BLACK GOLD LOSES ITS SHINE

Michael Bleaney

Oil prices are plummeting. An era is over. The West will certainly benefit. But for Britain it will be a mixed blessing.

THE VIRTUAL COLLAPSE of the Organisation of Petroleum Exporting Countries (Opec) could have widespread repercussions for the world economy. Opec's share of world oil production has shrunk to such an extent that there is really no prospect of oil prices returning to their 1985 levels, in real terms, for the foreseeable future. In many ways this marks the end of an era. The impact of Opec on the world economy during the 1970s was so great that some economists have argued that its actions alone were responsible for transforming the long boom into recession.

The 1950s and 1960s were decades of cheap oil - increasingly cheap relative to other energy sources, so that oil captured a steadily increasing share of the energy market. British oil imports, for example, increased at 8% a year. It was not until 1970 that the producing states began to change this situation by obliging the oil companies to pay more for the raw material, and there was a significant price increase in 1972. In late 1973 the effects of the Arab oil embargo demonstrated that this idea could be exploited much further, and Opec pushed through a four-fold increase in prices. From 1974 to 1978 the price remained fairly steady, but in 1979 a shortage caused by the Iranian revolution again pushed up Rotterdam spot prices, and once again Opec took the opportunity to jack up the official price. By 1982, the price was around $35 a barrel.

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As it turned out, this was the peak. From 1974, slower growth in the consuming countries combined with the gradual adoption of conservation measures, such as more fuel-efficient vehicles, to prevent the demand for oil from increasing; whilst the fast development of new oil-producing areas, such as the North Sea, was undermining Opec's control of the market. Many of these areas would not have been worth exploiting at pre-1973 prices. Opec found itself under siege from both directions: weak demand and competing sources of supply. Increasingly, it could only maintain the official price by deliberate restriction of its own production. But many member countries were unwilling to keep to their production quotas, and could not resist the temptation to engage in surreptitious additional sales. People began to speculate about the break-up of Opec. In 1973 its output had been close to 30m barrels per day. By 1985 its output was down to under 18m, and the whole organisation was depending on the Saudi Arabians to keep their production far below its potential. Efforts were made to persuade Britain, Norway and Mexico to play their part in shoring up the price - but without success.

The present crisis has erupted because Saudi Arabia decided that it would no longer play the game. With the Saudi taps turned on, the price has quickly collapsed. In early February, it stabilised at around $18 a barrel, as a spell of harsh weather in Europe helped to fuel demand. But the price could well fall further, maybe even as low as $10.

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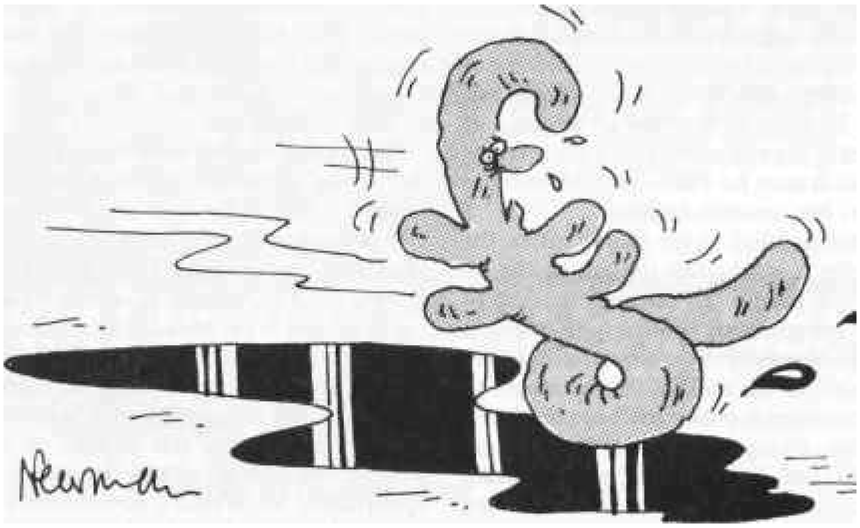
Good news for the West

Generally speaking, this must be good news for the advanced capitalist countries, who are the world's major importers of oil. Their import bill will fall, the price level will be reduced relative to what it would



otherwise have been, and expansionary policies will be easier to pursue because the inflationary pressures will abate a little. Prospects of economic recovery and an end to the growth of unemployment in western Europe must be enhanced. Most eastern European countries will also gain, but the USSR, as a major exporter of energy, will lose, and it is already cutting back its planned level of imports for 1986.

