How 1973 Oil Shock Shocked the World

by Tanweer Akram

OIL is a finite and exhaustible resource. If the rate of consumption exceeds the rate of discovery, it becomes scarce; hence, the oil market is equilibrated by an increase in price. Actually the price of oil is determined by more complex forces due to market imperfections, changing expectations and often destabilizing speculations, and overall global macroeconomic conditions.

As a country's national income rises, its energy consumption rises too. As a result, the demand for oil rises; however, its rise is less proportional than the rise in national income.

High price of oil leads to expanded production, opening of new fields, and greater demand for oil exploration. Moreover, increased price of oil can reduce the demand for oil due to substitution, efficient use, and greater conservation.

Pre-Embargo Mideast Oil Economy

During the colonial eras, the multinational oil firms were able to obtain concessions, that is, the right to explore for and develop petroleum and gas at terms favorable to them throughout the Mideast and elsewhere. The royalties that the Mideast states obtained for their concessions were minimal.

Since early days, the Mideast oil economy was controlled by integrated giant multinational firms, such as Exxon, British Petroleum (BP), Royal Dutch Shell, Gulf, Texaco, Standard of California, and Mobil — collectively known as the "Seven Sisters." The international oil industry was highly concentrated with effective barriers for others to have entry. Originally, the international price of oil was set according to a single-reference point system.

Prior to the early 1970s, the real price of oil was dropping. Indeed, it is the very attempt to prevent this downward trend that led to the formation of the OPEC. Needless to say, the OPEC was unable to arrest this trend in its early years.

Prior to the early 1970s, the real price of oil was dropping. Indeed, it is the very attempt to prevent this downward trend that led to the formation of the OPEC. Needless to say, the OPEC was unable to arrest this trend in its early years.

The changing demand and supply conditions of the 1970s created the objective basis for the price hike: A buyer's market became a seller's market. Moreover, the October 1973 Arab-Israeli war provided the political impetus for the Arab oil embargo against countries that were hostile to the Arab position vis-a-vis the occupied territories and the Palestinian question.

Performance of OPEC and OAPEC

It is widely believed that OPEC's oligopolistic behavior in the global oil market led to the oil shock of 1973 and subsequently to stagflation. Actually, the only price that OPEC directly "controls" is the nominal dollar price of crude oil.

Indeed, it is true that, in 1973, due to the concerted action of its members, OPEC contrived and raised the nominal price of crude oil. However, the ratio of the price of crude oil to the price of OPEC imports is more important for our purpose because that indicates OPEC's terms of trade. This ratio, or relative price, is jointly determined by OPEC, non-OPEC oil-producing states, and OPEC's trading partners, which are mostly industrialized countries.

During the 1973 oil shock, OPEC obtained advantageous crude oil price in terms of trade and, thus, accumulated substantial foreign exchange reserves. Demand and supply conditions in the oil market, in particular the increased dependence of the industrialized countries on imported oil, strengthened OPEC's bargaining position. However, the ability of non-OPEC producers to expand output due to commercial viability and the international inflationary pressures later undermined OPEC's ability to unilaterally raise the price level. As a result, OPEC has been unable to perpetuate its oligopolistic domination of the oil market.

On October 6, 1973, hostilities broke out between Arab and Israeli forces. Under such political circumstances, oil-exporting Arab states were compelled to express solidarity with the "frontline" Arab states, namely, Egypt and Syria, since they were trying to regain lost territories. The oil ministers of six Gulf states met on October 6, and decided to unilaterally raise the price of crude oil. Later, the members of the Organization of Arab Petroleum Exporting Countries (OAPEC) declared an oil embargo against the US and the Netherlands because of their support to the state of Israel. OAPEC ordered a production cut by 25 per cent of the September level and 5 per cent each successive month until the US changes its position on the Israeli occupation of Arab territories. The oil market reacted immediately and the posted price of oil quadrupled. In addition, OPEC countries declared that they will henceforth have a greater "participation" in the oil concessions, which again increased their revenue and extended their control.

The output reduction and embargo made sharp escalations of oil prices feasible. This was also the first time that the oil-exporting countries decided to determine the price and the quantity of production independently of the oil companies.

