9.1. BACKGROUND

9.1.1. Until the turn of the century, oil was used primarily as kerosene for lighting and heating, and secondarily as lubricant. Today, oil is the main source of commercial energy in the world. Sudden and substantial increases in the price of oil are bound to adversely affect the economies of oil-importing nations. They affect the economies of OPEC Member Countries as well. A number of macro variables such as inflation rates, employment levels, terms of trade, savings, investments, balance of payment etc. would be significantly influenced by changes in oil prices.

OPEC still plays a pivotal role as an oil supplier in the world. The oil reserves of OPEC Member Countries are by far the largest in the world, amounting to around 77.6 per cent (969 billion barrels) of total proven world oil reserves of some 991 billion barrels (excluding former CPEs). Considering the current rate of oil production, world's oil reserves are not likely to last for more than 45 years. The OPEC oil reserves also will get exhausted before the end of the next century. The enhanced rates of extraction of oil during the last two decades have reduced the life span of OPEC reserves as well.

9.1.2. Economics of oil became a distinct field of inquiry after the World War II. OPEC emerged on the World scene as a distinct Organization by 1960. The great structural changes in the world petroleum industry during the 1970s, mainly concerning oil prices, were the product of collective actions and policies of OPEC. Member States, acting in isolation might not have been able to exercise significant control over their national resource, namely oil, as it was still a domain of transnational Companies. OPEC has been using pricing mechanisms along with production targeting with a view to avoiding wide and frequent fluctuations in oil prices. Stabilization of the global petroleum market appears to be a desirable worldwide objective and OPEC's declared objective is also relative stability of global oil prices.

9.1.3. With the first oil price hike in 1973-74, OPEC caught the attention of researchers in the field of Oil Economics. The Economists, through various theoretical and empirical analyses, attempted to forecast OPEC behaviour and decisions. These studies
extensively dealt with the problem of oil prices and their impact on Countries of the World. Few, if any, studies however examined the impact of OPEC decisions (primarily relating to price and output of oil) on the Member Countries. Most of the studies focused on the economic performance of OPEC as a group but they have not dealt with the impact of decisions on the Members of OPEC. The present study has attempted to examine the impact of OPEC decisions on the Member Countries in general and on IR Iran and the UAE in particular.

9.1.4. For the purpose of this study, the Members have been grouped as 'high absorbing' (with relatively large populations, skilled manpower, good agricultural land and water resources but low per capita GNP) and 'low absorbing' (with an acute shortage of skilled work force, small farm lands and relatively few complementary resources) nations.

9.1.5. The Islamic Republic of Iran with a population of almost 54 million is in the 'high absorbing' and the UAE in the 'low absorbing' category. This categorization is based on the capacity of these countries to absorb the petrodollar surpluses into various economic and productive activities. Despite the efforts of IR Iran and the UAE to boost non-oil exports and develop oil-related industries, the exports of crude oil still account for almost 95 per cent of their foreign exchange earnings. This indicates the significance of OPEC decisions on price and output of oil for the overall economic conditions in the two countries.

The Iranian Government policies aimed at reducing the importance of oil in the national economy, but the dependence on oil is substantial even now. The oil sector remains an important determinant of growth rates in the Iranian economy as it contributes a lion's share to the Gross Domestic Product. Almost 94 per cent of UAE's reserves of oil are situated in Abu Dhabi. By far the most important oil producer and therefore revenue-earner of the UAE is Abu Dhabi, which accounts for ninety per cent of UAE's total earnings.

9.2. SCOPE OF THE STUDY

9.2.1. The study was designed so as to attempt:

[a] critical description of the pattern and growth of the oil industry,
[b] in-depth analysis of the events leading to the formation of OPEC and its structure,
[c] delineation of crude oil pricing policies followed by OPEC since 1970s and their implications,
[d] evaluation of the impact of the major oil shocks of 1973-74, 1979/80 and the 1986 oil price collapse on the economies of Member Countries
[e] assessment of the role of oil and OPEC decisions with regard to price and production of oil especially on the economies of Islamic Republic of Iran and the United Arab Emirates and
[f] formulation of different scenarios relating to oil prices by way of futuristic exercises, so as to assess their impact on certain economic variables in the Member Countries.

