Business Foundation 2009-2010

Economics coursework

**Would lower oil prices be good or bad news for the world economy?**

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**Introduction**

Nowadays oil is one of the most important resources on the Earth, it is an essential part of the world’s trade and economy. It takes the leading place in world’s fuel and energy sector and is an essential product for most of countries, which both produce oil and use it for production purposes and energy yields. The prices for oil, as for any other product, are measured by the demand and supply measures, but as the demand for oil is quite inelastic (people would anyway buy the same amount of oil even for higher prices), even inconsiderable fall of supply would cause a sharp rise in prices:

**Price D**

**S1 S**

$176 **E1**

$152 **E**

**Quantity** 1,98 - 2 barrels

At the same time, when some other oil reserves are found, the supply is going to increase, therefore causing lower oil prices. This is rather bad news for the world, than good, as there are much more disadvantages rather than advantages for the world’s market, economies of countries and our planet from ecological point of view.

**Advantages of lower oil prices**

Depreciation of prices on oil would be beneficial for the countries, importing and consuming oil. Among the top oil consumers there are such countries, dependent on oil, as the United States, which by 2007 were consuming 20,680,000 barrels a day, from which over 13 mln barrels are imported. But not as much for the US (because fall in oil prices would also be a bad news for them as producers of oil), but for such countries, trying to get out of economy’s recession, as Ireland, which is from 2008 trying to get out of recession (recent figures for GDP = -1,28% by January 2010), Italy ( which is also getting out of recession with current GDP rates of -0,3%, while its oil imports are over 1,7 mln barrels a day), Greece, which economy is also in trouble and other oil consuming countries. As oil becomes cheaper, the country spends less on importing oil, and the money saved are spent on government spending, therefore the national GDP grows as well as people’s material living standards, and the economy gets out of recession and high unemployment rates in the country.

**Disadvantages of lower oil prices**

However there are more disadvantages of cheap oil, rather than benefits, and firstly, it is bad news for countries exporting more than 80% of the oil they produce, such as Singapore (which exports 10,909% of domestic oil produced), Belgium (5, 816%), followed by Netherland, UK, some members of OPEC (Saudi Arabia (80,9%), UAE (100%), Nigeria, Kuwait, Venezuela (which oil exports account for 1/3 of its GDP) and others), Norway (about 3 mln barrels – 101,3%) and other countries,. As the price for oil goes down, the demand for oil will remain on the same level, and countries would make less profit than expected for oil exports. That would lead to fall of GDP rates, and would be followed by cutting government spending and increasing taxation, also as result unemployment would rise, and all that may even bring the country’s economy into recession because of their vulnerability to oil shocks.

Moreover, cheaper oil also would cause decrease in private investment into oil producing companies, as they see it quite risky and returns become too uncertain for financing. As a result, oil producing companies’ development slows down, and that process reflects on decreased volumes of production and exports. That would therefore bring less profit into a national economy, and result again in decrease of GDP rates and cause internal problems in the economy.

As a result of poor investment in oil companies and GDP falls, the world, which is dependent on strong oil exporting and importing countries, will have to overcome a general fall in GDP, which is bad in common.

In addition to this, low oil prices are also bad for the world. As the price on petroleum gets lower, more drivers, working for taxi and public transport, would try to benefit from cheap petrol by making more extra rides. Some companies, that produce plastic goods, might buy more oil to produce more products. As a result of it, the environment suffers the most. More pollution is caused because of increased emissions of carbon dioxide, and the government would have to increase spending on solving the problem, attempting to reduce petrol emissions, creating social campaigns, encouraging people to switch to using bio-fuel or natural gas, which are less dangerous for the environment. On the other hand, as more petrol would be bought, more oil would be required from the companies, and that would increase oil production, which is also environmentally damaging. That would even make environmental situation worse.

**Conclusion**

To sum up, oil prices in the world play an important role in each country’s economy, and most of the countries with strong economies are less likely to benefit from low oil prices, as they are bringing less profit, causing more extra spending (made by governments, e.g. on economy’s recovery) and even cause environmental problems. At the same time, those countries, which are trying to get out of recession, are more likely to benefit from buying cheaper oil and using it for increasing production (output) and therefore increasing its GDP rate and improving living standards in the country.

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Class notes

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