

Großer, Günter

Article — Digitized Version

A new oil price shock

Intereconomics

*Suggested Citation:* Großer, Günter (1986) : A new oil price shock, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 21, Iss. 2, pp. 57-58, <https://doi.org/10.1007/BF02925342>

This Version is available at:

<https://hdl.handle.net/10419/140014>

**Standard-Nutzungsbedingungen:**

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

**Terms of use:**

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*

## A New Oil Price Shock

The plummeting price of oil has fundamentally changed one of the major indicators underlying all forecasts of economic trends in the world economy as a whole and in individual countries. In view of the tremendous importance previously attached to the oil price explosion as a causal factor for the growth crisis which set in after the mid-seventies, the drastic reduction in oil prices can be regarded as the key to greater demand, less inflation, lower interest rates and, consequently, a strengthening of economic recovery in oil-importing countries, i.e. in the vast majority of the economies in the world. This contrasts with the adverse effects of the new – and new kind of – oil price shock for oil exporting countries.

There is considerable uncertainty with regard to how expensive, or rather how inexpensive, oil will be in future. This was already true before oil prices started to tumble, for the maintenance of a high price level was, in the short term, primarily dependent on Saudi Arabia's readiness to keep on cutting back its production. By the middle of last year, however, the fact that almost four-fifths of Saudi-Arabia's production capacity lay idle induced this country to take the bull by the horns. The strategy pursued since then of increasing sales via an aggressive price policy is not only directed against OPEC members who did not stick to production quotas, but also against the "new" oil producers, such as Britain and Norway, which were able continually to increase their market shares under the OPEC umbrella. Together with the proclaimed objective of inducing all major suppliers inside and outside the cartel to reach production agreements, one should not overlook Saudi Arabia's fundamental interest as the country with the greatest amount of oil reserves, which can be produced at extremely low costs. More and more doubts were cast upon the longer-term benefits of a high-price strategy in view of its clearly retardant effects on oil consumption and the stepping up of worldwide oil exploration activities and oil production. Against this background, everything would indicate that the slump in oil prices of recent months is not a short-term phenomenon.

If the world market price of oil eventually finds its level at US \$ 15 per barrel – which can only serve as an assumption and not a forecast in view of the uncertainties regarding the suppliers' policies – the annual costs for industrialised countries of oil imports from the rest of the world would decrease by almost US \$ 70 billion. This would on average represent 0.8 per cent of their national products, slightly more in Western Europe and slightly less in the USA. In the first instance there would therefore be a transfer of income from oil-exporting to industrialised countries of that order. The effects on demand, production, prices, interest rates and current accounts depend on the varied reactions of both the "winners" and the "losers" in this process.

All attempts to quantify ensuing developments, therefore, must be based on a series of assumptions concerning the behaviour of businesses and consumers as well as of economic policy-makers. Model calculations reveal that in the case of industrialised countries the increase in demand and production will at least correspond to the primary income stimulus. The rise in consumer prices is reduced to a much greater extent. The similarity of the findings of different calculations, however, cannot disguise their markedly hypothetical character.

Such reservations are even more necessary when forecasting the effects the drop in oil prices may have on economic developments in other parts of the world. A great deal would suggest that the export income losses of oil-exporting countries will soon lead to a noticeable reduction of imports. Many of these countries already saw no alternative but to cut back imports before oil prices fell because of the unfavourable development of their current accounts; in particular, Mexico, Venezuela and Nigeria find themselves among the countries faced by very serious debt problems.

On the other hand, the fall in oil prices has had considerable positive effects for oil-importing developing countries. The latter benefit, albeit to a much lesser extent than industrialised countries, from the accompanying transfer of real income, and their current account situation improves, especially in countries at an already advanced stage of industrialisation, such as Brazil, South Korea and Taiwan. Whether these contrary tendencies in oil-exporting and oil-importing countries will on the whole make it less or more difficult to manage the debt crisis is virtually impossible to predict.

The quantification of the effects of the drop in oil prices in industrialised countries generally concentrates on the resultant stimuli to demand. The same path is pursued by other – very dubious – assumptions, claiming that the curbing of inflation will now provide more scope for expansionist economic policies. Above and beyond the temporary stimuli, however, a lasting strengthening of the forces of growth in the industrialised countries would only then materialise if there was a further noticeable improvement in the general economic setting. The drop in oil prices, however, does just as little to change the numerous obstacles to greater elasticity and growth in Western European economies as it does to dismantle the numerous protectionist barriers to an efficient international division of labour. High structural budget deficits in the USA and in other countries mean that national savings will continue to be mischannelled into consumption. As a result, it is doubtful whether there will be a drop in real interest rates. Interest rate policy agreements between the world's leading economies would do nothing to change this situation.

The oil-price explosion in the seventies triggered rather than caused the long-lasting slowdown of economic growth. The friction in the adjustment process was so great due to the fact that there had been a considerably decreasing degree of economic and social flexibility in the industrialised countries for many years. A short-term drop in oil prices by a quarter or even more and the associated shift in factor price relations are – this time the other way round – also a shock, and will trigger numerous processes of adjustment. This especially applies to investment calculations in general and for those in the energy sector in particular. There are good reasons for assuming that industrialised countries will find it easier to overcome the accompanying problems than in the wake of an oil-price explosion. However, considerations as to whether efforts to save energy and substitute oil as well as exploration activities may now decrease, and thus preprogramme a surge in oil prices at a later date, reveal the continuing uncertainty for long-term planning.

Both the perspective of an oil-importing country, whose "oil bill" is drastically reduced, and the perspective of the world economy, in which the oil-price-induced gains of one country represent the losses of another, can easily lead to incorrect forecasting. The drop in oil prices is neither a miracle drug nor a zero-sum game. Future developments depend on the course of dynamic processes, in which chances continue to be confronted by considerable risks. These not only relate to the worsening of the situation of highly indebted oil-exporting countries, which places new strains on international financial markets. In the long term it would be more serious if a reversal of the adverse effects of at least the second oil-price explosion in industrialised countries were to foster illusions about the strength of the fundamental forces of growth and again weaken the – painstakingly strengthened – will to improve supply conditions. If, however, governments and central banks manage to keep these risks under control, the chances will improve that the economic upswing in the industrialised countries will not only be more pronounced than originally expected in 1986 (its fourth year), but will also last much longer.

*Günter Großer*