**OPEC’s Price Hike Was ‘Good News’**

**By JOHN H. LICHTBLAUL**

A year ago the world’s oil consuming countries gratefully acknowledged the decision of the Organization of Petroleum Exporting Countries (OPEC) to freeze the world price of crude oil for the year 1978. Last Sunday, OPEC had no such Christmas gift for its customers.

Notwithstanding repeated public and private requests from President Carter and Treasury Secretary W. Michael Blumenthal for a continuation of the price freeze or, at the most, “a minimal price increase,” the price setters raised the price of Saudi Arabian light oil — the “marker” crude to which all other OPEC oil prices are related — by a hefty 15 percent, to $13.96 per barrel for the year as a whole.

The increase will be phased in quarterly, with the result that the first one will amount to a modest 5 percent but the last one will run a massive 14.5 percent relative to a year ago. A potential effect of the change from a single annual price increase to one that is phased in is that any increase after 1979 would be on top of the fourth-quarter price, not the average 1979 price.

The Administration’s reaction was one of aggrieved disappointment. After all, the President’s two economic priorities for 1979 are to reduce the rate of inflation and the balance-of-trade deficit. Both of these goals will be rendered more difficult by OPEC’s decision, which will of course affect all our oil imports, not just those from OPEC, as well as the 30 percent of our domestic production which is not under price control.

For the world as a whole, the higher price means that an additional $13 billion will be transferred from the oil-consuming countries to OPEC, giving the latter a gross oil revenue of some $145 billion in 1979, or an increase of 22.5 percent over 1978. A year ago the world’s oil consuming countries gave OPEC a price freeze. Was this a gift, or was it a present for its customers.

**OPEC Needs**

Following the great oil-price revolution of 1973, it became the cartel’s stated policy to protect the gain of its revolution through maintenance of the real purchasing power of its oil exports in world trade. According to the International Monetary Fund, between 1974 and 1977 the real value (in dollars) of exports by the industrial countries rose by 22.5 percent, or by about the same as the unit value of OPEC’s exports. It is likely that the I.M.F. data somewhat overstate the purchasing power of OPEC exports during this period, but the basic conclusion stands. By and large, OPEC’s international purchasing power did not significantly deteriorate during this period.

However, the situation has changed significantly during the year, both because of continued inflation and the decline in the value of the dollar. Between the fourth quarters of 1977 and 1978, the industrial countries’ export unit value fell by an estimated 13 to 15 percent, notwithstanding OPEC’s export value remained unchanged. Thus, the average 10 percent OPEC oil-price increase adopted for 1979 does not nearly compensate for the decline in OPEC’s international purchasing power up to the end of 1978. Any increase in the cost of industrial country exports in 1979, because inflation or dollar devaluations, could cause a further decline in OPEC’s terms of trade vis-a-vis the industrial nations.

There is, of course, no reason why OPEC’s terms of trade should not decline if market conditions warrant it, particularly following the spectacular improvements achieved in 1974. However, there is also no reason why OPEC should not marshal its strength to prevent such a development, particularly in view of the sharp decline in its collective current-account surplus from $65 billion in 1974 to probably less than $10 billion this year. Without a price increase, it might have all but disappeared next year.

The United States Treasury contends that some of the benefits of OPEC from the mark-up will be eroded by the negative impact the higher American oil bills — estimated at an additional $4.5 billion next year — will have on the international position of the dollar. Directionally, this is correct. However, the net effect on OPEC will still be highly positive, especially since, on balance, our trade deficit will probably be reduced next year through the decline in nonoil imports, which should strengthen the dollar.

**American Benefits**

For the United States and the other importing countries, the increase will of course have its short-term negative aspects. But it is questionable whether the Administration’s ardently desired continuation of an absolute OPEC price freeze in nominal terms, which in effect would reduce the price in real terms, would really have been in our own long-term interest.

Following the shock of the 1973-74 price jump, which helped to bring about a major recession, the world has more or less adjusted to the new OPEC price levels. We know now that, contrary to some earlier fears, the resulting massive money transfers were not beyond the ability of the international financial system to manage.