In the short run, the impact of the oil price collapse depends on a number of imponderables. To the extent that the fall is passed on to consumers in the form of lower prices for petrol and other oil products, households will find their real incomes increased and can be expected to

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increase their consumption expenditure. But governments may act to prevent this by raising the taxes on petrol or (as President Reagan is considering) imposing an oil import tax. They may do this because they want to take the opportunity to grab some extra revenue, hoping that the voters will barely notice since the price is falling anyway, or because they wish to maintain the momentum of energy conservation, which would be undermined by a sharp fall in petrol prices. In the case of the United States, where the budget deficit has been a question of major political concern for many years, it is the former motive which is paramount.

On the other hand, the collapse of export revenue will mean sharp retrenchment for the world's major oil exporters. Their demand for imports will fall, and this will exert a deflationary pressure on the world economy. Most economic forecasters seem to believe that the outcome of these conflicting forces will be some net gains in output, but we are talking of figures in the region of, say, a 1% increase in growth rates for 1986 - tangible in other words, but scarcely dramatic.

What is much more important in the longer run is whether the fall in the oil price will permit the sustained pursuit of more expansionary policies, in western Europe especially. Ever since the inflationary crisis of the mid-1970s, the stance of macroeconomic policy has been distinctly cautious, giving higher priority to weeding inflation out of the system than supporting employment. This, more than anything else, is the reason why west European unemployment is currently so high. This policy stance is not going to change overnight, but it can be expected to adjust gradually as the conditions for non-inflationary growth begin to appear more favourable. The collapse in the oil price can only accelerate this process.

The international debt crisis

One of the major uncertainties in the current scene is the impact on the international debt crisis. Some of the major debtors, like Brazil, are oil importers and will benefit from the drop in prices; but others, such as Nigeria and Mexico, are highly dependent on exports of oil. The collapse of these revenues makes it extremely difficult for them to service their debts, and might oblige them to go into default. This could cause a serious financial crisis as banks are forced to write off loans to these countries, with a dramatic deterioration of their balance sheets. If a major US bank actually went under, this could send shock waves through the whole world financial system in a manner reminiscent of the 1930s.

Of course the banks always have the option of covering the prospective 1986 balance of payments deficit of these countries with new loans, but the problem here for a country like Mexico is that the fall in oil export earning capacity is permanent, and comes on top of an already enormous burden of debt. The Mexican are talking of borrowing another $9bn on top of their existing debt of around $97bn. The banks do not want to lend any more unless they can be confident of strong measures being taken to readjust the balance of payments in the immediate future. They know that this means more deflation, which will stimulate popular discontent and might create a political temptation to default. Rather than lend new money, the banks may accept the latest Mexican suggestion of a unilateral reduction of interest rates on its debt to 6% a year.

Although there has been a great deal of discussion about the international debt problem, it is difficult to see how, with competent handling, it could be allowed to erupt into a major crisis. The major debtor nations of Latin America have from time to time engaged in sabre-rattling talk about a debtors' cartel, but in practice since 1982 they have taken strong measures to correct their balance of payments deficits and avoid default. Given this attitude on the part of the debtors, there is plenty of opportunity for Western governments to agree, if the creditor banks cannot, on

Table 1: Unemployment Rates (% of labour force)

	1979	3rd qtr 1985	change
United States	5.8	7.1	+ 1.3
Canada	7.4	10.2	+2.8
United Kingdom	5.1	13.2	+8.1
Fed Rep of Germany	3.2	8.8	+ 5.6
France	5.9	10.1	+4.2
Italy	7.6	10.2	+2.6

some package of soft loans to oil-producing debtor nations.

