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Oil, Debt and Development: OPEC in the Third World

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Oil, Debt and Development: OPEC in the Third World

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George Allen and Unwin, 1981

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Our original monograph, *Oil, Debt and Development: OPEC in the Third World* was re-issued in 2016.[1] As there was not enough time to write a new *Preface* reflecting how our ideas had stood the test of time, we offer this short paper touching on some of the book's main themes, in particular, the nature of OPEC as a cartel, the terms of trade between oil prices and developing country non-oil primary commodity export prices, the generosity of Arab foreign aid, oil prices and oil importing countries' foreign debts, and the importance of migrant worker remittances from Arab OPEC host countries to the main sending countries.

The main thesis of our book was that the members of the Organization of Petroleum Exporting Countries were not in fact helping to promote 'Third World solidarity' against industrial countries; indeed, higher oil prices were more damaging for what we called the 'developing non-oil exporting countries' (the NOPECs) as they were for industrial countries. In the 1970s, following the quadrupling of oil prices (Arabian 34^{o} light), the OPEC secretariat and OPEC aid agencies had asserted a consistency of interest and objectives of OPEC members with

[1] Reissue by Taylor and Francis Group

the non-oil exporting developing countries. OPEC was a “full member of the Third World"[2] and “a pioneering group of *developing countries*”.[3] The same sentiments were expressed in the G77, in the United Nations General Assembly, and in the UN Integrated Program of Commodities. The main objective of these groups was to stabilize and, better still, raise commodity prices[4]. As the second Secretary General of UNCTAD[5] remarked “I am not interested in the mere stabilization of prices but in an overhaul of a system which still largely reflects a colonial or neocolonial relationship in terms of ownership, processing, marketing and distribution [of primary commodities].”[6] OPEC therefore was just the cutting edge for the creation of new international economic order (NIEO). While most of what we say below refers to the Arab members of OPEC, other OPEC members were also on board with the rhetoric. Thus, the Venezuelan government said it felt a shared interest with those countries which had as yet not succeeded in wresting control over their own mineral wealth. The Caribbean Development Bank received extra Venezuelan financing very shortly after the oil price rises. Also Nigeria was the first to implement an oil-price discount scheme to neighboring oil-importing countries. Up to 3-percent of Nigeria's crude oil exports were quickly received by other West African States.

How far had this talk of a NIEO, of Third World solidarity, and of OPEC blazing a trail been vacuous? Would something be accomplished in the next decades? The following sections discuss these questions.

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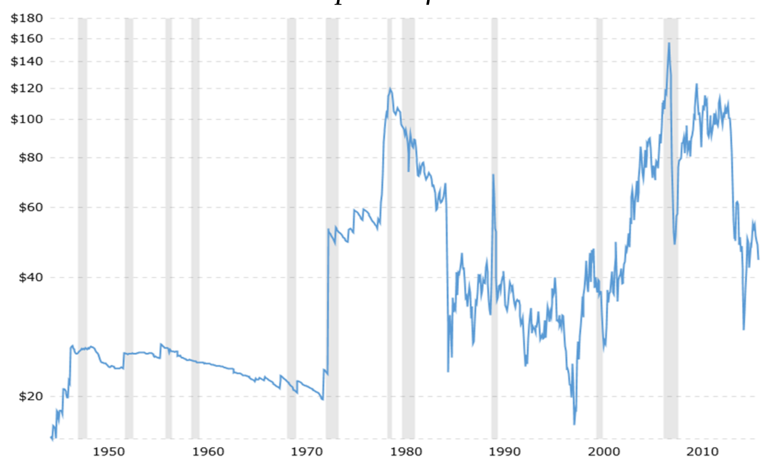
[2] A. A. Al-Anbari, President of the Iraqi Fund for External Development, at OPEC Headquarters, Aug 1980. Quoted in *OPEC Bulletin*, Sept. 1980, p. 14.
[3] Address of Rene Ortiz to UNCTAD V, May 1979, OPEC Press Release, 1979.
[4] On commodity price stabilization policies see Hallwood (1979).
[5] UNCTAD, United Nations Conference on Trade and Development.
[6] Quoted by U. Wassermann, “Key Issues in Development: Interview with the UNCTAD Secretary General”, *Journal of World Trade Law*, 1976, 10, pp 17-20.

OPEC

In 2017 there were 14 OPEC members: Algeria, Angola, Ecuador, Equatorial Guinea, Gabon, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates, and Venezuela. In 1981 there had been 13 members, Indonesia since dropping out and Angola (in 2007) and Equatorial Guinea (in 2017) becoming members.

