PETROL SHOCKS

The 1973 oil crisis began in October 1973 when the members of the [Organization of Arab Petroleum Exporting Countries](https://en.wikipedia.org/wiki/Organization_of_Arab_Petroleum_Exporting_Countries) proclaimed an oil [embargo](https://en.wikipedia.org/wiki/Embargo). By the end of the embargo in March 1974, the [price of oil](https://en.wikipedia.org/wiki/Price_of_oil) had risen from US$3 per [barrel](https://en.wikipedia.org/wiki/Barrel_(unit)#Oil_barrel) to nearly $12 globally; US prices were significantly higher. The embargo caused an oil crisis, or "shock", with many short- and long-term effects on global politics and the global economy. It was later called the "first oil shock", followed by the [1979 oil crisis](https://en.wikipedia.org/wiki/1979_oil_crisis), termed the "second oil shock."

The embargo was a response to American involvement in the 1973 [Yom Kippur War](https://en.wikipedia.org/wiki/Yom_Kippur_War). Six days after [Egypt](https://en.wikipedia.org/wiki/Egypt) and [Syria](https://en.wikipedia.org/wiki/Syria) launched a surprise military campaign against [Israel](https://en.wikipedia.org/wiki/Israel), the US supplied Israel with arms. In response to this, the Organization of Arab Petroleum Exporting Countries (OAPEC, consisting of the [Arab](https://en.wikipedia.org/wiki/Arab) members of [OPEC](https://en.wikipedia.org/wiki/OPEC) plus Egypt and Syria) announced an oil embargo against [Canada](https://en.wikipedia.org/wiki/Canada), [Japan](https://en.wikipedia.org/wiki/Japan), the [Netherlands](https://en.wikipedia.org/wiki/Netherlands), the [United Kingdom](https://en.wikipedia.org/wiki/United_Kingdom) and the [United States](https://en.wikipedia.org/wiki/United_States).

The crisis had a major impact on international relations and created a rift within [NATO](https://en.wikipedia.org/wiki/NATO). Some European nations and Japan sought to disassociate themselves from [United States foreign policy in the Middle East](https://en.wikipedia.org/wiki/United_States_foreign_policy_in_the_Middle_East) to avoid being targeted by the boycott. Arab oil producers linked any future policy changes to peace between the belligerents. To address this, the [Nixon Administration](https://en.wikipedia.org/wiki/Nixon_Administration) began multilateral negotiations with the combatants. They arranged for Israel to pull back from the [Sinai Peninsula](https://en.wikipedia.org/wiki/Sinai_Peninsula) and the [Golan Heights](https://en.wikipedia.org/wiki/Golan_Heights). By January 18, 1974, [US Secretary of State](https://en.wikipedia.org/wiki/US_Secretary_of_State) [Henry Kissinger](https://en.wikipedia.org/wiki/Henry_Kissinger) had negotiated an Israeli troop withdrawal from parts of the Sinai Peninsula. The promise of a negotiated settlement between Israel and Syria was enough to convince Arab oil producers to lift the embargo in March 1974.

Independently, OAPEC members agreed to use their leverage over the world [price-setting](https://en.wikipedia.org/wiki/Price_fixing) mechanism for [oil](https://en.wikipedia.org/wiki/Petroleum) to stabilize their incomes by raising world oil prices after the recent failure of negotiations with Western oil companies.

The embargo occurred at a time of rising petroleum consumption by industrialized countries and coincided with a sharp increase in oil imports by the world's largest oil consumer, the United States. In the aftermath, targeted countries initiated a wide variety of policies to contain their future dependency.

The 1973 "oil price shock", with the accompanying [1973–74 stock market crash](https://en.wikipedia.org/wiki/1973%E2%80%9374_stock_market_crash), were regarded as the first discrete event since the [Great Depression](https://en.wikipedia.org/wiki/Great_Depression) to have a persistent effect on the US economy.

The embargo's success demonstrated [Saudi Arabia](https://en.wikipedia.org/wiki/Saudi_Arabia)'s diplomatic and economic power. It was the largest oil exporter and a politically and religiously conservative kingdom.

Background

US oil production decline

In 1970, US oil production started to decline, exacerbating the embargo's impact. Following this, Nixon named [James E. Akins](https://en.wikipedia.org/wiki/James_E._Akins) as US Ambassador to Saudi Arabia to audit US production capacity. The confidential results were alarming—no spare capacity was available and production could only decrease.

