1960s-1970s: Energy geopolitics

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Lecture outline

- The oil shocks of the 1970s: the context, impact mechanism and crossboder cashflow
- The effects on developing and developed countries
- The long-term consequences
- The energy weapon - discussion

The road to the crisis (1949-1972)

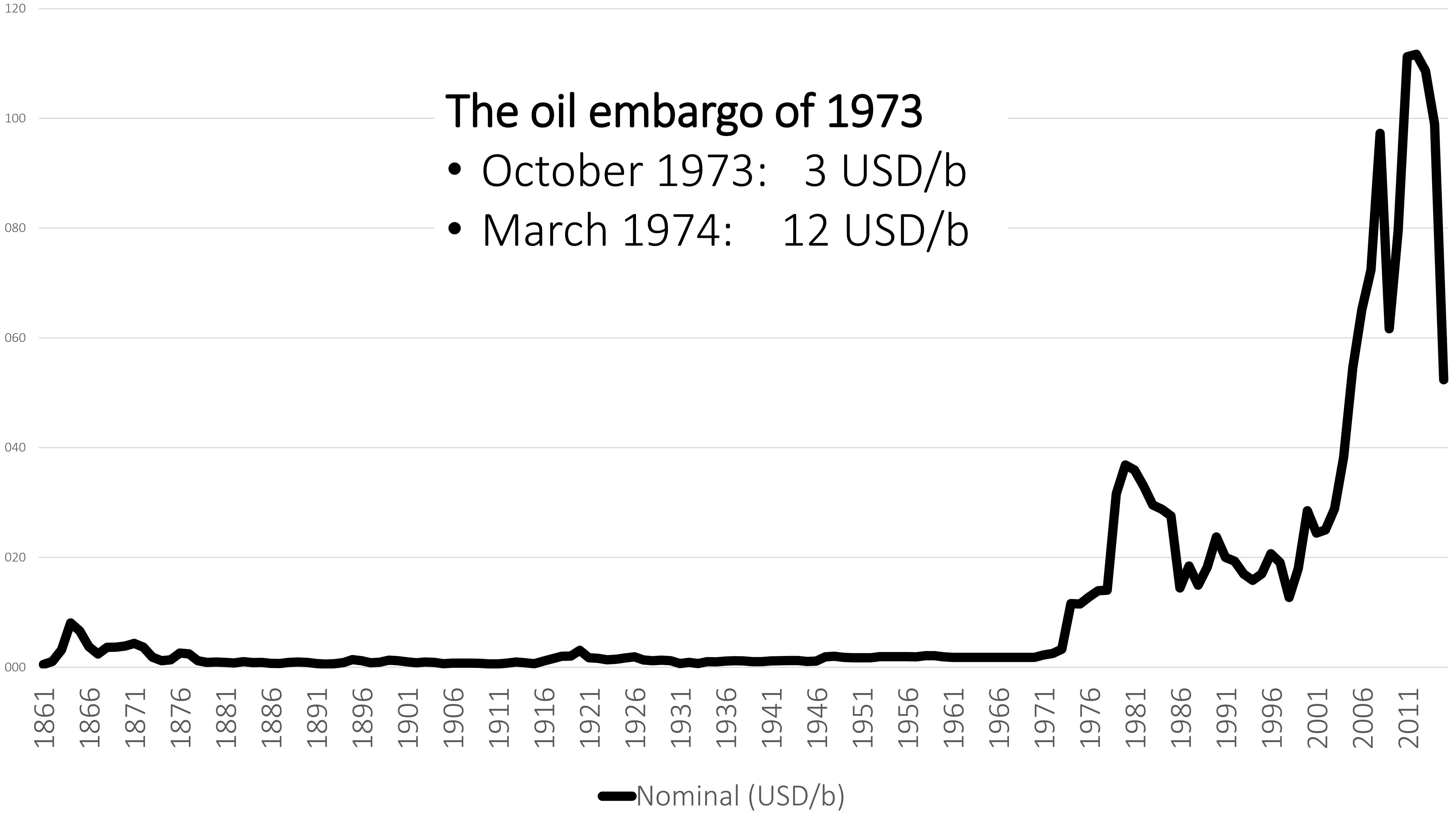
- World‘s energy consumption tripples
- World‘s demand for oil increases 5.5 times
- U.S. demand for oil increases 3 times
- Western Europe‘s demand for oil increases 15 times
- Japan‘s demand for oil increases 137 times

- 2/3 of the new demand covered by the MENA producers
- 1967-1972: U.S. domestic production peaks and import dependence increases from 19% to 36%

