Hans Apel, The oil-price shock and its aftermath

Caption: On 14 October 1975, at the International Energy Conference organised in Bonn by the Friedrich-Ebert Foundation, Hans Apel, Finance Minister of the Federal Republic of Germany, discusses the causes and the consequences of the global economic recession.

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The oil-price shock and its aftermath

The causes of the world economic crisis

The sudden fourfold increase in oil prices in late 1973 undoubtedly shook the foundations of the world economy and sent it deeper into recession. It is, however, wrong to maintain that this sudden increase in prices was solely to blame for the present worldwide recession. The truth is that other critical developments had already unbalanced the world economy.

An indication of this was given when the firmly established rules of the Bretton Woods Agreement broke down in the spring of 1973. This system of fixed exchange rates, which, after all, shaped nearly 30 years of post-war history, could no longer be maintained in the face of the monetary and economic policies being pursued. The supremely strong reserve currency that was needed for this system — a function fulfilled by the US dollar after the Second World War — had been gradually eroded, partly because of US involvement in the Vietnam War. There were more and more signs of imbalance, and these ultimately assumed dramatic forms. For the countries in surplus, the potential represented by international liquidity posed a permanent threat of additionally importing inflation. To avoid revaluing their currencies, they had to buy in currencies. At national level, tight credit policy measures provided only an inadequate means of countering this massive increase in the circulation of money.

Other Western trading partners, on the other hand, were suffering as a result of the substantial withdrawal of the international means of payment that they needed, since they were not in a position to keep the movement of prices at home under control. That had no direct effect on the system of fixed exchange rates, however. Even the outflow of currency reserves was not enough to force the imposition of national discipline measures under this system, since international liquidity had also increased to such an extent in this period that world trade partners did not, initially, experience any pressing problems.

The result was inflation on an unprecedented scale in almost every country of the Western world. In these years before the oil price explosion, only a few countries had the courage to do anything about such massive inflation. Their efforts were constantly defeated by external factors, however, because of the direct link between currencies. No doubt we all still remember the German economic policy efforts made prior to 1973 to escape this situation through national measures and international cooperation. National measures were, however, only effective once national economic policy gained momentum and validity through the abandonment of the Bretton Woods system and the introduction of floating exchange rates. German economic policy has, therefore, safeguarded the economy against external factors only since 1973. Its successes are obvious today in the degree of price stability that we enjoy.

The changeover to ‘floating’ exchange rates

We all know that the changeover to the system of floating exchange rates has generally gone much more smoothly than had initially been anticipated. On the other hand, there is no getting away from the fact that this system of floating exchange rates, to which I see no real alternative at the moment, is creating additional problems. Some 40 % of the Federal Republic’s exports are to countries in the European currency bloc with which we have fixed, but adjustable, exchange rates through the ‘currency snake’ system. Some DM 140 000 million worth of exports, however, go to economic areas that have either free-floating currencies or a currency otherwise subject to frequent fluctuations. A 1 % change in the value of the German mark against the currencies of foreign trade partners in these economic areas therefore means in principle a gain or loss of some DM 1 400 million to the German export trade. The mark–dollar rate has fluctuated some 10 % since the beginning of the year, however.

This highlights the degree and extent to which the system of floating exchange rates creates additional world trade risks that cannot be averted, even by extremely skilful forward transactions and other forward exchange cover measures. The call for a gradual return to fixed exchange rates is, therefore, understandable, although there is no way of generally moving towards this goal under the IMF while the major world trading partners’ economic and monetary policies are so divergent. With inflation in Britain currently running at

over 25 % and at some 6 % here, there is simply no possibility of a fixed sterling–mark rate, for example. A system of fixed exchange rates requires a willingness to take harmonious and coordinated action in the area of internal economic and monetary policy amongst others, and all the partners have to abide by the rules of the system. We must not lose sight of the goal of returning to less variable exchange rates, however. We therefore actively support anything that brings us closer to this goal, provided it is a real solution and is not likely to lead to new currency crises. It is, therefore, important to continue along the path that has worked so well in practice; in other words, the gradual development of the European currency bloc with its fixed but adjustable exchange rates. This is why the Federal Government is urging that Switzerland be allowed to join this currency club.

The effects of the oil-price shock

The oil-price explosion hit the world economy at a time of considerable instability and increasingly divergent economic policy on the part of the major trading partners. It heightened this instability in much the same way as the straw that breaks the camel's back. In fact it took the oil-price shock to highlight the shakiness of the world economy. In saying this, I do not mean to play down the significance of oil prices to the world economy. I do, however, wish to make it clear that it is wrong to lay the blame for our current problems solely at the door of the oil-price hike. The recession would have happened even without the oil-price shock, although the duration and depth of the recession are the result of the massive increase in the cost of energy and future oil prices.

