ECONOMIC AND BUSINESS HISTORY 22/23

LECTURE 16: THE OIL CRISIS

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Universidade de Lisboa

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PLAN

1. Oil Shock

2. The end of the Golden Age

3. Growth after the Golde Age

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1. The Oil Shock

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Strategic Commodities (1950-89) (average annual price)

	Gold (UK; $/ounce)	Oil (Saudi; $/barrel)	Wheat (US; $/*bushel*)
1950	35,00	1,71	2,23
1970	35,98	1,30	1,48
1973	100,00	2,70	3,81
1974	102,02	9,76	4,90
1980	607,87	28,67	4,70
1982	375,80	33,47	4,36
1989	381,28	17,18	4,61

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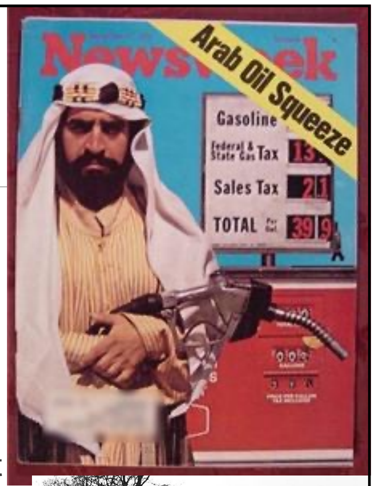
1973 Oil Shock

OPEC countries agreed to abruptly decreased output levels

- First rise in 1973 -4 (oil prices trebbled in 4 months)
- Second Oil crisis 1979-80
- Price peaked in 1985

Widespread recession amongst capitalist economies in 1974

Crisis led to a (then unthinkable) situation of high unemployment and high inflation



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Why an Oil Shock?

- Inflation was building-up throughout the Golden Age (via growing wages and income rises)
- In the 1950s and 1960s the effects of this inflation were smoothed down by the real decline (!) in oil prices
- In the 1970s non-Western economies tried to adjust oil prices to inflation. Check:
  - “*Of course [the price of oil] is going to rise... Certainly! And how!... You've [Western nations] increased the price of the wheat you sell us by 300 percent, and the same for sugar and cement... You buy our crude oil and sell it back to us, refined as petrochemicals, at a hundred times the price you've paid us... It's only fair that, from now on, you should pay more for oil. Let's say ten times more*.” [Persian Shah interviewed by the *New York Times*, 12 December 1973.]

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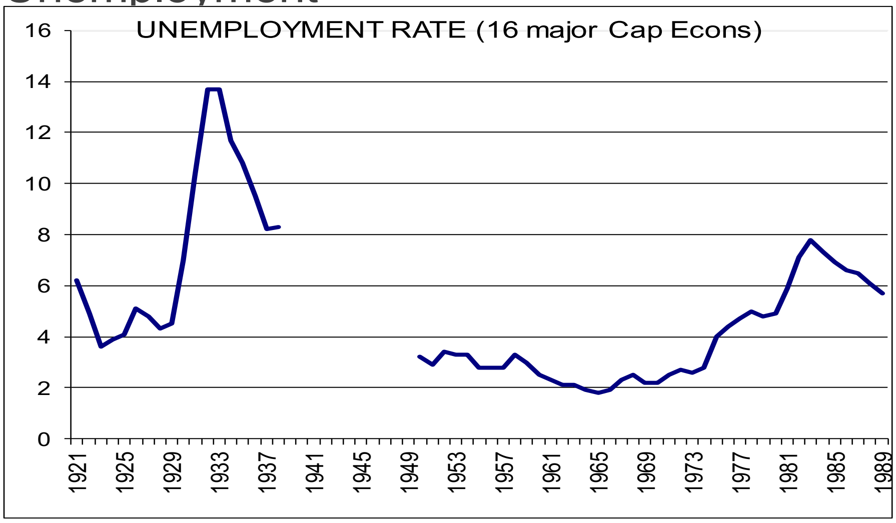
Consequences of Oil Shock: Unemployment



