



Oil and Gulf Economies within a Changing Regional Environment

By: Dr. Abdulla Al - Sadiq

Assistant Secretary-General for Economic and Strategic Studies,
Bahrain Centre for Studies and Research (BCSR).

Forward

- ◆ For more than 50 years, the oil sector has had an important impact on the overall economies of Gulf Cooperation Council (G.C.C.) countries. It is worth mentioning that Bahrain was the first country in the Arabian Gulf region in which oil was discovered in 1932.
- ◆ But it was not until the quadrupling of oil prices during the period October 1973 to January 1974, as a result of the coordinated action by OPEC members to raise the price of oil, that substantial amounts of financial capital became available and provided the potential for rapid economic development.

- ◆ Since the mid-seventies, the role of the G.C.C. countries in the international oil market (IOM) has been increasingly important. It has played an important role, through OPEC, in directing the oil sector in the world

- ◆ Oil revenues have transformed most of the aspects of socio-economic life in the G.C.C. countries. They have contributed to the establishment of the infrastructure, support in founding industrial companies, and for the financing of education, culture, defense and security.
- ◆ The acceleration of investment spending and the continuous growth of various economic sectors led to a rapid inflow of foreign labour which recently accounts for more than half of the total labour force in GCC economies.

The Performance of Oil and Gulf Economies

- ◆ G.C.C. economies were able to perform well during 2003, compared to the previous years. This was mainly due to the rise of average OPEC oil prices by 15.4%, where the average during 2003 was US\$ 28.10 which represented an increase of US\$ 3.74 compared to the 2002 average price of US\$ 24.36.

- ◆ Primary estimates indicated that the average Brent oil price from the beginning of 2004 to April 2004 was around US\$ 30.97.

- ◆ The military, political and economic situation in Iraq meant that Iraq was unable to increase its production up to its quota, and half of it was needed for local consumption. The fall of US and OECD strategic oil storage and labor disturbances in Nigeria and Venezuela, led to increased oil prices of up to an average OPEC price of US\$ 28/b through 2003. Saudi Arabia the largest producer within the GCC produced an average of 8.1 million b/d during 2003, well above the 2002 level of just below 7 million b/d.

- ◆ In view of the above, we can say that a mix of oil prices, and increased production, led to improved macro-economies, especially the budget indicators for the G.C.C. This allowed some G.C.C. states to realize financial surpluses and decrease deficits during 2003. On current showing, 2004 might turn out to be an even more rewarding year.

- ◆ In substance, the good economic performance of the G.C.C. during 2000, due to increased average oil prices of 58% compared to 1999 (table No.1), where the oil production of the G.C.C. countries increased on average by 6.7% (Annex No.1). Within this context, the main reason behind the increase in oil prices during 2000 was due to increased demand and not decreased production as in 1999.

- ◆ Table (1) indicates that the average oil prices of OPEC reached US\$ 27.6 during 2000, with an increase of US\$ 10.13 compared to 17.47, in 1999. It is to be noted that the OPEC average price for 2000 was the highest since 1984, when it reached US\$ 28.2.
- ◆ In view of increased oil prices, oil exports increased up to US\$ 125.76 billion during 2000, with an increase of 51.1% on 1999 oil exports valued at US\$ 83.21 billion (Annex No.2).

- ◆ The record of G.C.C. oil revenues for 2000 was much higher than the annual levels of the Nineties. In Saudi Arabia, for example, oil export revenues reached US\$ 70.42 billion for 2000, compared to US\$ 44.93 billion for 1999, with an increase of US\$ 25.49 billion (56.7% of the level in 1999). By the same token, Bahrain's oil export revenues increased from US\$ 1.71 billion to US \$ 2.59 billion, with an increase of 51.5%.

Table (1)
Average Oil Prices of OPEC Basket US\$/b (1995-2003)

Year	AV. Price of OPEC Basket
1995	\$16.9
1996	\$20.23
1997	\$18.77
1998	\$12.28
1999	\$17.47
2000	\$27.60
201	\$23.12
2002	\$24.36
203	\$28.10

Source: Middle East Monitor, Feb. 2002 & OPEC Brief.

- ◆ In view of that, the total G.C.C. revenues increase reached US\$ 112.4 billions for 2000 budgets, with an increase of 40.5% compared to 1999. The UAE's, total revenues increased from US\$ 13.0 billion in 1999 to US\$ 20.9 billion in 2000.
- ◆ In the Kingdom of Bahrain, total revenues rose from US\$ 1.8 billion in 1999 to US\$ 2.8 billion in 2000. In Saudi Arabia, total revenues increased from US\$ 39.3 billion in 1999 to US\$ 68.8 billion in 2000. For Qatar, Kuwait and the Sultanate of Oman the increase was up to US\$ 6.4 billion, US\$ 7.5 billion and US\$ 5.9 billion respectively.

The Main Causes of Fluctuations in Oil Prices

- ◆ Large fluctuations in oil prices have been noticed, raising the question of the main causes behind them. The price of a barrel of oil fluctuates usually between the minimum and the maximum price, within certain international economic and political circumstances. The question is what are these two prices and what are the determinant factors?

- ◆ Basically, oil is a commodity, like others, and thus the price of a barrel of oil is determined according to the surrounding market circumstances. It is well known that the price of a barrel of oil according to the market factors, without the producer's intervention, is equal to its marginal cost.