Some twelve months ago, we expected the oil-exporting countries to report balance-of-payments surpluses in the region of US$ 60–70 000 million, while the industrialised nations were expected to report balance-of-payments deficits of US$ 35 000 million and the developing countries US$ 30 000 million. This outlook threatened the world economy at the time. In the Federal Republic, however, it did not have serious foreign trade repercussions that would have led to depletion of our currency reserves in either 1974 or 1975. Even if the OPEC countries' currency surpluses had materialised to the extent initially anticipated and had been used largely to invest in the industrial potential of the OECD countries, this would ultimately have accounted for only 10 % of gross investment in the OECD countries.

The Western industrialised nations did not report deficits of the size anticipated because of the deep recession and the need to make energy savings as a result of the increase in the cost of energy on the one hand and the unexpectedly sharp rise in imports by the oil-producing countries on the other. The oil-producing countries' surpluses will be lower (IMF: US$ 50 000 million); the industrialised nations' balance-of-payments situation will look much better (current account deficit of some US$ 10 000 million), while that of the developing countries will be even worse than expected (a deficit of US$ 35 000 million). The fear of a crisis where some Western industrialised nations were unable to pay their way therefore proved to be unfounded.

International aid mechanisms

The frequently mooted catastrophic collapse of the industrialised nations did not materialise because international currency cooperation at all levels worked better than expected. So the previous 12 months had been put to good use, not only in making bilateral arrangements but also in creating a number of aid mechanisms within the OECD and the EEC and in the IMF, all designed to bridge and finance balance-of-payments deficits caused by the price of oil. Through these mechanisms, US$ 25 000 million are available from the OECD to help particular trading partners overcome acute balance-of-payments deficits that threaten free world trade, while US$ 3 000 million are available from the EEC and US$ 9 000 million from the IMF.

Although we hope that we never have to take up these offers, it is not beyond the realms of possibility that, one day, these mechanisms will have to be activated. We do not know what form the emerging economic upturn will take. Nor do we know how much of an upturn there will be. And so we cannot yet make reliable predictions about energy consumption trends in the wake of the upturn. Despite relatively low energy consumption levels at present, we must, however, continue to pursue our aim of making energy savings a

top priority in the long term as well. But we must also step up our efforts to develop new sources of energy. Nonetheless, some trading partners may experience financing problems during the next upturn because of the price they have to pay for oil.

I do, however, also think it important not to overlook the dangers posed by worldwide inflation even during the deep recession we are in at present. Many of the acute structural problems in the world economy are still being disguised by massive price rises. But these problems have not gone away. In coordinating our worldwide efforts to combat the recession, we must already think ahead to the next step. Overcoming the recession by unleashing inflation worldwide is not a solution; it marks the next setback.

The developing countries that are not exporters of petroleum or of expensive raw materials already find themselves in an economically untenable situation. So the international family of nations is faced with new obligations. I do not intend to dwell on the moral aspect of this issue here. However, the plain self-interest of all those of us involved in world trade is enough to compel us to pay much more attention to this problem than we have done in the past. The developing countries are also our customers, and the industrialised nations cannot be indifferent to the complete collapse of their markets and their purchasing power. On the other hand, we also know that it is the developing countries in particular that are currently having to pay the price for the worldwide recession. Their exports of raw materials and semi-finished products to the industrialised nations account for a substantial proportion of their revenue. A collapse in the prices and volumes of these exports has devastating consequences in these countries. This interdependence highlights the immense interest that the developing countries must also have in the stabilisation of the world economy.

Raw materials and development problems will be discussed with the same urgency as energy matters at the forthcoming conference of oil-producing and oil-consuming countries. In the organisations already in existence, we are, at the same time, trying to use the available resources to help the developing countries, particularly those hardest hit by the oil price rise. It is of the utmost economic importance, particularly to the developing countries which export raw materials, that work on the amendment of the IMF agreement is completed.

New IMF agreement in sight

We largely reached agreement on the questions of quotas and gold in Washington a few weeks ago. The 32.5 % increase in quotas gives the IMF greater scope in its lending, and that benefits the countries with balance-of-payments problems. It also increases the influence of the oil-producing countries by doubling their voting power. On the subject of gold, there was agreement that, in future, central banks should also be free to buy gold, whereas, previously, the law allowed them only to sell. The G-10 countries will impose certain restrictions on their own gold purchases and sales. The intention is that the total gold reserves of this group of countries, including the IMF, will not be increased by gold transactions, initially for a period of two years. This is in line with the generally accepted aim of demonetising gold. For the time being, we want to use only part of the IMF's gold holdings, amounting to some US$ 6 500 million at the current official price. One sixth of the gold is to be returned to member countries according to their quota subscription, and one sixth is to be sold on the market or to monetary authorities. The revenue from the gold sales, amounting to some US$ 2 500 million, is to be used to benefit the developing countries, especially the poorest among them. We are thinking of creating a Trust Fund, to be closely linked with the IMF. This Fund will hold the difference between the official price and the market value, which it will then pass on to the developing countries in the form of loan and interest-rate subsidies, also in conjunction with any revenue stabilisation. We are also thinking of using the profits from gold sales to set up an interest subsidy fund for certain World Bank loans, known as the World Bank's 'Third Window'. It is, however, vital that the decisions of principle reached in Washington should become actual policy as soon as possible. We would have to be in a position to take the relevant decisions at our next meeting, no later than early 1976.