Table 1 shows real oil prices over the period 1946 to 2017.[7] The two sharp increases in oil prices of the 1970s, in 1973 and 1979, are clearly seen, as is the weakening of real prices during the 1980s and well into the 1990s – with the exception of the Gulf War in 1991. Real oil prices then recovered with peaks in 2008, 2011 and 2014. By 2017 oil prices fell again and many OPEC members were suffering unsustainable reductions in foreign exchange reserves,[8] largely caused by crude oil prices at about $45 per barrel when they had been over $100 per barrel for much of the period 2004-2014.

Table 1: Real price of crude oil 1946-2017.



In contrast to such leading lights as Milton Friedman we predicted that OPEC would last for many more years, indeed, decades - which of course it did. The “OPEC would fail” thesis was

[7] The real price of oil shown is adjusted for inflation with 2017 as the base year using the US CPI and is shown on a logarithmic scale Source: Macrotrends, http://www.macrotrends.net/1369/crude-oil-price-history-chart. Downloaded 6/27/2017.
[8] Reported *The Financial Times*, “Oil exporters’ forex reserves hit 10-year low”, 6/27/2017, page 4.

simply that cartels inevitably breakdown due to cheating, rendered possible by difficulties of policing export quotas. Our argument was oil prices had risen so sharply in 1973 and 1974 because of changes in oil company ownership, and that, anyway, export quotas were rarely used by OPEC – briefly with some success in 1973 and 1974, and again in the mid-1980s but with no success. Our "change of ownership argument" was that in 1960s foreign oil companies in OPEC countries had relatively short time horizons because they might be nationalized (which in fact most were a few years before what the Japanese called the oil "shocku" of 1973) and wanted to "get the oil out of the ground quickly". That is, they applied high discount rates to expected future profits. However, with nationalization, discount rates fell because governments had longer time horizons and, consequently, valued future profits more highly – they had stronger incentives to 'leave the oil in the ground'. In other words, raising prices and containing oil exports was a decision made at the level of individual countries and did not have to be coordinated by the use of export quotas through OPEC.

In more recent years, crude oil prices have fallen because OPEC's share of world oil exports has fallen to between 57% and 60%, while in the 1970s it had been over 90% - a figure that excluded oil exports from the Soviet-Sino area. On a comparable basis OPEC's share is now about 70%, which is still down on its share 40-years earlier.[9] Secondly, while over the period 1971 to 2014, world total primary energy supply increase almost 2.5 times the share of oil in 2014 fell from 44% to 31%.[10] Thirdly, Saudi Arabia gave up its role as a 'swing producer' - when necessary cutting its output to maintain world prices while other OPEC members did not, with the effect of lowered prices aimed at discouraging surging US oil and gas production. The

[9] Data sources: 1970s from Hallwood and Sinclair (1981); 2011-15 from *OPEC Statistical Bulletin*, *2016* Table 5.3, page 52. http://www.opec.org/opec_web/static_files_project/media/downloads/publications/ASB2016.pdf
[10] International Energy Agency, *Key World Energy Trends, 2016,* page 4.

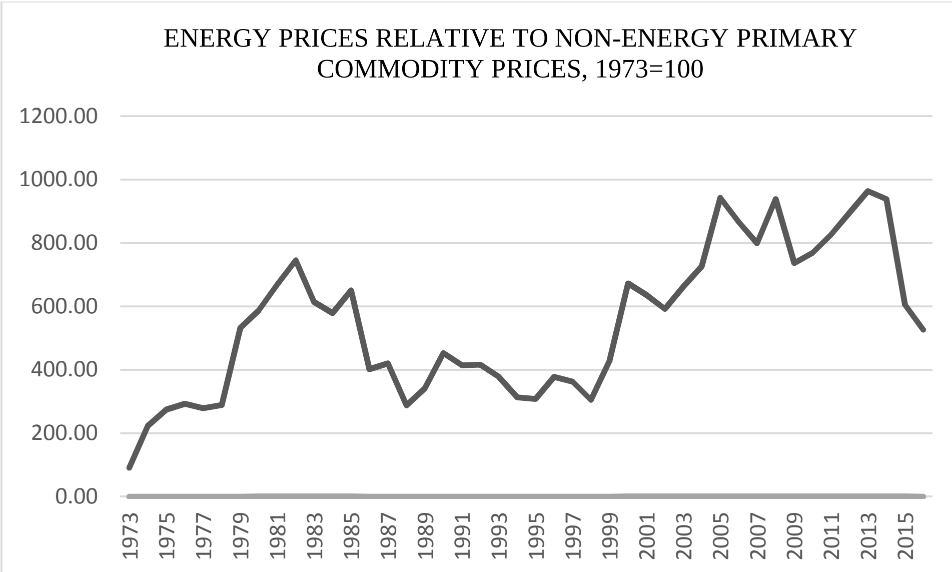
latter had increased from about 7 million barrels per day in 2013 to 9.5 million barrels per day in 2015. Yet, even as crude oil prices fell, the level of US crude oil production was maintained as its industry was able to cut production costs in line with prices.

