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We Should Be Preparing for Post-Oil Future Now

By Lili Fuhr

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Fossil fuel companies have lobbied hard — and often successfully — against effective climate policies. But a November 2013 report by the environmental research group CDP revealed that at least 29 major companies, including five major oil producers, are basing their internal planning on the assumption that such policies — specifically, a government-mandated carbon price — will be a reality as soon as 2020. The question now is whether oil-producing countries' governments and citizens share this expectation.

World leaders are ostensibly committed to keeping the increase in average global temperature below 2 degrees Celsius relative to preindustrial levels — the threshold beyond which the most catastrophic effects of global warming would be triggered. Indeed, they endorsed the limit at the 2009 Copenhagen Climate Change Conference and again in Cancun the following year.

Advanced nations are already

formulating more responsible climate-change policies.

Success will require that up to 80 percent of proven oil, gas and coal reserves not be consumed. This conclusion shapes the risk analysis of these carbon assets, which are a major contributor to their owners' market capitalization. It is also driving a global campaign to lobby municipalities, public universities and pension funds to divest from fossil fuels.

While the introduction of a more responsible climate change policy may seem far off, serious work by senior officials and business leaders to formulate one has begun in many advanced countries. This is because, unlike news cycles, which are measured in days or weeks, or electoral politics, which plays out over months and years, extractive industries' investment timelines are typically 20 to 25 years. This means, for example, that one only has to posit significant carbon taxes in 2020 — two government transitions away from now in most The Organization for Economic Cooperation and Development countries — for such taxes to affect returns over most of the lifetime of an investment decision made now. How to model such eventualities is a simple risk management question.

Most fossil fuel-producing countries are far from the locus of climate change policy development, despite the impact that it will have on their economic prospects. In fact, in the Middle East, Africa and Asia, there is no public debate on the specific impact that climate policies could have on fossil-fuel production. Instead, discussions focused on the consumer side — for example, carbon pricing's potential consequences for economic growth in India and China. As a result, these countries remain woefully unprepared for what is coming. As it stands, most oil contracts are structured so that the investor recovers costs first, with the remaining profits then divided between the producer and the government that granted it the concession. This means that, if carbon pricing reduces oil's profitability, as intended, the loss in government revenue could be larger than the drop in overall profits.

Making matters worse, the details of these agreements are largely hidden, thereby preventing citizens from holding their governments accountable, which in turn undermines democracy and facilitates corruption.

To remedy the situation, ongoing efforts to increase transparency should go beyond revenue flows — which are set to face new transparency requirements in the U.S. and the European Union — to include contracts. Once a contract is public, future carbon-pricing scenarios can be modeled to demonstrate that most governments will earn less than they expect and, more important, that many potential projects and new discoveries could become stranded assets.

Consider Afghanistan's Amu Darya oil fields. Following many years of commercial efforts to develop the country's oil and mining assets that were valued at more than $1 trillion by the U.S. Geological Survey, they were auctioned off to China National Petroleum Corporation at the end of 2011. Even under a modest carbon-pricing scenario, Afghanistan could be expected to earn $570 million over the first 10 years of the project under existing production profiles. This amounts to about $500 million less than under a business-as-usual scenario — and less than one-quarter of the $2.6 billion in earnings that some Afghan government officials projected. The decision to extract fossil-fuel resources should be a conscious one, resulting from robust public debate and broad consultations with unbiased experts. But such discussions rarely take place.

Nonetheless, the "decision to extract" is present either explicitly or implicitly in most of the paradigms used for extractive-industry governance, including those of the World Bank, Publish What You Pay and Revenue Watch. The Extractive Industries Transparency Initiative is also moving closer to the issue. While its recently revised standard does not specifically address the decision to extract, it does encourage more substantial policy discussions at all stages of the value chain.

Given how civil society has mobilized around such issues, the decision to extract would be a natural starting point for much-needed public debate. Moreover, it could spur a more realistic cost-benefit analysis of hydrocarbon development.

Such analysis places one of the central issues of natural resource management — economic diversification — in sharper relief. What are governments doing to prepare for a post-oil future? What alternative development pathways exist? How should scarce public resources be applied? And are citizens' voices being heard?

In this sense, "unextractable carbon" can form part of a broader political agenda linking issues like governance, community consent and transparency to local environmental issues, climate change and a sustainable future. That would be good for everyone.

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