The Price of Oil

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At the beginning of 2002, the increase in the world output of oil nearly ceased, having reached 3.4 billion tonnes a year. By itself, this fact was not unexpected. Scientific research into petroleum resources did not promise endless growth. But the majority of the prognoses of the last ten years expected output to peak in 2006 at 3.7 billion tonnes. The earlier and lower maximum was, however, easily explained. It was a result of the restrictive sanctions on the output of oil in Iraq, imposed by the United Nations in 1991. Under these sanctions, Iraq was compelled to reduce the production and export of oil by 700 million barrels a year. This amounted to just 2.5 per cent of world output. But this lost projected growth in oil production over four years would cause very sharp shortages, first and foremost for the United States.

The United States, which consumed 26 per cent of world oil production in 2001, suffered most acutely from the increasing energy deficit.

Hostages of prosperity

In 2000, the United States consumed 790 million tonnes of oil. The greater part of this, 675 million tonnes, was for transport. Americans consume a third of the world's energy for transport. This amounts to 18 barrels per person per year, more than twice as much as Europe, Japan or Australia, and thirty times as much as China.

For 15 years, from 1986 to 1999, the price of petrol in the United States was low and stable at between 25 and 30 cents a litre. There, motorists pay almost no tax on petrol, so that fluctuations in the price of petrol and diesel fuel depend almost directly on changes in the price of crude oil. In Europe and Japan the purchase of liquid fuel incurs very high taxes. In Britain, for example, petrol costs 80 pence a litre (one dollar twenty cents), but three-quarters of this is tax.

Cheap petrol in the United States allows

Americans to buy new houses and settle further and further away from the cities where they work. Inevitably, this lengthens the daily journey to work and to the shopping centres. Children have to be taken to school on special buses. By 2000, there were 132 million private cars in the United States, and 79 million goods vehicles and buses. During the past 15 years, the transportation of goods by road in the United States increased twice over, reaching two trillion kilometre-tonnes. This significantly exceeds the volume of goods transported in all the countries of the European Union, together with those of Eastern Europe. Since 1997, expenditure on transport has become the largest item in the budgets of the families of middle America, exceeding spending on housing and food. According to published statistics, an 'average American' travels twice as far a year and consumes four times as much petrol as an 'average German'.

The unexpected doubling of the price of oil in the second half of 2000, to between 30 and 35 dollars a barrel, caused a jump in the price of petrol in the United States to 50 to 56 cents a litre. This rapid rise in transport costs hit the United States economy hard. During the next year the value of shares on the general index of the New York Stock Exchange fell from 11,700 to 7,800, while shares on the high technology index fell to a quarter of their former value. This was the beginning of the recession which did not respond to the usual measures of cuts in interest rates and reductions in taxes. To these problems was added the rapid rise in the trade and budgetary deficits. Judging by the dynamics of prices on the world market, a new 'oil shock' had begun, although there was no war in the Middle East. Three previous 'shocks', in 1973, 1980 and 1991, were associated with wars and therefore considered unavoidable. The jump in 2000 was blamed on OPEC's economic policy.

The political price of oil

World export prices of copper, steel or coal are determined by free competition of producers and exporters within the confines of a market economy. The world export prices of oil depend on the decisions of the Organisation of Petroleum Exporting Countries (OPEC). This cartel was established in 1960 by five countries: Saudi Arabia, Iran, Iraq, Kuwait and Venezuela, especially to halt free competition between exporters, and to guarantee higher prices for oil and better profits for oil producing countries. In 1960, the OPEC countries produced about 35 per cent of world oil output. A further 35 per cent or so was produced in the United States. The rest of the world, including the Soviet Union, accounted for the remaining 30 per cent. In 1960, the United States was not an importer but an exporter of oil, and the increases in world prices for oil did not alarm Americans at all. At that time, the Soviet Union exported oil only to Eastern Europe, and not at world prices, but denominated in roubles. In 1960, general world production of oil was about one billion tonnes a year. During the following years, OPEC grew to include Qatar, Indonesia, Libya, the Arab Emirates, Algeria, Gabon and Equador. In 1973, when OPEC took a political decision to double the export price of oil and to embargo deliveries of oil to countries which supported Israel in the Arab-Israeli war, the main victims appeared to be the United States and Western

Europe. In 1973, the United States economy imported almost 30 per cent of its oil. Western Europe imported all its liquid fuel. The ‘oil shock’ caused a deep recession in all the western countries. For the Soviet Union, by contrast, OPEC’s decision turned out to be a stroke of luck. The vast oil resources of Western Siberia had already been opened up, but the cost of transportation to the European part of the country was prohibitive. At that time, the Soviet Union did not manufacture pipes of sufficient diameter to construct a viable pipeline. Pipes for the internal pipelines from the Caspian region were purchased in the United States.

