

Oil crisis and development in the 1980s

Content

- I. General trends
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Starting points:

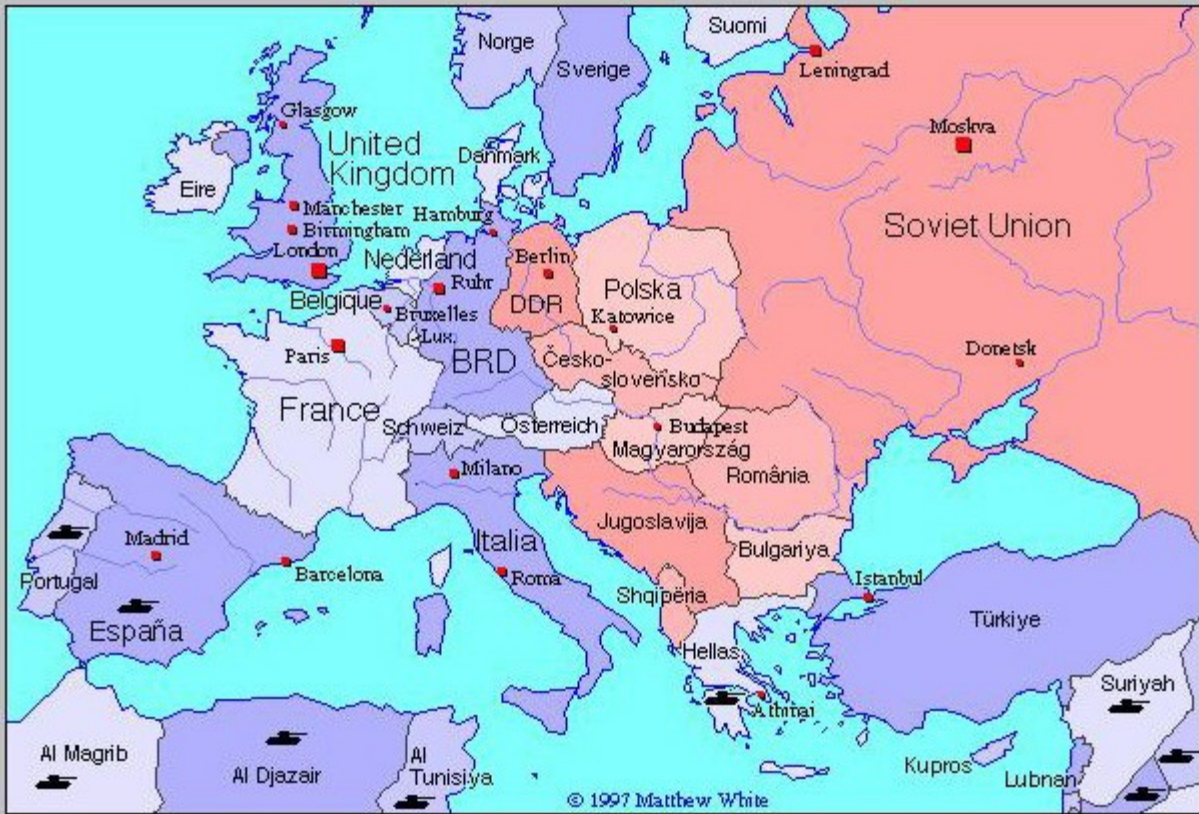
- after-war bipolar division of the world
- successful econ. development of Western countries during the after-war period
- period marked by increasing international trade supported by the Bretton-Woods system and GATT

General trends

- A. Political tendencies
- B. Technological progress
- C. Economic theory
- D. Global problems

A. Political tendencies

- **struggle in the bipolar world**
 - disarmament treaties (SALT I, SALT II)
 - Helsinki Peace Process (1975)
- **at the end of the 1970s**
 - right-wing shift in western countries – Reagan
 - new round of armament at higher technical level i
- **at the end of 1980s** – collapse of the socialistic bloc
 - Economic and military lagging behind
 - Afghanistan
 - Gorbachev – 2nd part of 1980s



- Communist Regimes
- Capitalist Regimes
- Authoritarian Regimes
- City with over 2 million inhabitants
- BRD Bundesrepublik Deutschland
- DDR Deutsche Demokratische Republik

B. Technological progress

- microelectronics
- automatization and robotization
- biotechnology
- USA leader + JP boom X Eur lagging behind

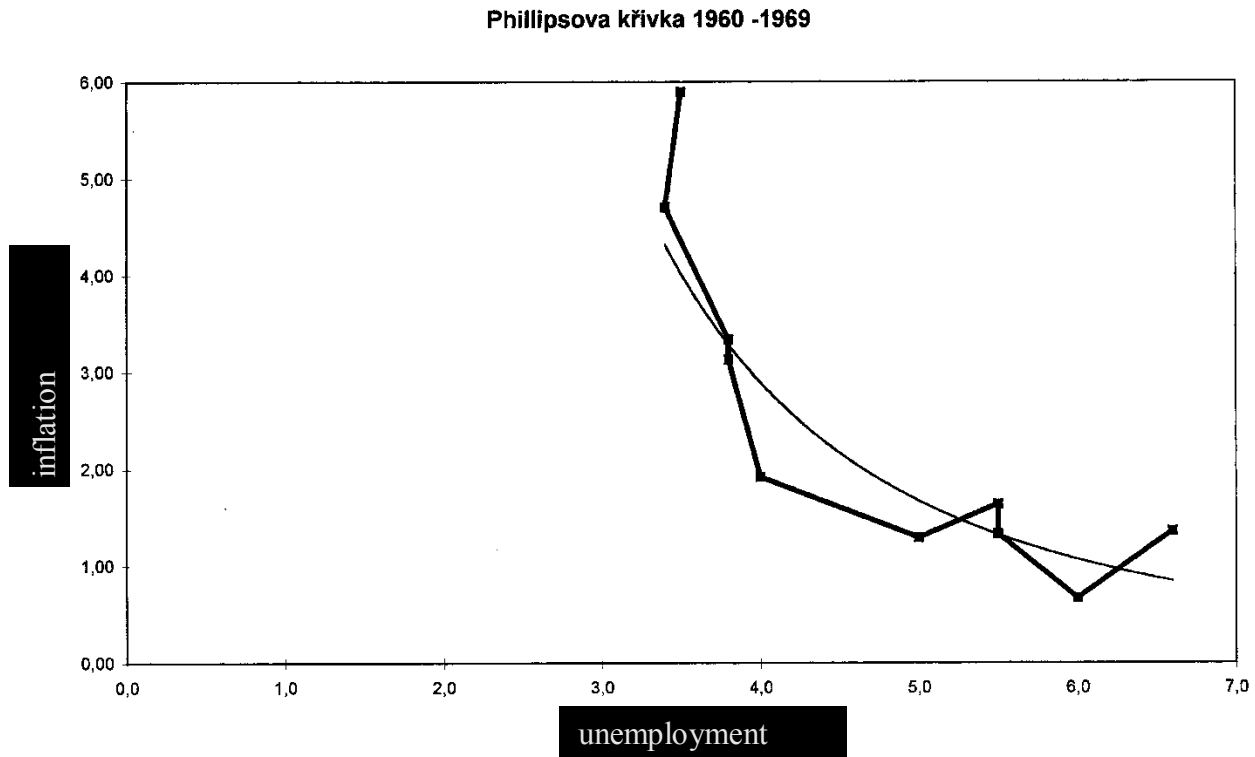
C. Economic theory

- Keynesianism replaced by **neoliberal theories**
- **Phillips Curve**
- **STAGFLATION** – new phenomenon
 - STAGFLATION = ↓ product and simultaneous ↑ prices