- 1970-1973: World‘s spare production capacity decreases from 3 mbd to 0.5 mbd (less than 1% of total consumption)

The oil embargo of 1973

- October 1973: 3 USD/b
- March 1974: 12 USD/b



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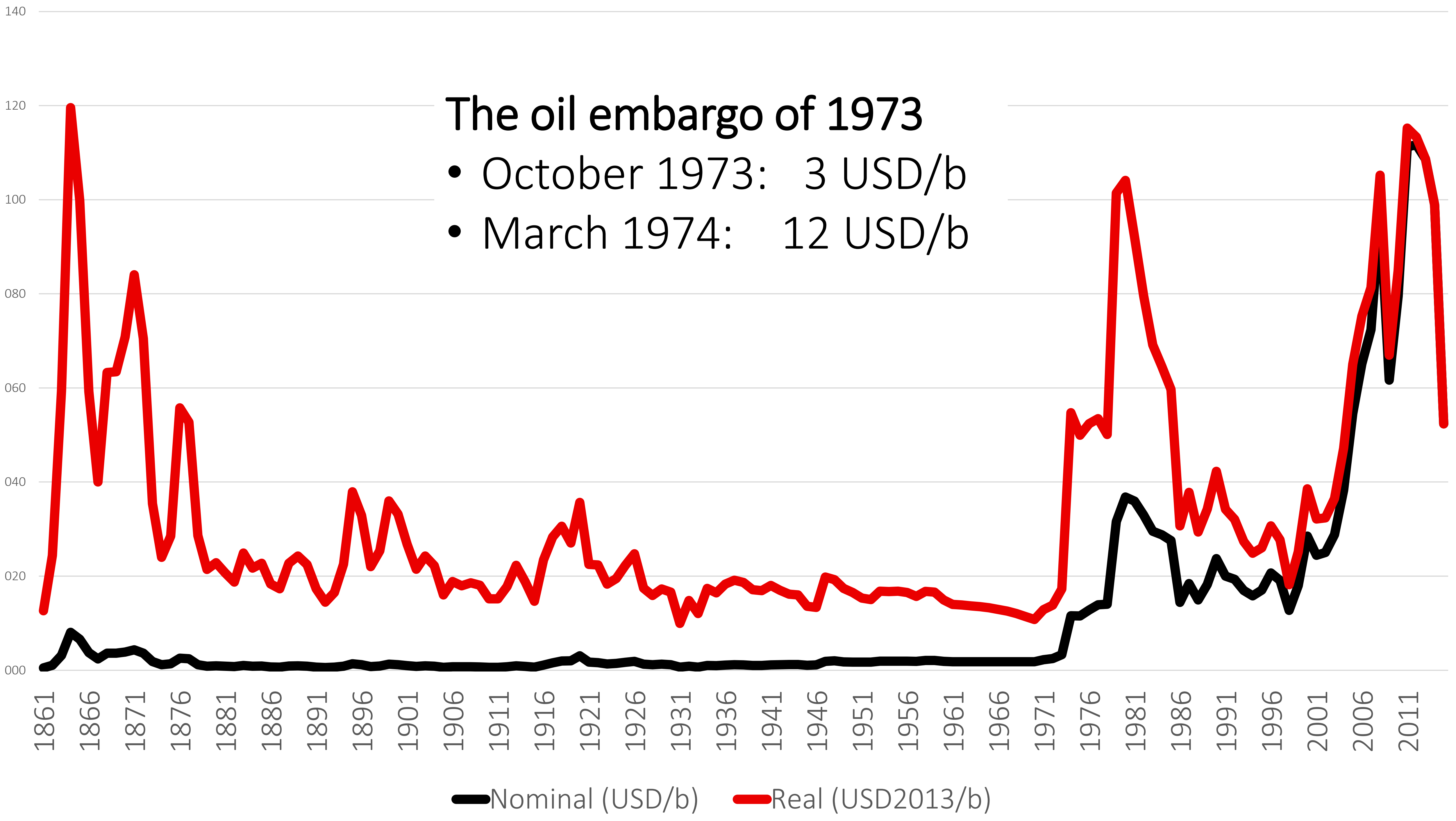


The to-do lists and cashflow of the 1970s oil shocks

OPEC

- Increase oil prices
- Collect additional revenues
- Send them to the Western banks

Developed countries

- Pay more for energy
- Collect OPEC deposits
- Lend them to domestic subjects (rebuilding)
- Lend them to developing countries

Developing countries

- Cheer for OPEC‘s demonstration of power
- Pay more for energy
- Borrow money from the Western banks
- Find yourself unable to pay the debt

