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Review

Organisation of petroleum importing countries: An idea, whose time has come

Prabhakar Deshpande

16/9 JPM Society, Sant Ramdas Road, Mulund (E), Mumbai – 400081, India. E-mail: prabdesh@gmail.com. Tel: +91-22-21631436, +91-9821089074.

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The author has been advocating for Organization of Petroleum Importing Countries since almost a decade. The argument is simple – OPEC; Organization of Petroleum Exporting Countries, forces up oil prices by restricting supply. It is intuitively obvious to a layperson as well as economists, that by restricting demand, oil prices should come down. It is especially important to remember that even a small cut in oil supply – as less as 3 to 5% can increase oil prices by more than 100%. So, a small cut in oil demand can be successful in reducing oil prices significantly. And oil prices have significant impact on global economy. Indeed, it is no coincidence that there was a recession in 2008 and there is a recession in 2011 periods, when oil prices have been on higher side. The arithmetic is simple. The world consumes around 30 billion barrels of oil every year. At $10 a barrel, the world pays around $300 billion for oil. But at $100 a barrel, world spends almost $3000 billion for oil. Clearly escalation of oil prices has significant impact on economy. Indeed high oil prices leads to both stagnation and inflation. Again high oil prices transfers wealth and money from oil importing nations, to oil exporting nations. This could have significant political impact. Hence, it is important to control oil prices. It is hence recommended that an organization of petroleum importing country be created to reduce oil demand and thus check oil prices.

Key words: Organization of petroleum importing countries (OPIC), organization of petroleum exporting countries (OPEC) oil, prices.

INTRODUCTION

Prices of commodities are determined by supply and demand. This is elementary economics. Other things remaining same, including supply, an increase in demand, raises the price, whereas, a decrease in demand, reduces prices. Conversely, other things remaining same, including demand, an increase in supply reduces prices, whereas, an increase in demand, increases prices.

Oil prices have since 1960 often been a subject matter that has preoccupied attentions of economists and politicians alike (Deshpande, 2003; Mitchell et al., 2001; Mabro Robert, 1986; IAN Skeet, 1988). Indeed some might argue that oil prices have also received due attention from military generals, who may have been forced to fight wars to gain access to oil.

OIL PRICES SINCE 2003

Oil prices have been very high since 2003. Indeed oil prices reached around $147 a barrel (www.opec.org, www.bp.com, www.imf.org). Coincidentally, it was also a time for recession. The causal relationship between high oil prices and economic downturn needs to be explored. Oil prices are once again very high in 2011. And global economy is once again seeing a down turn. It may be argued that global recession in 2008 or 2011 are unrelated to oil prices and have different reasons. But one must not commit the fallacy of ignoring the impact of high oil prices on global economy. The world consumes around 30 billion barrels of oil a year (Karl, 1970, www.opec.org, www.bp.com). Oil prices have varied between $10 a barrel and almost $150 a barrel (www.opec.org, www.bp.com). At $10 a barrel, the world spends $300 billion on oil. At $150 a barrel, the world spends almost $ 4500 billion on oil. The global GDP is around $65000 billion. Very clearly there is likely to be some impact on economy, if world spends $4500 billion on a commodity, on which, it spent a mere $300 billion (Hunt et al., 2009; Backus et al., 1994).

Indeed escalation of price of a commodity that has very clear forward linkage, through transportation, is most certainly going to lead to inflation. Again if so much money is being spent on one commodity, it permits little else to be spent on other commodities, either through consumption or investment. This must necessarily lead to stagnation. Hence, oil price escalation, curiously manages, that oxymoron of economics, of stagnation and inflation coexisting – appropriately termed as stagflation. Such massive change in oil prices transfers purchasing power, wealth and money from oil importing nations to oil exporting nations, who in turn could use this money to purchase capital assets and thus control economies in oil importing nations. It is hence pertinent to take actions to control oil prices since it impacts economy so drastically.

