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
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.
• 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%