The 1970s crisis in numbers

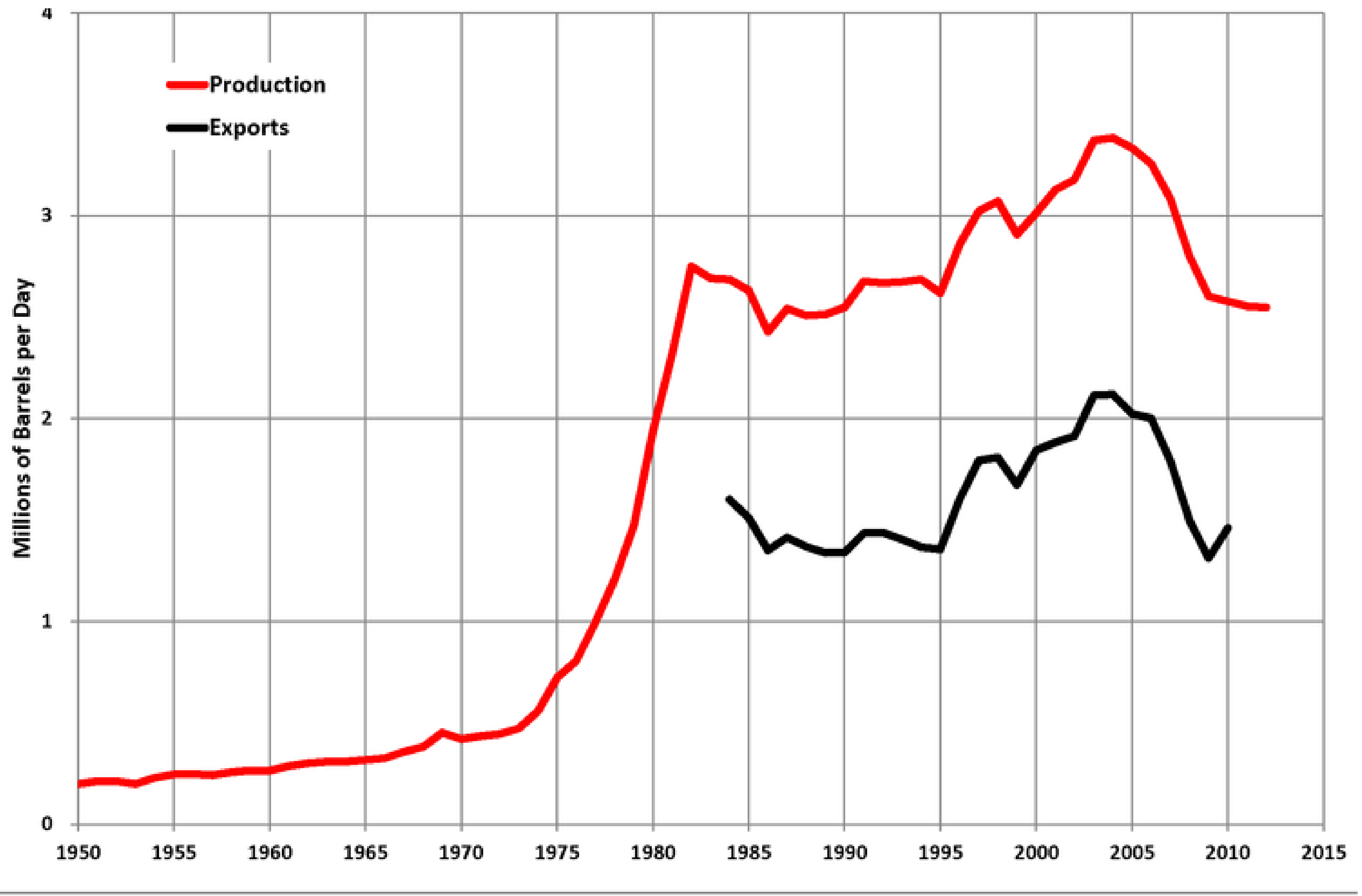
Saudi Arabia‘s current account surplus:
- 1973: 2.5 bn USD
- 1974: 23 bn USD

Additional costs associated with higher oil prices between 1970 and 1980: 260 bn USD

Increase in foreign debt (bn USD):

	Argentina	Brazil	Mexico	Developing world
1970	5.8	5.7	7.0	72.7
1980	27.2	71.5	57.4	586.7
1984	48.9	103.9	94.8	921.8

Mexico oil production and exports



Macroeconomic consequences: developing countries

Developing countries (mainly Latin America) hit particularly hard during the 1970s:

Internal factors: the „import substitution industrialization“ development strategy

- Effective isolation of the national economy from the international markets
- Subsidies to selected sectors/industries
- Requires imports of goods and capital, compromises exports