X

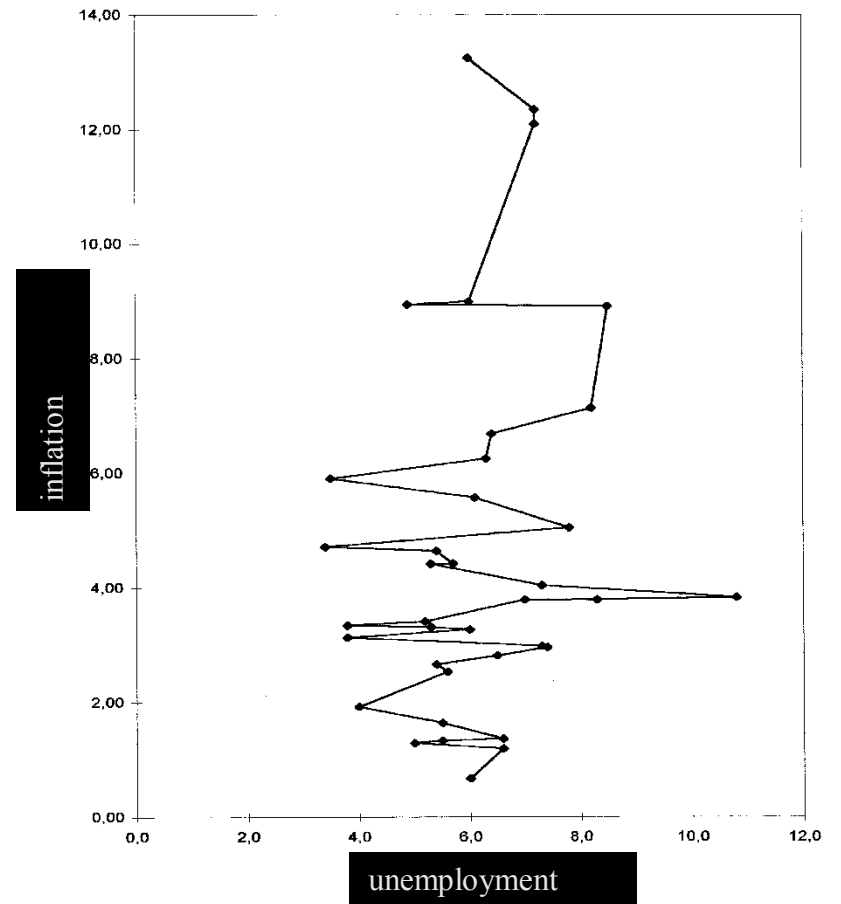
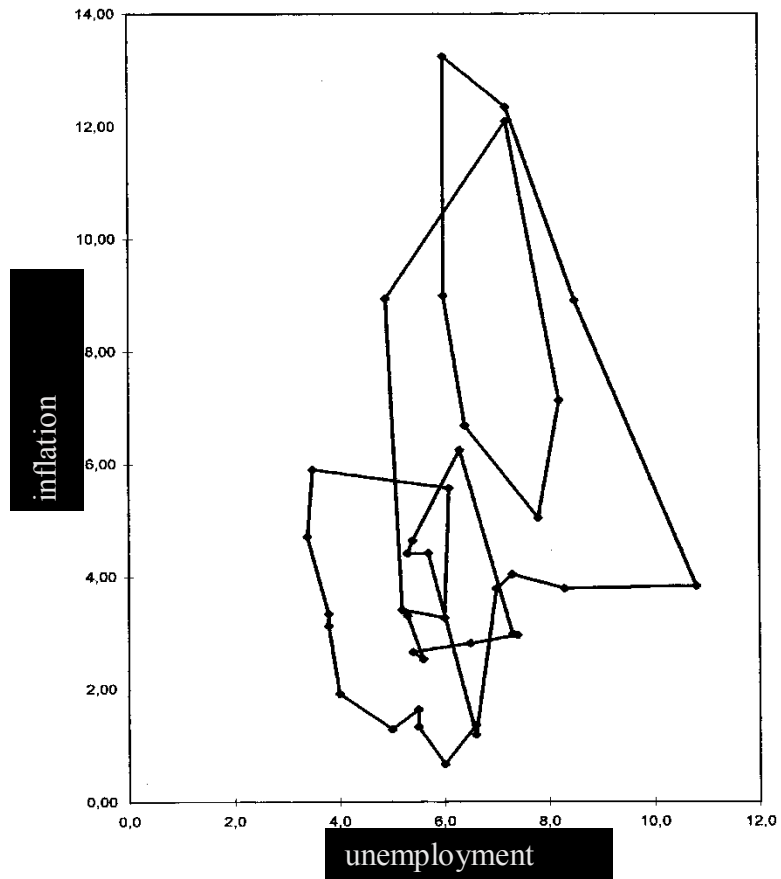
- CLASICAL RECESSION = ↓ product a ↓ prices

Phillips Curve 1960 - 1969

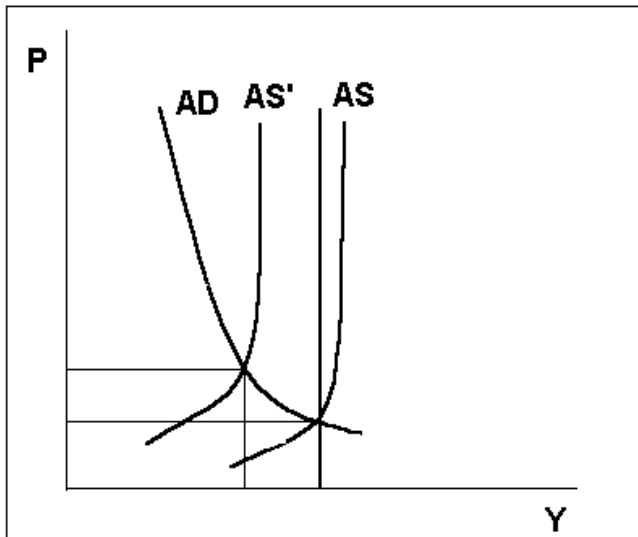


Phillips Curves 1960 - 1996

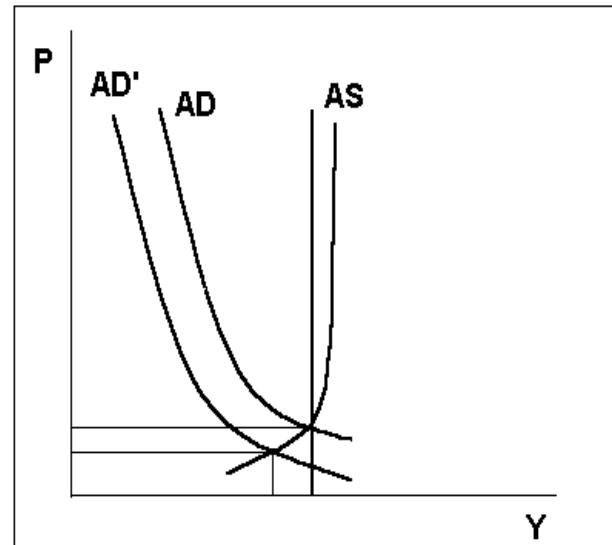
(SR - left, LR – right)