It is widely believed that the first oil shock pushed the economies of the industrialized countries into the 1973-1975 recession. In the West, public opinion and the media held the OPEC, especially the Arab states, responsible for the slowdown in economic activity. Actually the downward trend in output had started prior to the oil shock. The general environment of the early 1970s, particularly the international monetary crisis, US balance of payments disequilibrium, increasing mobility of financial capital, suggests that the oil price hike was not the sole cause of the recession.

The OPEC states themselves were not insulate from global inflation. The stagflation of 1973-1975 also put a downward pressure on oil prices.

Although the oil embargo created the momentum for US "shuttle diplomacy" in the Mideast, the political gain for the Arab states was limited.

The oil-exporting Gulf countries are now much more dependent on the West for their economic growth, development, and modernization. Moreover, the entry of several non-OPEC producers has changed the structure of the international oil market. Hence, the Arab are unlikely to benefit from an embargo in the near future.

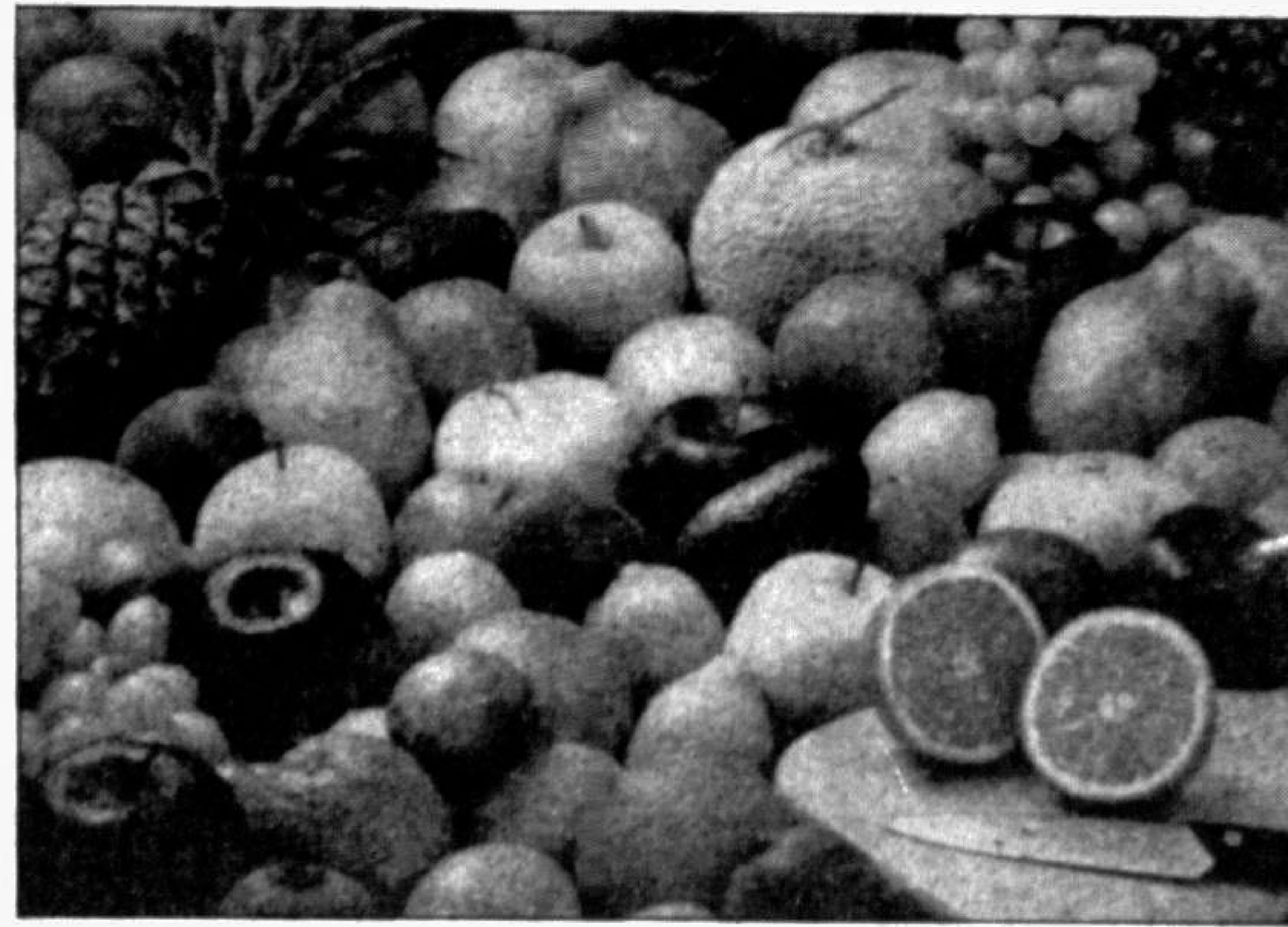
[Tanweer Akram is graduate student in International Political Economy and Development at Fordham University, NY.]