External factors: oil shocks

- Countries unable to reduce demand for oil, decrease imports or increase exports
- Non-existent financial reserves to cover the higher energy costs

=> Massive borrowing from the U. S. and European banks

- The investments did not produce anything of economic value sufficient to enable the borrowers to repay their loans
- By 1988: the debt costs higher than incoming loans => the „Debt crisis“

The Debt crisis

- Inability to pay back the loans + no new loans coming
- Risk of another global recession caused by multiple state defaults
- The governments turn to the international economic institutions (WB, IMF) for assistance
- Until 1985: macroeconomic stabilization
  - Reduction of government budget deficits: reduction of domestic consumption => reduction of imports, reduction of domestic consumption => unemployment => reduced wages => exports => current account surpluses
- After 1985: Structural adjustment
  - Debts reduced or written-off in exchange for lowering tarrifs, privatizing industries, reducing subsidies and general opening up of the economy.

The Debt crisis

Table 14.6
Economic Conditions in Latin America, 1982–1990

	1980–81	1982	1983	1984	1985	1986–90
GDP[1]	100	95.6	91.3	92.2	92.7	94.1
Consumption[1]	77.0	74.0	70.3	70.4	69.9	71.6
Investment[1]	24.4	19.6	14.9	15.2	16.1	15.9
Unemployment[2]	6.7				10.1	8.0
Real Wages[3]	100.0				86.4	68.9
Imports[4]	–12.3	–9.7	–7.5	–8.0	–7.9	–9.2
Exports[4]	12.5	12.6	13.6	14.5	14.2	15.2
Net Transfers[4]	12.2	–18.7	–31.6	–26.9	–32.3	
Fiscal Deficit[5]	3.7	5.4	5.2	3.1	2.7	
Inflation	53.2%	57.7%	90.8%	116.4%	126.9%	

[1]As a percentage of 1980–81 GDP.
[2]Rate of open unemployment as a percentage of total labor force.
[3]Index of real wages in unemployment.
[4]$US billions.
[5]Percent of GDP.
Source: Thorp 1999; Edwards 1995, 24; Edwards 1989, 171.


STANDARD
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Developed countries