We have also come to understand that the higher oil prices are just one of many factors contributing to the post-1973 slowdown in economic growth.

Moreover, we have seen that the prevailing growth rates in most countries are not as low as they threaten political or economic stability.

Meanwhile, the higher oil prices have led to successful conservation efforts in all major industrial countries, reducing the growth rate in oil demand below that of other energy sources — a complete reversal of the record of the pre-1974 period. In several major countries, such as the United States, Japan and West Germany, the post-1973 oil demand growth rate has also dropped below the growth rate of the gross national product, another historic change. (Although it is unlikely that these changes can be maintained for long in countries such as Japan and West Germany where the import cost of oil has dropped below the 1974 level in the last 15 months solely because of the dollar decline.) Altogether, world oil demand in the period 1974 to 1978 has risen at an annual rate of only 2.5 percent, or about one-third of the pre-1974 growth rate.

Higher prices have undoubtedly brought about additional oil production. For instance, the well-head price of the portion of Alaskan crude oil that cannot be marketed at the West Coast but must be shipped eastward, about 600,000 barrels a day, is currently below $4 per barrel.

At any significantly lower world oil price, the volume of oil could not be profitably produced, certainly stifling additional exploration and production in the area. The same goes for the "marginal" North Sea oil fields. Current speculation is that most of the new finds in the North Sea are likely to be in that category. And the potentially huge Athabasca Tar Sands development in Alberta which is just beginning to get off the ground, is based on the economic assumption that world oil prices will rise, not fall, in real terms.

The energy crisis of the mid- and late 1970’s, whose specter has so often been conjured up since 1973, is neither inevitable nor even probable. But it may become so if our oil prices once again start going into a decline, giving both consumers and producers false signals of inexhaustable supplies.

This does not mean that every OPEC price increase should be appalled by the importing nations. Probably the fourth-quarter increase just adopted by OPEC is at least a couple of percentage points too high by any test of reasonableness. But, given the stated seriousness of our aim to contain our dependence on foreign oil, a policy aimed at achieving a steady reduction in real world oil consumption is in the interest of the consuming countries than it is of the producing countries.

John H. Lichtblau is executive director of the Petroleum Industry Research Foundation Inc.
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The Administration's official reaction of aggrieved disappointment was therefore hardly unexpected. After all, the President's two economic priorities for 1979 are to reduce the rate of inflation and the balance of trade deficit. Both of these goals will be rendered more difficult by OPEC's price decision which will of course affect all our oil imports, not just those from OPEC, as well as the 30% of our domestic production which is not under price control. For the world as a whole, the higher prices mean that an additional $13 billion will be transferred from the oil consuming countries to OPEC, giving the latter a gross oil revenue of some $145 billion dollars in 1979, assuming no
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change in the volume of their oil exports.

Thus, from the short run interest of the oil importing countries it would obviously have been preferable if there had been no increase or only a "symbolic" one for 1979. But what about OPEC's interest? Was it really reasonable to expect its members to continue the year-old price freeze on its principal export commodity for another year? Even more importantly, could there be some positive results for the importing nations from the latest OPEC price increase?

Let us first look at OPEC's position. Following the great oil price revolution of 1973, it became the organization's stated policy to protect the gains of its revolution through maintenance of the real purchasing power of its oil exports in world trade. In the first few years, OPEC was approximately able to accomplish this. According to IMF annual data, between 1974 and 1977 the unit value (expressed in dollars) of exports by the industrial countries, with which OPEC does about 83% of its foreign trade, rose by 22.5% or by about the same as the unit value of OPEC exports. The IMF data exclude service exports which loom very large in OPEC's imports. Since the unit values of service exports appear to have risen faster than those of merchandise exports from the industrial countries, it is likely that the IMF data somewhat overstate the purchasing power of OPEC exports during this period. But, by and large OPEC's international purchasing power did not significantly deteriorate during this period. (A somewhat different calculation published last April in the Morgan Guaranty Trust Bank's World Financial Markets comes to the same general conclusion).
The situation has changed significantly, however, in the last 12 months, both because of continued inflation and the decline in the value of the dollar. Between the fourth quarters of 1977 and 1978, the industrial countries' export unit value rose by an estimated 13-15% while OPEC's export value remained unchanged. Thus, the average 10% OPEC oil price increase adopted for 1979 does not nearly compensate for the decline in OPEC's international purchasing power up to the end of 1978. Any increase in the cost of industrial country exports in 1979, due to inflation or dollar devaluations, could cause a further decline in OPEC's terms of trade vis-a-vis the industrial nations.