Fruit Juice Enjoys Sweet Global Sales

by George Javier

GLOBAL sales of fruit juices have grown steadily over the last few years, auguring well for Third World countries unable to cash in on fresh fruit exports.

A new study conducted by the International Trade Centre (ITC), shows that total world trade in fruit juices reached almost US$4 billion in 1989 and further went up to an estimated US$5 billion in 1990, a three-fold increase in value terms since 1980.



Fruits prove to be fruitful, financially too.

This trend is especially significant for developing countries since they account for about half of total world exports, says ITC, an executing agency of the United Nations Development Programme (UNDP) and a joint subsidiary organ of GATT and United Nations Conference on Trade and Development (UNCTAD).

Funded by UNDP, ITC help developing countries establish national trade promotion strategies, look for sales opportunities for exports and market the products effectively.

Brazil thus far is the largest juice exporter, and a number of other developing countries also supply fruit juices and pulp on the international market.

In Asia, the major exporters include India, the Philippines and Thailand, according to ITC.

Orange juice tops the world market, accounting for US$2.2 billion in sales in 1989, or 56 per cent of the total traded. Pineapple juice exports were placed at US$174 million, followed by grapefruit juice at US$158 million, citrus juices at US$109 million and tomato juice at US$22 million.

Imports of juice of other fruits or vegetables (apple and grape, for example) totalled US$987 million, while mixtures of juices reached about US$116 million that year.

The study did not provide separate trade statistics for tropical fruit juices and concentrates (other than pineapple). But estimates placed annual world trade in these commodities as ranging from 175,000 tons to 200,000 tons in single-strength equivalent, valued at between US$175 million and US$200 million.

The three leading tropical fruit juices traded, apart from pineapple, were banana, passion fruit and mango. Together, these account for about three-fourths of world exports of tropical fruit juices and pulps, excluding pineapple. This trend is particularly appealing to developing countries like the Philippines which has been a major producer of banana and mango.

The study has a bright note for citrus juices, particularly oranges which, it says "are expected to remain in the lead in world trade," since these juices exist in large quantities and are well accepted by consumers in most markets.

Prospects for individual fruit juices, concentrates and pulp may vary from one market to another, says the study.

Leading import markets for fruit and vegetable juices are the United States (with imports worth US$900 million in 1989), Germany (US$637 million), United Kingdom (US$386 million), the Netherlands (US$305 million) and France (US$293 million).

Together, these countries accounted for almost two-thirds of total world juice imports in 1989.

Other market in decreasing order of import value in 1989 were Canada, Japan, Belgium and Luxembourg, Italy, Saudi Arabia, Sweden, Austria, Switzerland and South Korea. Countries that appear to offer increased sales opportunities in the next few years are Japan, South Korea and other Asian nations that have not been traditionally major consumers.

— *Depthnews Asia*

No Fast lanes for Car Makers

by Prakash Candra

INDIAN car manufacturers say they may soon have to administer the last rites to their ailing industry. And they are holding the government responsible for their precarious existence.

Industry sources say unless the government comes out with a rescue package soon, some car manufacturers will have to close shop before the end of 1992. This means loss of jobs for thousands of people and reduced investment.

And Indian companies may be forced to link up with American or British car makers to survive.