Comparison of stagflation and classical recession



STAGFLATION



CLASSICAL RECESSION

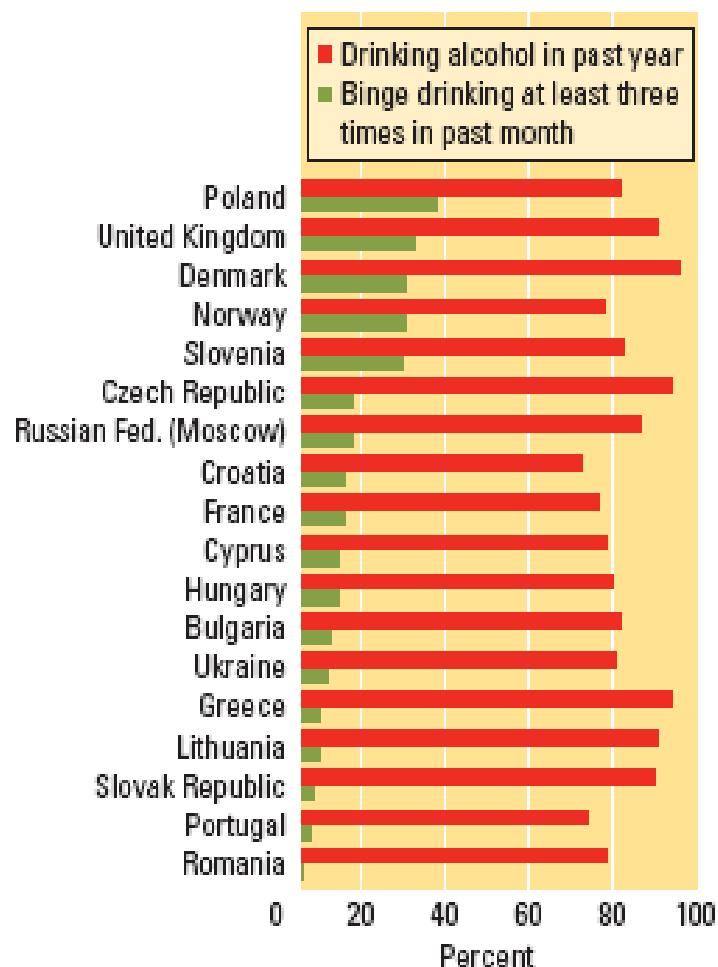
Practical changes in economic policy

- **deregulation** in USA already under Carter but mostly under Reagan + Thatcher in GB
 - Anglo-Saxon deregulation + support of competition ⇒ pressure on Eur to follow them
 - ⇒⇒ creation of single market in Europe
- **monetary policy** – monetarism – monetary aggregates
- further round of **liberalization** of foreign trade
 - Uruguay Round of negotiations in GATT + NAFTA

D. Global problems

- **global problems**
 - concerning the whole humankind
 - reaching beyond borders of individual countries
 - Ignorance -> decline of the whole human civilisation
- **The Club of Rome (1968)**
- since 1972 **UN Environment Conference** (international conference on envir. issues)

Figure 5.3 Alcohol consumption is common among 15- to 19-year-olds in some countries



Sources: Computed using data from Hibbell and others (2000) and Bloomfield and others (2003).

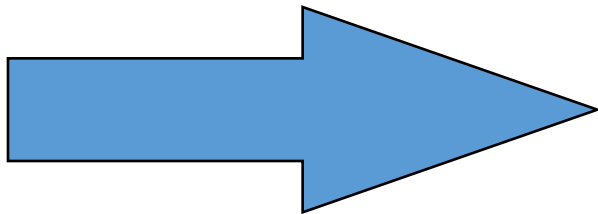
Note: "Binge drinking" is defined as consuming five or more drinks in a row.

Development IN 1970_s and 1980_s

- A. Crises in the 1970s
- B. Development of GDP
- C. Development of price levels
- D. International trade
- E. Capital flows
- F. Migration

A. Crises in the 1970s

- collapse of the Bretton-Woods system
- food crisis
- raw material crisis
 - oil crisis

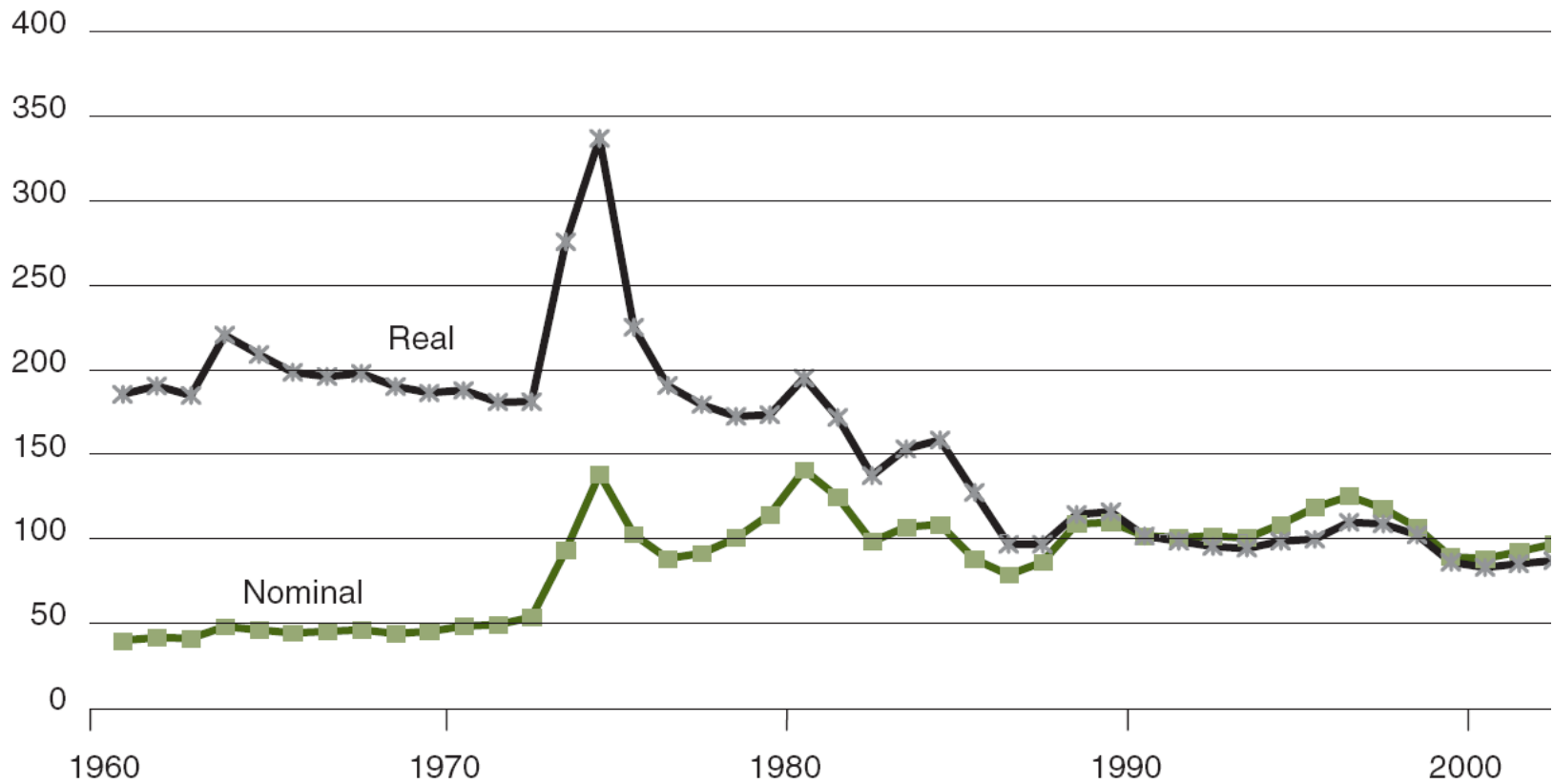


GLOBAL CRISIS-
STAGFLATION

The Food Crisis (1972)