- Macroeconomic effects
- International politics
- Energy policy

Developed countries: macroeconomic effects

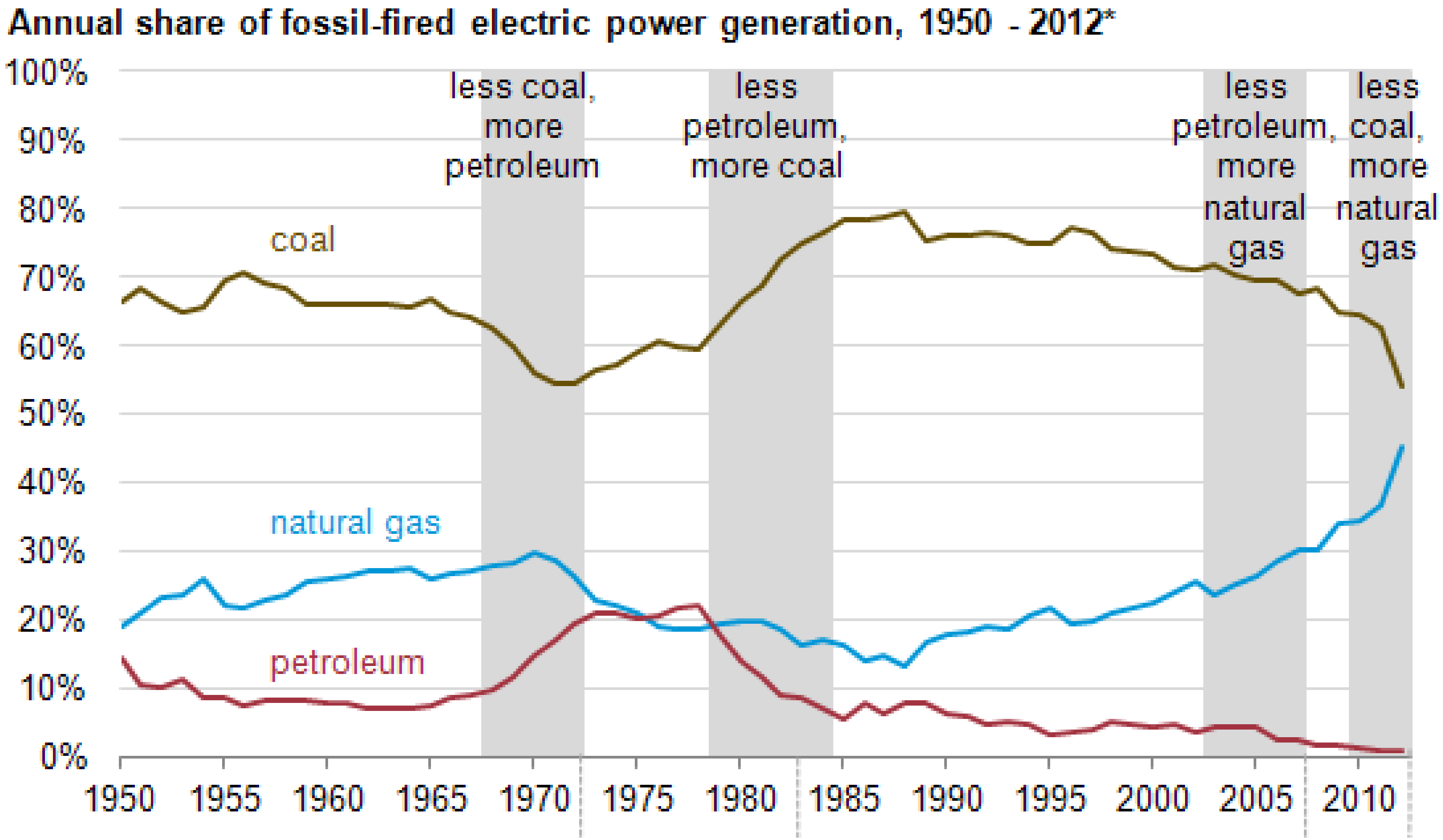
Structural changes in economies

- Japan: moving from energy-intensive industries to electronics; car industry boom
- USA and Europe: recycling petro-dollars requires relaxation of capital controls: the beginning of exponential growth of Western capital markets

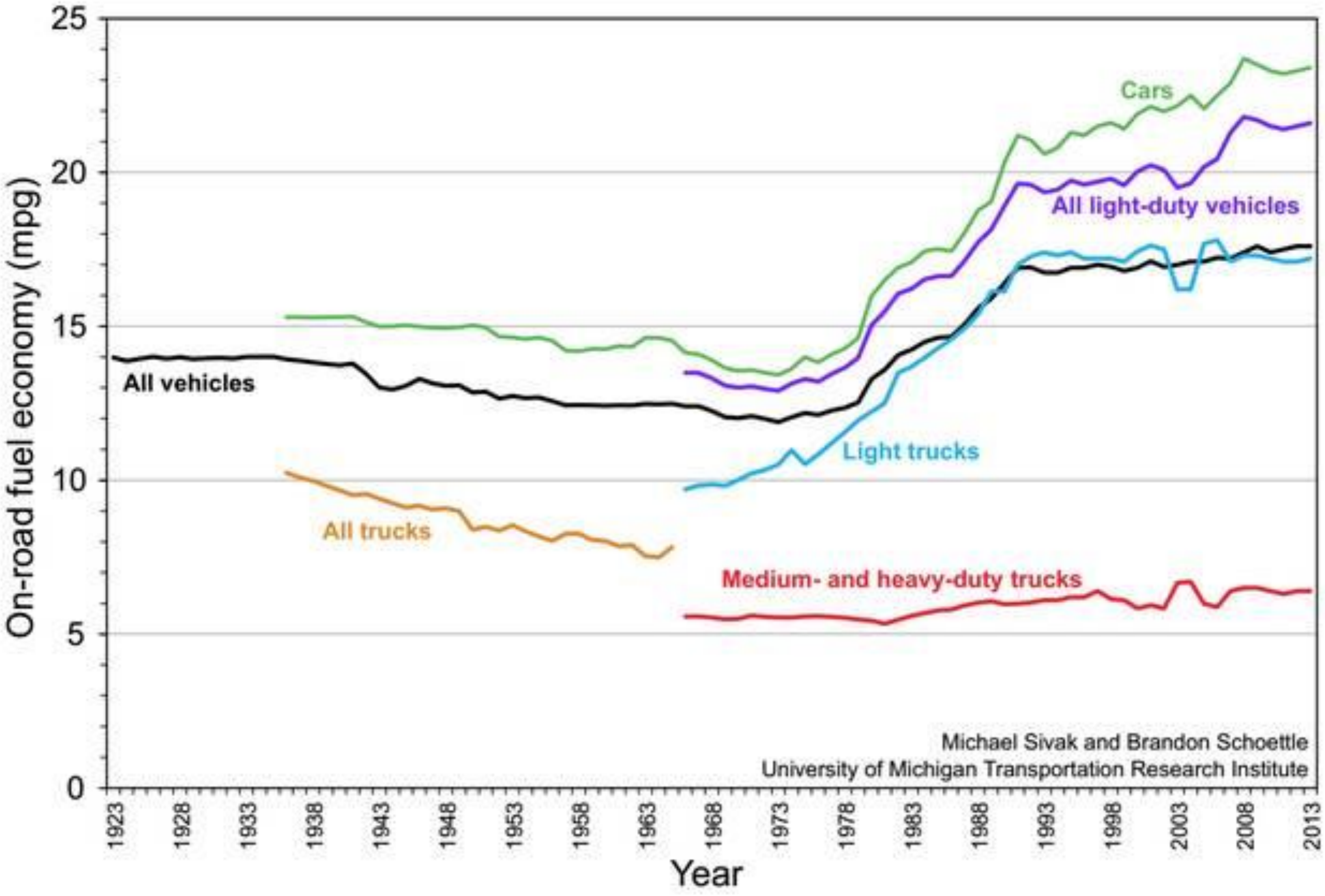
Developed countries: international politics