Local car producers say they are suffering from a severe recession which has left them with a growing "pile" of unsold cars. Figures submitted to the government by the car makers — Premier Automobiles, Hindustan Motors and Maruti Udyog Limited — showed that some 13,000 cars worth 2,600 million rupees (US$92.8 million) remain unsold.

The paper *"Business Standard"* said Premier Auto has the most number of unsold cars in its hands - some 7,000 units remain in its inventory. Maruti Udyog has the least with 1,300 and Hindustan Motors account for the rest.

The car makers say their troubles started with the Gulf War last year. Sales figures started falling after the war. At that time, the problem was felt mainly by Hindustan, which had trouble selling its "Ambassador" model, and Premier, which had problems with its "Padmini."

But now they have been joined in their woes by Maruti, which has a tie-up with the Japanese firm Suzuki.

Already, car makers have started cutting back production by 40-50 per cent. Production of some models has been stopped altogether.

Industry sales figures show that as of November, 1991, only 3,000 cars were sold as compared to 5,179 in July. Sales involved mainly the Maruti 800 model, which is a great petrol saver and a favourite of the Indian middle class.

But bigger models particularly the Omni Van, were increasingly becoming difficult to sell although 1,257 units managed to move in November.

Despite advertisements which tell consumers: "Hurry. They are disappearing," and price reductions of as much as 20,000 rupees (US$715) for each Omni, customers are still reluctant to reach for their cheque books and purchase the car.

For the growing resistance of consumers to the industry's most dazzling blandishments, car makers only have the government to blame.

A major complaint is the excise duty which has gone up from 35 to 66 per cent. Car makers say this has combined with the sharp cut in depreciation loss allowed to the industry, reduced from 33.3 to 20 per cent, is making their products less affordable.

One of the sharpest critics of the government is RC Bhargava, managing director of the Maruti, a public sector firm which brought the automobile industry into high gear in 1983. He says "The government's policies have caused a slump in the industry. It has become customary for every government to hike the excise duty on cars in every budget. But this time it has gone beyond the critical point and the customer has refused to take it any more."

Vinod Joshi, another top automobile executive, notes that individual buyers are only a small percentage of the industry's customers, the bulk being the government and private companies. But cash flow problems are making even these major buyers less than eager to purchase new vehicles. With banks and financial agencies in deep trouble, interest on a car loan can be as high as 30 per cent annually.

Says CK Birla of the Birla family which owns Hindustan Motors: "The cash crunch has hit the Indian corporate sector very badly. Companies are no longer buying cars at the same rate as they used to. Since their own companies are facing trouble, car purchases have been postponed for better times."

The government itself seems bent on making this happen soon. Following Prime Minister Narasimha Rao's order for sharp cuts in government spending, Finance Minister Manmohan Singh ordered a 10 per cent cut in national budgets. The use of petrol has to drop by at least 20 per cent.

The government also told its employees that the use of cars is not a necessity but a luxury, especially with the country facing a severe shortage of foreign exchange, which means less dollars to pay for oil from the Middle East.

A senior official said, "We have to cut down on government expenditure. If it means a halt to buying cars and other equipment, it just cannot be helped."

Mr Birla said, "The sale of 'Ambassador' cars was sustained by government orders. But with the (cost-cutting) drive we have been badly hit." But even non-luxury vehicles, like jeeps, are not faring so well.

The big firm of Mahindra and Mahindra, which produces jeeps for the Army, other government units and the rural sector, has also fallen on bad times. Last year, the company sold 57 per cent of its product to the rural sector.

Already, car makers have started cutting back production by 40-50 per cent.

Car industry insiders say that without government relief, it is only a matter of time before mass layoffs and voluntary retirement schemes are effected. They also say that trade unions will have to accept the inevitable displacements and reorganisations that will occur.

Into the Valley of Debt

FOR every day of the past six years that Philippine President Corazon Aquino has been in office, her country has been paying US$6 million to service its foreign debt.

Payments on the total US$30 billion borrowings eat up nearly 43 per cent of the South-east Asian nation's annual budget. Their is little left to look after the health and education of Filipinos, or to restore the country's deteriorating environment.

