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OIL AND THE WORLD ECONOMY

The price of oil is high. It is true when it is seen in the light of its increase from 30 cents a barrel in sixties to $ 30 a barrel in seventies and the sudden jolt it gave to the world economy. But it should not appear high when considered in the context of high prices of manufactures from the industrialised countries. In fact, the oil price would not have appeared high if the oil producing countries could form the producers organisation in fifties or early sixties and start increasing the price gradually. It could have posssibly attained similar height and that also without giving so sudden shocks to the world economy. One must admit that oil used to be supplied to the industrialised world virtually at very nominal prices and this helped them to prosper. However, this sort of benevolence could not continue for ages at the cost of the oil producing countries—which are also developing countries—and hence the increases in the oil prices. A consumer of oil cannot obviously appreciate such increases in oil prices but one must also see what else many of these oil producing countries which hardly produce any other important exportable commodity, could do to make a reasonable living which the industrialised countries have been enjoying for centuries.

2. Until 1973, before the oil price increase, there existed a set of economic relationships which used to keep the industrialised countries (ICs) as a group with surplus capacity leaving the developing countries (LDCs) generally in deficit. With some exceptions this has been the general balance sheet of the world economy. The situation changed dramatically through the collective actions of of OPEC when they increased the oil price in 1973. Painful though

it was for oil importing countries, this not only brought in meaningful changes in the world economic situation but also generated new directions in the economic and political relationship between ICs and LDCs and certainly between ICs and the OPEC.

Oil became an effective mechanism for transfer of resources from one economy to another and it could turn out to be a helpful one for the world economy as a whole and LDCs economies in particular if the surplus fund could be effectively recycled to the developing economies that needed them most and also utilised for production purposes.

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3. With the four-fold increase in the oil price from about \$ 2 per barrel in 1973 to \$ 9 per barrel in early 1974[1] dollar started flowing into OPEC hands. The nominal surplus of OPEC amounting to about \$ 5 billion in 1973 suddenly turned into a surplus of over \$ 64 billion in 1974. Some \$ 60 billion flowed into the hands of OPEC, out of which about \$ 50[2] billion came from industrialised countries. Thus oil became an effective mechanism for transfer of resources from one economy to another and it could turn out to be a helpful one for the world economy as a whole and LDCs economies in particular if the surplus fund could be effectively recycled to the developing economies that needed them most and also utilised for production purposes. Such recycling could also partly compensate the developing countries which suffered due to high oil prices and could not go for any adjustment in their economies. But unfortunately, this did not happen. Most of the oil money remained with the West and largely benefitted the industria-

1. Rehman Sobhan. *The Political Economy of Petro-dollar Recycling : The Significance of Ayatollah Khomeini,* Bangladesh Institute of Development studies, Dhaka, 1980.
2. *The United States and World Development Agenda 1980,* Overseas Devlopment Concil, U. S. A, Praeger, New York, 1981

lised countries. Moreover, whatever oil money went to some developing countries through capital markets also benefited the western banks.

4. 1973 oil price increase did have considerable effect on the economies of the oil importing countries. Some industrialised countries slowed down their economic activities and faced somewhat rising prices. But the general complaint that the oil price increase was responsible for western recession, global monetary and financial crisis and large scale balance of payment difficulties, does not appear to be based on facts. The Bretton Woods

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system virtually collapsed much before 1973. Severe balance of payment difficulties led USA in August 1971 to opt out of the fixed exchange rate by suspending the convertibility of dollar into gold, which meant virtual devaluation of dollar. Periodic currency crisis of considerable magnitude continued to occur due to volatility in the exchange market with temporary runs in individual currencies. These obviously gave rise to inflationary pressure on these economies. The extreme instability in the monetary market also adversely affected the economic activities of these countries. Thus, an extremely unfavourable economic situation did exist even before 1973. The oil price increases, however, complicated the situation further. Therefore, oil price rise was not solely to blame for disorderly situation in the world economy.