9.2.2. It was hypothesised that:

[a] OPEC as an international organization could and in fact did manipulate oil prices,
[b] the price changes effected by OPEC had significant impact on the economies of Member Countries,
[c] the impacts could be observed on certain important macro variables and could be quantified,
[d] the impact of OPEC decisions on IR Iran and the UAE has been significant.

9.2.3. The period chosen for the study was 1974-1989. It is a widely know fact that quadrupling of oil prices (First Oil Shock) in 1973-74 and doubling of oil prices in 1979-80 (Second Oil Shock) were witnessed during this period. It was of interest to examine the impacts of OPEC decisions, and of the consequent inflow of oil reserves into the OPEC treasury on the expenditure and saving patterns of the Member Countries. The study is 'expost', although an attempt is made to have a peep in the future through some futuristic exercises in the Eight chapter.
POLICY MEASURES AND THEIR IMPACTS

9.3.1. It was observed that the growing export revenue of OPEC Countries during the 1970s is almost exclusively due to increase in prices and not the volume of oil. Taking the group as a whole, the export revenue jumped from $42 billion in 1973 to a peak of $307 billion in 1980.

The absorption capacity of the OPEC Members following two major hikes in oil prices appears to be much higher than expected. Imports increased steadily in response to the increase in exports, reaching $127 billion in 1980 against $20 billion in 1973. OPEC as a whole, experienced a peak of current surplus of $105 billion in 1980 as compared to only $7 billion in 1973. Following the 1986 oil collapse, OPEC’s oil revenues plummeted from a peak of $284 in 1980 to about $77 billion in 1986.

As a result of the diversification efforts by Member Countries, the non-oil exports including oil and gas based products rose sharply in US Dollar terms. This rate later decelerated during the 1980s, due partly to reduction in subsidy dependent exports. OPEC’s endeavor to diversify the economic structure of Member countries succeeded in achieving a 5 per cent real rate of growth in non-oil exports in 1982.

9.3.2. The policy of production maximization followed by non-OPEC countries with a view to acquiring a greater market share created disequilibria in the oil market and exerted further pressure on the price structure during 1985-86.

The gain in market share by non-OPEC producers meant fall in the relative share of OPEC. OPEC’s crude oil production fell to an average of about 15.5 million b/d in 1985, compared to 31 million b/d in 1979. Most of the OPEC Members resorted to policy measures like devaluation, import restrictions, rise in the public debt and postponement of development of development projects.

The OPEC Members introduced stricter controls on public expenditure, reduced budgetary transfers and subsidies, increased non-oil taxes and raised energy prices.
9.4. PRESENTATION OF THE STUDY

The study is presented in NINE chapters.

9.4.1. Chapter ONE dealt with literature review, need, objectives, research methodology and the limitations of the study.

9.4.2. Chapter TWO presented the profile of economies of the Islamic Republic of Iran and the United Arab Emirates, keeping in view the role of oil in their respective economies.

9.4.3. Chapter THREE covered an up-to-date development of the oil industry. It stated various estimates of crude oil reserves, (life span), production and the concept of recovery, highlighting the position of OPEC in the global oil industry.

9.4.4. Chapter FOUR attempted to evaluate various events leading to the formation of OPEC in 1960. It discussed the objectives, Membership and the structure of the Organization.

9.4.5. Chapter FIVE dealt with the concept of 'oil prices' and proceeded to discuss price changes effected since the 'First Oil Shock'. It included also discussion concerning market structures, need for OPEC and non-OPEC cooperation to bring stability into the global oil market and significance of sound pricing policy benefiting all the parties in the oil game.

9.4.6. Chapter SIX examined the impact of the three major oil shocks on economies of Member Countries. Changes in some of the important macroeconomic variables like GDP growth rates, inflation, current account balances, non-oil exports, foreign exchange earnings etc. caused by fluctuations in oil prices and output were examined in detail.