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Inflation

16BigCap Inflation (change in consummer price index; annual rate)		
	1950-73	1973-82
	4,1	**9,6**
Lowest	2,7 (US)	4,4 (Switz)
Highest	5,6 (Fin.)	14,5 (GB)
		Maddison, *The Role…*, p. 174, 188

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External accounts deficit

16BigCap Balance of Payments Surplus (av.; % of GDP)		
	1961-73	1974-81
	-0,2	**-2,0**
Lowest	-2,2 (Austrál.)	-5,1 (Nor.)
Highest	1,6 (Italy and Bel.)	3,4 (Switz)
		Maddison, The Role…, p. 187

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Public Accounts Deficit

	Public Accounts Surplus (average; % of GDP)	
	1960-73	1974-81
France	0,5	-0,9
Germany	0,6	-3,1
Japan	1,0	-3,5
GB	-0,8	-3,9
US	0,0	-0,9
Average	**0,3**	**-2,5**
		Maddison, *The Role…*, p. 182

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2. The End of the Golden Age

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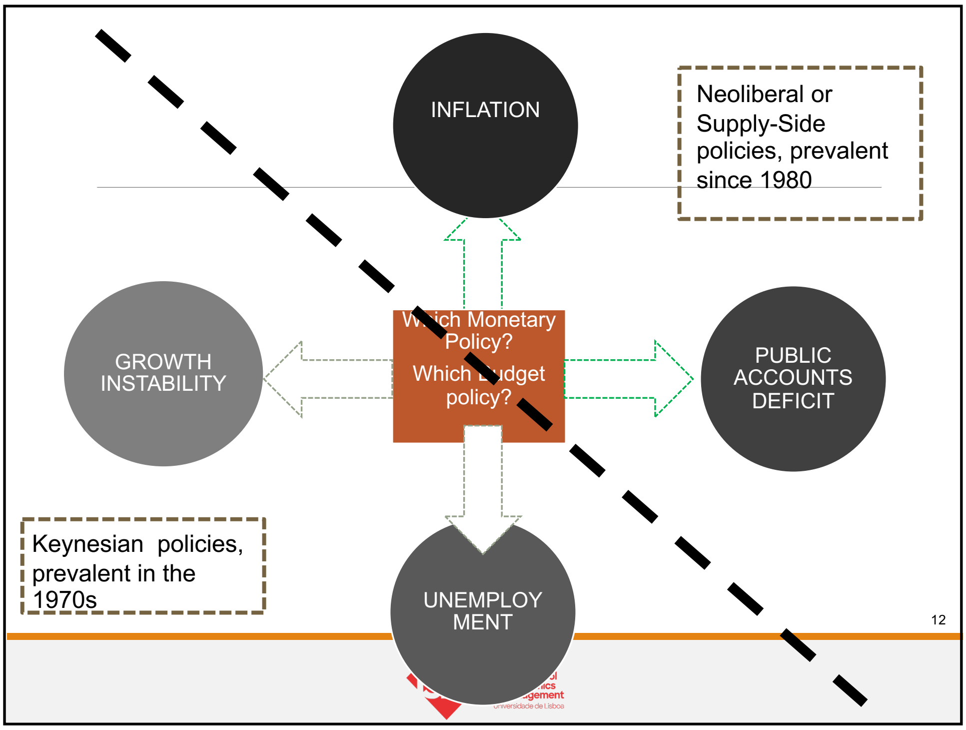

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The End of the Golden Age

Exhaustion of the growth forces
- Exhaustion of the catching-up (end of the 4th Kondratieff innovations)

International System
- Collapse of Bretton Woods and dollar standard
- Oil shocks and loss of competitiveness

Policy reasons
- Shortcomings of social market economy to face crisis became obvious

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Supply-side Policies

From 1980, new governments are elected with one clear mandate: dismembering what Friedman and other economics called the *big government*
- Low taxes
- Reduction of public expenditure
- Check the power of unions
- Providing “sound money”

Did they succeed?

government is not the solution to our problem; government is the problem.

