CHAPTER XIII

THE PRINCIPLES OF OIL PRICING

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The principles of oil pricing

In capitalist economy prices have various roles, one of the most important of it is regulation of production and consumption. Oil price has also the distributor role in sharing of resources among the producers and also has the role of sharing the production among the consumers; and the another role is from the internal view of the industry or competition role. The act of dumping may cause increase in the share of one producer in the market.

The other subject which we have to mention is the Elasticity of Demand of the society with a little increase or decrease in the price level. But let us consider how the price can be determined? The basic factor for determination of the sale price is "the price which can cover all the costs and at least provide minimum profit for the producer".

In complete competition situation the act of production can take place till the price is not less than the ultimate cost (ultimate cost means the cost of last unit of production). In fact the maximum of profit can be gained when the volume of production is arranged in such a way that the ultimate income (income gained from the sale of last unit of production) be equal with ultimate cost. Because till the income gained from the sale of one extra unit of production is more than the cost of the same unit of production that means ultimate income is more than the ultimate cost. With increase in units of production the incomes will increase more, so the profit will increase and this increase till equali-
zation of ultimate income and ultimate cost will continue. This principle can be observed in all types of markets: in complete competition or in monopoly situation.

Now-a-days in capitalist economy most of the industries are in situation between complete competition and complete monopoly which is known as an incomplete competition. Since there are few companies in oil industry so the sale policy of each of them has effect on oil prices in the world market. So oil industry is under complete oligopoly. Usually the prices in oligopoly situation have less fluctuation, because if one producer increases the price the other producer may not increase the prices and the first one might lose his market and vice versa if the one producer decreases his price because of getting more sale market the other companies might decrease their prices at the same level and all the producers will lose. So in the oligopoly situation the sale price will be determined through the producers so there is the necessity of a leader. One company because of its skill or its domination over the market, will determine the oil prices and has the leadership in this situation; or all the producers or all the sellers together might determine the oil price like OPEC.

Future of oil pricing

The statistical information issued by the Organization shows that the total of world energy consumption has increased from 2608 million tons to 4377 million tons between the years 1955-1960 and the contribution of oil in providing this energy has increased from 701 to 1399 million tons. This increase was not the same all over the world, and was an
average of 4.5% per year. This increase was mostly in the Middle East and Southern Asian countries. In spite of this increase in energy production, the standard of living in this area is low. The standard of living has a direct connection with the consumption of energy.

The future of oil pricing highly depends on the following factors:

1. Discovery of new oil field especially in Swamp area of Iraq and Central area of Iran where these sources were already proved.

2. Oil price also depends on the development of means of transportation and pipeline and increase in capacity of the shipments to 80 and 100 thousand tons. This will decrease the cost of transportation.

3. Interference of Government in economic fields of the country especially in situation of more production than consumption and decrease in oil prices and also in situation of oil exports and limitation of oil imports for protection of internal products. Interference of Government in this way is maintainence of national resources.

4. Cost of Refining: The other factor which has serious effect on oil prices is the cost of Refining. If the Refinery is in oil producer country the oil price will be less as compared with those oil prices where the Refinery is located in another country.

5. Increase in energy consumption: If the energy consumption increases the demand will increase and in accordance with "Demand and Supply" rule the oil prices will increases.
6. Forestall: Some times the oil consumers countries forestall oil and this will cause increase in oil prices.

Declining Surplus for OPEC

The monetary surplus of the Organization of Petroleum Exporting Countries (OPEC) could start falling in the middle of 1980, in spite of higher oil rates. The European countries, specially England, will probably continue rising but oil exports and prices could slow down owing to international sluggishness and consumption curbs by importing countries. In the current year the OPEC members' surplus could be £ 50 million to £ 55 million compared with £ 26 billion in 1977, £ 36 billion in 1976 and £ 31 billion in 1975. In the year ending in middle of 1980, the surplus would reach around £ 70 billion and then start declining.