The economic crisis in Europe changed the oil situation. The Federal Republic of Germany began to finance the construction of an oil pipeline from Siberia to central Europe. Industry in the Federal Republic supplied large diameter steel pipes and high capacity cladding on credit. Future repayments of credit were guaranteed not in money but supplies of oil. The Soviet Union soon became the most significant exporter of oil, second in volume terms after Saudi Arabia.

The war between Iraq and Iran, which lasted from 1980 to 1988, and then Iraq’s occupation of Kuwait in 1990, greatly weakened OPEC’s political and economic position. These were wars between member countries of the organisation. In these circumstances, it was impossible to regulate oil output effectively and control export prices. Competition broke out between OPEC members themselves. In 1991, Saudi Arabia, Qatar and the Arab Emirates joined the US coalition in its blitzkrieg against Iraq. Permanent American military bases were established in these countries in connection with this war, and Kuwait became an American protectorate. OPEC approved UN sanctions against Iraq, which limited it export quotas to a minimum. The world supply of oil did not suffer as a result, since Saudi Arabia and other OPEC members had reserve capacity, and they increased their own quotas for production and export. The founding Arab members of OPEC came under the strategic and political control of the United States and fulfilled US requests for increases in the export of oil. Naturally, world prices for oil began to fall, to 20, 15 and, in 1998, to 10 dollars a barrel. Oil producers outside OPEC, including Russia, Mexico and Britain, whose production prices fluctuated between 11 and 14 dollars a barrel, suffered losses and were displaced from the world market. In the United States, conversely, there began an economic boom, and the growth in the economy coincided with the two terms of President Bill Clinton. This boom, of course, sharpened the appetite for consuming oil. The domestic production of oil in the United States continued to decline. The production of oil from Alaska cost about 15 dollars a barrel. By 2000, the proportion of imported oil in the US economy was approaching 60 per cent. At the same time, the OPEC countries had almost exhausted their existing oil production capacities and could not increase oil exports without capital investment to establish new oil fields. To increase exports in this way would demand much time and capital.

Sanctions or war?

The military operation ‘Desert Storm’, to free Kuwait of the occupying Iraqi army, stopped unexpectedly on 28 February 1991, on the road to Basra, where it had already led to an uprising of the Arab Shiites against Saddam Hussein. Iraq's regular army was destroyed in the first battle, but the elite forces and the presidential guard remained untouched and were deployed to defend the cities and oil production facilities. Now Saddam could use these forces to put down the uprising of the Shiites in the South and the Kurds in the North. The US leadership and command of the Anti-Iraq coalition, comprising 31 countries, declared a victory which still had not actually been achieved. But for many reasons which it is not essential to go into here, it was decided to finish the war without storming Baghdad, but with strict economic sanctions approved by the United Nations. The idea of the authors of this plan was that Iraq, formerly a developed, enlightened and multi-ethnic country, could not withstand a political and economic blockade which condemned her people to poverty and food rationing. An uprising or coup in Baghdad was expected in two or three years, undoubtedly, not without help from outside.

Iraq actually was a rich country, primarily thanks to her oil. In 1989, the output of oil in Iraq reached one billion barrels a year, of which only 177 million barrels were for internal consumption. Oil production was nationalised in 1971, and the profits from exports, more than ten billion dollars a year, boosted the budget. Iraq had intensive, irrigated land use, horticulture and developed cattle breeding dependent, however, on imported corn. In 1990, gross national product was 73 billion dollars, or 4,110 dollars per capita. This was four times higher than in neighbouring Syria, and twice as high as Turkey.

The introduction, in 1991, of a regime of economic sanctions allowed Iraq to export oil only in exchange for food. This accounted for 100 to 200 million barrels a year, but quotas were set each month and depended on fluctuations in the export price of oil. By 1994, oil exports were worth only 400 million dollars to the country's budget. The sanctions regime actually destroyed the economy of Iraq rather quickly. By 1999, gross national product had fallen to 19 billion dollars, or 850 dollars per capita. Industry and agriculture were in decline. The army could not purchase new equipment. The population subsisted on the physiological minimum, suffering sharp deficits in the rations of livestock products. Every one had 2,446 calories a day. This was just one per cent higher than the United Nations recommended minimum. It was surprising, however, that in these conditions male average life expectancy increased by five years, the birth rate rose, and the population increased from 18 to 24 million. There was no coup. Saddam's regime grew even stronger, since the majority of the dictator's opponents went abroad to western countries, establishing oppositional groups in the United States, Britain or France. In 2001, regular flights from Baghdad to the capitals of neighbouring countries were re-established, and the rail link with Turkey re-opened. Food rations were increased. By mid-2002, eleven years after sanctions were introduced, patience was exhausted, not in Baghdad, but in Washington. Iraq could withstand sanctions for a long time yet. But America could not wait any longer.

Translated by Tony Simpson