

Körner, Heiko

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# ARTICLES

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## Development Policy

### The "Oil Crisis" – a Crisis for LDCs

by Professor Dr Heiko Körner, Hamburg \*

**It is the group of LDCs whose reserves of indigenous energy are so small that they desperately need sizeable imports of oil, but which do not have sufficient other resources to earn the necessary foreign currency for their oil imports, that is suffering most under the economic changes which came over the world economy as a sequel to the oil crisis. Its future destiny is now literally a difficult balancing on "a knife's edge".**

It was Barbara Ward, the well-known British economist, who described the general feeling imbuing the debates during the Special Session of the UN General Assembly on problems of commodities and economic development in the spring of 1974 as one of certainty that nothing would be any longer as it had been before<sup>1</sup>.

And it must be added that this is true not only of the emotional situation which determines both private and public attitudes to development approximately from the time of the Club of Rome publishing its report, but also for the state in which world trade now finds itself: During the last 18 months or so the actual position of individual countries and groups of countries in the world economy has changed, often fundamentally.

Changes in the relations between the big groupings of the so-called "First", "Second" and "Third Worlds" are most conspicuous. Also within these groups there are crucial shifts of position to be discerned, notably those among industrialized countries, which are torn asunder by strong centrifugal forces that threaten further growth of world trade and the international division of labour among developed nations. But by far the most fundamental variation of conditions prevails at the side of the LDCs which, in the past, saw themselves as a unified block, and were seen as one by industrialized nations.

It is no longer possible to unite under the one collective label of the "Third World" a relatively homogeneous grouping of countries, all of which suffer from low personal incomes per head of their populations, from the middle of which, at best, a few so-called "semi-industrialized" countries were emerging with a more highly diversified structure of production: Under the pressure of

soaring oil costs and fast growing prices for industrial imports, on the one hand, and of the recently incipient decline of commodity prices in the raw material markets, on the other, natural and historical differences appear, at the basis of which highly diversified problem "mixes" arise.

It is clearly visible how, from the "Third World" – on the one hand – the group of oil producers is rising to hitherto unknown heights of affluence, which consists of the Arabian oil states and Iran, and, with a considerable lag, also Nigeria and Indonesia. On the other hand, there is a distinct group of LDCs whose reserves of indigenous energy are so small that they desperately need sizeable imports of oil but which, unfortunately, do not possess big reserves of other essential commodities or diversified export industries. These were not able to share the benefits of the until now expanding commodity markets for earning currency reserves, whilst their population growth is high and the productivity of their farms becomes progressively deficient. This in turn means that the indigenous sources of economic modernization more and more will yield only a thin trickle of capital and are threatened by a complete dry-up.

This new "Fourth World" contains such huge units as India and such small ones like Ethiopia, altogether about 35 individual countries harbouring roughly half of the world's entire population. This is the group that is suffering most under recent economic changes. Its future destiny, in many respects, is now literally a difficult act of balancing on "a knife's edge".

It is fairly easy to find an explanation of this dangerous plight, simply by studying the development of price indexes of the international commodity trade<sup>2</sup>: between October 1973 and Octo-

\* Institute for Foreign Trade and Overseas Economics Research, Hamburg University.

<sup>1</sup> The Economist, London, May 18, 1974.

<sup>2</sup> cf. INTERECONOMICS, Hamburg, No. 12, 1974, p. 391.

ber 1974, the HWWA price index for foodstuffs (on the basis of 1952–56 = 100) rose from 191 to 312 p.c. Price averages of all other raw materials crept up, simultaneously, from 214 to 305. But at the same time, the price index for fuels jumped from 179 to 468!

These figures show convincingly — since all other types of fuel follow oil prices because of their interchangeability — that the speed with which fuel prices “ran away” from those of all other commodities has been indeed fantastic, beside which the bullishness of food (especially of wheat and rice) and other organic and inorganic raw material markets looks indeed puny. Any breakdown of price averages, moreover, demonstrates the fact that the moderate *average* rise of *all* raw material commodity prices (except food) masks a longer-term price decline of important organic raw material crops, which started years ago.

The decay of prices for agriculturally produced raw materials provides the key for the penury of those “Fourth World” countries whose most important exports are tropical farm products of the non food type: there is a new “scissors” gaping between declining export earnings and rising payments for imports, whose ever widening opening forces the deficits of trade balances up further and further, leading to a dramatic shrinking of currency reserves which is typical for this group of countries.

Thus, the African countries south of the Sahara were still able, in 1970, to pay for their imports from currency reserves of their own for about 4½ months, whilst during the first quarter of 1974, this capacity had shrunk to a mere three months, in which imports could be paid for by the foreign currency holdings of their central banks<sup>3</sup>.

India, too, is threatened by a swift drying-up of its currency reserves and its ratio to import requirements. It has been estimated that this country had to spend, in 1974, at least US \$ 750 mn over and above former payments for fuel imports alone. In a similar position are for instance Pakistan, Thailand, South Korea, the Philippines, Brazil, Senegal, Kenya, the Sudan, all of which must spend a share of the order of 20 p.c. of their total export earnings and incomes from capital aid for financing the increase in oil import costs that have become so much dearer<sup>4</sup>.