- **causes:**
 - **the hundred years crop failure** in Southeast Asia and Sub-Saharan Africa
 - **USSR crop failure 1972** - IM of large amount of grain from USA
 - ↓ **crop areas** in developed countries (USA)
 - ↓ **stock of food** in USA
- ⇒ **food shortage** ⇒ ↑ **prices** in 1973 by 2x
- but in 2 years ↑ **prices halted**

Food price index, 1960-2003 (1990=100)



The Raw Material Crisis

- since 1950s **low and stable prices**
 - ⇨ improving exchange rates in developed countries
 - ⇨ development of industry dependent on low prices of raw materials
- at the same time as The Food Crisis
- **causes:**
 - simultaneous boom phase of economic cycle in developed countries (1973) ⇨ lack of raw materials
 - insufficient capacities ⇨ unsustainable in LR
- **problems for** raw material-intensive industries

I. Oil Crisis (1974)

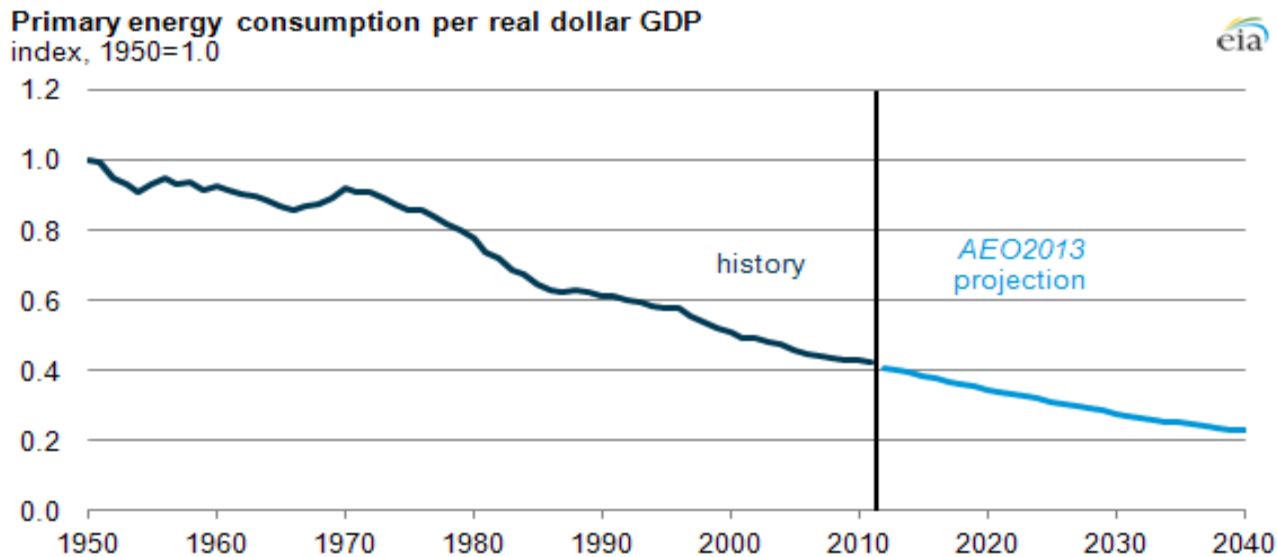
- **↑ oil dependence** in developer countries
 - 1950 $\frac{1}{4}$ of energy from oil X 1973 $\frac{1}{2}$
- **I. Oil Shock (1973)**
 - political reasons
 - fourth Arab-Israeli War (Jom Kippur War)
 - Israel l. serious problems – help from USA
 - OPEC as reaction ↓ production by 5%
- ⇒ **↑ prices** from 2,5\$/1973 to 11,65\$ /1974

II. Oil Shock (1979)

- **causes:**
 - uncertainty on markets
 - Iran Revolution
 - Iran - Iraq War– attack on Iran oil fields

- $\Rightarrow \uparrow$ **oil prices** from 13,34/1979 \Rightarrow 36,22/1982 =12x higher than in 1972
- predictions of absolute shortage \Rightarrow failure \Rightarrow **BUT reaction in developed countries**
 - \downarrow oil dependency + \downarrow energy intensity
 - saving – e.g. cars
 - discovery of new oil resources
 - North Sea – GB, NO
- \Rightarrow in LR \downarrow consumption \Rightarrow **negative for OPEC**