More international cooperation essential

What will happen now? It is a truism to say that we need a much greater measure of international cooperation than before. Even the oil-exporting countries have recognised that it is not in their own interests

to keep putting up petroleum prices. Recession and the social upheavals that follow cannot be contained. They spread like wildfire, causing existing problems and difficulties to spiral out of control. If we do not wish to sink into this abyss, the dialogue between oil producers and oil consumers simply must be resumed over a broader range of topics and a broader geographical area. Talking brings better understanding.

We must also make efforts to achieve a world monetary policy that is, to some extent, concerted. We shall have to put up with floating exchange rates for a while longer. And so the political cooperation and political will of those responsible will take the place of established and familiar arrangements. The present world monetary system requires more, not less, activity on the part of politicians; it requires more, not less, insight into the interdependence of world economic relationships; and more, not less, consideration for one’s partners.

We must, however, also recognise that we shall not succeed with unilateral projects that serve our national interests in the short term. Anyone who thinks that he can solve his own problems in the short term by a rigorous improvement in raw materials or petroleum exports or through a rigorous restriction on imports is mistaken. That is why we are expressly supporting the revenue stabilisation debate and have also made our own contribution to it. That cannot, however, mean opting for arrangements that are untenable. After all, we have learned one thing from the past years of mounting world monetary crises: policy cannot be directed against market forces in the long term.

Responsibility on the Federal Republic’s shoulders

Finally, in the decades stretching before us, we shall be constantly reminded of the need to find new energy sources and to secure the world’s energy supply. The oil-price explosion was a shock to our system, and it will take us a long time to get over it. It has, however, made it spectacularly plain to us that the future of humanity will depend very much on whether we succeed in meeting the increasing demand for energy at reasonable prices. The market economy cannot do it on its own. What is needed is forward-looking national and international budgeting and planning by both government and industry. The Federal Government has adopted an ambitious energy programme for this purpose at national level. We should lend our support to energy being sold at prices that truly reflect the longer-term scarcity of the particular energy sources, wherever possible. In the short term, that may well put pressure on consumers. In the longer term, however, a price policy of this kind, combined with efforts to develop new energy sources, can make a significant contribution in terms of maintaining the future prosperity of the Western world, at the same time enabling more and more people to enjoy that prosperity. Our country, like the rest of the world, is too dependent on the supply of energy for us to be able to sit back and do nothing.

The Federal Republic bears considerable responsibility for the future of the world economy.

Our drastic measures to stabilise the domestic economy have not been without effect. We were able to stabilise demand at home, which also had a positive effect on our imports. In the first seven months, they were up 1.4 % on 1974 in real terms. At the same time, our volume of exports fell by 12.7 % in real terms. The situation was exactly the opposite over the same period in 1974. Imports were down 2.6 % on 1973 in real terms, while exports were up 17.3 %. This makes it clear, however, that we are not exporting our problems, even though they are largely the result of the worldwide recession. Our measures to stabilise the domestic economy are also designed to help boost the worldwide upturn that is needed and to meet the responsibility that we, along with our partners, have for the future of the world economy. We intend to continue shouldering this responsibility in the future, and we have made our currency reserves available to help overcome pressing problems.

On the basis of this responsibility, we are prepared to shoulder financial obligations, as we have proved by our bilateral and multilateral participation in international financing mechanisms. The Federal Republic has played its part in all financial solidarity actions by direct lendings, by giving guarantees and by granting credit lines.

In the case of the OECD assistance fund, we took on just under DM 7 500 million — the second-highest

quota after the USA; in the case of the EEC loan, we are liable for up to DM 1 500 million of the sum available from the Community; under the EEC assistance mechanisms, we may have to come up with as much as DM 10 000 million; we contributed just under DM 1 000 million to the IMF oil facility; and the German Central Bank has also made swap arrangements worth nearly DM 7 000 million. These figures demonstrate unequivocally the Federal Republic's willingness to commit itself internationally, even if it means financial sacrifices. We are amongst the frontrunners when it comes to contributing to greater international solidarity and mutual assistance, although we are also doing this in the national interests of which we are well aware. Both our prosperity and the output of our business community and its employees stand and fall with world economic trends and the free growth of world trade. That applies equally to all our partners, however.

We shall continue to do our bit. What we cannot and will not do is to promise more than we can deliver. After all, that would not help anyone. The facts are serious enough. A considerable degree of imagination and political authority is needed to find answers to the challenges in the years that lie ahead of us.

We have no reason to give up.