"It is the burden of debt that in part impels the government' to persist with exports of hardwood timber at a level that is plainly not sustainable," says Norman Myers in a report on the Philippines commissioned by the World Bank.

Third World leaders who attended the Earth Summit in Brazil in early June argued that debt servicing, low commodity prices and trade protectionism are diverting their precious resources away from nature conservation.

Today, the Third World is 60 per cent more indebted than it was ten years ago. And it is the poorest people in poor countries that are hit hardest as government bend over backwards to keep international banks happy. Developing countries also want the industrialised north not compensate them for keeping the poor from using up their forests, corals and mangroves.

To be sure, foreign debt is not the only reason why forests have disappeared in some developing countries. One big factor is the greed and corruption of local political business elites. Today, the Philippines has one of the lowest rates of rainforest loss in South-east Asia — mainly because there isn't much forest left to cut. Most of it was shipped to Japan in the 1960's.

But whatever the reasons for past plunder, experts say it is the Philippines' monstrous debt burden and its puzzling persistence to pay back every cent of it that is driving the country to take unsustainable economic short cuts.

The Philippines is growing pineapples, bananas, sugarcane and coconut for export so it can earn hard currency. But Myers says prices for these commodities are at an all-time low, and do not reflect the true ecological and social costs to the country.

Pineapple and sugarcane plantations occupy huge swaths of the most fertile lowlands of the Philippine islands like Luzon, Mindanao and Negors — forcing landless peasants to the hills, where they slash and burn forests to survive.

When she came to power in 1986 in a 'People Power' uprising, Aquino inherited nearly US$26 billion of foreign debt amassed by former dictator Ferdinand Marcos. Aquino refused to use her immense popularity to get the largely-odious loans written off, and proceeded to demonstrate to foreign bankers that the Philippines was a model debtor.

Philippine President Corazon Aquino is stepping down this month, but her decision to honour the country's Philippine foreign debt may condemn her country to years of environmental neglect. Kunda Dixit of IPS reports.

Advisers like her former Economic Planning Secretary Solita Monsod quit in disgust. Today, Monsod is one of the harshest critics of the Aquino debt policy. "We had the world eating out of our hands in 1986," Monsod said in a recent IPS interview. "IF you don't ask for debt relief with fire in your eyes and use every bit of leverage you have, the creditors will spit on you. We have been spat upon."

A report by the United Nations Development Programme (UNDP) last year said debt reduction was essential for the country's economic recovery. "If creditors prove unwilling to grant debt relief, the government should simply default in payment without paying for moratorium," the report said.

Critics say the policy of trying to be a darling of the creditors to get more development aid and seek rescheduling rather than write-off has backfired. The Philippines is mired deeper in debt and poverty.

An effort recently to get a US$4-billion debt rescheduling agreement with the International Monetary Fund (IMF) ran aground, and the decision has been deferred to the new government.

Aquino officially transfers power on June 30 to her most likely successor : former general Fidel Ramos. Economists say Ramos' debt policy will be pro-export, pro-big business and even more conservative than Aquino's.

Perhaps the most glaring example of tainted Marcos-era loans is a US$2.6 billion nuclear power plant 100 km northwest of Manila. The reactor sits on an earthquake fault and near a string to volcanoes, including sizzling Mt Pinatubo which erupted last year. A study also found serious construction defects.

The plant was mothballed in 1987. But faced with a crippling power crisis this year, the Aquino government settled out of court with the US manufacturer Westinghouse to rehabilitate the plant. The Philippines is still paying US$300,000 a day just to service loans for this nuclear power plant that has not generated a single watt of electricity.

Robert Pollard, a nuclear safety engineer with the Washington-based 'Union of Concerned Scientists' wrote to Aquino in May, saying he had grave doubts about whether the plant could be run in a manner "both safe and economical."

Debt repayment is a life or death issue for the Philippines. The US$42 million the Philippines pays every week to service its foreign debt is money taken away from supplemental feeding programmes for children, sewerage treatment plants, drinking water projects and vaccination campaigns.

It is difficult to quantify the human loss of the debt crisis, but the Manila-based Freedom from Debt Coalition has tried. It says one Filipino child dies every hour because money to take care of it is missing.

