

The rising price of oil

By **Kanes**

World's proven oil reserves are about one trillion barrels and 64 per cent or almost two-thirds of them are in the Middle East. The shares of total oil reserves of other regions are Latin America 8.5 per cent, Europe 8.3 per cent, North America 8 per cent, Africa 7 per cent and Asia-Pacific 4.2 per cent.

At current production rates, the Middle East has about 88 years worth of proven reserves. Saudi Arabia has the largest oil reserves in the world - about 262 billion barrels - and its reserves are estimated to last 80 years. Iraq, the second largest, has 110 billion barrels and they are expected to remain for over 100 years. The United Arab Emirates, Kuwait and Iran each has nearly 100 billion barrels estimated to last over 100 years in the case of the first two and 65 years in the case of Iran. The OPEC as a whole consisting of the Middle Eastern as well as Latin American, African and Asian oil producers have 75 years of oil reserves while the non-OPEC countries have only 14 years. This means that OPEC will control a growing share of world oil reserves and the Middle East's grip on oil supplies will intensify.

The largest consumer of oil is the USA. Its proven reserves of about 30 billion barrels are estimated to last only 10 years. The largest European oil producer, Norway will have its small reserves exhausted in nine years while USA's neighbour, Canada's reserves will also last for another nine years. Thus, it is clear that both North America and Europe will become almost wholly dependent on OPEC oil, particularly Middle East oil. Russia's oil reserves will remain for about 22 years more and will therefore be not available in the world market at the end of that period. Further, among the OPEC countries, Asian and African producers have only small reserves which will remain for a relatively short period. In Asia, Indonesia's reserves will last for only nine years while China's will last a little longer - 21 years; in Africa, oil reserves of Nigeria and Angola are

estimated to last 20 to 30 years. Latin America has one large producer - Venezuela - and a medium-size producer - Mexico; Venezuela's reserves of 70 billion barrels will last for 61 years and Mexico's reserves of 40 billion barrels will remain for 39 years. Thus, the Middle East mainly and Latin America to a smaller extent, will be the principal oil suppliers to the world; both the developed countries of North America and Europe and the developing countries of Asia and Africa will turn to these producers.

Oil Prices

Price of oil fell almost continuously for about three years. It was at a peak of \$40 a barrel in the 1980s and then fell to \$22.60 a barrel about three years ago and then declined further to \$12.82 in September 1998 and to low as \$9 in December 1998. The 1998 price was in real

Oil Reserves by Region %

Middle East	64.0
Latin America	8.5
Europe	8.3
North America	8.0
Africa	7.0
Asia-Pacific	4.2
	100.0

terms the lowest for 25 years. The low price was caused partly by the weak demand; oil consumption rose by only 0.1 per cent globally, the lowest in five years. In Asia, oil consumption fell by 2.7 per cent led by Japan's sharp decline of 4.2 per cent. The other reason was rising supplies; global oil production rose by 1.4 per cent in 1998 led by OPEC's output rise of 3.2 per cent.

Nearly all the OPEC members experienced financial difficulties on account of the low price of oil which prevailed for about two years. Their external reserves for instance fell to low levels, e.g. \$7.2 billion in Saudi Arabia, \$5.0 trillion in Iran, \$4.1 billion in Nigeria and \$2.4 billion in Russia as compared to \$146.6 billion in China, \$95.2 billion in Taiwan and

\$71.8 billion in Singapore. Iraq is perhaps the most adversely affected on account of UN trade sanctions which restrict her oil exports. Saudi Arabia spent \$ 120 billion on the war against Iraq and was in serious trouble for some time. Her per capita income fell from \$14,000 a year in 1982 to \$6,410 now - on account of low oil prices - and thousands of university graduates are unemployed. Her welfare system has run out of cash; hospitals in Riyadh ask surgical patients to bring their own catheter tubes which the hospitals cannot afford to buy. The royal family number 15,000 and draw off about 5 to 8 per cent of the country's GDP. Oil exports account for 90 per cent of the country's export earnings and 75 per cent of government revenue. Iran's economy has suffered most from the fall in oil prices as oil provides more than 80 per cent of its hard currency earnings and around half of government revenue. The government faced a revenue shortfall of \$6 billion in 1998 or one-third of the state budget and was forced to suspend most of its development projects.

The OPEC decided in March 1999 to cut oil supplies by 4.3 million barrels a day in order to raise prices; and it appears to have succeeded in doing so. The price of oil which was as low as \$9 a barrel in December and \$11.10 in March 1999, rose to about \$24.00 a barrel by late September 1999. The price of oil is to be kept high for another six months as the OPEC decided in September to maintain their cuts until at least March 2000. Analysts expect the \$27 level to be breached before the end of 1999 and oil at \$30 a barrel may not be as far fetched as it sounds.

Fear of Inflation

The rising oil prices have fueled fears of inflation in the West and even in some developing countries, particularly as demand for oil will increase in the coming winter in the West. The rising oil prices are not expected to have a big impact on most East and South East Asian economies as they are in a deflationary spiral anyway. Japan, China, Hong Kong, and to some extent Singapore are fighting deflation

Estimated Proven Reserves of Oil - 1998

Country	Estimated Oil Reserves Billion barrels	Years or Reserves remaining
1. Saudi Arabia	262	80
2. Iraq	110	100+
3. United Arab Emirates	97	100+
4. Kuwait	96	100+
5. Iran	93	65
6. Venezuela	70	61
7. Russia	45	22
8. Mexico	40	39
9. USA	30	10
10. Libya	25	56
11. China	20	21
12. Nigeria	18	29
13. Norway	10	9
14. Algeria	9	20
15. Kazakhstan	8	42
16. Azerbaijan	7	84
17. Canada	7	9
18. Angola	6	20
19. Oman	6	16
20. Indonesia	6	9

Source: The Economist 3 July 1999 and 18 July 1998.

and consequently rising oil prices can be something of a boon. Oil producers such as Indonesia, Malaysia and Brunei will earn more from oil exports - Indonesia alone about an additional \$3 billion but oil importers will have to pay more for their oil, for instance, South Korea, an additional \$4 billion. Thailand may also face difficulties as the baht is also weakening against the US dollar and the Philippines may experience difficulties. If the oil prices stay high for a prolonged period, however, all oil importing countries will face difficulties. Many fear what effect high oil prices will have on the American economy. Crude oil at \$27 to \$30 a barrel may cause US Federal Reserve to raise interest rates again and a 0.5 per cent to 0.75 per cent increase

over the next six months may puncture the US stock market. If the American economy then grinds down, the consequences on the global economy will be disastrous.

In Sri Lanka the cost and freight cost of crude oil was \$13.35 or Rs. 871.04 a barrel in July 1998. By July 1999 the cost had gone up by 28.8 per cent in dollar terms to \$17.19 a barrel and by 40.3 per cent in rupee terms to Rs. 1222.15. This is likely to rise further with the recent decision of OPEC to maintain their output cuts for another six months. The higher cost of transport in particular may push up prices all round and accelerate the current low rate of inflation. The situation may get worse if inflation in Western countries raise the prices of Sri Lanka's imports of goods and services.