OPEC

The [Organization of the Petroleum Exporting Countries](https://en.wikipedia.org/wiki/OPEC) (OPEC), which then comprised 12 countries, including [Iran](https://en.wikipedia.org/wiki/Iran), seven [Arab](https://en.wikipedia.org/wiki/Arab_world) countries ([Iraq](https://en.wikipedia.org/wiki/Iraq), [Kuwait](https://en.wikipedia.org/wiki/Kuwait), [Libya](https://en.wikipedia.org/wiki/Libya), [Qatar](https://en.wikipedia.org/wiki/Qatar), [Saudi Arabia](https://en.wikipedia.org/wiki/Saudi_Arabia) and the [United Arab Emirates](https://en.wikipedia.org/wiki/United_Arab_Emirates)), plus [Venezuela](https://en.wikipedia.org/wiki/Venezuela), [Indonesia](https://en.wikipedia.org/wiki/Indonesia), [Nigeria](https://en.wikipedia.org/wiki/Nigeria) and [Ecuador](https://en.wikipedia.org/wiki/Ecuador), was formed at a [Baghdad](https://en.wikipedia.org/wiki/Baghdad) conference on September 14, 1960. OPEC was organized to resist pressure by the "[Seven Sisters](https://en.wikipedia.org/wiki/Seven_Sisters_(oil_companies))" (seven large, Western oil companies) to reduce [oil prices](https://en.wikipedia.org/wiki/Price_of_petroleum).

At first, OPEC operated as an informal bargaining unit for resource-rich [third-world](https://en.wikipedia.org/wiki/Third_World) countries. OPEC confined its activities to gaining a larger share of the profits generated by oil companies and greater control over member production levels. In the early 1970s it began to exert economic and political strength; the oil companies and importing nations suddenly faced a unified exporter bloc.

End of the Bretton Woods currency accord

On August 15, 1971, the United States unilaterally [pulled out](https://en.wikipedia.org/wiki/Nixon_Shock) of the [Bretton Woods Accord](https://en.wikipedia.org/wiki/Bretton_Woods_system). The US abandoned the [Gold Exchange Standard](https://en.wikipedia.org/wiki/Gold_Exchange_Standard) whereby the value of the [dollar](https://en.wikipedia.org/wiki/United_States_dollar) had been [pegged](https://en.wikipedia.org/wiki/Fixed_exchange-rate_system) to the [price of gold](https://en.wikipedia.org/wiki/Gold_as_an_investment) and all other currencies were pegged to the dollar, whose value was left to "float" (rise and fall according to market demand). Shortly thereafter, Britain followed, floating the [pound sterling](https://en.wikipedia.org/wiki/Pound_sterling). The other industrialized nations followed suit with their respective currencies. Anticipating that currency values would fluctuate unpredictably for a time, the industrialized nations increased their reserves (by expanding their [money supplies](https://en.wikipedia.org/wiki/Money_supply)) in amounts far greater than before. The result was a [depreciation](https://en.wikipedia.org/wiki/Depreciation_(currency)) of the dollar and other industrialized nations' currencies. Because oil was priced in dollars, oil producers' real income decreased. In September 1971, OPEC issued a joint communiqué stating that, from then on, they would price oil in terms of a fixed amount of gold.

This contributed to the "Oil Shock". After 1971, OPEC was slow to readjust prices to reflect this depreciation. From 1947 to 1967, the dollar price of oil had risen by less than two percent per year. Until the oil shock, the price had also remained fairly stable versus other currencies and commodities. OPEC ministers had not developed institutional mechanisms to update prices in sync with changing market conditions, so their [real incomes](https://en.wikipedia.org/wiki/Real_income) lagged. The substantial price increases of 1973–1974 largely returned their prices and corresponding incomes to Bretton Woods levels in terms of commodities such as gold.

Yom Kippur War

On October 6, 1973, Syria and Egypt, with support from other Arab nations, launched a [surprise attack](https://en.wikipedia.org/wiki/Yom_Kippur_War) on Israel, on Yom Kippur. This renewal of hostilities in the [Arab–Israeli conflict](https://en.wikipedia.org/wiki/Arab%E2%80%93Israeli_conflict) released the underlying economic pressure on oil prices. At the time, Iran was the world's second-largest oil exporter and a close US ally. Weeks later, the [Shah of Iran](https://en.wikipedia.org/wiki/Mohammad_Reza_Pahlavi) said in an interview: "Of course [the price of oil] is going to rise... Certainly! And how!... You've [Western nations] increased the price of the wheat you sell us by 300 percent, and the same for sugar and cement... You buy our crude oil and sell it back to us, refined as [petrochemicals](https://en.wikipedia.org/wiki/Petrochemical), at a hundred times the price you've paid us... It's only fair that, from now on, you should pay more for oil. Let's say ten times more."