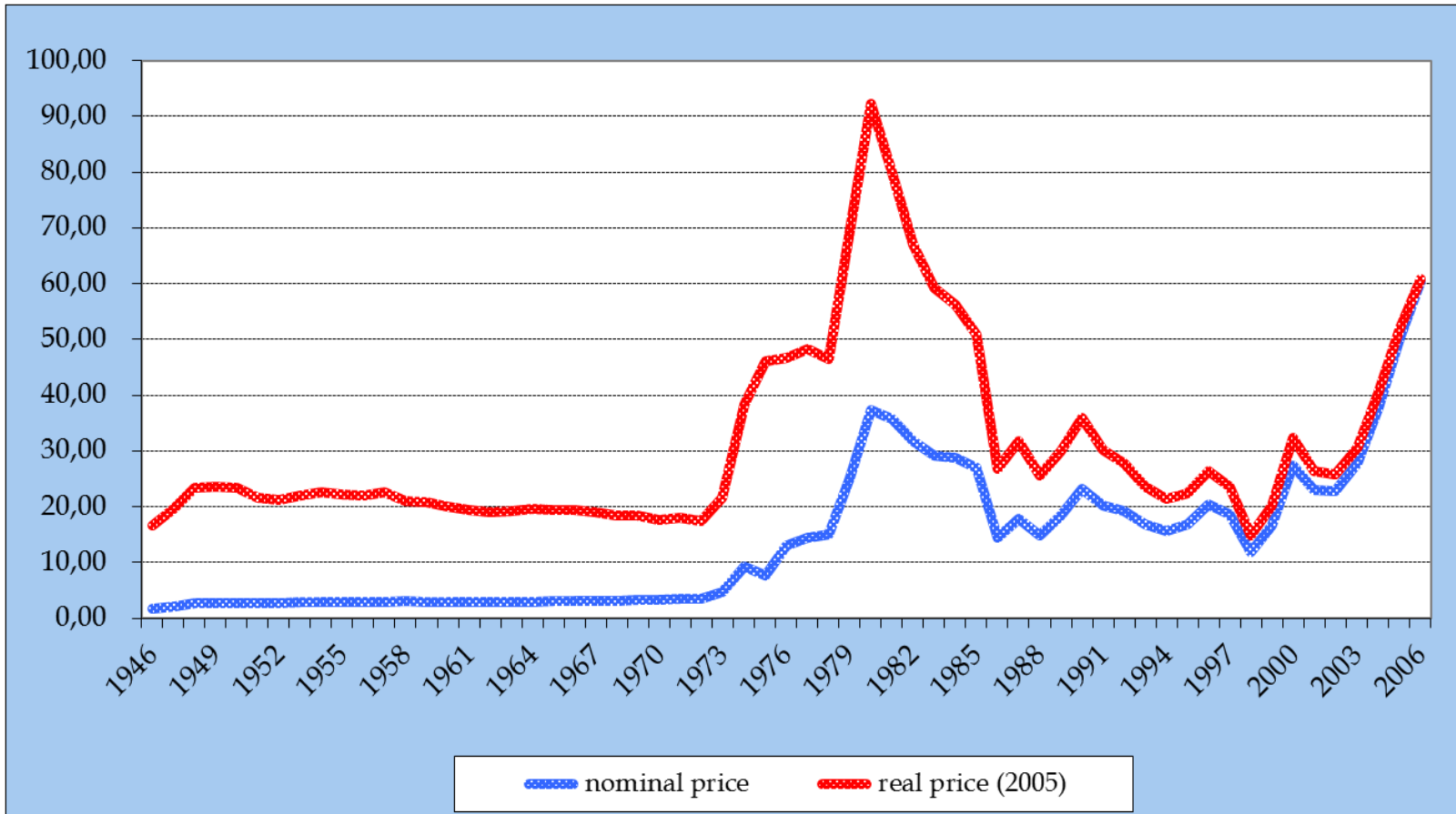
U.S. energy intensity since 1950



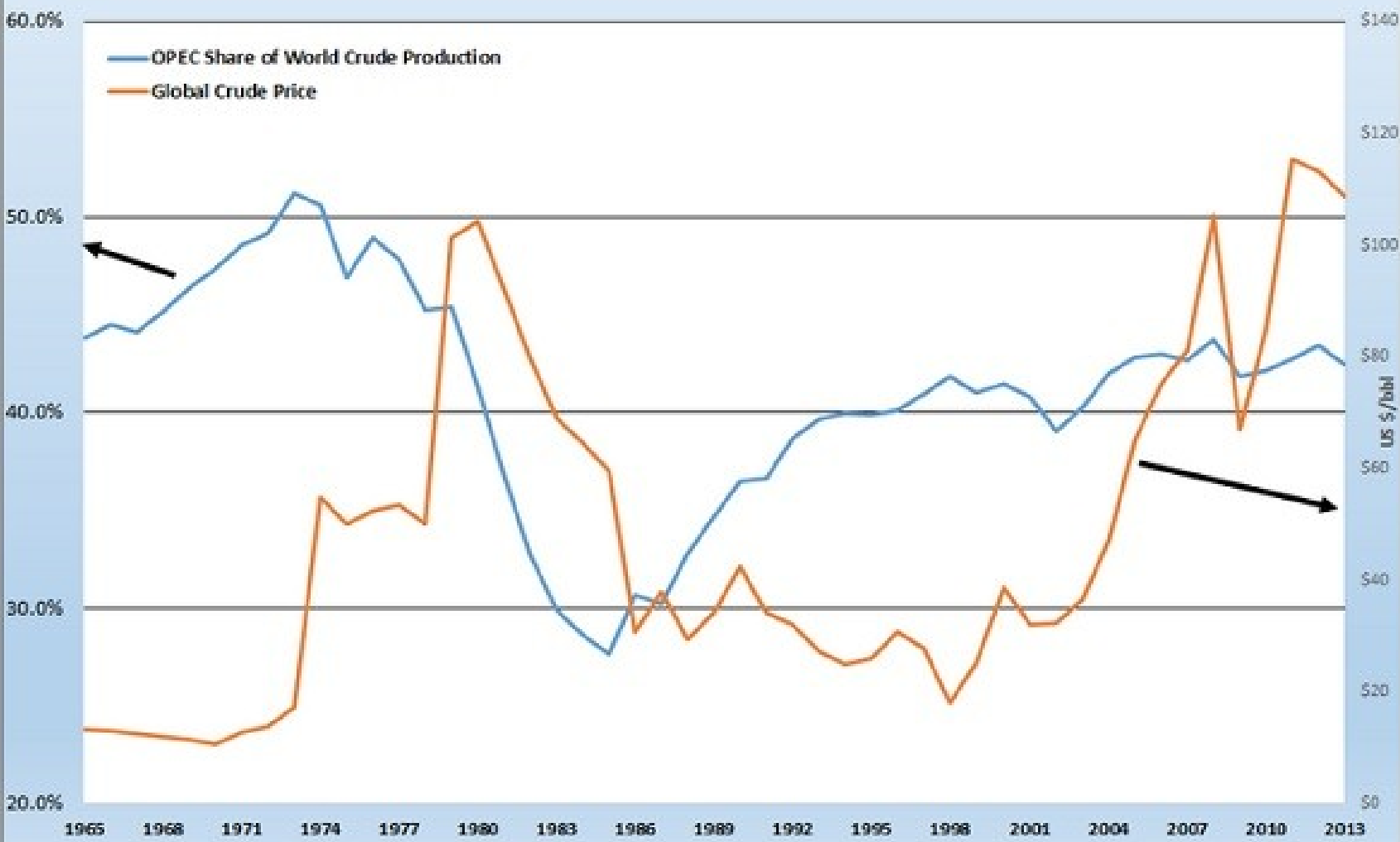
Boeing 737

- **first model** in 1967
 - approx. 100 passengers
 - range of flight 2 775 km
- **modern version** B737-800
 - almost 2x more passengers
 - 2x longer range of flights
 - energy consumption lower by 23%
- ... **lower costs per seat** (by 48%)

Nominal and real price of oil



OPEC Share versus World Crude Price 1965-2013



Data source: BP Statistical Review of World Energy 2014

B. GDP

- **1973** very strong ↑
- **1974** ↓ GDP in certain countries
 - mainly large countries such as GB, USA, JP and DE
 - small ones – not so bad situation
- **1975** worsen – all countries ↓ except NO
 - ↓ industrial production in 10 developed capitalistic countries by 7,5%
= at the first time after WWII
 - the mostly effected – „traditional“ industries (ships, cars, ...)
- **1976** – rapid ↑ production
 - pre-war level pf production
 - but certain countries problems - GB, JP
- **in total slowdown BUT from LR favourable**
 - BUT at the end of the 1970s production 5-15% below the potential

Growth of GDP in market prices, 1972-1978 (in %)

Country	1972	1973	1974	1975	1976	1977	1978	Average 1970/78
USA	5.8	5.4	-1.3	-1	5.5	4.8	4.4	2.9
Japan	8.9	9.8	-1	2.4	6	5.4	5.6	6.1
EEC	4	5.9	1.7	-1.4	5.1	2.3	3.1	3.2