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Results: deficit reduction

	Public Accounts Surplus (average; % of GDP)	
	1974-81	1982-9
France	-0,9	-2,4
Germany	-3,1	-1,7
Japan	-3,5	-0,7
GB	-3,9	-2,9
US	-0,9	-2,9
Média	**-2,5**	**-2,1**

Maddison, *The Role…*, p. 182

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Inflation

BigCaps Inflation (change in consummer price index; annual rate)			
	1950-73	1973-82	1982-9
Average	**4,1**	**9,6**	**4,5**
Lowest	2,7 (US)	4,4 (SWit)	1,7 (GER)
Highest	5,6 (Fin.)	14,5 (GB)	8,1 (Itália)

Maddison 1991, p. 174, 188

BigCaps Balance of Payments Surplus (av.; % of GDP)			
	1961-73	1974-81	1982-9
Average	**-0,2**	**-2,0**	**-0,1**
Lowest	-2,2 (Austrál.)	-5,1 (Nor.)	-4,8 (Austrál.)
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Maddison, 1991, p. 187

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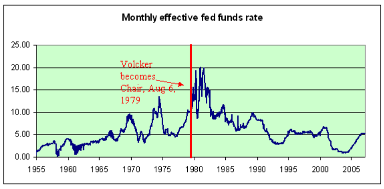
Interest Rates Hike



- The most effective policy tool to fight inflation was the increase of interest rates
- While Germany, Switzerland and Austria tightened interest rates early in the 1970s, the rest of the countries hesitated to do so, fearing the political consequences of unemployment
- Thus, the adjustment was more brutal and controversial in England and the US (where Paul Volcker's interest rates' hike is credited with ending the inflation and allowing a later recovery of employment

http://www.andrew.cmu.edu/course/88-301/phillips/phillips_curve.gif

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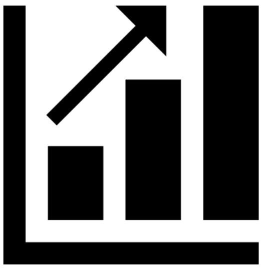

3. Growth after the Golden Age

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Reform-based Growth

Growth level on pair with pre-1914 period

Better conditions for Businesses
- Privatization and decrease of the fiscal burden
- Flexibilization of the labour market
  - Wages increases disciplined
  - Unions loose bargaining power
  - Easier hiring and firing

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Innovations of the 5th Kondratieff

- Services see productivity increases, thanks to IT Technologies since the 1980s
- Privatizations and low taxes stimulate the entrepreneurial ventures and R&D (*supply-side economics*)

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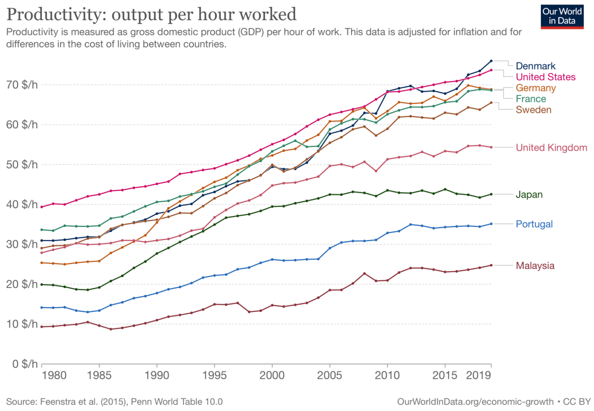
Margin of Convergence with the Leading Economy



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Source: 2020 OCDE

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Energy Price Stabilization

- Energy prices stabilised, as new oil reserves appeared (North Sea, Gulf of Mexico and Alaska)

- New, alternative sources of energy (mostly nuclear
- Start of R&D on renewables)
- Adaptation of technology

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