On October 12, 1973, US president [Richard Nixon](https://en.wikipedia.org/wiki/Richard_Nixon) authorized [Operation Nickel Grass](https://en.wikipedia.org/wiki/Operation_Nickel_Grass), a [strategic airlift](https://en.wikipedia.org/wiki/Strategic_airlift) to deliver weapons and supplies to Israel, after the Soviet Union began sending arms to Syria and Egypt.

Embargo

In response to American aid to Israel, on October 16, 1973, OPEC raised the posted price of oil by 70%, to $5.11 a barrel. The following day, oil ministers agreed to the embargo, a cut in production by five percent from September's output and to continue to cut production in five percent monthly increments until their economic and political objectives were met. On October 19, Nixon requested Congress to appropriate $2.2 billion in emergency aid to Israel, including $1.5 billion in outright grants. [George Lenczowski](https://en.wikipedia.org/wiki/George_Lenczowski) notes, "Military supplies did not exhaust Nixon's eagerness to prevent Israel's collapse...This [$2.2 billion] decision triggered a collective OPEC response." Libya immediately announced it would embargo oil shipments to the United States. Saudi Arabia and the other Arab oil-producing states joined the embargo on October 20, 1973.[[16]](https://en.wikipedia.org/wiki/1973_oil_crisis#cite_note-FOOTNOTEYergin2008590-16) At their Kuwait meeting, OAPEC proclaimed the embargo that curbed exports to various countries and blocked all oil deliveries to the US as a "principal hostile country".

Price increases were also imposed greatly. Since short-term oil [demand](https://en.wikipedia.org/wiki/Price_elasticity_of_demand) is [inelastic](https://en.wikipedia.org/wiki/Inelastic), immediate demand falls little when the price rises. Thus, market prices rose from $3 per barrel to $12 per barrel to reduce demand to the new, lower level of supply. The world financial system, which was already under pressure from the Bretton Woods breakdown, was set on a path of recessions and inflation that persisted until the early 1980s, with oil prices remaining elevated until 1986.

Over the long term, the oil embargo changed the nature of policy in the West towards increased exploration, alternative energy research, energy conservation and more restrictive monetary policy to better fight inflation.

Immediate economic effects

The effects of the embargo were immediate. OPEC forced oil companies to increase payments drastically. The price of oil quadrupled by 1974 to nearly US$12 per [barrel](https://en.wikipedia.org/wiki/Barrel_(unit)) (75 US$/m3).

This price increase had a dramatic effect on oil exporting nations, for the countries of the Middle East who had long been dominated by the industrial powers seen to have taken control of a vital commodity. The oil-exporting nations began to accumulate vast wealth.

Some of the income was dispensed in the form of aid to other underdeveloped nations whose economies had been caught between higher oil prices and lower prices for their own export commodities, amid shrinking Western demand. Much went for arms purchases that exacerbated political tensions, particularly in the Middle East. Saudi Arabia spent over 100 billion dollars in the ensuing decades for helping spread its fundamentalist interpretation of Islam, known as [Wahhabism](https://en.wikipedia.org/wiki/Wahhabism), throughout the world, via religious charities such [al-Haramain Foundation](https://en.wikipedia.org/wiki/Al-Haramain_Foundation), which often also distributed funds to violent Sunni extremist groups such as Al-Qaeda and the Taliban.

Control of oil became known as the "oil weapon." It came in the form of an embargo and production cutbacks from the Arab states. The weapon was aimed at the United States, Great Britain, Canada, Japan and the Netherlands. These target governments perceived that the intent was to push them towards a more pro-Arab position. Production was eventually cut by 25%. However, the affected countries did not undertake dramatic policy changes.

In the United States, scholars argue that there already existed a negotiated settlement based on equality between both parties prior to 1973. The possibility that the Middle East could become another superpower confrontation with the USSR was of more concern to the US than oil. Further, interest groups and government agencies more worried about energy were no match for Kissinger's dominance. In the US production, distribution and price disruptions "have been held responsible for recessions, periods of excessive inflation, reduced productivity, and lower economic growth."

The embargo had a negative influence on the US economy by causing immediate demands to address the threats to U.S. energy security. On an international level, the price increases changed competitive positions in many industries, such as automobiles. Macroeconomic problems consisted of both inflationary and deflationary impacts. The embargo left oil companies searching for new ways to increase oil supplies, even in rugged terrain such as the Arctic. Finding oil and developing new fields usually required five to ten years before significant production.