5. Moreover, the effect of oil price was not uniform even over all the ICs, West Germany and the Netherlands enjoyed current account surplus even after oil price increase in 1973. The

countries like Japan, Italy, the UK and France had combind current account deficit of about $ 27 billion in 1974[3] and other ICs experienced situations somewhere between these extremes. However, the ICs as a Group absorbed the oil shock pretty well and fairly quickly. The current account deficit of ICs amounting to about $ 8.5 billion in 1974 turned into an impressive surplus of $ 22 billion in 1975[4]. This they obviously achieved through increased exports to the most OPEC countries and that also at higher prices on the grounds of increased prices of oil. In fact, OPEC's large scale import continued over the years and their surplus of about $ 64 billion in 1974 came down to $ 24 billion in 1977 and almost levelled off in 1978. According to one estimate, during the period of 5 years from 1974, OPEC imported goods and services worth $ 492 billion[5] from the rest of the world and obviously in this share of ICs was the biggest. As for example, in a single year 1977, 84.5%[6] of the OPEC imports came from ICs. Moreover, during the period from 1974 to March, 1978, ICs won contracts worth $ 159 billion[7] (83.6%), out of the total OPEC development project contracts amounting to $ 191 billion. Thus oil price increase created vast new markets for ICs and these markets would continue to absorb various capital goods and large quantities of consumer goods from the ICs because of the nature and sophistication of these markets, thus rendering more or less permanent export benefit to the industrialised world.

6. Oil price increase also gave rise to higher exports by the ICs to the LDCs as many of the LDCs and particularly the advanced LDCs, instead of undergoing economic contraction, borrowed considerable funds from the capital markets in order to either maintain or expand their levels of economic development which

3. *Ibid*
4. *The World Bank Annual Report* 1981.
5. Rehman Sobhan. op. cit.
6. *Ibid.*
7. *Ibid.*

resulted in higher imports from the ICs. Some other LDCs which received concessional and non-concessional funds from OPEC also imported large quantities of goods and machineries from ICs and thus a large part of these funds also found their way to ICs.

7. Even on the question of inflationary effect due to oil price increases, facts show that ICs very well managed to either contain it to a large extent, or pass it on to both OPEC and to other LDCs in form of increased prices of their manufactures. Consumer prices in ICs were up by 31% by 1974 but inflation rates on average came to about 7% by 1978[8]. But the situation was quite different in non-oil-producing LDCs. Their average inflation rates remained at 25 per cent or above since 1974. The situation in OPEC was analogous. ICs effectively manipulated the prices of manufactured goods and passed the inflation to OPEC. According to one estimate "of $ 492 billion OPEC's import of goods and services between 1974-78 some $ 274 billion or 56% was

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really made up from the export of inflation"[9]. Thus ICs were able to take back a large part of their extra payments for oil. Oil exporters could not, however, remain oblivious to such unfavourable terms of trade. In fact, OPEC's terms of trade which rose from 100 in 1973 to 320 in 1974, dropped to 171 in 1978[10], thus drastically reducing the real price of oil. In fact, in 1978 real

8. *The United States and World Development*, op. cit.
9. Rehman Sobhan op. cit.
10. *Ibid.*

price of oil was reduced to $ 3.57 per barrel as compared to $ 2.09 in 1973[11]. They were also worried over their continued loss in their oil assets held in the ICs and particularly in the assets denominated in US dollars. Thus taking the advantage of their bargaining strength they went for another round of oil price increase in 1979 in order to protect themselves against these losses. But their terms of trade with ICs continued to remain uufavourable and in fact deteriorated in some sectors in the meantime. Thus their increased prices in June, 1979 which took the minimum price to $ 20.75 per barrel actually came down in real terms to $ 5.48 per barrel[12] in view of their deteriorating terms of their trade with ICs. Similar calculations can be applied to further oil price increases in real terms for ICs. Thus, if considerations are given to these facts, oil price increases, though in nominal volume they looked very high, were not really that high for the ICs. Their effective price manipulation for export of both goods and services to OPEC brought down their economic loss due to oil price increase to the minimum. In fact, they derived substantial export benefit of permanent and diversified nature in the form of new markets for their goods and services, which otherwise would have been impossible.

