THE IMPACT OF HIGHER OIL PRICES ON GLOBAL LIQUIDITY

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INTRODUCTION

Recent trends in energy prices, particularly oil and gas, have been widely discussed in the literature on energy economics, international trade, national security, global finance and development studies. Without energy the production of goods and services to support sustained economic growth would not be possible. In most oil consuming countries, oil represents the main source of energy needed for promoting economic growth and improving the quality of life. Imbalances between demand for and supply of energy could jeopardize efforts to induce modernization and encourage industrialization. In other words, such high dependency on energy has linked the future development of mankind to the existence of energy sources to ensure the meeting of man's basic needs and the enhancement of productivity growth. Until today, the prospect of developing new sources of energy to substitute for fossil fuel has shown very little sign of encouragement. Despite attempts to invest in various projects related to energy worldwide, finding a substitute for hydrocarbon energy sources has yet to be achieved.

The gap between production and consumption of energy stems from the uneven distribution of fossil fuels where most consumers are highly industrialized countries with heavy dependence on imported oil. Oil and gas, which represent the main sources of conventional energy, are primarily located in developing countries with low population density. Oil exporters enjoy low price elasticity of demand which allows them to earn substantial amount of revenues by increasing prices of oil. Due to the narrow economic base and small absorptive capacity of these countries, they are able to accumulate large reserves and enjoy current accounts surpluses. Such trends could have spillover effects by creating global imbalances through higher prices, liquidity shortages and currency devaluations.

In this paper, the main objective is to highlight the importance of liquidity imbalances and its impact on global trade and finance. International liquidity is important for maintaining balances of payments equilibrium, strengthening global economic management and enhancing international financial stability. Higher oil prices could produce adverse effects on global stability by redistributing income and reducing flows of international transactions.

THE IMPORTANCE OF OIL PRICES

Since early 1970s, oil prices have been experiencing a high degree of instability reflecting the vulnerability of global oil markets and the impact it may have on the stability of the global economic system. In addition, rapid economic growth, especially in China and India, has been putting pressure on global demand for energy which is far beyond the existing capacity of supply. Heavy dependence of many industrialized and non-industrialized countries on imported oil to meet their demand requirements is expected to impose constraints on government budgets, balance of payments equilibrium, aggregate expenditures, human development, poverty alleviation programs and economic growth.[1]

Earning of foreign exchanges to pay for trade transactions in most developing countries depend heavily on a limited number of primary products the demand elasticity of which is usually high. As a consequence, higher petroleum prices could weaken the ability of these countries to increase production for exports and promote global competitiveness. In addition, higher oil prices weaken national economic policies by reducing the country's capacity to import, especially capital goods and raw materials. Economic development underscores the importance of access to global knowledge, skills, technology and information for building capacity capable of increasing productivity and sustaining economic growth. Petroleum and pe-

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[1] See International Monetary Fund, The Impact of Higher Oil Prices on the Global Economy, Paper prepared by the IMF Research Department, *www.imf.org/external/pubs/ft/oil/2000/index.htm.*