Research Department
Federal Reserve
Bank of
San Francisco
February 1, 1974

Feet of Clay?

The specter of a global energy shortage, long feared by the industrialized world, suddenly seemed closer late last year as supplies ran short of the oil and natural gas needed to fuel the world's expanding industrial economies. The crucial blow, of course, was the November announcement by Persian Gulf producers of a 25-percent initial production cutback and progressive 5-percent monthly reductions until satisfactory conclusion of the war with Israel. Subsequently, the scheduled January reduction was rescinded in favor of a 10-percent increase for that month, after vigorous peace-making efforts began to bear fruit.

Although the severity of the current energy situation is still obscured by inadequacies of available data, the production cutbacks by Arab producers and the series of price increases by these and other producing countries apparently have confronted the industrial world with an emergency approaching crisis proportions. These developments have raised not only the threat of worldwide recession, but also the prospect of severe balance-of-payments dislocations and associated currency problems. The picture may be overdrawn, but the damage already created by these developments suggests to some pessimistic observers that the immensely productive economies of the Western world have feet of clay.

Arabs and the world
The magnitude of the present problem can be judged by the fact that six Persian Gulf states (Iran, Iraq, Kuwait, Saudi Arabia, Qatar and Abu Dhabi) were the pre-crisis source of over 40 percent of the Western world's petroleum. The complexity of the problem can be seen from the varied dependence of the major industrial user nations on this form of energy. Japan, which relies on imported oil for over three-fourths of its total energy supply, normally obtains about 42 percent of its oil from Arab countries. Western Europe is also vulnerable, being relatively less dependent on oil for its total energy needs but relatively more dependent on Arab oil. In contrast, the U.S. has been importing only a third of its oil requirements, with roughly a third of those imports of crude and refined products coming from Arab sources.

To minimize the adverse impact of the oil shortage on output and employment, user nations have taken a number of steps to conserve energy and to allocate fuels to productive uses. This country has taken a number of well-publicized steps to shift energy use away from non-essential activities. Elsewhere, non-essential uses have been restricted even more severely. Sweden (temporarily) and the Netherlands established gasoline rationing programs. Japan has banned the sale of gasoline and the use of private autos on Sundays and holidays, and has also cut back industrial-power consumption. The United Kingdom is on a three-day work week, but the oil shortage has been overshadowed there by the crippling effects of labor disputes

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involving coal miners and railroad workers.

Paying the bill

The impact of reduced Arab oil supplies, coming as it did at a time of emerging longer-term energy maladjustments, has now been exacerbated by the recent price upsurge. October's 70-percent rise to $5.11 per barrel in the posted price of Persian Gulf crude was followed by a doubling of the price to $11.65 per barrel late in December. (The posted price is an accounting base for calculating royalties and taxes due producing countries.) Actual export prices, though lower, rose proportionately. Thus the new posted price corresponds to an actual export price of $7.60 per barrel f.o.b. the Persian Gulf. Landed in Western Europe, this oil commands a c.i.f. price of some $9 per barrel—slightly higher in the U.S. and slightly lower in Japan.

If prices remain at the new level—as they may well do, at least in the immediate future—oil import payments stand to rise enormously. Estimates vary widely, but at the new prices, the added cost of oil imports this year could be in the range of $50 billion.

For the U.S., net imports may rise to some $14 billion from last year's level of around $6½ billion. Japan's oil payments might rise by a similar amount, while Western European countries also face huge increases. Oil imports of the developing countries could rise by more than $6 billion.

Oil import payments of this size would have far-reaching effects on world trade and payments. Large trade deficits are in store for nearly every oil-importing country. Among industrial countries, only Germany had a trade surplus last year large enough to offset the expected increased costs of its oil imports. The less-developed countries will be particularly hard hit. A recent World Bank study indicates that oil payments of 41 such countries this year will more than offset all the foreign aid they are scheduled to receive. If these countries are not to be unduly hurt, increased aid will be necessary, either directly from the oil-exporting countries and the industrial countries or indirectly through international financial institutions.

Handling the windfall

In these circumstances it is not clear how a balanced pattern of international payments can be achieved. The use of oil revenues for economic development in the oil-exporting countries or in other developing areas would benefit the exports of industrial countries and help close their oil-import gap. Development is a long-term process, however, and, in the case of the oil-exporting countries, it would probably be limited by the comparatively small size of their populations. Most of these countries are not in a position to increase their imports from the industrial countries substantially, or at least to do so quickly.

Nor can the balance of payments of oil-importing countries be restored

through trade adjustments with each other, given the magnitude of the adjustments involved. Attempts to do so through "beggar my neighbor" policies, including competitive currency adjustments, would almost certainly fail.

Nor are the monetary reserves of oil-importing countries adequate to finance oil imports for any considerable period at presently prevailing prices. If payment were made in dollars, dollar reserves of a great many countries would soon be depleted. If payment were made in other major currencies, reserve pressures would be eased only to the extent that oil-exporting countries retained these currencies in their reserves.

Recycling?

The most immediate need is to recycle these funds. Although some increase in spending by the oil-exporting countries is to be expected as their exchange earnings mount, most of these earnings probably will be placed for the time being in liquid earning assets, pending decisions concerning longer-term investment. How the oil exporters will invest these funds is a matter of conjecture. But the fact is inescapable—the structure of payments has changed, and oil-exporting countries have suddenly become major potential capital exporters, capable of large-scale investment in industrial as well as developing countries.

Readily accessible channels for these funds are the Eurocurrency market and the national money markets in various financial centers, including New York. Funds deposited in banks in Arab countries (reportedly an objective of some oil-exporting states) would in turn have to be invested in large financial centers where they could be placed with borrowers.

Meanwhile, the International Monetary Fund has stressed the importance of avoiding competitive currency devaluations and an escalation of restrictions on trade and payments. The Fund is also considering a plan for recycling oil-export earnings, whereby the Fund would borrow these sums from the oil-exporting countries and relend them to countries with oil crisis-induced balance-of-payments deficits. The plan has been criticized on the ground that the Fund is equipped to make short- to intermediate-term loans, whereas the balance-of-payments problem, which the plan is intended to mitigate, is long-term in nature.

The currencies which the oil-exporting countries will be receiving constitute a pool of funds upon which the industrial countries potentially can draw to finance their deficits, perhaps by some form of joint sharing of the deficits now in view. The forthcoming (February 11) meeting of oil-importing countries in Washington, D.C. will provide an opportunity for devising not only a program of concerted action, but also some form of mutual support for financing their deficits.

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