

Understanding Sudan

A Teaching and Learning Resource



Fact Sheet Two: A History of Oil Production

We tend to think of crude oil as a very modern invention, powering our cars, trucks and airplanes. Actually, crude oil was used to make walls and towers in the ancient world over four thousand years ago, according to the Greek historian Herodotus. Babylon and other ancient places using crude oil in this way, however, did not extract the oil using the technological methods discussed in Fact Sheet One. Instead, they used oil from naturally occurring oil pits.

The first modern oil pits opened in the 1850s, after a method was found to extract kerosene from petroleum. Kerosene was used for light and heat, among other things, and is still used today in many places.

It took another hundred years, however, for oil to become the world's dominant fuel. In the meantime, coal was the most important. Even the first generation of internal combustion engines in cars, which we now associate so strongly with oil, once ran on coal or gas.

International prices and politics of oil

Today, oil is traded on the open market, meaning that prices are not set between a particular seller and buyer, such as two countries, but as a function of the supply and demand in the market generally. Because of oil's centrality in the world economy, however, there have been frequent attempts to structure the market to use it for political purposes.

For example, one of the biggest changes in the history of oil was the creation of the Organization of Petroleum Exporting Countries (OPEC) in 1960. The organization was founded in an attempt to support and promote the interests of its members, after President Eisenhower enacted a U.S. law that attempted to put quotas on oil imports from the Persian Gulf in favor of Mexican or Canadian oil. OPEC member countries now coordinate production to adjust their supply of oil in order to combat shortages or gluts in the market. Today, member countries include Algeria, Angola, Ecuador, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, the United Arab Emirates, and Venezuela. Sudan began talks to join OPEC in 2007.

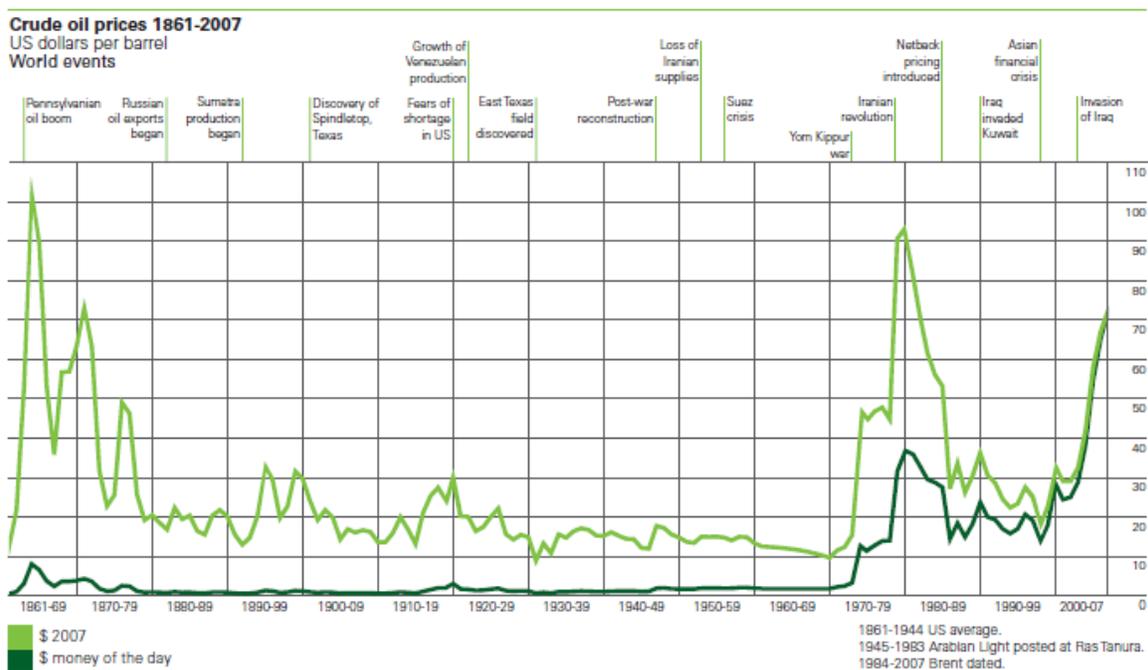
One of the most famous cases of the political use of oil occurred in the early 1970s. In 1972, crude oil cost roughly \$3.00 per barrel. By the end of 1974, the price had quadrupled. During this time, the Yom Kippur war took place in the Middle East. The war began as an attack on Israel by Syria and Egypt. The United States and many other oil consuming nations supported Israel during the war, and as punishment, many Arab oil-exporting nations, including OPEC members, imposed an oil embargo on countries supporting Israel. While other oil-exporters increased production attempting to make up for the shortfall in the market, their attempts were not sufficient, and prices skyrocketed.

The media reactions from the early 1970s are uncannily similar to those heard in the American media when crude oil prices rose dramatically to a record high \$147.30 per barrel in July 2008.

One result of the 1970s oil embargo was the creation of “strategic stocks.” Nations heavily dependent on oil imports realized it was in their interest to build up reserves of oil, which they could use to offset losses from future embargos. The only time the U.S. has since needed to use its reserves was very briefly during the 1991 Gulf War. Another political use of oil occurred around this same time – the United Nations imposed sanctions on Iraq after its invasion of Kuwait in 1990. Part of the embargo was to limit the amount of oil Iraq could sell on the world market.

Oil is not only used as a political weapon. It also reacts to political events. For example, due to fears about potential decreases in supply, the Iranian revolution was the cause of the largest spike in world oil prices since WWII.

We can see in the chart below the way that oil prices are tied to world events:



Source: BP Statistical Review of World Energy. June 2008.

Further questions and discussion

Given the close connection between oil prices and world events, what type of pressure do you think this puts on countries like the United States in their dealings with oil-producing nations? Can these pressures be avoided?

Are there ways that oil could be insulated from political shocks? What are they? Should it be?

Do you think the use of oil as a political tool is justified? Why or why not? Can you think of any cases today in which one could use oil as a political weapon profitably? What are they?

Further readings

Daniel Yergin. *The Prize: the epic quest for oil, money & power*. Free Press.