

Another Oil Shock in the 1990s?

A Dissenting View

Jan 1, 1987



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Executive Summary

Contrary to the forecasts of many oil industry analysts, the current state of relatively low oil prices is likely to continue throughout the next decade. As a result, there is little reason to fear the economic power of a resurgent oil cartel.

The strongest force depressing oil prices will be the revenue needs of oil exporting countries and the increasing competition for market shares. Spending patterns of most oil exporters have showed them to be "large absorbers" of oil revenues. In fact, many OPEC countries have come to rely on continued production and export of oil to satiate their large appetite for revenues. Saudi Arabia, for example, needs oil revenues to maintain the high level of expenditure to which it grew accustomed in the 1970s and to cope with its growing budget deficit. If current trends continue, Saudi Arabia will completely exhaust its once-huge financial reserves in about four years.

In addition, a number of other factors will help keep oil prices down over the long term:

* With the eventual end to the Gulf war, both Iran and Iraq will exploit their huge potential as rapidly as possible to repay large foreign debts and to finance postwar reconstruction and development, thereby contributing to downward pressures on prices. * Any increase in consumption as a result of lower oil prices will probably be modest improvements in energy efficiency and the trend in fuel-switching away from oil is likely to continue, though at a slower pace. In less developed oil-importing countries, balance of payments and foreign debt problems will pressure governments to restrain oil imports. * Projections of oil demand and supply must take into account the role of technological change and the potential for oil exploration and development. While the impact of these cannot be estimated accurately, the record shows that the errors have almost always been on the side of underestimating future supplies and overestimating future demand.

In short, the United States has not entered, nor is it about to enter, a period of reduced energy supplies. The U.S. government should exploit the current opportunity to promote a free market policy for energy and to oppose, perhaps with countervailing duties, any OPEC attempt to artificially raise oil prices.

• 30 pages

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