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On 30 November the Organisation of Petroleum Exporting Countries (OPEC) finally reached agreement on the details of a long-awaited oil supply cut. This apparently confirms a shift in its strategy after two years of 'low' oil prices, brought on partly by the group's key member – Saudi Arabia – having decided to fight for market share with other suppliers, notably US shale oil drillers. What this means for the global economy depends on numerous factors.

First, does the proposed cut represent a meaningful magnitude? OPEC announced that its members had agreed to reduce their collective production by about 1.2 million barrels per day (mbpd) from January 2017. Saudi Arabia promised a 0.5 mbpd cut, while its Gulf allies pledged 0.3. Iraq conceded earlier objections by agreeing to a 0.2 mbpd decrease. Iran was exempted from the cut. Russia – the largest non-OPEC oil exporter – has also come to the party, announcing that it will curb supply by 0.3 mbpd. But the Saudis, among others, typically reduce their domestic consumption of oil substantially in the winter as they don't need to generate extra power from oil for air-conditioning. Thus Saudi oil *exports* might not actually change significantly.

The next issue is whether the parties will translate words into action. Every member of OPEC has an incentive to cheat, and in the past some members have not adhered to production quotas. But if there is external monitoring of production quantities, free-riders could suffer reputational damage. Russia, on the other hand, is not bound by any formal agreement or membership relationship. Also, Libya and Nigeria were exempted from production cuts, and their oil output is currently far below potential – collectively by at least 1 mbpd. If their security situations improve, allowing production to recover, this could nullify much of the OPEC cut.

Should the promised cuts materialise, this will speed up a rebalancing of the global oil markets, following two years of supply glut. But the International Energy Agency (IEA) has been projecting that the glut would in any case erode due to market forces by the second half of next year. However, OECD oil stocks are near a record high and will provide a buffer against substantial price recovery in the near term.

Following OPEC's announcement, the price of Brent crude immediately rose by nearly 10% – but in absolute terms this amounted to less than $5 per barrel, which hardly significant compared to the roughly $60/bbl lost since mid-2014. It is possible that prices could rise a bit further, but given all the uncertainty the markets will probably wait to see what actually happens to supply early next year.

Supposing oil prices do rise to around $55-60 per barrel over the next six months, this could begin to have an impact on both non-OPEC supply and on consumer demand. In particular, higher prices are likely to

trigger increased drilling by the US shale oil industry. Already, the number of oil rigs in action has risen 50% from a low point in January, amid sub-$30 oil prices. Since the price collapse, shale drillers have reduced production costs, making their operations more competitive at lower prices. This has partly been the result of improved technology. But it also partly due to the industry slump, which has reduced wages and equipment rentals. Furthermore, companies have focused on 'sweet spots' that deliver more barrels per well. If activity picks up, average production per well will likely slide again, pushing up average costs.

On the demand side, an extra $10/bbl is unlikely to have much impact on oil consumers, given that typically crude comprises less than half of prices at the pump, which also incorporate refining and distribution costs, and taxes. Nevertheless, higher oil prices could somewhat dampen demand among cash-strapped households.

Would higher oil prices be good for the global economy? The Saudi Oil Minister said to reporters after the meeting, "I think it is a good day for the oil markets, it is a good day for the industry and ... it should be a good day for the global economy. I think it will be a boost to global economic growth". Of course, this is the perspective of the world's largest oil exporter. Higher prices will certainly help to stabilise the economies of oil exporters, which have experienced haemorrhaging foreign reserves and whose governments have been forced to slash public spending. Any increase in oil prices will benefit Africa's oil exporters, including Angola, Gabon and Nigeria, which are all OPEC members. As long as the percentage rise in price is larger than their percentage output cut under the agreement, then their oil revenues will rise. This will bring in much-needed foreign exchange, alleviate pressure on their exchange rates, and boost government revenues at a time when the need for investment and social spending is high. However, it would take a much larger increase in prices – to a level closer to $100 per barrel – to restore their oil-dependent economies to pre-2014 conditions. Thus continued efforts towards economic diversification are warranted.

But what is interesting is how the broader narrative about oil prices has changed significantly over the past two years. Somehow, 'low' oil prices have widely come to be seen as 'bad' for a global economy trying to stave off deflation. But that view is mistaking symptoms for causes. Relatively low oil prices in the past two years have partly reflected anaemic demand, itself a consequence of record levels of debt, shifting consumption patterns in an ageing OECD population, China's economic restructuring, and huge income and wealth disparities across the globe.

Furthermore, we must place today's oil prices in historical perspective. Prices of $40-50 per barrel are not actually low in historical terms. Between 1986 and 2003 – a period of low inflation and stable growth dubbed 'the great moderation' – they averaged around $30 in today's money. It was only in 2004-2008 that prices spiked to levels last seen during the second oil shock of the 1970s, which was sparked by the Iranian Revolution and subsequent war between Iran and Iraq.

The days of really cheap oil – under $30 a barrel – seem to be permanently over. This is fundamentally because supplies of cheap-to-produce conventional oil are depleting, with production from existing fields declining by about 6 per cent a year. Production of conventional oil has not risen much from a 'plateau'

reached in 2005. Since then, the bulk of net incremental demand for oil has been met from deep-water oil wells (off-shore Brazil, Gulf of Mexico and Gulf of Guinea) and unconventional sources (US shale oil and Canadian tar sands). These latter sources have significantly higher production costs, reflecting their lower energy-return-on-energy-invested ratios.

Highly indebted or low-wage consumers can only afford to pay so much for fuel, before cutting back on consumption. To the extent that oil demand is inelastic and consumers forgo consumption of other goods and services instead, this still implies less energy is needed for production and transport. But oil demand is somewhat less inelastic than it used to be, thanks to technological progress with electric vehicles and improved public transport infrastructure in the developing world.

Historically, contrary to the Saudi Minister's claim, higher oil prices have pushed up inflation and dragged down economic growth in the world as a whole. Significant spikes – a doubling of prices or more – have invariably triggered recessions in the oil-importing industrialised countries. Higher oil prices imply a transfer of income from net oil importers – the US, Europe, Japan and South Korea, along with China, India and many other emerging market countries – to net exporters. This usually suppresses global demand, as the former group has a higher marginal propensity to consume than the latter. Conversely, a fall in oil prices has historically been a fillip for global growth.

There are, nevertheless, two ways in which higher oil prices could be seen as 'good' for the global economy. The first is that they will encourage increased investment in oil exploration and production. The IEA says that 2016 will mark an unprecedented third year in a row of falling oil industry investment – which sets the stage for more serious supply cuts in a few years' time. Thus higher prices are needed now to avoid a more serious supply crunch and potential price spike further down the line.

In the long term, the far greater threat to our economies and societies is posed not by temporary fluctuations in oil prices or even the permanent depletion and eventually declining output of our foremost energy source – but rather by anthropogenic climate change. For that reason, a far-sighted perspective will welcome higher oil prices, as this will accelerate the much-needed transition to clean and renewable energy sources and non-oil based transport systems.