Before this background, the situation of those African and Latin American countries which export minerals is still relatively easy. Anorganic commodities have benefited so far from the general upward trend of world market prices for raw

materials, and exporters of such, consequently, were able to absorb increased import costs by export revenues moving on parallel lines. However, it is now obvious that the world market boom for industrial raw materials has come to an end in the middle of 1974. Therefore, the generally declining trend in international trade earnings will, from now on, also affect adversely the trade balances of this sub-group.

On the whole, the aggregate deficit of the balances of trade for all non-oil producers among LDCs has grown between 1970 and the first quarter of 1974 from US \$ 13.6 bn to US \$ 22.8 bn. It must be assumed that export earnings of suppliers of anorganic commodities will drop further, and this makes it a realistic estimate to put the entire trade balance deficit of all non-oil producers among LDCs, during the whole of 1974, at about US \$ 50 bn<sup>5</sup>.

### Industrialization at Risk

Within this framework of facts, the only way out of this dilemma for most LDCs seems to be an expansion of their own energy sources and the quick creation or expansion of modern export industries, that could save them from a lethal deterioration of their balances of trade<sup>6</sup>. For there is no doubt that the LDCs were also among those which neglected the development of substitute energy forms in the land of Cockaigne established by relatively cheap oil and oil derivatives from which the world was rudely catapulted by the “oil crisis”. The more recent development of world markets for anorganic commodities also demonstrates that their export earnings can be stabilized only by processing the exporters’ own raw materials to a much higher degree, for which world markets are willing to pay adequately.

However, such considerations are far from supplying directly cut-and-dried nostrums for all economic ills: for strictly spoken, the chances adumbrated here are not only open exclusively to such LDCs which own significant reserves of indigenous fuels and industrial raw materials. One other condition for success is the availability of a minimum of technological knowhow and structural mobility. Yet it is precisely these resources which are lacking in the typical single-product farming countries, with their dual economies, of the “Fourth World”.

But also countries with a wide variety of natural resources, e.g. India, cannot expect quick and durable successes in building up new export in-

<sup>3</sup> cf. DIW-Wochenbericht (Weekly Reports), Berlin, November 14, 1974, p. 399 et seq.

<sup>4</sup> The National Institute Economic Review, No. 67, 1974, p. 11.

<sup>5</sup> cf. DIW-Wochenbericht, Berlin, November 14, 1974, p. 401.

<sup>6</sup> It goes without saying that reinforced growth of export industries will also help reducing the pressing problems of unemployment and underemployment.

dustries, as long as the downward trend persists which is at present prevailing in the markets for manufactured goods.

For the soaring prices of oil and oil products have not only made severe inroads in the balances of payments of many industrialized countries. The "oil crisis" is also driving up the rates of inflation in such countries, and these in turn lead to a determined tightening of the screws of conventional stabilization attempts. But it is exactly this policy which at least in the short run hits the false targets. So the industrialized economies show declining economic growth, rising unemployment, but, at the same time, a continuing rise of price levels.

If all these trends should bring about a worldwide economic depression — and there are many reasons for making fears of a severe slump come true<sup>7</sup> — the attempts at industrial diversification are bound to suffer particularly grievously in those countries which have only just entered on this path.

Export-directed industrialization usually begins with simple manufacturing processes, the products of which make up for their inferior quality by low labour and other input costs, which means that (in contra-distinction against highly sophisti-

cated industrial manufactures) cost and price advantages play a decisive role. If and when these economies gradually disappear, substitute supplies regain their competitive attractiveness, which industrialized countries, behind their protectionist barriers, can and will still produce themselves. This is not only a consequence of the intensified fight against unemployment through protectionism in industrialized countries. The "oil crisis" will bring with it a new, intensified variant of this phenomenon: until recently, LDCs have been successful in throwing, for example, inferior textiles and domestic hardware on to world markets because of the low input costs. If the costs of inputs rise because of oil growing more expensive, this competitive advantage will fade away unless the disappearing cost superiority can be continued through a drop in real wages. But, in most countries, this is not likely to be possible without stoking up social turmoil where a chronic rise in grain prices already accumulates sufficient fuel.

#### **"Perverted" Transfer of Resources**

To sum up, it must be stated that the "Fourth World", and in case of a world slump, also the "Third World" will experience difficulties from an overall increase of import prices and declining export possibilities that will go far beyond all the dimensions hitherto experienced.

It is impossible to treat these problems only as a matter of balance-of-payments policy. The same factors make for a deterioration of real resources of the LDCs. For the worsening of the terms of trade of the non-oil producing LDCs forces a transfer of real resources to the oil producers and to most of the industrialized countries. The relevant mechanism is simple enough: The appreciation of oil alone forces the non-oil producing LDCs to spend more of their incomes for fuel imports even when their energy requirements remain at a constant level. Inflationary price rises in the case of capital goods supplied by industrialized countries are bound to accelerate the same process. All this sets in motion a process of "compulsory saving" in favour of the suppliers of oil and capital goods.

