**Declining oil prices**

Shifts in oil prices have two key characteristics. The first is that the shifts are unpredictable and can be large. The second is that shifting oil prices have far reaching effects on the global political economy.

The first large post 1945 shift in oil prices occurred in the 1970s as Middle Eastern oil producing states quadrupled prices in response to Israel’s initiation and Western support for the 1973 Arab – Israeli War. The rise in prices triggered a transfer of wealth from oil consumers to oil producers. Oil consuming countries in both the developed and developing world paid more for oil and the oil producers whether in the Middle East, Africa or Latin America benefitted from the inflow of money. The rising price of oil also led to a wave of inflation in the global economy as goods became more expensive due to rising costs of production and transportation. A second oil shock in 1979 at the time of the Iranian Revolution caused the United States Federal Reserve to embark upon an inflation fighting strategy of raising interest rates to record levels. This in turn precipitated recession in Western states and the debt crisis in many developing countries as borrowing became extremely expensive.

In 2014-16 the global economy experienced a different rapid shift in oil prices, this time in the downward direction. Oil prices plummeted from US $115.00 to $30.00 a barrel between June of 2014 and February 2016. A number of factors contributed to the collapse in oil prices (Baffes 2015). The previous high price had led to greater exploration and expansion of new sources of oil, such as US shale operations and the Canadian tar sands. Slowing growth in China reduced demand for oil in its factories and cities. The key cause, however, seems to have been the decision by Saudi Arabia to flood the market with oil in order to drive higher cost producers out of the market. In comparative terms Saudi oil is very cheap to extract. Saudi Arabia hoped that lowering the price of oil would drive higher cost producers out of the market. Lower prices would also undermine the economies of Saudi Arabia’s rival, Iran.

The collapse of oil prices has had a number of implications. Higher cost producers such as the US shale oil industry, Canadian tar sands and off shore oil producers (Newfoundland, UK, Norway, Venezuela) have seen revenues plummet. In many cases these producers operate at a loss but continue to pump oil because shutting down operations is too expensive. However, plans for expansion have been shelved and employees laid off. For countries heavily dependent upon oil revenues such as Russia, Nigeria and Venezuela, the shortfall in revenue poses the risk of social instability as governments must find other sources of funds or institute large scale cutbacks. Oil producers in the Middle East have also been hit hard. Saudi Arabia itself faces increasing budget deficits, forcing it to draw on savings to fund government operations. A series of cutbacks to social and employment programs in the kingdom have also been implemented.

The implications for climate change are mixed. On the negative side, falling oil prices reduces the incentives to switch to renewable energy. On the positive side the crisis in the oil industry weakens the political influence of oil companies and has resulted in the postponement of future oil exploration, development and infrastructure. By the time the oil industry gets back on track they may have lost considerable ground to the growing renewable energy sector and climate change activists.

**References**

Baffes, M., Kose, A., Ohnsorge, F., and Stocker, M. (2015) ‘The Great Plunge in Oil Prices; Causes, Consequences and Policy Responses’ *Policy Research Note* PRN/ 01/15 (Washington: World Bank Group).