OPEC-member states raised the prospect of [nationalization](https://en.wikipedia.org/wiki/Nationalization) of oil company holdings. Most notably, Saudi Arabia nationalized [Aramco](https://en.wikipedia.org/wiki/Aramco) in 1980 under the leadership of Saudi oil minister [Ahmed Zaki Yamani](https://en.wikipedia.org/wiki/Ahmed_Zaki_Yamani). As other OPEC nations followed suit, the cartel's income soared. Saudi Arabia undertook a series of ambitious five-year development plans. The biggest began in 1980, funded at $250 billion. Other cartel members also undertook major economic development programs.

US retail price gas prices rose from a national average of 38.5 cents in May 1973 to 55.1 cents in June 1974. State governments requested citizens not to put up [Christmas lights](https://en.wikipedia.org/wiki/Christmas_lights_(holiday_decoration)). [Oregon](https://en.wikipedia.org/wiki/Oregon) banned Christmas and commercial lighting altogether. Politicians called for a national gas rationing program. Nixon requested gasoline stations to voluntarily not sell gasoline on Saturday nights or Sundays; 90% of owners complied, which produced long queues.

The embargo was not uniform across Europe. Of the nine members of the [European Economic Community](https://en.wikipedia.org/wiki/European_Economic_Community) (EEC), the Netherlands faced a complete embargo, the UK and France received almost uninterrupted supplies (having refused to allow America to use their airfields and embargoed arms and supplies to both the Arabs and the Israelis), while the other six faced partial cutbacks. The UK had traditionally been an ally of Israel, and [Harold Wilson](https://en.wikipedia.org/wiki/Harold_Wilson)'s government supported the Israelis during the Six-Day War. His successor, [Ted Heath](https://en.wikipedia.org/wiki/Edward_Heath), reversed this policy in 1970, calling for Israel to withdraw to its pre-1967 borders.

The EEC was unable to achieve a common policy during the first month of the War. It issued a statement on November 6, after the embargo and price rises had begun. It was widely viewed as pro-Arab supporting the Franco-British line on the war. OPEC duly lifted its embargo from all EEC members. The price rises had a much greater impact in Europe than the embargo.

Despite being relatively unaffected by the embargo, the UK nonetheless faced an oil crisis of its own—a series of strikes by coal miners and railroad workers over the winter of 1973–74 became a major factor in the [change of government](https://en.wikipedia.org/wiki/United_Kingdom_general_election,_February_1974). Heath asked the British to heat only one room in their houses over the winter. The UK, Germany, Italy, Switzerland and Norway banned flying, driving and boating on Sundays. Sweden rationed gasoline and heating oil. The Netherlands imposed prison sentences for those who used more than their ration of electricity.

A few months later, the crisis eased. The embargo was lifted in March 1974 after negotiations at the Washington Oil Summit, but the effects lingered throughout the 1970s. The dollar price of energy increased again the following year, amid the weakening competitive position of the dollar in world markets.

Alternative energy sources

The energy crisis led to greater interest in [renewable energy](https://en.wikipedia.org/wiki/Renewable_energy), [nuclear power](https://en.wikipedia.org/wiki/Nuclear_power) and domestic fossil fuels. There is criticism that American energy policies since the crisis have been dominated by crisis-mentality thinking, promoting expensive quick fixes and single-shot solutions that ignore market and technology realities. Instead of providing stable rules that support basic research while leaving plenty of scope for [entrepreneurship](https://en.wikipedia.org/wiki/Entrepreneurship) and innovation, congresses and presidents have repeatedly backed policies which promise solutions that are politically expedient, but whose prospects are doubtful.

The Brazilian government implemented its "[Proálcool](https://en.wikipedia.org/wiki/Pro%C3%A1lcool)" (pro-alcohol) project in 1975 that mixed [ethanol](https://en.wikipedia.org/wiki/Ethanol) with gasoline for automotive fuel.

Israel was one of the few countries unaffected by the embargo, since it could extract sufficient oil from the Sinai. But to supplement [Israel](https://en.wikipedia.org/wiki/Israel)'s over-taxed power grid, [Harry Zvi Tabor](https://en.wikipedia.org/wiki/Harry_Zvi_Tabor), the father of [Israel's solar industry](https://en.wikipedia.org/wiki/Solar_power_in_Israel), developed the prototype for a [solar water heater](https://en.wikipedia.org/wiki/Solar_water_heater) now used in over 90% of Israeli homes.