



Pergamon

Futures, Vol. 28, No. 5, pp. 433–452, 1996
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0016-3287/96 \$15.00 + 0.00

S0016-3287(96)00026-2

OIL AT THE TURN OF THE TWENTY FIRST CENTURY

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This paper focuses on the interplay of market forces and politics in the world oil market to the year 2010. It argues that world oil demand will increase considerably, with Asian demand growing the fastest. Given that the growth of non-OPEC oil supply will be trivial, the call on OPEC oil will increase substantially. Yet, given the declining per capita oil revenue of OPEC, member countries may not be able to make timely investments in required upstream projects. If this happens, the supply constraint will lead to higher prices and intensified international competition for the Persian Gulf oil. Thus, foreign investment will be increasingly needed in the OPEC countries if prices are to remain stable and international competition manageable. Yet, there are geopolitical and institutional barriers to foreign investment in many OPEC countries. Therefore, it is imperative that major players in the world oil market cooperate to reduce such barriers in time to ensure a supply situation that will correspond to the rising demand. Copyright © 1996 Elsevier Science Ltd

The last 15 years have witnessed several international events of historic proportions: the eight-year Iran–Iraq war, the Tankers War in the Persian Gulf, Desert Storm, and the collapse of the Soviet Union. All of these, and other less dramatic events, have occurred in or around the world's major oil fields. Yet, contrary to popular expectation, the impact of these major events on the flow and price of oil has been minimal. Except for short periods, prices have remained low, creating market conditions detrimental to exporters and favourable to buyers. This is certainly the case at the present time. This outcome has resulted in what some have called an 'atmosphere of complacency' in most consuming nations, where oil is believed to be readily available in the future at current or even lower prices.¹ However, looking deeper into trends in, and influences on, the world oil market,

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one is compelled to conclude that the future holds uncertainty for consumers and producers, including governments and oil companies.

World oil demand is increasing steadily. In the long run, supply will most likely catch up with demand and oil prices will stabilize. Competition, increasingly introduced in the world oil market by the advent of the telecommunication and futures market, will play a major role in eventually bringing supply and demand into balance. In the interim, however, capital and capacity constraints are sure to make the future of oil supply uncertain, leading to higher prices in the next decade. Current projections also warn of increasing disparity in oil reserves and production capacity among producing countries. This means that the Middle East producers, particularly those in the Persian Gulf, are becoming even more important than they have been. OPEC is predicted to remain a leader in the world oil markets, as demands on its oil will rise significantly in the decades ahead. However, OPEC's declining per capita oil revenue in recent years will most likely exacerbate its present capital shortage, reducing the organization's ability for sufficient and timely expansion of production or to create capacity overhang for possible crisis management. Meanwhile, foreign investment in most OPEC countries faces institutional and political constraints. Although 'free market' forces and competition have had a significant role in determining oil prices in the recent past, in the absence of a new holistic approach emphasizing regional and international cooperation these constraining forces could cause distortion in the working of oil markets.²

The purpose of this paper is to assess the pertinence of these and similar trends and influences on oil markets and implications that follow for policy development. It will provide secular trend analyses and explain various enabling and disabling causal factors that affect both the demand and supply sides of oil economies, including market and regulatory measures. To accomplish the task, I shall rely, in part, on the International Energy Agency's (IEA) assumptions and projections, along with forecasts made by other organizations.³ In the 1995 edition of its *World Energy Outlook*, IEA presents two new models for oil supply and demand forecasts, a capacity constraints case (CC), and an energy savings case (EC). The CC case assumes rising energy prices, while the EC case assumes that a great deal more efficiency improvements and energy conservation will take place than is suggested from past experience. A critical reading of current views on the future of oil politics, OPEC's authority, and impact of the environmental movement will also be utilized for a thorough examination of underlying causes of possible market imbalance or political instability. This paper is organized into four parts focusing, respectively, on world oil demand and underlying assumptions, world oil supply and constraining factors, geopolitics of Middle East oil, and the implications for international cooperation among participants in the world oil market.

World oil demand and underlying assumptions

Despite recessions since 1990 in almost all of the major industrialized countries, global demand for oil has remained strong, and there is considerable consensus in the oil industry about significant growth in demand for oil over the next 20 years. IEA expects world oil demand to rise at an average rate of 1.5 (CC)/1.4 (EC) % per annum into 2010, when total demand is projected to reach 95.2 (CC)/92.0 (EC) mb/d or 86.0 mb/d in case the world economy was to grow slowly. It will reach 77.3 mb/d by the year 2000. The 1992 figure for world oil demand was 67.4 mb/d. According to IEA, world oil demand growth, in