THE RISE IN THE PRICE OF OIL: TERRIBLE DISASTER OR GREAT OPPORTUNITY?

by

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Summary

The recent rise in the price of oil has caused some immediate problems. But, provided these are overcome, it can break the present impasse in the Third World. Part of the increased revenues of oil exporters will become a new source of aid (which will be spent largely in the industrial countries). Moreover, the shift in the price structure will favour traditional rather than modern techniques, agricultural rather than industrial products and natural rather than synthetic materials; it will also reduce the concentration of real income. Much depends, however, on the price policies of petroleum importers and the aid policies of the new donors.

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The International Development Strategy of the United Nations, adopted for the decade of the 1970s, is dead, like the Pearson Report and the UNCTAD resolutions on which it was based. It has been killed, before the scheduled mid-term review, by the rise in oil prices from about $3 to $11 a barrel. I shall try to show, however, that this has opened up entirely new possibilities of international cooperation to make inroads into mass poverty.

The implausibility of the "International Development Strategy"

The "strategy" was never really credible, because in the rich countries it has relied essentially on an appeal to internationalism. This is not likely to be a powerful political force in countries where self-advancement has been the mainspring of economic progress, and there are strong currents of racialism and chauvinism.

Political objectives, such as acquiring bases and consolidating spheres of influence, have been more persuasive arguments for the trade and aid policies which lie at the heart of the "strategy", but the importance of such arguments has been reduced by the development of long-range missiles and the East-West détente. Currently the main support of aid lobbies is the multinational corporation and the motives stressed in the statements of major donors are trade and private investment. However, their commercial interest has been switching to other parts of the world.

The effects of unselective modernisation

Even if the "strategy" had been sincerely endorsed by the industrial countries and implemented, it could hardly have halted the polarisation which is taking place both within and between countries. This derives its momentum from the rapid advance of technology. The great bulk of technical research

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* I am much indebted to my colleagues at IDS for comments

takes place in the industrial countries and it has been designed to produce techniques which save labour and undercut the prices of hand-made products and natural materials.

These techniques are transferred to the Third World to back the implementation of growth targets (such as the 6% mentioned in the "strategy"), but they are too expensive, in both capital and foreign exchange terms, to be used widely in all but a few economies. Outside the modern sector, unemployment and under-employment have remained chronic or even, in some cases, increased.

The rising incomes in the modern sector tend to be spent on goods and services that incorporate recent technology, such as consumer durables, motor cars and air travel. A large part of the incomes generated by these purchases flow overseas (because of the investment and technology needed) - most of the remainder accruing to the capitalists and workers of the modern sector itself.

There are other reasons why polarisation tends to be cumulative. A la part of the explanation of the persistence of high fertility in the traditional sectors of the Third World lies in their social deprivation, but the consequent fast rate of growth in the labour force depresses incomes and perpetuates the deprivation.

Inequality is further promoted by the political power generated by modernisation. Governments in the Third World are increasingly controlled by the modern sector, furthering its interests by the operation of exchange controls, high tariffs, etc. They defend stubbornly the imported life style of a small minority, often oppressing egalitarian forces by police brutality, even torture. In the end, a number of such régimes may be overthrown by mounting internal tensions, but the struggle could prove long and painful.

Although some aid is beneficial (e.g. to the rural sector in countries where egalitarian policies are followed) much of it accelerates the process of polarisation. Both capital aid, especially tied aid, and technical assistance are channels through which inappropriate technology flows. Moreover, donors naturally have a bias towards governments with policies of welcoming multinational corporations to develop the modern sector, and resisting radical internal changes.

<u>The dangers of a world recession</u>

It may seem strange to talk of new development opportunities at a time when many oil importers, especially India and Bangla Desh are facing acute foreign exchange problems due to the rise in the price of oil. The world economy could indeed deteriorate disastrously this year. As the industrial countries find their payment deficits increasing, they will be tempted to adopt deflationary policies and also devalue their currencies, in order to throw the problem as much as possible onto their competitors. The result would be a collapse of world trade, as in the early 1930s. The Third World would face big declines in the price (and value) of their exports, as well as a fall in aid, on top of the sharp rise in their import bills - which has already occurred.