- USA does not alter its support for Israel (several European countries do)
- The U.S. obsession with the Middle East/foreign oil begins
  - The Carter‘s doctrine
  - YouTube: „American presidents promise security through energy independence“
  - Energy is typically tackled as a „crisis issue“ ever since
- Establishment of International Energy Agency

Developed countries: Energy conservation/diversification



Developed countries: Energy conservation/diversification



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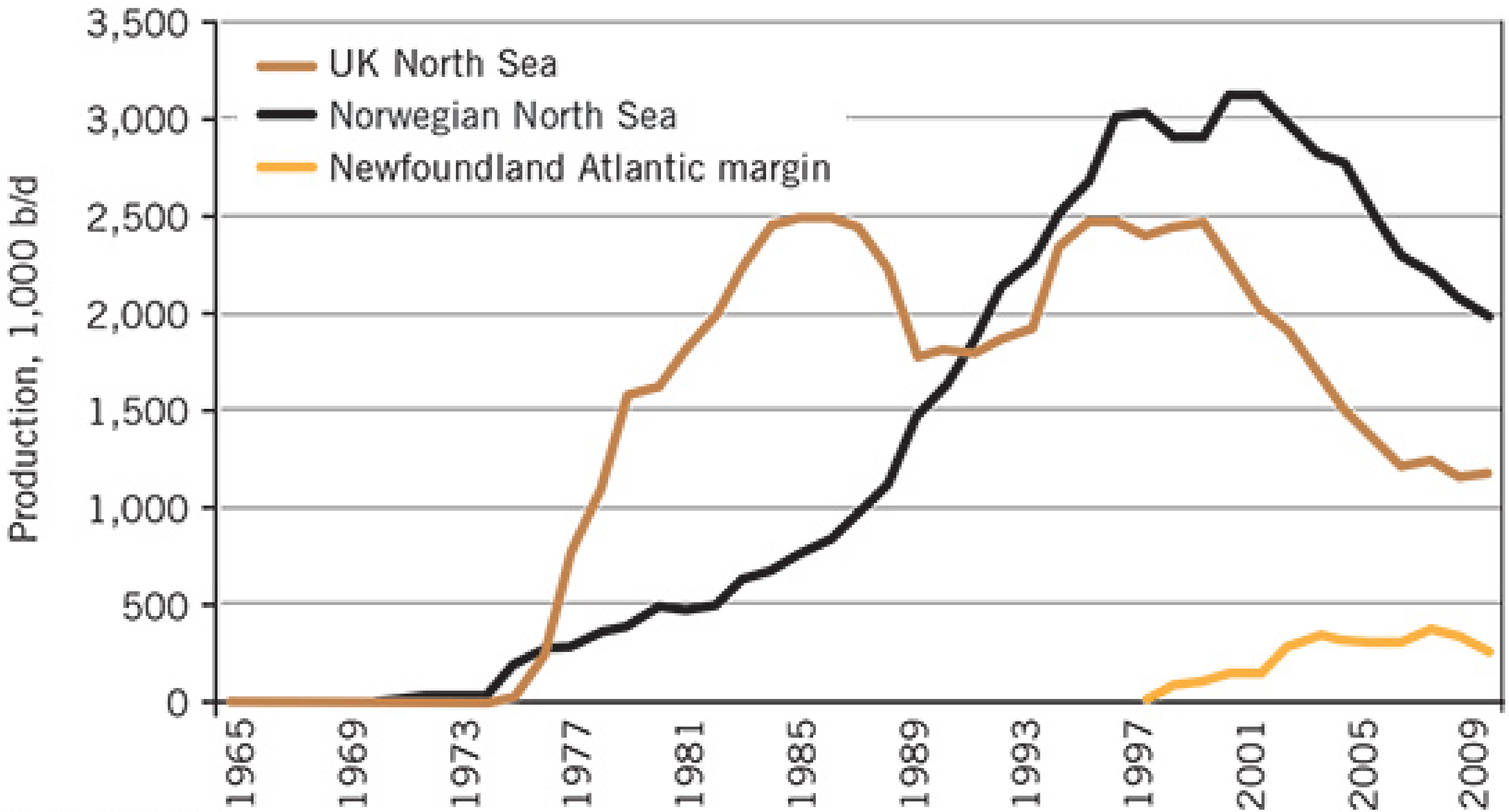
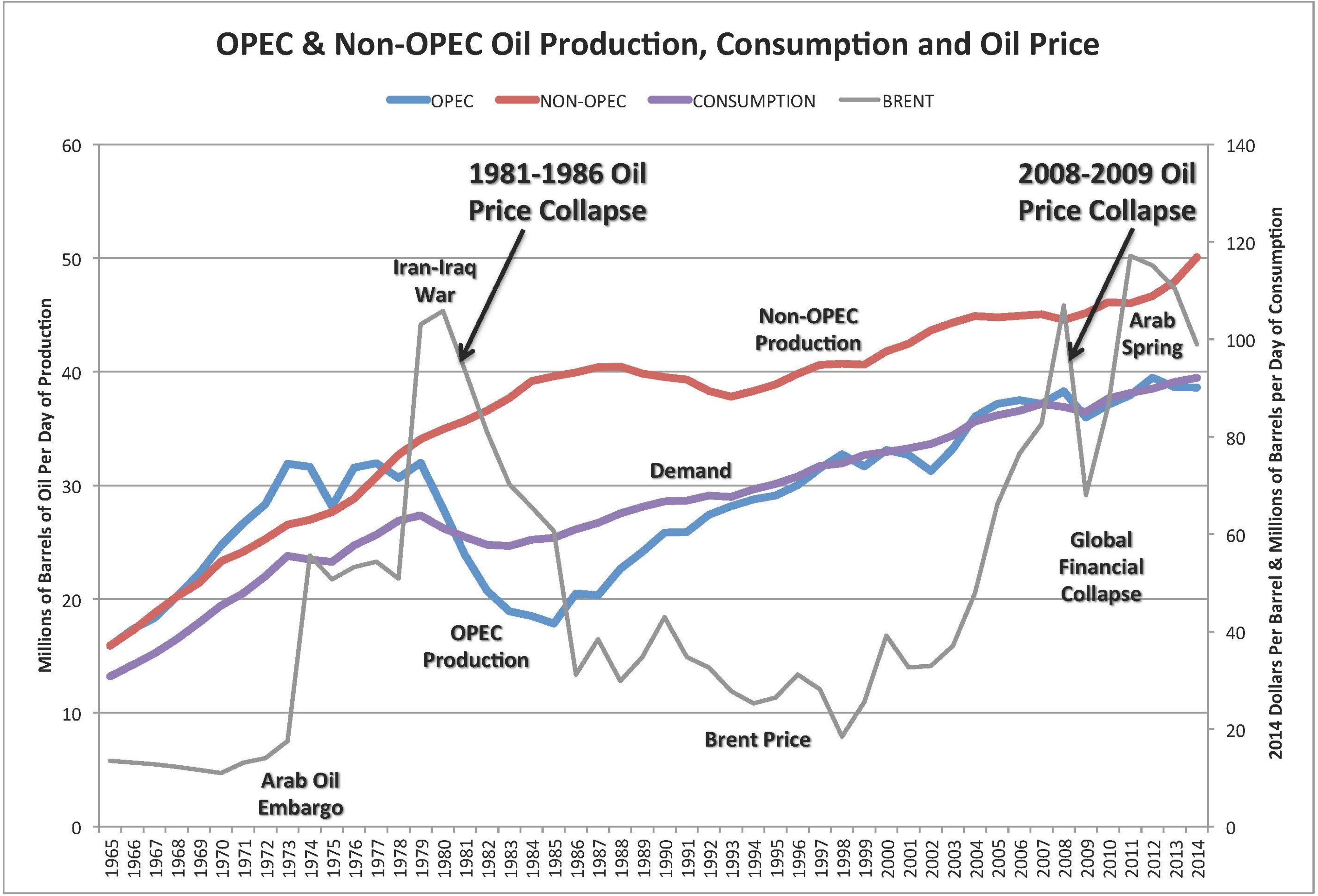
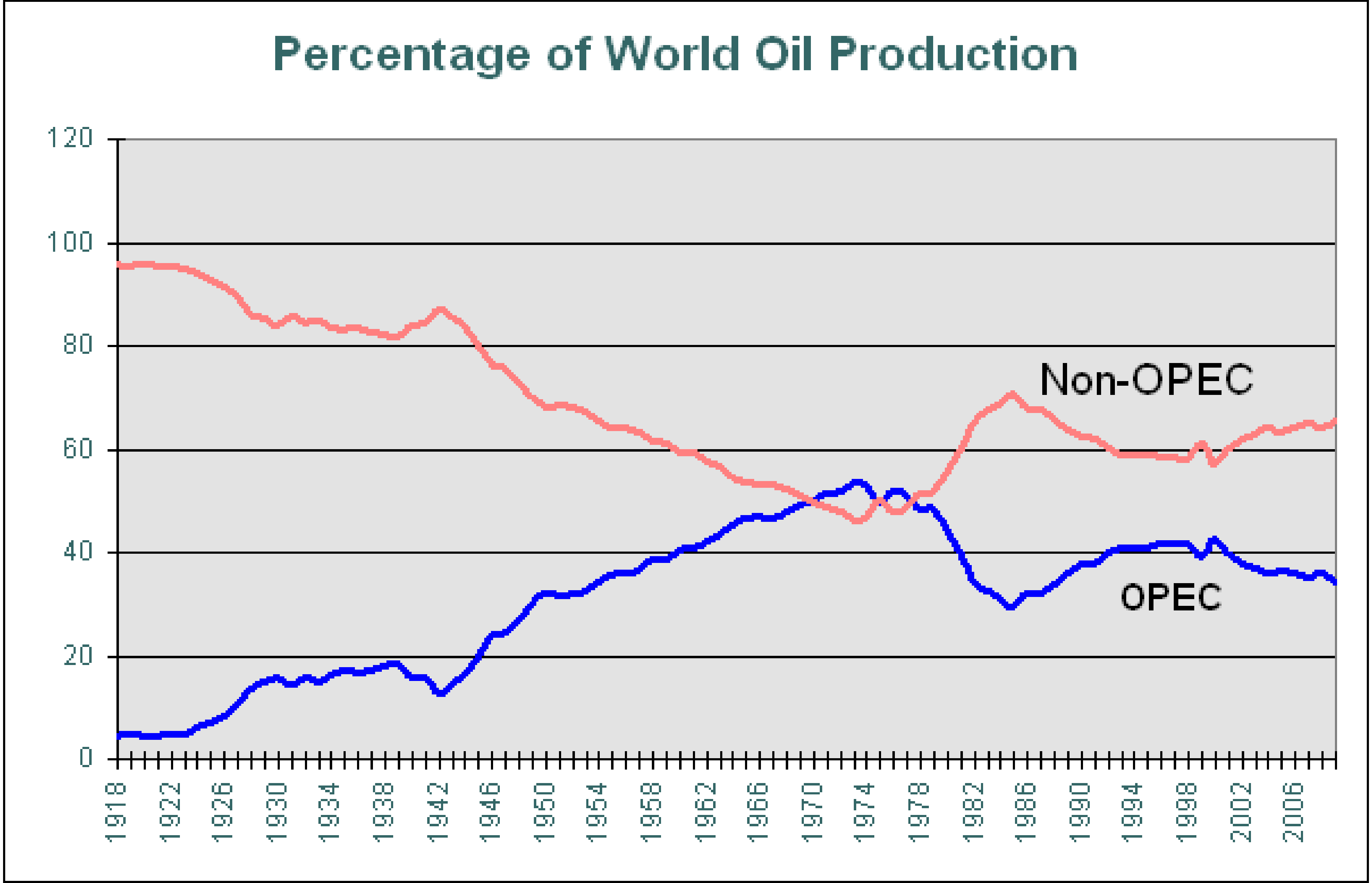


Source: Nalcor Energy

Energy conservation/diversification



Energy conservation/diversification



Oil shocks consequences

"The oil crisis set off an upheaval in global politics and the world economy. It also challenged America's position in the world, polarized its politics at home and shook the country's confidence“

Daniel Yergin, 2013

- The debt issue placed at the center of North-South relations
- U.S. obsession with the Middle East/foreign oil/energy independence begins
- Energy conservation and diversification measures take off
- Long-term weakening of OPEC begins

Discussion: the energy weapon

- What other cases of its use do you know?

Discussion: the energy weapon

- What other cases of its use do you know?
- Under which circumstances it can be effective?