The impact of oil in world trade

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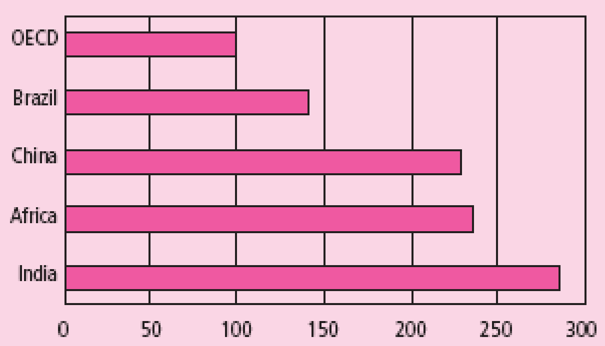
The two oil crises of the 1970s, which saw the price of oil increase tenfold, left an enduring impact on patterns of world trade. In 1973, the Organization of Petroleum Exporting Countries (OPEC), the oil producers' cartel whose members controlled 85 per cent of the world's oil, decided to raise the price of oil fourfold and limit the amount of oil produced. OPEC member countries are Saudi Arabia, Iran, Venezuela, Iraq, United Arab Emirates, Kuwait, Nigeria, Libya, Indonesia, Algeria and Qatar. The seemingly endless supply of cheap oil, which had fuelled industrial growth, mainly in the US, in the previous decades, came to an abrupt halt. Further price rises were to follow, culminating in the 1979 crisis brought about by the Islamic revolution in Iran and the Iran–Iraq war, which disrupted supply. For a time, OPEC countries grew rich from oil revenues, but their market dominance (and their oil wealth) was to decline in the 1980s, as demand fell. The crisis led to world recession, the search for alternative energy supplies, reduced demand for OPEC oil and increased output by non-OPEC countries, notably Norway, Mexico and Russia.

In the period 1997–8, both OPEC and non-OPEC oil-producing countries saw prices fall as a result of the Asian financial crisis, down to $10 a barrel in 1998. Some, including Saudi Arabia and Iran, then decided to cut production drastically. By then, the Asian recovery was under way, demand surged and the result was a trebling of oil prices, bringing fears of another oil crisis. Could there be a repeat of the 1970s' crises?
Oil prices rose to over $40 a barrel in 2004, amid fears of terrorist disruption to supplies and political instability in the Middle East. Economic growth in industrializing economies has sent demand surging. While oil-producing countries have increased output, fears remain that oil supplies are vulnerable. Oilfields, pipelines, refineries and ports could all be vulnerable to terrorist attack. Should prices continue to rise, faltering economic growth in the rapidly developing countries would impact on the world economy. Net exporters would gain from higher earnings, but this gain would be more than offset by the depressing effect on net importers. Countries dependent on oil imports would suffer, but effects would vary. Eurozone countries dependent on oil imports would see rising inflation and slowing in GDP growth. Oil-importing developing countries would be more seriously affected, as they use on average twice as much oil to produce a unit of output as advanced economies, which have become much more energy efficient (see figure).



Oil consumed per unit of GDP (OECD = 100)
Source: *Financial Times*, 17 May 2004.

Demand is increasing most rapidly in China, which has overtaken Japan to become the world's second biggest consumer of oil after the US. China's energy demand accounted for nearly half of the annual global growth in demand in 2004. Its energy infrastructure is struggling to cope with demand and it has become the world's most rapidly growing vehicle market. The Chinese government has been active in pursuit of deals with oil-producing countries to provide it with energy security. Much attention is turning to Russia and the Caspian, where oil reserves are estimated to be greater than previously thought. Developing these sources would help to reduce reliance on imports from the Middle East. Building infrastructure, including pipelines, to exploit these resources has attracted the large oil companies to Russia. The lesson remains from previous oil crises, however, that spreading the risk should focus on developing alternative energy supplies, promoting efficient technology and conserving energy.

Sources: Gause III, G.F. (2000) 'Saudi Arabia over a barrel', Foreign Affairs, 79(3), pp. 80–95; Crooks, E., 'A barrel of woes', Financial Times, 26 January 2000; 'The end of opaque?', The Economist, 22 April 2000; 'Lifting the veil', The Economist, 8 July 2000; 'Oil's taxing times', The Economist, 16 September 2000; Mallet, V., 'Power hungry: Asia's surging energy demand reverberates around the world', Financial Times, 12 May 2004; Morrison, K., Hoyos, C. and Khalaf, R., 'Terror attacks, capacity shortages and a herd of speculators: how can Opec bring calm to the world oil market?', Financial Times, 3 June 2004; Crooks, E. and Morrison, K., 'A new surge in prices raises fears for the world economy. But this is not the next great oil shock – at least, not yet', Financial Times, 17 May 2004.

Case questions

How does the price of oil affect world trade and economic development?
What are the concerns of oil-importing countries?

@ OPEC's website is http://www.opec.org . The site has links to member countries