economic policy making in Sri Lanka.

Boost for Asian Economic Power Houses

It is reported that during the last 9 years US oil imports mainly from the Middle East has reduced from 60% of total consumption to less than 45% today. It could be safely assumed that this trend will continue until US reaches zero level dependence on oil imports. As hydraulic fracturing and horizontal drilling technologies will become widely available to the EU and other major oil importers such as China and India, countries which thus far have played dominating roles in world economics and politics will experience an eroding of their power and influence. This is more so with regards to current energy exporters such as Saudi Arabia, other Middle Eastern countries, and Russia.

In this changing environment the economic beneficiaries in Asia are larger oil and gas importers including China, India and Japan. The reduced cost of importing energy will provide a further boost to these emerging economic giants. This will have a positive impact on highly energy dependent economies such as Sri Lanka.

Sri Lanka's Energy Future

The anticipated sharp fall in energy prices will have the following implications for Sri Lanka.

- At present Sri Lanka's annual petroleum import bill amounts to Rs. 624,000 million. A 20% - 30% decrease of this expenditure will provide a boost to the balance of payments. (The trajectory of declining energy prices, and hence the extent of foreign exchange savings, will depend on the balance between increased supplies made possible through the new "fracking technology" and increasing demand from large emerging market economies and other developing countries.)
- As against this, lower levels of economic activity in the Middle Eastern oil-exporting countries are likely to have a negative impact on foreign remittances earned by Sri Lanka.
- Lower energy prices will eliminate the need for energy subsidies. This will provide a boost to fiscal consolidation.
- Lower energy prices will have a positive impact on the cost of living by reducing prices pressures across the economy.
- This will also enhance the competitiveness of the economy. Though other countries will also benefit similarly, Sri Lanka is likely to enjoy a greater advantage as its energy costs are relatively high by international standards.

Strategic decisions need to be taken regarding Sri Lanka's energy policy in the context of rapid technology-driven changes in the global landscape. Sri Lanka has significant installed hydro and coal capacity. Non-renewables account for about 8% of the current electricity generation mix. Additional coal-based capacity is being built in Sampur and commercial quantities of natural gas have been discovered off Mannar. There are several other lots which are yet to be licensed. Hard-headed decisions need to be made. The benefits of developing new coal-based power generation capacity and/or the expensive natural gas supplies from the "marginal fields" off the Mannar coast need to be weighed against the forecast that imported fuel costs are likely decline in the future (though the actual trend in prices will depend on the balance between rapid increases in both supply and demand). The technical analysis should be located within broader strategic considerations related to the country's energy security.

Danger of Petroleum/Gas Discoveries: Giving in for Opportunism at the Expense of Competitiveness

While the Sri Lankan political leadership, policy planners as well as businesses and ordinary citizens of the country could 'feel good' regarding emerging trends in energy prices, it also signals that the benefits of our own findings of natural gas and petroleum reserves will be more limited. In many countries where large-scale corrupt practices are prevalent, natural resources have become a curse rather than a blessing. The discovery of natural resources can disguise bad economic policies as well as inefficient and wasteful state-owned enterprises, especially monopolies. This could provide a cushion for opportunistic and short-sighted leaders and policy planners to spread 'feel good' messages within the framework of an internationally uncompetitive domestic economy.

Under such circumstances it may results in political leaders, opportunistic policy planners and even the ordinary citizens seeing the world through the lens of the status quo. They cannot grasp how much better things could be if different policies and business practices were pursued.

*This is the Third Energy Alert published by the Pathfinder Foundation.
Readers' comments are welcome at www.pathfinderfoundation.org*