On this scanario, the political repercussions would be immense. The tensions in the Third World would become still greater. There would be upheavals in many industrial countries, and while these might produce overdue changes in their social structures, there is no guarantee that the régimes that succeeded to power would follow policies which were less destructive, either nationally or internationally. There could come a point at which the governments of industrial countries, separately or together, would invade petroleum exporters (or organise coups d'état) and seize oilfields, risking the consequent short-term disruption. The dangers of a world war would become severe.

Development specialists have acquired a taste for pessimism, and with these possibilities ahead it is not surprising that they are gloomy. But although the sequence outlined above has already started to unroll, the bitter end is by no means inevitable.

The Third World's immediate problem could be solved if Venezuela's initiative is adopted and OPEC members agree to supply oil on long-term credit. There is a strong moral case for this, especially in the case of really poor countries, such as India.

For the industrial countries to maintain economic expansion over the next 2 or 3 years the conditions are (i) that central banks cooperate to prevent the movement of oil exporters' funds causing national crises; (ii) that total investment is maintained, which requires astute policies, since funds need to be diverted from industries which are energy-intensive (such as steel) or produce energy-using products (such as cars) to the development of petroleum, coal and other sources of energy; (iii) that governments facilitate the necessary shifts of labour; (iv) that governments do not lose their nerve when price inflation accelerates as it will do on this scenario because not merely will oil prices rise: those who suffer will try to maintain their incomes.

The options before petroleum exporters

In the longer term, the crux of the matter is how members of OPEC will use their foreign exchange earnings, which are now running at over $100-billion a year. Some with limited development possibilities (such as Saudi Arabia) might be tempted to leave their oil in the ground, but they would themselves be affected if the result were a world recession, especially since they are somewhat dependent militarily on the industrial countries. They would also not want to stimulate the development of other sources of energy too strongly, or to strengthen the United States too much at the expense of Western Europe, which would be the result of a serious oil shortage.

There are not many ways they can use their foreign exchange earnings. There is a limit to what they will want to import, including arms, as there also is to the monetary assets they will want to hold, even if these are guaranteed against inflation - and huge, highly mobile, liabilities are not convenient for the industrial countries either.

Petroleum exporters could tie most of their exchange receipts up in direct investments (or equities) in the industrial countries. But they may well consider that this would leave them exposed to the threat of expropriation, which would reduce the political leverage they would otherwise enjoy. Moreover governments of industrial countries would naturally look askance at rising foreign ownership of their productive systems.

The latter will want to earn enough to balance their foreign payments. Some of them individually may be able to manage this by bilateral deals, but that only increases the pressure on the remainder. As a group the only way they can do this is if big sums are lent to the Communist bloc or the Third World, and used to buy manufactures. Then the productive power of the industrial countries would get a stimulus comparable to what it obtains from a minor war. The Communist countries are hungry for capital, and would no doubt be able to provide a good financial return, but governments of petroleum producers have their own reasons for not investing a large fraction of their revenues in the COMECON (or Chinese) area.

A big aid programme is the only way left of absorbing sizeable funds. Moreover it would diversify the assets of the petroleum countries, increase their political power, and reduce international criticism of high oil prices. It would be a mighty boost to Third World development if even only 10% of the proceeds of oil exports were used in this way.

A real international development "strategy" is therefore now possible. Unlike the present one, this could be based on the clear self-interest of all types of government. Although parts of the dead strategy could be incorporated in a new one, it should be formally buried, so as to clear the ground.

<u>The effects of changes in the structure of prices</u>

The effect of the change in oil prices on price structures will tilt the world's economic axis: it will offset the influences of modern technology, which contribute to polarisation.

- Techniques which require little commercial energy in relation to human labour will be favoured, if only marginally. Peasant agriculture gets a somewhat better chance to compete against the highly-mechanised farmers of the Third World (and the industrial countries). Moreover, artisans producing (e.g.) hand-loom cloth will be able to compete more effectively with textile factories. In general, traditional techniques will be favoured at the expense of the modern sector, and the advantage of scale will be reduced. Big projects of the age of technophilia will appear increasingly like dinosaurs.

- Products requiring a good deal of energy to make, in particular engineering goods, will become somewhat dearer in relation to foodstuffs, especially those requiring little processing, such as bananas and coffee. (This will be partially offset by the sharp increase in freight rates on bulk cargoes.) As a broad generalisation, industry will lose ground slightly, relative to agriculture and services.

