HIGHER OIL PRICES MAY SPELL DIFFICULTY, BUT NOT, NECESSARILY, WORLD RECESSION

Whenever there is a rapid and material rise in the price of crude oil, it nearly always has an immediate and dramatic effect on the economies of the world.

The real threat is that a material and rapid increase in the price of oil has the ability to undermine an economy's growth.

The imagined threat, however, is even worse than the real threat because it can send an economy reeling to levels that are hardly justified and completely unproportional to the attendant, concomitant oil price rise.

A stable oil price is much preferred by all nations of the world because the formula for the price of staples, as well as a multitude of manufactured goods, includes the oil coefficient, which adjusts the formula to take into account production costs.

Transportation costs are determined by the price of oil, to a very great extent.

Many, if not most, of the manufactured goods that are very commonly used require petroleum-based products as their raw materials: Chemical fibre products, such as polyester and polypropylene, just to mention 2, widely used products that are required in the manufacture of man-made garments, piece goods, packaging products, passive restraint systems for motor cars, automotive trim … and the list is, just about, endless.

For many months now, the price of crude oil has been rising. This has caused widespread complaints, internationally, from Europe to Asia – because the economies of the world are feeling the pinch.

Revolution is in the air; and protests have been staged in London, England, Washington, Toronto, Canada, and, even in the Hongkong Special Administrative Region (HKSAR) of the People's Republic of China (PRC).

People want their respective governments to take definitive action in order to alleviate the evils of inflation, the inevitable outcome of escalating oil prices, as well as to protect certain industries that cannot absorb operating costs of 150 percent and more.

Operators of trucking companies, a mode of transportation of the utmost importance in many parts of the world, cannot make ends meet since they cannot pass on the higher operating costs to the wholesalers who, in turn, cannot continually pass on to the consumer the higher costs of doing business.

The fuel component in cost determination to the customer, standing in the supermarket line, speaks louder than many people realise.

The direct result has been seen to be less consumption of certain items by the consumer, who will resort to only purchasing necessities.

The question that must be posed, today, is whether or not the current oil-price rises will have much of an effect on the economies of the world and, if so, when, and by how much?

About one decade ago, Iraq invaded Kuwait.

The immediate result: Oil prices shot up from about $US16 per barrel to about $US40 per barrel.

The 150-percent increase in the price of crude oil was not appreciated for its effects on the economies of the Western World, immediately, but the following year, 1991, the penny dropped.

The US and many other developed (and developing) countries of the West recorded negative growth in their respective Gross National Products (the total value of goods and services, produced by a nation) for 1991.

And the beginnings of a global recession were the natural and inevitable result.

There are similarities between what took place in 1990-1991 and what has happened of late since, among other things, the price of oil has hit a decade high and was touching on the 1990 highs.

Over the past year, the price of oil has jumped from a low of about $US10.50 per barrel to a high of about $US35 per barrel (disregarding adjustment to take account of the effects of inflation).

Countries, aligned within The Organisation for Economic Cooperation and Development (OECD), have reported that their total spending on fossil fuels has dropped from the 1990 Gross Domestic Product (GDP) figure of about 1.50 percent to the 2000 figure of about one percent on spending, associated with fossil fuel costs.

The reason for this drop is due, in part, to the change in textures of many OECD countries, from a heavy reliance on industrialization to a more rapid acceleration and expansion into the service industry.

Summarising the above, what it means, in a nutshell, is that the burden on OECD countries on spending on fossils fuels has been receding at an unprecedented rate.

There is every reason to believe that this phenomenon will continue since the most developed countries of the West are becoming more prone towards a technocratic social order, leaving *'soft'* industrialization to less developed countries, namely those underdeveloped and developing countries of Asia and the Middle East.

And this transformation, or metamorphosing, if you will, is gathering pace.

The International Monetary Fund (IMF) and the OECD have studied the effects of a $US10 increase in the price of fossils fuels and have come to the conclusion that, at most, it will have an effect on inflation in the order of about 50 basis points, plus or minus, at most.

On the assumption that the increases in the price of Middle East fossil fuels is now coming, or has come, to an end, it would appear that the increases have been well absorbed, and will be discounted in the overall scheme of things.

Iraq has stated that it wants to be paid in euros instead of US dollars and that, in the event that its demands are not met, it will turn off its oil tap.

Nonsense!

It cannot afford to antagonize the West any more: It is, already, the pariah of the world; the virtual armpit of Western civilization.

And, even if it did turn off its oil tap to the West, The Organisation of Petroleum Exporting Countries (OPEC) would step in, immediately, to put a finger in the oil dyke lest, in the future, the world remember its non-action in times of need.

This is not to suggest, of course, that oil prices could not rise again due, perhaps, to a very harsh and cold winter, with supply-demand factors, kicking in, forcing up prices, but one must, also, remember that OPEC members have a very clear incentive to keep prices within acceptable bounds.

OPEC members have to import raw materials, other than oil-producing materials and machinery, that is, and, if producers of these raw materials have to raise prices due to increases in the cost of oil, these increases will, naturally, be passed on down the line.

If the price of oil remained higher than, say, $US30 per barrel for an extended period of time, higher-cost producers would take advantage of the situation, enter the market in a big way, and thus signal the collapse of the oil dollar.

The effects may not be felt, immediately, but OPEC knows only too well of the consequences since, in today's world, no one country can claim to be independent of his neighbours.

Though the fingers of the hand may not be of the same length, conjoined, the fingers make for a formative prehensile appendage.

In summary, therefore, there is little reason to think that the existing high price of oil will lead to world recession, although, there are risks attendant to the situation.

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