FINANCIAL TIMES
November 25, 2014 3:54 pm

Smart politicians use cheap crude to oil the wheels of reform

Michael Levi

Market volatility creates opportunities for smart policy, writes Michael Levi

For two months, as plummeting oil prices have roiled global economics and politics, policy makers have watched, rapt. But this should not just be a spectator sport: it creates opportunities that national leaders ought to exploit.

The key lies in recognising that the fall in prices might not last. Foolish policy makers will take steps that make sense only if prices stay low. Wise ones will revisit old ideas that were always sound but politically difficult ï and that are now more feasible.

Narendra Modi is a great example. Last month, as oil prices plunged, Indiaôs prime minister moved to end subsidies for diesel. Those subsidies cost the Indian government more than $10bn last year. Economists have long argued that these allowances are a net drag on the economy and do little to help the poor. They also contribute to pollution and boost oil imports. Yet they have proved impossible to remove.

Falling prices created a perfect opportunity for Mr Modi. Cheaper oil means lower market prices for diesel, easing the politics of reform. Focusing only on the economics, lower prices should have made subsidy reform less urgent by reducing the outlays the subsidies entail. But Mr Modi, keenly aware of the politics, seized his chance.

Or consider recent developments between Russia and Ukraine. The two have been haggling over natural gas prices as part of their broader conflict. The dispute threatened severe disruptions to Ukrainian ï and perhaps European ï gas supplies this winter. In the past month, though, the parties have reached at least a temporary agreement on prices. Much of this is undoubtedly explained by geopolitical currents. But part of it should be chalked up to the fact that oil prices play a large role in Russiaôs preferred formula for calculating gas prices. Falling oil prices were bound to reduce the gap between what Russia demanded and Ukraine was willing to pay, creating space for compromise.

Other leaders should seek similar opportunities in falling prices. Policy makers in Malaysia, Mexico, Indonesia, Thailand, Vietnam and elsewhere, who are exploring subsidy reform, should accelerate those efforts. The time is also ripe for natural gas consumers from Europe to Asia to

South America to press suppliers for reforms to contract structures that would add flexibility and reduce the role of oil prices in the contract formulas that are used to determine the price of natural gas.

Just as volatility creates opportunities for smart policy, it can also make stupidity easier. Little about the market turmoil should inspire confidence that anyone knows where oil prices will be in a year, let alone a decade or more, often a more appropriate horizon for energy.

Policy makers who are wrongly confident that low prices are here to stay might be tempted to pare back support for energy efficiency or alternative fuels ï notwithstanding the oil price decline, both often remain justified. Enemies of regulation could use the threat low oil prices pose to producersô viability to argue against prudent environmental protections. Enlightened policy makers should guard against these risks.

Convinced that prices will stay low or even fall further, some policy makers may see little urgency. But with global oil demand still rising, threats to production in many regions continuing and uncertainty about how much oil Saudi Arabia will choose to produce, there is no reason to be confident that prices will remain low indefinitely. If prices rebound, the political window for action may close. The time to take advantage of low oil prices is now.

The writer is a senior fellow at the Council on Foreign Relations and author of 'The Power Surge'