OPEC - ORGANISATION OF PETROLEUM EXPORTING COUNTRIES

OPEC – Organisation of Petroleum Exporting Countries – was created as a cartel of oil exporting countries. It is recommended that one studies www.opec.org for more information. The goal of OPEC is to protect the interests of oil exporting countries that are part of the cartel.

The cartel has in its history of about 50 years, seen varying successes in its effort to bolster crude oil prices. Often its failures have arisen out of member countries failing to stick to quotas of production allocated to them. OPEC however has had remarkable success in keeping oil prices high in the new millennium and oil prices have been uniformly higher than $50 a barrel and sometimes higher than $100 a barrel.

OPEC controls oil prices by checking supply and constraining supply. It has been observed that OPEC checks oil supply by as less as 3 to 5% and this is sufficient to increase oil prices by more than 100%. Thus it is very clear that oil prices are highly sensitive to smallest variation in demand and supply.

ORGANISATION OF PETROLEUM IMPORTING COUNTRIES

It is proposed that oil importing nations create a cartel to be called Organization of Petroleum Importing Countries (OPIC). The function would be to check oil prices by controlling oil demand. Additionally, OPIC would conduct research to find alternative to oil as fuel resource. There cannot be any mathematical model that can predict that a certain amount of regulation would increase oil prices by so much. However it is very certain that regulating demand of oil would bring down oil prices. And if oil price behavior upon checking of supply by OPEC is any indication, it is safe to predict that constraining demand would reduce oil prices substantially. But Organization of Petroleum Importing Countries would not merely check demand, but also fund research into alternative fuel technologies.

HOW TO REDUCE DEMAND FOR OIL

Demand for oil can be reduced by as much as 50 to 90%. For instance a bus is almost 10 times more fuel efficient than a car. A fuel efficient car can reduce, demand for gasoline by almost 50%. A motor cycle can reduce fuel demand by up to 75%. In case people pool cars, oil demand can once again be reduced by 50 to 75%. Thus by adopting few methods, oil demand can be reduced significantly, though controlling oil prices requires us to reduce oil demand only marginally.

These are few ways that oil demand can be reduced:

1. Public transportation,
2. Fuel efficient vehicles,
3. Use of two wheelers,
4. Car pooling,
5. Rationing,
6. Video conferencing,
7. Better insulation for homes,
8. Using natural gas,
9. Increasing price of petroleum products.

The world consumes around 30 billion barrels. Theoretically at least, if all out massive efforts are made to reduce oil demand, it can be reduced to as less as 15 billion barrels. Practically though, oil demand cannot be reduced as much, but certainly can be reduced significantly. But oil prices rise significantly even if oil supply is reduced by as less as 1 to 3%.

Organization of Petroleum Importing Countries (OPIC) would also explore fuel alternatives to oil. This is because generating alternatives to oil would reduce demand for oil and also make oil last longer. Bio-fuels seem to be promising. However bio-fuels are constrained by land availability. And the reason land is not available in plenty is because humans eat meat. And it takes almost 8 kg of food grains to produce 1 kg of meat. Unless adequate land is available it would not be possible to grow crops to produce bio0fuels. Hence there is need to discuss and debate Vegetarianism, and views of everyone concerned must be taken into account.

SUMMARY, CONCLUSION AND RECOMMENDATION

Oil prices are determined by supply and demand. Since demand for oil is inflexible, even slightest reduction in supply can increase oil prices drastically. Organization of Petroleum Exporting Countries (OPEC) uses this anomaly in oil as a commodity to its advantage. OPEC reduces its supply slightly and this increases price manifold times. But if reducing supply can increase the price of oil, reducing demand can reduce the price of oil.

Hence it is proposed to create Organization of Petroleum Importing Countries to keep oil prices under control by reducing demand and facilitate discussion and debate on Vegetarianism so that more land is available to grow crops for bio fuel.

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