8. But the situation was different for the oil-importing LDCs and particularly for the least developed countries (LLDCs). They were hard hit by both high prices of oil and manufactures from industrialised countries. The over-all deficit of the oil importing LDCs reached $ 33 billion in 1974 from a deficit of about $ 7 billion in 1973[13]. In 1975, it climbed to $ 38.6 billion while the aggregate current account for the ICs showed a surplus of $ 22 billion in 1975 from a deficit of $ 8.5 billion in 1974. For the same group of oil importing LDCs the current account deficit stood at $ 44 billion in 1979 from $ 25.5 billion in 1978. This was mainly due to another

11. *Ibid.*
12. *Ibid.*
13. *The World Bank Annual Report* 1981.

round of oil price increase in 1979 and increased prices of some manufactures from ICs. The oil importing developing countries imported (for energy only), 5.8 million barrels of oil per day in 1978 costing them a total of $ 29.2 billion whereas their import in 1980 fell to 5.3 million barrels per day but the total cost jumped to $ 57.8 billion[14]. Higher payments on account of increased prices of manufactured goods from ICs are evident from the fact that the price indices of manufactures from ICs (developed countries) moved from 72 (1975=100) in 1973 to 109 in 1977, 142 in 1979 and 157 in 1980[15].

9. Some of the advanced LDCs made financial adjustments through increased borrowing from the capital market, which suddenly increased their indebtedness. The seriousness of the situation can be seen from the fact that the debt for more than half of the LDCs grew two and half time as fast as exports, thus putting them into serious debt management problem. The low income of the LDCs and particularly the LLDCs, because of relative lack of creditworthiness in the capital market, could not go for such financial adjustments. They, therefore, had to cut back on their imports and on the over-all development activities. The LDCs and particularly the LLDCs were the real sufferers and this is likely to continue unless suitable arrangements for aiding these countries are made by the international community as a whole on priority basis.

10. The recent cut in the oil price by $ 5 to $ 29 for the Saudi Arabian light bench mark was acclaimed by many countries around the world. This was, of course, a welcome step by OPEC, which would benefit both developed and developing countries.

11. What led to the recent cut in oil price is known to all. Some of the OPEC countries because of their need for more foreign exchange either to maintain or boost economies or support their war or

14. *World Development Report* 1980, World Bank.

15. *International Trade* 1980-81, GATT,

war postures with neighbouring countries started pumping oil beyond the world demand and also the quantities set by the OPEC and in the process created glut in the oil market. However, ultimately the OPEC countries were able to come to an agreement through very difficult and long negotiations to reset the reference price at $ 29 and at the same time fix up the production quota for the OPEC which now stands at 17.5 million barrels a day. Apart from the fact that OPEC member countries themselves were responsible for over-production which led to this chaotic situation in the market, the other factors which were also partly responsible for the situation are attempts by some countries and some multinationals to run down their oil stocks to the minimum. Of course, it is also a fact that the demand for oil has been declining for sometime due to conservation in the energy sector and more use of alternative energies.

12. The present debate is whether the price set by the OPEC would hold. The speculations are still there that oil price would further drop and might find a level around $ 22-25 per barrel. The market situation during the recent months does not, however, justify the speculation. The recent meeting of the OPEC in Helsinki also reconfirmed the present reference price at $ 29 and production target at 17.5 million barrels. It seems that the new prices will hold provided OPEC members do not violate the individual country quota and also do not resort to discounting under the table. For this purpose the OPEC may also have to reach an understanding with non-OPEC members, particularly with Mexico, North-Sea producers and the Soviet Union.

13. Some OPEC countries which face the problems of repayment of their debts would have to come to agreements with their creditors for re-rolling of the loan so that they can gain extra time which would enable them to stick to their production quotas. It is also worth noting that the world economy is showing some signs of recovery and any sustained recovery would lead to extra demand for oil. With the reduction in the oil prices at the consumers' level the holiday makers would also tend to drive more and thus burn more

gasoline. It is also possible that switching over of various industries from oil to gas or to some other sources of energy, which picked up during the last couple of years, would slow down. So long the governments in the cold countries have been exercising great restraint on uses of oil for heating. In some cases, people were encouraged to make themselves comfortable by putting on more warm clothings, but the people may now like the thermostates to go up. All these may make the situation more favourable for the OPEC members not only to sustain the present price but even look for some modest increases by early 1985. However, it would be important for the OPEC to concentrate more on recapturing the lost market than on immediate price increase.

14. There is no doubt that the importers would always welcome continued reductions in the prices of the raw materials and other commodities including oil, but there are other considerations which need to be looked into.

15. The down-ward reductions in prices of raw materials have been the characteristic of the contemporary world economy. All interested quarters have been making sustained efforts for such reductions in the prices of raw materials and other commodities produced by the developing world. Thus, the developing countries which are mainly the producers and exporters of raw materials have been facing serious unfavourable trade situation with the developed countries which are largely the producers of manufactured goods.

