

SUMMARY

Oil prices still matter to the health of the world economy. Higher oil prices since 1999 – partly the result of OPEC supply-management policies – contributed to the global economic downturn in 2000-2001 and are dampening the current cyclical upturn: world GDP growth may have been at least half a percentage point higher in the last two or three years had prices remained at mid-2001 levels. Fears of OPEC supply cuts, political tensions in Venezuela and tight stocks have driven up international crude oil and product prices even further in recent weeks. By March 2004, crude prices were well over \$10 per barrel higher than three years before. Current market conditions are more unstable than normal, in part because of geopolitical uncertainties and because tight product markets – notably for gasoline in the United States – are reinforcing upward pressures on crude prices. Higher prices are contributing to stubbornly high levels of unemployment and exacerbating budget-deficit problems in many OECD and other oil-importing countries.

The vulnerability of oil-importing countries to higher oil prices varies markedly depending on the degree to which they are net importers and the oil intensity of their economies. According to the results of a quantitative exercise carried out by the IEA in collaboration with the OECD Economics Department and with the assistance of the International Monetary Fund Research Department, a sustained \$10 per barrel increase in oil prices from \$25 to \$35 would result in the OECD as a whole losing 0.4% of GDP in the first and second years of higher prices. Inflation would rise by half a percentage point and unemployment would also increase. The OECD imported more than half its oil needs in 2003 at a cost of over \$260 billion – 20% more than in 2001. Euro-zone countries, which are highly dependent on oil imports, would suffer most in the short term, their GDP dropping by 0.5% and inflation rising by 0.5% in 2004. The United States would suffer the least, with GDP falling by 0.3%, largely because indigenous production meets a bigger share of its oil needs. Japan's GDP would fall 0.4%, with its relatively low oil intensity compensating to some extent for its almost total dependence on imported oil. In all OECD regions, these losses start to diminish in the following three years as global trade in non-oil goods and services recovers. This analysis assumes constant exchange rates.

The adverse economic impact of higher oil prices on oil-importing developing countries is generally even more severe than for OECD countries. This is because their economies are more dependent on imported oil and more energy-intensive, and because energy is used less efficiently. On average, oil-importing developing countries use more than twice as much oil to produce a unit of economic output as do OECD countries. Developing countries are also less able to weather the financial turmoil wrought by higher oil-import costs. India spent \$15 billion, equivalent to 3% of its GDP, on oil imports in 2003. This is 16% higher than its 2001 oil-import bill. It is estimated that the loss of GDP averages 0.8% in Asia and 1.6% in very poor highly indebted countries in the year following a \$10 oil-price increase. The loss of GDP in the Sub-Saharan African countries would be more than 3%.

World GDP would be at least half of one percent lower – equivalent to \$255 billion – in the year following a \$10 oil price increase. This is because the economic stimulus provided by higher oil-export earnings in OPEC and other exporting countries would be more than outweighed by the depressive effect of higher prices on economic activity in the importing countries. The transfer of income from oil importers to oil exporters in the year following the price increase would alone amount to roughly \$150 billion. A loss of business and consumer confidence, inappropriate policy responses and higher gas prices would amplify these economic effects in the medium term. For as long as oil prices remain high and unstable, the economic prosperity of oil-importing countries – especially the poorest developing countries – will remain at risk.

The impact of higher oil prices on economic growth in OPEC countries would depend on a variety of factors, particularly how the windfall revenues are spent. In the long term, however, OPEC oil revenues and GDP are likely to be lower, as higher prices would not compensate fully for lower production. In the IEA's recent *World Energy Investment Outlook*, cumulative OPEC revenues are \$400 billion lower over the period 2001-2030 under a Restricted Middle East Investment Scenario, in which policies to limit the growth in production in that region lead to on average 20% higher prices, compared to the Reference Scenario.