

It is rightly stated by many that oil price trends are set by economics, while the actual movements are determined by politics. This is because of the fact that oil supplies in a highly imperfect market are strongly affected by domestic issues in key oil producing countries and by the political relations among them.

Some analysts¹¹ not only foresee increased potential for conflict among the Gulf producers that enhances the uncertainties for the oil markets, but they also emphasize the possibility that the former Soviet Union may once again play a more active role in the Middle East, keeping fairly close political links with Iraq, and improving relations with Iran and Saudi Arabia. A triangle of Iran, Iraq and the former Soviet Union would be a potential force to take into account in Middle East politics because all these countries have a common interest in high oil prices.

The political circumstances in the Middle East will influence various countries', particularly Saudi Arabia's, decisions to invest in raising productive capacity. Moreover, the world's growing dependence upon oil from the Gulf area does imply that, as in the past, oil prices will continue to be subject to Middle East politics. Doubts and uncertainties concerning oil supplies from the Middle East are likely to persist.

3) Capacity Expansion and Financial Constraints

Although there are plenty of identified reserves around the world, low prices do create strong disincentives for reinvestment in production capacity growth. OPEC recognizes that, even with moderate demand growth forecasts, and without substantial current investment, there are likely to be severe capacity constraints by mid decade.

Therefore, most of the leading producers have announced ambitious production capacity expansion programmes (see Table A16). The total of these announced programmes for OPEC alone will require around \$160 billion by the end of 1995. If the programmes for Mexico and the republics of the CIS are added, the capital needs for capacity expansion come to more than \$250 billion over the next five years, as shown in Table A17 in the Appendix.

¹¹ O. Noreng and J.M.Bourdair, "Beyond the crisis - Middle East oil supplies after the Gulf conflict - the strategic and economic issues". Energy Watchers III, ed by D.H.El Mallakh (1992).