The results of this process will not even be compensated through some "natural" recycling of the resources siphoned away. The experience of recent months proves that oil producers hardly use their revenues for purchasing goods from

<sup>7</sup> The relapse from normal 5.5 p.c. growth of the world economy to nil growth in 1974 and prospectively in 1975 implies a short-fall in world demand of approximately US \$ 250 bn each year. The Economist, London, January 18, 1975, p. 14. cf. also Wirtschaftskonjunktur, Monthly Reports of the Ifo Institute for Economic Research, Munich, No. 12, 1974, p. 21 et seq., especially p. 25 et seq.

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LDCs, because those can supply only raw materials or simple and crude manufactures which are insignificant for the industrialization of the oil countries. On the contrary, capital goods and sophisticated goods for consumption (including arms!) are progressively bought from Japan, the US and other West European countries.

Investment policies of oil countries also operate along the same lines because most LDCs lack both the economically attractive project possibilities and the general business climate conducive to investment incentives. Therefore a big slice of the monies accumulated by oil countries finds its way back to the industrialized countries but not to the LDCs. So "natural" recycling operates according to the forces of the markets evidently only between industrialized and oil-producing countries, whilst for LDCs it must be stated that the savings imposed on them by the "oil crisis" threaten to intensify the tendency of pauperization through adverse terms of trade, which Singer and Prebisch have underlined in the past.

#### More Foreign Aid?

If it is true that most industrialized countries are able to absorb part of the loss in income caused by the oil price boom by rising exports of goods to and growing capital imports from the oil producers, may there be a hope that this income at least partially can be transferred to the LDCs by means of "political" recycling? Generally the "oil shock" has strengthened in the industrialized countries the feeling of being fed up with development aid that has been building up for a long time: In the decade 1963-73 the industrialized countries that are DAC members were able to increase their aggregate GNP per head of population, in constant US \$ of 1970, by 47 p.c., but their development aid from public funds at the same time per head of donor countries' population went down by 15 p.c. and per head of recipient countries' population (which rose more rapidly) by as much as 27 p.c.<sup>8</sup>

This balance sheet presents a very sad appearance which cannot be beautified by the industrialized countries pointing an accusing finger at the oil producers as the true responsible ones. Typical for such an attitude are the various prescriptions for "political" recycling brought forward by the industrial countries recently: as much as they may differ in detail, all these proposals mostly centre upon the idea that the billions of oil dollars, which supposedly are lying fallow, should be pumped back in the first place to the industrialized countries which show the most spectacular balance-of-payments problems. Consequently,

under the influence of reviving "sacro egoismo" of the OECD group of nations, the far more pressing problems of the LDCs remain widely underestimated in the present phase of the recycling debate.

Fortunately, the finance ministers have proven at their Washington conference recently to be far more sensible. The decision to combine the creation of the so-called "Kissinger Fund" (mainly tailored according to the needs of the industrialized countries) with a prolongation and expansion of special drawing rights with the IMF points to the right direction. But this only can be a first step. It must be followed by a general revision of development aid policy, aiming to increase development aid from public funds and to draw up, for their use, more effective strategies of mutual cooperation<sup>9</sup>, a new list of priorities for strengthening LDCs' own potential in their farming sectors, and for making a start with industrializing the "Fourth World".

Semi-industrialized countries, which have so far been granted the very bulk of capital aid, would have to be compensated for the shift in emphasis to the countries of the "Fourth World" arising from their reappraisal through "aid by trade", i.e. by dismantling barriers that still make their exports an obstacle race. In further support of a liberalized world trade policy, industrialized countries ought, at last, throw overboard the often short sighted restrictions used for stabilization of their own economies according to the conventional wisdom which often enough recedes behind the standards given by the late John Maynard Keynes. They should instead feel obliged to follow their anti-inflationary policies in ways that do not export slump to other countries.

Through the revolution in world trade conditions, the development problems of the LDCs are thrown into sharp relief as never before. Nonetheless, this revolution has not brought with it a diminution of the responsibilities of industrialized countries: oil countries are only drawing an income which industrialized countries had withheld from them for a long time. And they may be only at the van of other raw material producers attempting the same strategy. Therefore if the industrialized countries are to avoid a much more deeper and general crisis generated by the collapse at least of the countries of the "Fourth World" they must not resign. It is only the bare duty of industrialized countries to help them more rapidly and effectively.

<sup>9</sup> cf. for example the proposal by D. Schumacher: *Wirtschaftliche Integration von Entwicklungsländern und Verteilung von Entwicklungshilfe (Economic Integration of Developing Countries and the Allocation of Aid)*. In: *DIW-Vierteljahreshefte*, Berlin, 4/1974, p. 300 et seq.

<sup>8</sup> OECD Observer, No. 72, 1974, p. 5.