- ◆ Ahmed Alyousha. Fluctuation of Oil Prices and Economic Development Policies. Bahrain Experience. BCSR. Dec. 1999. & Khadour, Walid. Arab Oil in International Policies. Delmon Press.
- ◆ It is believed that the cost varies from US\$ 4-5. In other words, let us suppose that the oil producers do not cooperate to influence oil prices, and they are left to market forces. The market will force the price to the marginal cost that is to the lower level. For instance, over production in 1997 and early 1998 lead to the fall of oil prices, which caused much concern to both governments and oil companies of the oil exporting countries.

- ◆ The price of dated Brent reached \$9.20 per barrel of oil on 10th December 1998. On that same day the light sweet future contract, known as the WTI contract, traded at \$10.72 per barrel on the NYMEX and the Dubai price at \$9.98 per barrel. By the same token, table (2) shows export prices of Saudi Arabian and Mexican Crude corresponding to the lowest reference prices obtained in December 1998.

Table 2
Export Prices of Saudi Arabian and Mexican Crude
Corresponding to Lowest Reference Prices obtained in
December 1998. US dollars per Barrel

Crude	Destination	
	To USA	To Europe
Arabian Light	\$7.50	\$7.35
Arabian Medium	6.2	6.6
Arabian Heavy	5.4	6

Source: Robert Mabro, Fluctuations of Oil Prices: Current Situation & Future Expectations. Bahrain Centre for Studies & Research, April, 1999.

- ◆ It is worth mentioning that market factors are a supporting factor for consumers, when it comes to getting lower prices than that demanded by the producers. Within this context, we understand the phenomenon of spot markets encouraged by the International Energy Agency (IEA), whereby oil deals are arranged, and have an increased role in determining oil prices.

- ◆ On the other hand, the maximum level is determined by the insistence of the producers on using the demand or production factor to determine the price of a barrel of oil. In the oil market, the institutional mechanism for coordinating decisions does exist in the form of OPEC.

- ◆ For example during the period October 1973 to January 1974, OPEC managed to achieve a virtual four-fold increase in oil prices. As a result of this, substantial amounts of financial capital became available to GCC. countries and provided the potential for rapid economic development. At that time, the Kingdom of Bahrain enjoyed a virtual five-fold increase in its total public revenues over the period 1973-1981.

- ◆ Further more, when using this factor, which happened during the October war when production was stopped, the producers could raise the level of oil prices to unprecedented levels. Thus, oil prices are determined to a great extent through the cooperation of the producers in raising the price of a barrel of oil .

- ◆ In view of the above, one could say that the interaction of market factors and producer pressure to influence the barrel price causes the fluctuation of the oil prices between the maximum and the minimum; that is the minimum that the consumers seek to realize and the maximum that the producers seek using the demand factor.

Oil - The Long-Term Outlook

- ◆ The prospect is that the general trend in the oil market situation will tilt towards the interests of the Gulf States. Most of the international oil reserves are within OPEC states (about 80% of the international oil reserves) (IOR). Within OPEC, Saudi Arabia ranks first with oil reserves of more than 24.6% of the IOR for 2001, then Iraq 10.6%, Iran 9.4%, UAE 9.2% and Kuwait 9.1% .

- ◆ Thus the total Gulf oil reserve is about 64% of the known world oil reserve. On the other hand, the reserves of the advanced states will be depleted soon. It is expected that the importance of the Gulf States will increase, as it is expected that OPEC will supply more than 50% of the total world oil consumption until 2020, when world oil consumption is expected to have increased by up to 100 m b/d by 2020.

- ◆ It is reasonable to say that 2000 signaled a significant change in the IOM. This is not only due to increased average oil prices which have reached their peak since the eighties, but also because of the return of OPEC as a major party in the IOM.
- ◆ It is safe to say that the reasons behind this return, have been increased consumption by the rapidly developing countries, especially China and India during the eighties and the nineties.

- ◆ In addition to that, environmental considerations in advanced countries have deterred the option of more dependence on electricity generated by nuclear reactors, as in the case of Germany, and Sweden, and this has led to more dependence on oil. The transport sector is also completely dependent on oil.

Annex (1)
Oil Production of GCC Countries Thousand Barrels/Day

Country	1995	1996	1997	1998	1999	2000
UAE	2,160.00	2161	2161	2244	2049	2233
Bahrain	146	157	163	183	176	183
Saudi Arabia	8023	8102	8011	8095	7564	8095
Qatar	390	393.1	405	618.1	608.5	639.6
Kuwait	2007	2006	2007	2052	1873	1985
Oman	852	885	904	899	904	928
Total	13578	13704	13652	14091	13175	14062

Source: Arab Economic Report. Sep.2001 & Secretariat-General- Arab League.

Annex (2)
Oil Exports of GCC Countries US\$ billion

Country	1995	1996	1997	1998	1999	2000(A)
UAE	13.4	15	15.3	10.3	15	19.09
Bahrain(A)	1.85	1.32	1.2	0.9	1.71	2.59
Saudi (B)	42.7	50.1	48.2	32	44.9	70.42
Qatar	2.6	3.8	4.66	3.11	4.78	6.7
Kuwait(C)	12.1	14.1	13.5	8.47	11.1	18.16
Oman	4.75	6	6.18	3.86	5.69	8.8
Total	77.3	90.3	89	58.5	83.2	125.76

Source: Economic and Social Commission for Western Asia (ESCWA) UN 2000. p. 10.

- ◆ Arab Economic Report, Sep. 2001. P.314.
- ◆ ESCWA estimates.
- ◆ Includes Bahrain's share of the Abu Safa Oil field (100,000 b/d for 1995 and 140,000 b/d starting April 1996).
- ◆ Includes a 50 per cent of the Natural Zone.

Thank You