16. One should also look at the unfavourable effect of any deep oil price cut on the producers of oil as well as on the related aspects of the world economy. Had there been no oil prices increase and the money were left with the industrialised countries, possibly there would not have been proportionate rise in the aid disbursement from industrialised countries. Moreover, such transfer of funds were effected through appropriate trade and not as charity and as such this led to increased exports from industrialised countries to OPEC. There is no doubt any deep price cut would have adverse effect on such

transfers and exports. Though some OPEC countries have recently been facing some shortage of resources, they have been on the whole generous in giving aid to many non-OPEC LDCs. In fact, aid disbursement from OAPEC, the Arab members of the OPEC, varied from 2.64% to 2.90% of their GNP between 1978-79[16], which is much higher in terms of GNP than those of industrialised countries. In absolute terms, their contribution in ODA in 1975 was about $ 4.9 billion, which rose to about $ 6.8 billion in 1980. The ODA contributions from OPEC in 1975 was about $ 5.5 billion which rose to about $ 7 billion in 1980. There is no doubt that if there was some differential treatment for the developing countries in form of lower prices of oil, they would have been better off, but under the existing situation OPEC's aid contributions did try to partly compensate many developing countries.

17. The present price cut has made the OPEC for the first time very cautious about their future, particularly on spending the oil money. They seem to have realised that oil market is no longer their monopoly and their good days are almost over. This psychological effect on OPEC about their future would work more retrogressively than actual reduction in their material wealth. Their share of market has fallen from nearly 30 million barrel per day in 1973-74 to about 14 million per day in March. 1983, which is about one third of the world consumption whereas OPEC used to meet over 60% of the total world consumption in 1973-74[17]. In fact, non-OPEC oil producers now matter very much in the world oil market because of high prices of OPEC oil made some of the non-OPEC oil fields in the West including North Sea commercially profitable and this made the difference to a large extent. Another non-OPEC oil producer, namely the Soviet Union, went on pumping more oil with a view to earning more foreign exchange to support their ailing economy and thereby added to the already existing oil glut. The Soviet Union is also going to be adversely affected by this oil price cut. According

16. *World Development Report 1982*, World Bank.

17. *The Newsweek*, March 7, 1983.

to various estimates, they are likely to lose around $ 3 billion a year as oil revenue. Any worsening of situation may also work as a disincentive for further oil search at a high cost in the snow-packed Siberia. Instead, it may be profitable for them to look for other minerals and gold.

18. World trade is also likely to be adversely affected if there is real slow down of aid from OPEC and if this is not compensated by the industrialised countries in the form of higher aid which, under the present aid climate, appears very unlikely. There is, however

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the possibility of some increased intra-industrialised countries trade, but that would not be enough. The combined trade statistics show that LDCs imports have been very important to industrialised countries economies. The total exports of ICs to LDCs jumped from $ 69 billion in 1973 to $ 130 billion in 1975, $ 200 billion in 1978 and and $ 285 billion in 1980[18].

19. In fact, LDCs with vast possibilities and opportunities for development can act as the locomotive for world economic development as well as for sustained world economic recovery provided concerted efforts are made by all concerned and particularly the industrialised countries to provide necessary resources to the LDCs. Such action may help maintain the importing capabilities of the developing world. Any cut in the export of industrialised countries goods and machineries to the LDCs would adversely affect the world economic recovery.

18. *International Trade* 1980-81, GATT.

20. Apart from the fact that non-OPEC LDCs were partly benefited from increased trade with OPEC, their benefit was largely in the area of export of labour, both skilled and unskilled. Many countries exported considerable number of wage earners and their remittances became good sources of foreign exchange earning, which immensly helped their economies. In 1978-79 countries like Yugoslavia, Egypt, Pakistan, India and Turkey received remittances on account of wage earners amounting to \$ 2.9 billion, \$ 1.8 billion, \$ 1.3 billion, \$ 1.02 billion and \$ 1.01 billion respectively[19]. For Bangladesh latest figures show that she received about \$ 600 million in the year 1982-83 as against \$ 425 million in 1981-82[20].

