

## MICROECONOMICS AT WORK EXERCISE

### THE PRICE OF OIL

**REFERENCE:** 'Running on empty' (from *The Economist*), *The Australian*, 6 April 2005, p.23.

**CHAPTERS RELEVANT TO THIS EXERCISE:** 3, 5, 6, 7 and 9.

### CONTEXT

The price of a good or service is determined by the demand for it on the one hand and the supply of it on the other. If the determinants of either, or both, demand and supply change over time, price will change accordingly. Furthermore, *over time*, both demand and supply may *adjust* to changes in price, thus causing a subsequent change in the price itself. This may in turn *subsequently* influence demand and/or supply, and cause *further* changes in price ... and so on. In addition the price that the market forces of demand and supply tend to determine may be influenced by *other* forces (e.g. of government), which have the power to modify the way in which the market works.

This article, taking as its cue the sharp increase in the world price of oil in early 2005, analyses these forces in seeking an explanation of the increase and likely responses to it.

### QUESTIONS

1. What have been the 'demand factors' compared to the 'supply factors' in causing the increase?
2. Is the high price of oil likely to bring forth an increase in *supply*? What factors might influence this?
3. What effect is the increase in the price of oil likely to have on future *demand*? How is the concept of 'price elasticity' relevant here?
4. How is the price elasticity of the demand for oil related to the observation made in the article that 'economies have become a lot more fuel efficient' in recent decades?

5. What is meant by, and what is the significance of, the control exerted by many governments, particularly of Asian countries, over the price of oil? Explain the suggestion that the 'ending of fuel subsidies ... could make a difference'.
6. What is the significance in the determination of price of the extent to which governments impose a tax on fuel?
7. What is OPEC and what effect does OPEC have on all this?