OPEC's oil Review in the first nine months of this year totalled £ 125 billion compared with £ 124 billion for all of last year. OPEC's imports diminished by 15 percent in the first half of this year. Iran and Nigeria accounted for three quarters of that decrease.

Oil Energy Crisis, Russian Style

The Soviet Union had an energy crisis, just the opposite of the one in the United States. It is being bled of its immense oil reserves by foreign countries and is powerless to stop the outflow. As a result, it could find itself going hand in hand with the Arab oil Moguls while its own supplies sit untapped beneath thousands of feet of Siberian wasteland. With proven reserves totalling about 12 percent of the
world's oil supply, the Soviet Union controls more petroleum than any other nation. But political commitments to energy-starved Eastern European satellites and its own hunger for foreign currency are growing away at Soviet output faster than it can be increased. Soviet citizens already have felt the strain.

The Soviet Union is aware of the problem. It created a commission to study methods of energy conservation in the 1980s. Until this year the Soviets predicted they could produce enough oil, natural gas and coal for themselves and their allies. Energy shortages and gas lines, the Kremlin said, were unique and inevitable results of capitalist economies. It can't happen here, they implied. Then it happened.

The Soviet nemesis is the drain on its reserves from outside its borders. It is a situation that has left western oil experts tantalized.

"If they had to, they could be self-sufficient in all forms of energy", says one economist. "That's the bottom line, economically". But the bottom line economically is far different from the bottom line particularly.

As the driving force behind the Council for Mutual Economic Assistance (CMEA) roughly translatable into an Eastern European common market, the Soviets have committed themselves to supply energy to Poland, Czechoslovakia, East Germany, Hungary, Romania and Bulgaria. That those nations are politically at the mercy of Moscow is no coincidence. Their energy dependence is merely another hold
exerted by Russia.

As allies, they have been provided since 1949 with oil well below world prices. By 1980, according to CIA estimates, the Soviet will ship 95 million tons, or roughly 16 percent of their total oil production, to other communist nations. Until 1974, this cost would be written off as the price for political patriarchy. But when that year the organization of Petroleum Exporting Countries (OPEC) first jumped its prices, the Soviets found themselves delivering oil to East Europe at a fraction of its real value.

"Their Contracted price was based on the old five-year plan (1971-1975) and they had no way of foreseeing the Arab action". Although Moscow increased the price of its oil the next year by basing it on an average of world prices, they are still providing COMEA nations with petroleum at well below OPEC prices.

Partly to counter this financial loss, they became major sellers of petroleum to Western nations. Their main goal was to earn hard (foreign) currency to buy badly needed Western Technology including modern equipment to drill new oil wells.

Sales of oil and natural gas now are the largest hard currency earner. They'll do anything, to keep the money coming in, said Veteren, Soviet Trade analyst. But that commitment conflicts with the everpresent, ever-growing demands of (COMEA) nations.

"For them to cut back significantly on energy shipments to say, Czechoslovakia, where there are already murmurs of
discontent, could cause political instability", said another
source. "That is certainly unacceptable". Thus the Soviets
are in a "Rob Peter to pay Paul" situation.

Economic analysts calculate that if the Soviets entered
the world oil market as buyers, they would be forced to spend
15-20 billion a year to meet their needs. "Their absolute
there should would be 10 billion", said one economist. "They
are not in a position to spend that kind of hard currency.
Comparatively, they have quite a few options in the current
period of energy shortages. They can discontinue the level
of oil supplies, they are sending to OPEC countries. They
can reduce their own industries use levels, which would do
their economy serious damage, or they can go for an all-out
push of domestic oil production at the expense of other areas
of the economy".

The main hope of Soviet oil production is Western Siberia,
especially a vast basin called Tyumen Oblast. Its wells are
expected to produce up to 315 million tons of the 606 million
targeted for 1980 production, a goal Western analysts call
unattainable. Soviet Union Government called for an infusion
of capital and labour into the area, but that will require
again foreign currency to buy foreign technology; man power
too, is a problem.