Causes

- **end of the catch-up effect**
- inflation \Rightarrow \uparrow uncertainty \Rightarrow \downarrow **INV**
 - \downarrow introduction of new technologies
- **problems in energy-intensive industries**
- **worsening exchange rates**
- \downarrow **productivity growth** by 1% after 1970
 - changes on the labour market \Leftarrow rapid growth of population from previous baby boom \Rightarrow \downarrow average level of experience
 - ecology \Rightarrow \uparrow gov. regulations
 - oil prices \Rightarrow writing-off the high-performance machines with high energy-intensity
 - slowdown of technological progress
 - no further possibilities to shift resources from agriculture

Share in the world economy production, 1960-1980 (in %)

Country	1960	1970	1980
Less developed countries	11.1	12.3	14.8
Japan	4.5	7.7	9
China	3.1	3.4	4.5
EEC	26	24.7	22.5
USA	25.9	23	21.5
Other developed countries	10.1	10.3	9.7
USSR	12.5	12.4	11.4
Other socialist countries	6.8	6.2	6.1

- **early 1980s problems**

- II. Oil Crisis
- restrictive fiscal and monetary policy
 - considerable change X after-war period

- ⇒ **econ. decline and stagnation**

- 1980 – 82 simultaneously almost all capitalistic countries
- less deep than after I. Oil Shock but longer ⇒ slow recovery
- + further problems: ↑ inflation (effect of II. OS), negative INV, gov. deficit, current account deficit, high U
- the mostly effected – traditional industries

Growth of real GDP, 1979-1983 (in %)

Country	1979	1980	1981	1982	1983
USA	2.8	-0.3	2.6	-0.5	2.4
Canada	3.4	1	4	-4.2	3
Japan	5.1	4.9	4	3.2	3
EEC (10 countries)	3.5	1.1	-0.3	0.5	0.8

- **improvement** of indicators in the 2nd ½ of 1980s
 - elimination of inflation ⇒ stabilization of macro situation
 - modernisation + rationalisation of production (automatization and robotization)
⇒ ↓ production costs + ↑ labour productivity
- 1984 - 1990 - ↑ **GDP** (except 1986)
- the end of the 1980s better than the beginning – **problem U**
- **in total considerable slowdown** X after-war growth

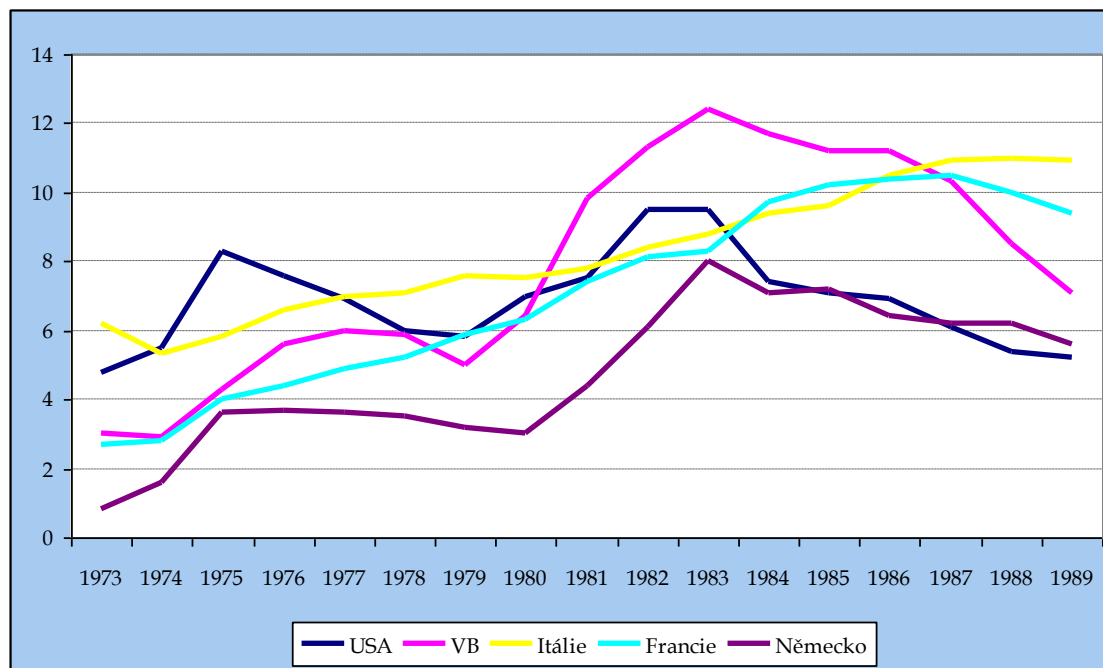
Growth of GDP p.c., 1948-88

country	1948-72	1972-88
Canada	2.9	2.6
France	4.3	2.1
FRG	5.7	2.2
Italy	4.9	2.8
Japan	8.2	3.3
GB	2.4	2.1
USA	2.2	1.7

Unemployment

- recession after II. Oil Shock \uparrow **U**
 - youth
 - long-term unemployment
 - structural
 - \Rightarrow new
- **peak** in 1984 and persisting
- **reasons:**
 - slow econ. \uparrow
 - restrictive policy of government and CB
 - rigidity of labour market
 - generous soc. policy
 - gov. regulations
- \Rightarrow \downarrow interest in foreign LF \Rightarrow attempt to return to native countries

Unemployment as % of labour in selected countries, 1973-1989



C. Increasing price level

- \uparrow prices of raw materials \Rightarrow \uparrow costs \Rightarrow **inflation pressure** BUT
- **expansive monetary policy**
- in $\frac{1}{2}$ 1970s all except DE and CH two-digit Π
- **+ changes of price relations**
 - slower \uparrow prices industrial production
 - \Rightarrow exchange relations unfavourable for developed countries
 - the worst DC

- **2nd ½ of 1970s** moderation (persisting) Π and at the **end of 1970s** ↑
 - budget deficit – attempt to provide public goods
 - better anticipation of Π \Rightarrow wage negotiations
 - high wage claims (powerful unions) e.g. GB
 - \Rightarrow wage spiral of wages and prices in certain wages
 - rapid disinflation would have impacts on real economy and E X policy
- **II. Oil Shock-** more rapid disinflation
 - peak of prices in 1980 except those of energy (1982)

Reasons of rapid disinflation

- **strict EPs**

- governments concerned about repeated wage price spirals
- $\uparrow r$ in USA and appreciation of \$ \Rightarrow pressure on Eur to $\uparrow r$
- \Rightarrow contribution of EP to $\downarrow \Pi$ expectations