21. The export of labour not only helped earning of substantial amount of foreign exchange by these developing countries, but also helped them in acquiring some form of technologies which, when these labour would gradually go back home, would help the economies of the concerned LDCs. With the reduction of economic activities due to reduction in oil revenues particularly in the construction and other infrastructural projects, many of these labour will have to quickly return home resulting in the closure of the source of foreign exchange earning and also adding to the already acute unemployment problems of these countries. Industrialised countries will also be looser as there will be much reduced contracts, less export of machineries and no easy money for the architects, engineers and advisers from industrialised countries. Many Gulf states are declaring redundancies by thousands. In Kuwait alone over 4,300 people left in three months from May to July 1983. About 1,000 British businessmen and their families left Qatar after the spending cut started and it is estimated that there would be a reduction in the population by 15 percent. Situation is also difficult in Abu Dhabi, once a booming city, as a number of oil companies have started reducing their staff after completion of their projects. Therefore,

19. *World Development Report* 1982, World Bank.
20. Bangladesh Finance Minister's Budget Speech 1983-84, *The Bangladesh Observer*, July 1, 1983.

the Gulf is no longer a "secure job area" and this will have considerable repercussions on many economies and particularly some developing economies around the world.[21]

22. The adverse effect of the oil price cut can be minimised if actions are taken by insdustrialised countries to utilise the savings on account of oil prices cut for maintaining the demand of the non-OPEC LDCs through increased aid. Utilization can also take the form of investment by concerned industrialised countries even in some OPEC countries through mutual agreements, which will help maintain the demand to a considerable extent. It has been suggested by various quarters that a good course would be to suitably tax multi-nationals dealing with oil and oil product and let not price reductions reach the consumers. Consumers have become more or less used to the present oil price and any reduction will lull them into complacency and towards burning of more oil either for holidaying or extra comfort. The tax realised under this head should not, however, be diverted for armaments. This should be kept separately in a budget for aiding LDCs, may be with the stated purpose of creating more demands for some specific products of the concerned industrialised countries. LDCs may not have any objection to receiving such aid under specific schemes provided these add to their effective economic development. LDCs should be particularly helped for exploration of oil and other mineral resources. This would help industrialised countries in the form of exportation of their oil exploration machineries, expertise and ultimately some form of tacit agreement to receive oil through such exploration effort. This would also help some industrialised countries which are still far away from the UN target figure of 0.7% of aid to the LDCs to quickly chase that figure and help meet one of the basic demands of the LDCs on aid flow under the North-South Dialogue.

23. One of the reasons for unhelpful attitude of some of the ICs in the UNCTAD-VI which ended virtually in a failure

21. *Financial Times*, London, August 23, 1983.

appears to be, apart form their traditional apathy towards the problems of the developing countries, their present complacency on the recent oil price cut and expectation of further drop in oil prices. The ICs appear to be sure of the recovery of their economies even without any additional support in terms of international trade

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from LDCs economies and could, therefore, continue to ignore the demands of LDCs for sometime more. But the signs of the world economic recovery came earlier also and then died down. The present world economy beset with explosive debt problems, high budget deficits in many countries including the US, high interest rates, instability in exchange rates, unemployment and wide scale poverty and ever decreasing purchasing power of the developing world, etc., cannot be sure of sustained recovery. Moreover, instability and explosive political situations in various parts of the world may further worsen with increased East-West tension. Any escalation of present Gulf War and renewed fighting between armies facing each other in the Middle-East, which is possible because of breakdown of various peace initiatives, may turn the present oil supply situation extremely difficult leading to fresh uncertainty in prices and supplies.

24. Therefore, this seems to be an opportune moment for talks for reaching an arrangement or at least an understanding on oil prices over a long period. It is hard to say whether OPEC would be interested to go for such an arrangement or even an

understanding on oil prices as this would mean for the OPEC to give up their right and strategy to fix up future oil prices, but it is worth making an effort. Any reasonable arrangement on oil would ensure its steady supply at predictable prices, which is more important for the managers of the world economy. Such talks should, however, be held in the context of North-South Dialogue on other pressing issues particularly commodity trade, aid and debt problems etc. This brings in the question of launching the long awaited Global Round of Negotiations (GRN) under the auspices of the UN General Assembly. Sooner an understanding is reached on this, better would it be for the world economy as a whole. This would help maintain the present world economic system which is so dear to ICs.