Oil embargo: its effects on the price, supply and demand of oil in the us

Oil Embargo: Its Effects on the Price, Supply and Demand of Oil in the US In October 16, 1973, the Organization of Petroleum Exporting Countries (OPEC) led by Saudi Arabia cut production and placed an embargo on shipments of crude oil to Western countries particularly the US and the Netherlands and a total boycott in Israel. This was a political strategy connected with the Yom Kippur War. The oil companies and other intermediaries participated with the embargo resulting to unheard levels of increase in world oil prices, reaching as high as four times the previous highs. Economies in industrialized countries in the world were greatly affected.

The primary effect of the oil embargo was price increase, not supply disruption. Although countries such as the US, Netherlands, France and Britain experienced very tight oil supplies, and countries who continue to ally themselves with Israel suffered even more repercussion in terms of provision of oil supply, this strategy did not succeed in winning their political demands against Israel. Nevertheless, the Arabs grew enormously wealthy from the oil embargo.

On the other hand, countries started looking for other potential sources of oil. Old fields were expanded and new fields were discovered such that supply of crude oil increased. This likewise resulted to other sources of oil such that the Middle East was no longer the dominant world supplier of oil. These transformations changed the position of the Middle East particularly in their strategy of using oil as a weapon. Saudi Arabia has disavowed this practice since the country, including others in the Middle East need the cash flow from their oil.

During the past 25 years, the nominal price of gasoline for the United States has risen at an average annual rate of 5. 2% and the real price of gasoline rose only one-fourth of a percent per year. Gasoline prices reached a peak in 1981 and declined thereafter despite increase in real taxes. As a result of the oil embargo, the nominal price of gasoline dropped about 31% and the real price of gasoline dropped by 43% between 1981 to 1986. This decline continued for the succeeding two years and by 1988, the price of gasoline fell by 45%, for a post-embargo low.

The embargo initially led to high prices of oil in the western countries particularly the United States. The change in demand, specifically increase in demand, led consumers to bid prices because of the change in supply (decrease in supply). The reason of course was the political crisis in the Middle East. In general, the effect of war as a determinant for change in supply worked out. On the other hand, consumers anticipated the drop in supply of oil so buyers competed and others bought in large quantities to keep leading to increase in demand, thus prices increased.

Other countries started looking for sources of oil using their own natural resources. Even other countries in the Middle East expanded their production since the embargo caused an increase in oil price in the international market. After 1981, price of oil started to go down because of the increase of supply of oil.

Sources:

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Energy Information Administration, Annual Energy Review 1997, DOE/EIA-0384(97). (Washington, DC, July 1998), Table 5. 22. Note(s): 1972-1977: price of leaded regular gasoline was used; 1978-1996: price for all types of gasoline was used as cited in .