Marketplace

Tim Congdon

'Absolutely no one believes that the earth could produce 17 times as much oil as today. The stuff simply is not there'

Is audacity the better part of economic forecasting? In an essay entitled *Economic Possibilities for Our Grandchildren*, published in 1930 as share prices were tumbling all over the world, John Maynard Keynes conjectured that "mankind is solving its economic problem". He predicted "that the standard of life in progressive countries one hundred years hence will be between four and eight times as high as it is today".

As far as Britain is concerned, Keynes will be right. Consumption per head today is about five times higher than it was in 1930. If the next 22 years enjoy the same rate of material progress, our "standard of life" in 2030 will be roughly eight times that of our grandparents.

But what can we say about our grandchildren? Keynes' essay was silent on one theme that we cannot avoid. As he was writing, it was not only stock markets that were falling month by month. The prices of all commodities were also sliding, driven by overproduction and falling demand. Shortages of energy and basic materials did not seem possible, even looking ahead to 2030 for one's grandchildren and great-grandchildren after a huge multiplication of output in the intervening century. Anyone proposing that "the earth is running out of resources" would have been regarded as daft.

The central problem in repeating Keynes' exercise is that today the resource constraint has started to become compelling. In 1930, Keynes could extrapolate indefinitely the 2-per-cent-a-year growth of productivity and living standards that had been customary in "progressive countries" once modern industrialism had begun. The magic of compound interest is such that, over a century, growth at two per cent a year multiplies seven times. Keynes could assume – very reasonably – that the world's production and consumption of oil, coal, copper, steel and so on would rise several-fold over the next 100 years.

By contrast, we cannot assume anything of the kind. The biggest problem comes with the most important single commodity, oil. Back in 1930, the motorcar and aeroplanes had been invented, but only a small fraction of the world's population had driven a car or flown in a plane. The world's oil consumption was about 5m barrels a day. Nowadays, with tens of millions more Asians becoming motorised and jet-lagged for the first time every year, the world's oil consumption is 85 barrels a day, up 17 times from its 1930 level.

Unfortunately, the bounty of nature is finite. Geologists and oilfield engineers are resourceful people, and their techniques of discovery and extraction are far more sophisticated than in the 1960s. But the truth is that they are making fewer big finds now than then, and that the oil left in the biggest fields is more limited. It is inconceivable that the world's oil output can rise 17 times between now and 2075 or 2108. Debates rage about whether the earth's remaining oil reservoir is 1,500bn barrels or 3,000bn barrels, and about whether world oil production is peaking now at 30bn barrels a year or will peak in around 2025 at 40bn barrels a year.

But no one with any knowledge of the subject — absolutely no one — believes that the earth could produce 17 times as much oil as today, about 1,500bn barrels a year. There are even extreme but rational pessimists, such as Matthew Simmons of the influential Texas-based oil and gas advisory group Simmons & Company International, who believe that world oil output is peaking at present. The stuff is simply not there.

In this fundamental respect, the economic outlook for our grandchildren is radically different from that of Keynes' contemporaries. Given that the world's population will be higher 100 years from now, it can be said with some confidence that the average global citizen will be consuming *less* oil than we do now. During the Great Crash, Keynes assumed, bravely and with astonishing prescience, that nations such as Britain could enjoy never-ending long-run economic growth without having to think about resource depletion. We cannot make the same assumption.

The surge in oil prices to more than $140 a barrel has led to another round of megaphone petro-diplomacy, with the West lambasting Saudi Arabia and the Gulf states for not producing enough oil, and Saudi Arabia and the Gulf states pointing out that energy in the West is taxed more heavily than other products.

But the tenor of the recent exchanges has been very different from at the time of the first oil shock in 1974 and the second in 1981. In the first two shocks, the oil producers were openly confrontational in their attitudes towards the industrial nations, and made no secret that they saw the interests of oil producers and consumers as in conflict. Today the key oil-producing nations in the Gulf (apart from Iran) are apologetic about the $140-a-barrel price and emphasise the long-run similarity of their interests and those of the industrial West.

When the oil sheikhs think about the economic possibilities for their grandchildren, they – like us – are beginning to recognise that the oil will run out.