

# Recoil

*The Economist*

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## In the early 1970s ...

- A fourfold rise in the oil prices by the Arab embargo
- America subjected its cars to fuel-efficiency standards
- France embraced nuclear power
- Oil prices have quadrupled again, but this time it is a **slow-motion oil shock**

## Action reply

- The wage-price spiral of the 1970s has been avoided, but the income shock is painful
- America's emergency tax rebate has in effect been taken away
- Politicians have been looking for scape-goats

## Speculators profiting?

- Some \$260 billion is invested in commodity funds. Hot money has supercharged the demand for oil?
- **Wrong!** — Every barrel they buy in the futures markets they sell back again before the contract ends
- Someone is hoarding oil today? **No evidence!**
- Oil company fails to increase output? **If so, Shell and Exxon are not maximizing profit!**
- Oil is running out? **Not really.**

# The truth

- Finding and developing new oil fields is expensive
- When prices are low, oil-rich company welcome the oil firms
- When prices are high, countries like Russia and Venezuela kick them out

# Stop subsidies

- Governments should speed up the adjustment—or at least stop delaying it
- Half the world's people are sheltered from fuel prices by subsidies—which have boosted demand and **mostly benefited the better off**

- The 1970s showed how demand and supply, inelastic in the short run, eventually give rise to conservation and new production
- Eventually the down-cycle will take hold
- By then the slow-motion oil shock could have catalyzed momentous change

# Fuel subsidies

- Half of the world's population enjoys fuel subsidies
- Venezuela—5 cents per litre
- China—79 cents per litre
- U.S.—\$1.04 per litre
- Taiwan—\$1.2 per litre
- Germany—\$2.35 per litre



## Rising oil prices

- Rising oil prices should reduce demand. But if domestic prices are capped, the emerging economies will continue to guzzle oil, pushing world prices still higher
- Emerging economies accounted for more than the whole increase in world oil consumption last year—because demand in the rich economies fell

## Who benefits from subsidies?

- Government fear that lifting fuel prices will hurt the poor and trigger social unrest
- Fuel subsidies mainly benefit the richer owners of cars and air-conditioners
- An IMF study: the richest 20% of households received 42% of total fuel subsidies; the bottom 20% received less than 10%