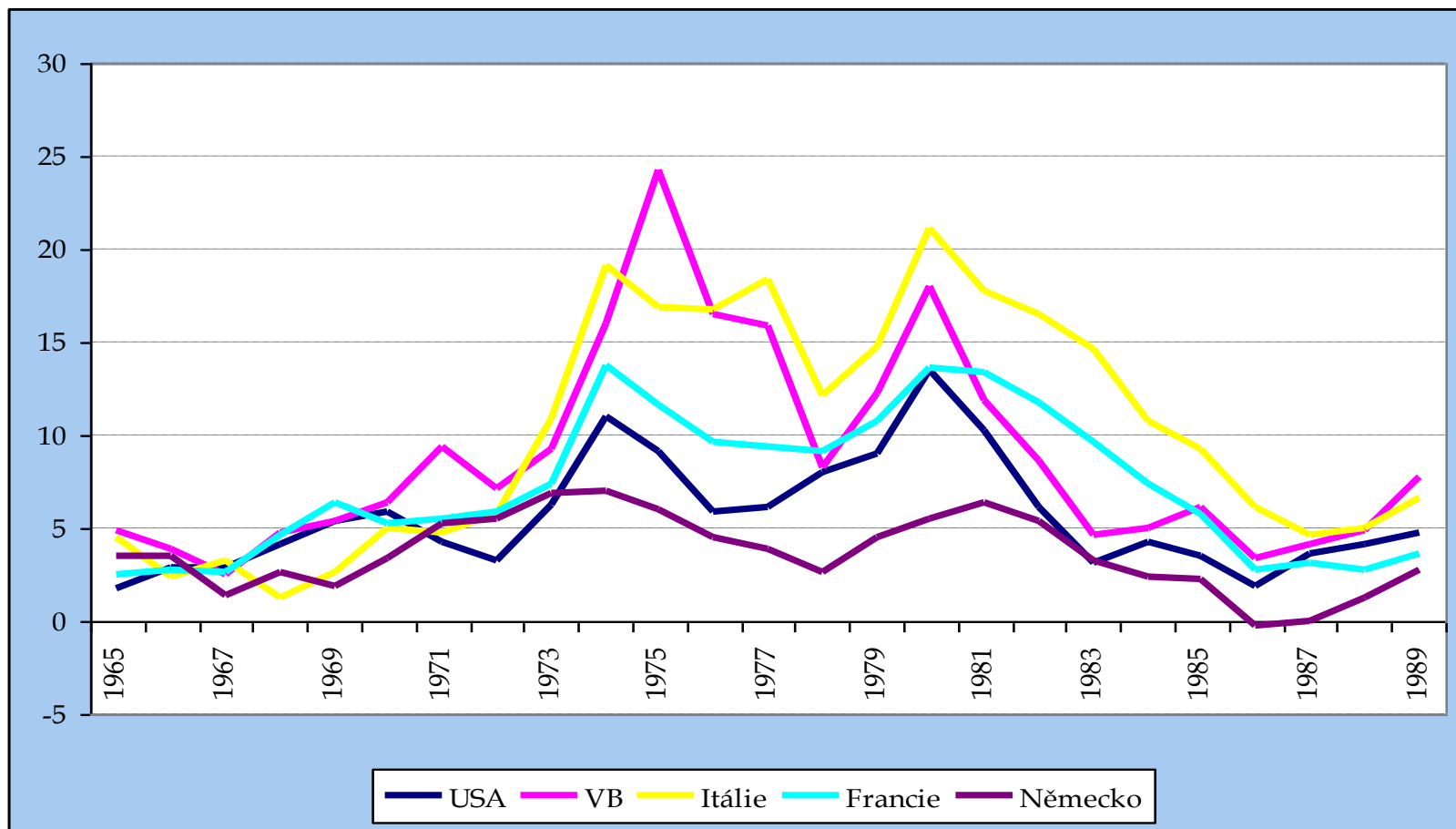
- limited \uparrow **wages**

- \uparrow **productivity**

- \downarrow prices of **raw materials**

- substitutes + slow \uparrow industrial activity

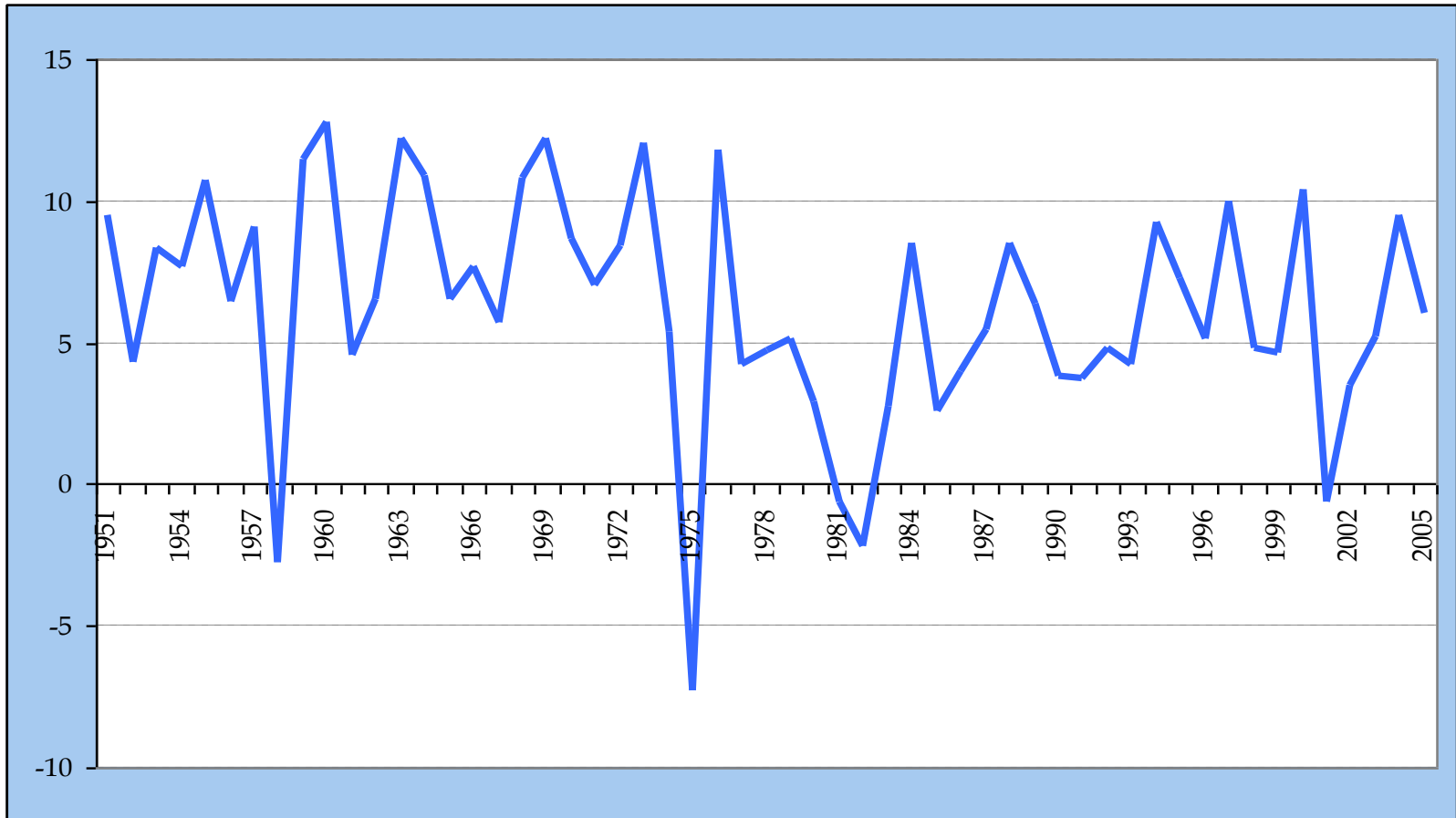
Changes in price levels in selected countries, 1973-1989 (in %)



D. International trade

- NO ↑ protectionism in response to crisis x 30s
 - only Common Agricultural policy of EC
- continuous ↑ - ↓ only in 1975 and 1982
- direction of trade
 - still mainly among developed countries
 - ↓ share of USA and GB
 - ↑ share of DE and JP
 - ↑ share of OPEC and NIS

Development of the world export, 1951-2007 (percentual change)



Leading world exporters by regions, 1963-1987 (in %)