- Synthetics with a petrochemical base, such as nylon, will become more expensive in relation to natural materials such as cotton; the same applies to plastics, detergents and artificial rubber and fertilisers. Goods and services which are heavy users of petroleum will suffer competitively.

- Travel by aeroplanes and cars (especially large cars) will become dearer relative to ships, trains, buses and - much more so - cycles, bullock carts and horses. The 2-litre car will be extremely expensive to run and the modern pterodactyl, Concorde, can expect a coup de grace. Air forces will become even more of a luxury than they are already.

One consequence will be that research, even in the industrial countries, will be shifted towards technologies which save petroleum, which means in many cases capital as well. Technical innovations will become somewhat more relevant to the needs of the Third World, and its local research will be stimulated.

Another general effect will be egalitarian. The oil price acts like a progressive tax, because the higher a person's income the higher the proportion spent on petroleum products and on goods (and services) which are oil-intensive in either their production or use (or both). This applies to nations or regions as well as individuals: industrialised countries will be hit much harder than the "least developed", and cities more than rural areas.

Many of these effects are slight in themselves but they all work in the same direction. Thus the factory owner faces increases simultaneously in the cost of power, spare parts and petrochemical products. And psychological resistance to modernisation should be strengthened.

Just as in the era of cheap fuel, changes in technique, income distribution and politics reinforced each other, especially in fast-growing economies, so there could now be in some countries a cumulative movement in the other direction, alleviating unemployment and poverty - provided of course a world recession is avoided.

The major questions

There are other big question marks. Much depends on whether the increased price of oil is fully passed on to the consumer, both directly through products and indirectly through electric power. The realignment of fuel prices, which will cause bankruptcies and job changes, will of course be fiercely resisted by the politically powerful capitalists, workers and bureaucrats of the modern sector. Will they succeed in getting fuel tax reductions, special exchange rates, subsidies, etc.? And how much of the price increases will be captured by the petroleum companies?

A great deal also hangs on whether effective ways are found of promoting egalitarian development strategies. Will petroleum exporters take over the role of the present major donors, pouring capital and technique into the modern sectors of the Third World and backing authoritarian régimes? They would be under some pressure to do so - and would be bound to rely on foreign consultants in some degree. They might also be tempted to provide aid in the form of cheap petroleum. Nearly all countries of the Third World where oil accounts for more than 25% of their import bill are military dictatorships that protect inequality. * Besides cheap petroleum would make it unnecessary to adjust technologies.

Moreover, all aid donors tend to export their own ideologies and institutions, however inappropriate these are to local conditions, and the governments of oil producers, especially the small ones (precisely those with most funds available) do not see in their own experience reason to distrust modern technology.

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* The effects would be similar if petroleum producers steered aid towards Third World petroleum consumers, though this may be necessary as a short-run expedient, see above.

However, they have built up experience in handling multinational corporations and controlling markets: this could be useful elsewhere, not least to metal exporters. And the very appearance of a major new source of aid, whatever the accompanying ideology, will weaken the dependence of Third World countries on their traditional sources, reducing the constraints on radical social policies.

Aid from petroleum producers will not merely be untied (they have little motive for tying); it need not be spent on equipment at all. Balance-of-payments support would, just as well as project aid, fulfil the function of stimulating the world economy. It would be much simpler to administer - and speed in absorbing the oil funds is essential. It would also be less likely to carry with it technology which was inappropriate. Another possibility would be to build food reserves for famine reli

The remainder of 1974 will be decisive - the impact of the oil crisis will become clear, including the extent to which governments are prepared to cooperate in solving it and turning it to the advantage of the world as a whole.

There is only one forum for this cooperation - the United Nations. The new strategy cannot be worked out just at a Washington conferenc of industrial countries, or an OPEC meeting. It needs the interacti of the political interests of all three parties, especially the Thir World, which is at present not being adequately consulted. This is the biggest opportunity the United Nations system ever had. But do staff members (in New York and in the agencies) have the capacity to seize it? Will they be permitted to do so by their political masters?

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Perhaps ultimately the most significant effects of the end of the era of cheap energy will be on the ways in which people think about the problems of development. Scepticism about philosophies of fast growth, based on protected industrialisation and rapid urbanisation, will be strengthened. Secondly, it is now possible to envisage a programme of international cooperation without relying primarily on altruism.

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