Bombay Broker Rocks India's Banking System

A mere share-broker known to only a small circle of investors in Bombay has suddenly become a household name.

He is Harshad Mehta, 37 and flamboyant, who is being investigated for a security scam involving billions of rupees.

Mehta has acquired the distinction of rudely disturbing India's financial system and casting a dark shadow over the new liberalised economic policies of Prime Minister Narasimha Rao.

Although he has become a notorious national figure, it is not yet clear whether he will go down in history as a skilful manipulator or a crook like Wall Street's wheeler-dealer Ivan Boesky or junk bond dealer Michel Milken.

Even after his house was raided by authorities in February and his business premises sealed, he was able to write cheques worth Rs 6.2 billion to the State Bank of India, the country's largest bank, and Rs 2 billion to the Bombay Stock Exchange to settle his accounts.

The name of the burly broker has even figured in Parliament, where the biggest financial scandal in India's history has caused immense embarrassment to Rao and his finance minster Manmohan Singh.

Mehta, popularly known as the Big Bull of Dalal Street (where Bombay's stock exchange is located), is being investigated by the Central Bureau of Investigation (CBI) for fraudulent securities' dealings.

Until recently Mehta was the oracle of Dalal Street, the king of the stock market. He received a great deal of media attention, with business publications featuring him on their covers and video shows seeking his advice for their viewers.

He was identified with the euphoria in the stock market generated by the government's new economic policies. He became the darling of investors, big and small, who marvelled at his brains, guts and megabucks.

Today, Mehta is a different person. The CBI has issued orders to seized his properties, while the banks have been told to seize his and his family's accounts. The family has had its membership rights to the Bombay Stock Exchange suspended.

According to market sources, the value of his stocks has dropped drastically from an estimated portfolio of Rs 20 billion to Rs 8 billion. His personal worth is, however, estimated to be Rs 1 billion.

Harshad Mehta
A stock-market sensation involved in India biggest financial scandal.

His rags-to-riches story began 10 years ago, as a clerk in an insurance company, earning less than Rs 2,000 a month. In a decade he became the richest individual in India, if the tax he paid is any criterion — he paid an advance tax of Rs 260 million for 1991-92.

The fast-talker was born into a Bombay cloth merchant's family which moved to Raipur, in central India, and enrolled him in a convent school. But he did not have his heart in studies and had to leave school because of his rowdy behaviour.

He finished his schooling privately and tried his hand at more than a dozen different jobs, including running a library for children, selling cement and hosiery and sorting diamonds. During this period he graduated from a Bombay college and took a job as a clerk in an insurance company.

The stock exchange opposite his office attracted him. He resigned and joined a broker in 1980. Four years later he bought his broker's card for Rs 150,000.

Mehta had his ups and downs in the early years of his career as a broker. The big break came after he moved into the securities market 18 months ago with invisible funds of Rs 1 billion, using banks to finance his stock market deals.

He is no run-of-the-mill stock broker. His success is largely due to his financial shrewdness and the knowledge available from employing experts, including some top retired bank officers.

Mehta understood the implications of the new economic policies — the middle classes pumping into the share market colossal sums of money previously locked into the low-interest savings bank accounts or government securities — and cashed in on the opportunity.

He brilliantly used the banking and stock market systems to his advantage, funding and exploiting loopholes along the way. He understood the complicated securities market and used it to generate billions, which he pumped into the stock market.

Mehta sold the banks bonds or securities (debt papers issued by the government to raise money for its expenses). The banks then issued receipts acknowledging the transaction.

In his case the receipt was a bogus instrument not authorised by the Reserve Bank of India (the central bank). Mehta used these receipts for his giant operations.

Mehta, who has influential friends among industrialists, politicians and senior civil servants, asserts that he is innocent. Will business houses that benefited from his operations come to his rescue? Will the government treat his with kid-gloves because any drastic action against him might bring down the stock market and end the euphoria of the new economic policies?

One thing is clear : he has exposed the gaping loopholes in India's banking system. The crucial question now is : Will the government be able to correct the aberrations in the country's financial system?

— Gemini News