

Opinion [Oil & Gas industry](#)

# Oil crash only a foretaste of what awaits energy industry

The end of hydrocarbons as a lucrative business is a real possibility



The shale revolution and renewables have eroded oil industry profitability

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The oil-price crash of March 2020 will probably not last long. As in 2014, when the oil price dropped below \$50 from \$110 in a few weeks, this one will trigger a temporary collapse of the US shale industry. Unless the coronavirus outbreak causes

Armageddon, cheap oil will also support policymakers' efforts to help the global economy.

But there will be at least one important and lasting difference this time round — and it has major market and geopolitical implications.

The oil price crash is a foretaste of where the whole energy sector was going anyway — and that is down.

It may not look that way at first. Saudi Arabia will soon realise, as it did in 2015, that its lethal decision to pump more oil is not only killing US shale but its public finances as well. Riyadh will soon knock on Moscow's door again. Once American shale supplies collapse, Russia will resume co-operation with Saudi Arabia.

With the world economy recovering from the Covid-19 crisis by then, moderate supply cuts by both countries will accelerate oil market recovery. In time, US shale producers will return too.

Yet this inevitable bounceback should not distract from two fundamental factors that were already remaking oil and gas markets. First, the shale revolution has fundamentally eroded industry profitability. Second, the renewables' revolution will continue to depress growth in demand.

The combined result has put the profitability of the entire global hydrocarbon industry under pressure. That means fewer petrodollars to support oil producing countries' national budgets. It also means less profitable oil companies, which traditionally make up a large segment of stock markets, an important component of so many western pension funds.

Start with the first factor to see why this is so. Historically, the geological advantages that made oil from countries such as Saudi Arabia so cheap to produce were unique. Because oil and gas were produced at costs far below the market price, the excess profits, or "rent", enjoyed by the industry were very large.

Furthermore, collusion among low-cost producers has been a winning strategy. The loss of market share through output cuts was more than compensated by immediately higher prices. It was the *raison d'être* of Opec.

The US shale revolution changed all this. A large oil-producing region emerged with a remarkable ability to respond quickly to price changes and shrink its costs over time.

Cutting back cheap Opec oil now only increases US supplies, with little effect on world prices.

That is why Russia refused to cut production this month. Even if its cuts did boost world prices — doubtful given the coronavirus outbreak's huge shock to demand — that would slow the shrinkage of US shale that Moscow wants.

Shale has affected the natural gas industry even more. Exports of US liquefied natural gas now put an effective ceiling on global prices.

On top of all this, there is also the renewables' revolution. Around the world, wind and solar have become ever-cheaper options to generate electricity. Storage costs have also dropped and network management improved. Even in the US, renewables are displacing coal and gas. Electrification of vehicle fleets will damp demand further.

Eliminating fossil fuel consumption completely would require sustained and costly government intervention. That is far from certain. Meanwhile, though, market forces are depressing the sector's usual profitability.

The end of oil and gas is not immediately around the corner. Still, the end of hydrocarbons as a lucrative industry is a distinct possibility. We are seeing that in dramatic form in the current oil price crash. But this collapse is merely a message from the future.

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[\[Return to head of page\]](#)