9.4.7. Chapter SEVEN was concerned primarily with the economies of IR Iran and the UAE. In this chapter an attempt was made to state the expenditure patterns and the allocation of the large inflow of oil revenues during the first two oil shocks.

9.4.8. Chapter EIGHT took past OPEC decisions and the international politico-economic conditions as a datum and then attempted to project oil prices during the
Nineties. It is essentially a futuristic exercise under certain assumptions. Similar projections by other researchers in this area were used for purposes of comparison.

9.5. CONCLUSIONS

The Organization of the Petroleum Exporting Countries has striven hard to achieve its stated goal of coordinating Members' petroleum policies. It has achieved a measure of success in ensuring stable and fair earnings to its Members. OPEC could prepare a ground for its Members to iron-out the differences keeping in view the mutual self-interest both politically and economically. OPEC nations' behaviour is a combination of certain features which are specific to each Member's political and economic goals. It is observed in the study that OPEC Members showed high degree of solidarity on certain issues, but got sharply divided on certain others. It is also noted that the key decisions taken by few Members within OPEC were followed, sometimes reluctantly by other Members.

Some of the conclusions of the study are as under:

9.5.1 The impact of oil price hikes of 1973/74 and 1979/80 on some of the macroeconomic variables like GDP growth rates, foreign exchange earnings, balance of payments, employment levels, etc. was on the whole beneficial for all OPEC Members, but more so for the 'low absorbing' countries.

9.5.2 A large and unprecedented inflows of petrodollars into the treasuries of Member Countries enabled them to improve their infrastructure facilities, diversify production base, and improve welfare and standards of living of their peoples by rapidly expanding facilities of schools, hospitals and public utilities.

9.5.3 Due to reduction in physical bottlenecks the growth rates of both imports and domestic production increased.

9.5.4 Public investment in oil and gas based industries such as fertilizers and petrochemicals also increased considerably.

9.5.5 It is observed that OPEC prices have risen sharply only in periods of crisis. Price changes were not based on protracted and well-designed policy of administered prices.
9.5.6. OPEC responds partially to high spot prices in a tight oil market but insists on administering the nominal prices in a glut.

9.5.7. It is observed in the study that OPEC had a firm grip on the international oil market between 1973 and 1983, when OPEC behaved as a swing producer and Saudi Arabia as a dominant oil producer. However, production maximization policy followed by non-OPEC oil producers, and the need of Member Countries for higher earnings to finance their developmental projects, decisively weakened the Organization to maintain the position of a swing supplier.

9.5.8. When the price of oil crashed almost to US$9 per barrel in July 1986, OPEC Countries had hard time to cope with the reduced revenue. They were forced to draw upon their past accumulated savings and reduce both internal and external spending.

9.5.9. It is interesting to note that the 'low absorbing' Countries managed to recover with a greater speed, than the 'high absorbing' Countries on account of their relatively lighter debt burden.

9.5.10. It is noted that OPEC decisions directly influenced the budgetary planning and various developmental schemes of Iran and the UAE. Although efforts were made by both the countries to promote non-oil exports, oil-based products continued to claim a large share in the non-oil exports. Iran consciously attempted to reduce its total dependence on oil but succeeded only to a limited extent.

9.5.11. Taking various factors influencing demand for oil into consideration, it is estimated that the world demand for oil would reach 54.45 million b/d in 1995 and 59.76 million b/d by the year 2000. Similarly, the world oil supply is projected to be 55.06 million b/d in 1995 and 60.00 million b/d in 2000 A.D. Thus there would be an excess supply of oil. The gap however would narrow over time.

9.5.12. Under two price scenarios of $21 and $26.57 per barrel, there are different growth rates and varying ratios of export earnings to GDP. Optimistic growth rates in OPEC Countries accompanying higher oil prices and higher ratios of export earnings to GDP are anticipated on the basis of certain assumptions.