The effects on Britian

Britain is in the rare position of being both a net oil exporter and also a major consumer. This means that some of the price gains are lost as the exchange rate falls in aniticipation of lower earnings on oil exports. Oil is still cheaper in sterling terms, but other imports are more expensive. The manufacturing sector benefits from increased competitiveness. In the present situation, with UK interest rates relatively high, the government has a clear choice: it can either keep interest rates high in order to minimise the fall in the pound, or let them drop and accept a larger devaluation. The advantage of the second course is that, in time, it would stimulate manufacturing exports and employment. The disadvantage is that prices would increase faster. All signs are that, true to its previous pattern of behaviour, the government is trying to support the pound, and hoping that something somewhere will turn up to reduce unemployment. Politically the government certainly is worried about the unemployment figures, but it cannot risk the one achievement which it *can* claim on the economic front: the reduction in inflation rates.

The big loser from the drop in North Sea oil prices is the exchequer. The tax regime

for the taxpayer, the party is over

is designed to cream off most of the revenue from increases in the sterling oil price, but when the price falls, this goes into reverse. The major oil companies will see some fall in their profits as producers, but can be expected to make most of it up by making smaller reductions in the price charged to consumers. In the expectation of this, their share prices have been relatively buoyant.

The precipitous fall in North Sea oil tax revenue poses difficult problems for the government. Its plan was to repeat the 1983 strategy of sweetening the voters with tax cuts and surreptitious expenditure increases in the run-up to the general election. Preparations have already been made for this by accelerating the programme of privatisation and forcing the gas and electricity industries to raise their prices by more than they would have chosen to do. As a short-term vote-catching measure, financing tax cuts by massive sales of public assets at discount prices is an idea so brilliant that it is recently reported to have attracted the attention of President Reagan. The problem is that in the new circumstances most of the proceeds will have to go on replacing the lost revenue from the North Sea. Fiscal handouts will be a lot more difficult to find.

The party is over

A further major headache for the government is that, unless more tangible signs of recovery appear soon in the British economy, its policies risk being condemned by the electorate as a disastrous and expensive failure. In 1983, criticism could be fended off with the argument that the policies were always expected to take longer than the lifetime of one government to work. That will no longer wash. But if unemployment was clearly on the way down, the government could at least argue with a modicum of plausibility that the benefits of its policies were coming through.

From a political point of view, the most important aspect of unemployment is the impression given by the headline figure announced every month. In December and January the figures gave out some alarming signals, with indications of a renewed upward trend after months of approximate stability. The potential seriousness of this is indicated by the figures in Table 1, which show how much greater has been the increase in unemployment under this government than in other major countries.

Many readers of *Marxism Today* will no doubt believe that the best way to reduce the unemployment figures is to reduce unemployment. This government realised a long time ago that this is not so. The surest way to reduce the figures in a short time is to change the regulations so as to discourage some people from registering (as was done in 1981 with married women) and to expand the special employment schemes. These schemes are flexible and cheap, because the allowances paid are little greater than could be claimed anyway, and every person taken on them is a unit off the unemployment figure. Hence the recent proposal to extend the Youth Training Scheme into a two-year programme. This was applayded by the CBI and the TUC, but it would be naive to believe that the timing of the change is accidental.

North Sea oil production is now just about reaching its peak. It has been responsible for about half of the growth in the British economy recorded over the last decade. The sudden fall in price (which has been accentuated by the retreat of the dollar *vis-a-vis* the pound during 1985) effectively brings forward to the present the effects of the gradual decline in output that was anticipated over the rest of the century. For the taxpayer, the party is over. For the manufacturing sector, it represents an opportunity to come back from the dead. The strategic task for the next government will be to recreate a modern, efficient manufacturing industry out of what is left, and to produce a sustained fall in unemployment. •