There is of course no reason why OPEC's terms of trade should not decline if market conditions warrant it, particularly following the spectacular improvements achieved in 1974. However, there is also no reason why OPEC should not marshal its strength to prevent such a development, particularly in view of the sharp decline in its collective Current Account surplus from $65 billion in 1974 to probably less than $10 billion this year and which might have all but disappeared next year without a price increase.

The Treasury contends that some of the benefit to OPEC from the price increase will be eroded by the negative impact the $4.5 billion additional U.S. oil import cost will have on the international position of the dollar. Directionally, this is correct. However the net effect on
OPEC will still be highly positive, especially since on balance our trade deficit will probably be reduced next year through a decline in non-oil imports, thereby strengthening the dollar. Thus, from OPEC's viewpoint the new price increase is both equitable and rational.

For the importing countries the increase will of course cause some short time negative aspects, as pointed out earlier. But it is questionable whether the Administration's ardently desired continuation of an absolute OPEC price freeze in nominal terms, which in effect would reduce the price in real terms would really have been in our own long-term interest. Following the shock effect of 1973/1974 which helped to bring about a major recession, the world has more or less adjusted to the new OPEC price levels. We know now that, contrary to our earlier fears, the resulting massive money transfers were not beyond the ability of the international financial system to manage. We have also come to understand that the higher oil prices are just one of many factors contributing to the post-1973 slowdown in world economic growth. Furthermore, the prevailing growth rates in most countries are not so low as to threaten their political or economic stability.

Meanwhile the higher oil prices have had a more positive impact on both supply and demand than is generally realized. Thus, successful conservation efforts in all major industrial countries have reduced
the growth rate in oil demand below that of other energy sources, a complete reversal from the pre-1974 period. In several major countries, such as the U.S., Japan, and Germany, the post-1973 oil demand growth rate has also dropped below the GNP growth rate, another historic change. Altogether, world oil demand in the four year period 1974-78 has risen at an annual rate of only 2.5%, or about one third of the pre-1974 growth rate. However, it is unlikely that these highly welcome structural changes can be maintained for long in countries such as Japan and Germany where the dollar import cost of oil has dropped below the 1974 level in the last 18 months solely because of the dollar decline.

On the supply side the higher oil prices have undoubtedly brought forth additional production. For instance, the wellhead price of the portion of Alaskan crude oil which cannot be marketed at the West Coast--about 600,000 barrels per day--but must be shipped eastward, is currently below $4.00/Bbl. At any significantly lower world oil price this volume of oil could not be profitably produced. This would certainly stifle additional exploration/production in the area. The same goes for the "marginal" North Sea oil fields. Current speculation is that most of the new finds in the North Sea are likely to be in that category.

Similarly, the potentially huge Athabasca Tar Sands development in Alberta which is just beginning to get off the ground with two plants in operation and several more under construction or planned,
is based on the economic assumption that world oil prices will rise, not fall, in real terms.

The energy crisis of the mid to late 1980's whose specter has so often been conjured up since 1973, is neither inevitable nor even probable. But it may become so if our oil prices once again start going into a decline, giving both consumers and producers false signals of inexhaustible supplies. This does not mean that every OPEC price increase should be applauded by the importing nations. Probably the 4th quarterly increase just adopted by OPEC is at least a couple of percentage points too high by any test of reasonableness. But, given the stated seriousness of our aim to contain our dependence on foreign oil, a policy aimed at achieving a steady reduction in real world oil prices is no more in the interest of the consuming countries than in that of the producing countries.