Country	1963	1973	1979	1987
Developed countries*	64.3	68.2	63.4	68.2
Australasia, South Africa	2.8	2.7	2.1	1.7
Developing countries	20.7	19.2	25.3	19.7
CPE	12.1	9.9	9.3	10.4
total	100	100	100	100

Mutual trade between regions in 1963, 1979 a 1987 (in %)

			1963		
RTE	49,5	14,8	2,5	0,4	67,1
DC	15	4,3	1,1	0,2	20,7
CPE	2,3	1,6	0,8	0,2	12,1
Total	66,8	20,7	11,6	0,9	100
			1979		
RTE	47,4	14,3	3,2	0,6	65,5
DC	18,1	5,9	0,9	0,3	25,3
CPE	2,8	1,3	4,8	0,3	9,3
Total	68,4	21,5	9	1,2	100
			1987		
RTE	54,6	12,3	2,6	0,5	69,9
DC	13,3	4,7	1,3	0,2	19,7
CPE	2,8	1,7	5,5	0,4	10,4
Total	70,8	18,6	9,5	1	100

Export share of the most influential economies, 1937 - 1987 (in %)

Country	1937	1950	1960	1973	1979	1987
GB	20	20	14	9	10	9
USA	23	32	28	20	20	17
France	7	10	9	11	11	10
Germany (since 1950 BRD)	16	6	15	19	19	20
Rest of Western Europe*	20	20	21	23	24	23
Canada	8	9	7	7	6	7
Japan	6	3	5	11	11	15
Total	100	100	100	100	100	100

Share of commodities

Year	Primary production			Manufactures	Total
	Food	Raw Materials	Total		
1937	23	40	63	37	100
1950	23	34	57	43	100
1960	20	25	45	55	100
1973	15	23	38	62	100
1979	12	29	41	59	100
1987	10	18	28	72	100

E. Capital flows

- relative **inhibition of ↑ capital flows in 1970s**
- **BUT end of constraints** on capital flows
 - USA 1974-75, GB 1979, JP almost all in 1980 and Eur until the end of 1980s
 - ⇒ more interconnected markets ⇒ return to the situation before WWI
 - mainly portfolio INV
- huge **↑ foreign INV in 1980s**
 - main investors USA, GB, JP, DE, FR and NL

- **direct foreign INV (DFI)**

- relative ↓ importance of USA as an investor + ↑ share of certain Eur countries + JP
- in 1980s USA ↑ as a host country for INV+ ↓ DC

- huge ↑ **portfolio INV** in 1970s and 1980s

- at the beginning of 1970s 10 000 mill. SDR ⇒ in 1986 150 000 mill.
- at the end of 1980s JP main portfolio investor (more than 50%) + DE and GB
- host countries – mainly USA + GB, DE, FR, CA

Direct foreign investments in the world according to country of origin, 1960-1995 (% of the total volume)

Country	1960	1975	1985	1990	1995
USA	47.1	44.0	36.6	25.8	25.9
Great Britain	18.3	13.1	14.6	13.7	11.7
France	6.1	3.8	5.4	6.5	7.4
subtotal	71.5	60.9	56.6	46	45
Japan	0.7	5.7	6.5	9.0	11.2
Germany	1.2	6.5	8.8	6.5	8.6
subtotal	73.4	73.1	71.9	61.5	64.8
Netherlands	10.3	7.1	7.0	6.5	5.8
Canada	3.7	3.7	6.0	4.7	4.0
Switzerland	3.4	8.0	3.1	4.0	4.0
Italy	1.6	1.2	2.3	3.3	3.2
Sweden	0.6	1.7	1.8	3.0	2.3
total	93.0	94.8	92.1	88.7	85.1

Capital and DC

- since 2nd ½ 1970s **commercial banks – capital to DC**
 - mainly after 1978
- **reasons**
 - development of international banking
 - liberalization of capital flows
 - free capital – „petrodollars“

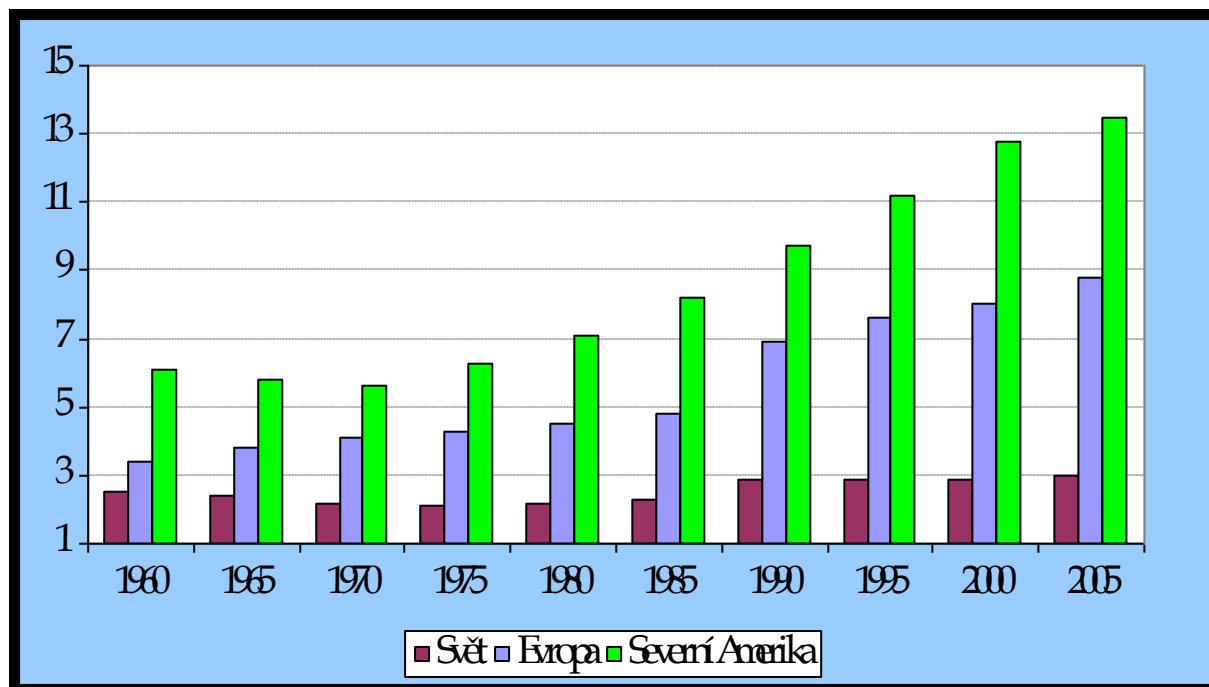
Problems with indebtedness of DC

- **reasons:**
 - \uparrow oil prices
 - current account deficits
 - \downarrow foreign reserves
 - deterioration of terms of trade
 - inflation pressures in developed countries $\Rightarrow \uparrow r \Rightarrow$ change of capital direction
 - appreciation of USD
 - recession in western countries $\Rightarrow \downarrow$ IM
- **1982 MX bankruptcy** (similar problems in AR, BR) – IMF ...

F. Migration

- **population growth** - 1970-1990 from 3,7 bill. to 5,3 bill.
- **stagnation of migration** to developed countries in 1970s
 - + somewhere even outflow

Percentage share of foreign migration in the world, European and North-American population, 1960-2005



Thank you for attention