NOPECs terms of trade

Comparing world crude oil prices with some other primary commodity prices, from 1960 to 1973, the year of the first oil shock, oil prices tended to move similarly with other primary commodity prices, for example, iron ore, coffee and cocoa and a good deal less than copper.[11] However, after 1973 world crude oil prices moved very sharply upward compared to the other four commodities and the wider group of primary commodities as a whole. By 1981crude oil prices on the world market had increased 21 times compared with 1960, but the prices of iron ore, copper, cocoa and coffee had increased only, respectively, by 2.6, 2.6, 3.5 and 3.1 times. There was, therefore, a substantial deterioration in the terms of trade of other primary produces versus the oil exporters.

Figure 2 shows the terms of trade of energy exporters calculated as energy export prices divided by non-energy primary commodity prices received by developing countries. This series proxies the terms of trade of OPEC exporters measured against other primary commodity prices. An increase in the index means that there was a deterioration in the terms of trade of the NOPECs.

[11] Data from World Bank Pink Pages. Annual data starts in 1960.



Source: World Bank Commodity Price Data (The Pink Sheet)

The sharp increase in OPECs' terms of trade beginning with the increase in oil price in late-1973 is clear shown; and this accords with the deterioration of the NOPECs' terms of trade versus OPEC countries that was discussed at length in *Oil, Debt and Development: OPEC in the Third World.* The effect of lower oil prices from 1982 for about 16 years is seen on deterioration in OPECs' terms of trade and the corresponding improvement in the terms of trade of NOPEC countries; but even in 1998, energy prices were still three times higher relative to non-energy prices than they had been in 1973. Also, seen is the rise in energy prices relative to non-energy primary commodity prices from the end of the last century to 2016, peaking in 2005, 2008 and 2013. The obvious conclusion is that measured by the behavior of the terms of trade from 1973 to 2016 non-oil primary exporters never recovered their relative position *vis a vis* oil import prices.

Aid

As far as we know, *Oil, Debt and Development: OPEC in the Third World* was the first academic study of post-oil price-increase Arab foreign aid. In Chapter 6 we pointed to the generosity of Arab aid as measured by the much higher percentages of their GDPs given in foreign aid compared with Western countries, a feature persisting to this day. However, we did *not* argue that this generosity was especially striking. Hernandez and Vadlamannati, (2014) believe that it was so on the grounds that most Arab OPEC member income was and still is derived from the production of a depleting asset. Our argument remains that Arab oil exporting countries regimes are family and tribal based and are relatively insecure compared with more democratic countries. Their foreign aid is given therefore not only to secure national interests – as with Western aid – but also the specific interests of ruling families.

We discussed other motivations for Arab OPEC foreign aid emphasizing that it was given to countries to help with regional security – especially Yemen and Oman, the gatekeepers to the Indian Ocean at the heads of the Red Sea and the Arabian Gulf; to similarly Islamic countries in Africa south of the Sahara, Mali and Niger in particular, and that some of this aid was given to build mosques to promote the Wahhabi branch of Islam based in Saudi Arabia; to support countries with anti-Israeli stances, especially Egypt, Lebanon and Jordan, as well as in Africa (we wrote that a recipient's position on Israel was of "paramount importance", page 106); and in the case of Arab aid to Mauritania, to confront a communist guerrilla movement. Almost 40-years later these motivations, except the latter, are still significant – see Hernandez and Vadlamannati, (2014), Neumayer (2003), and Villanger (2007). Any systematic link between Saudi Arabian aid and the spread of radical Islam in Africa south of the Sarah has not been established. For one thing this aid is also aimed at poverty relief, such as the building of water towers in poor villages alongside mosques; and, for another, central and/or local governments maintain a tight rein on imams, especially in larger towns and villages.[12]

[12] These latter points derived from a conversation (June, 17th, 2017) with a US A.I.D. worker whom recently back from working for one year in Niger.

Saudi Arabia is the largest shareholder and donor in several aid organizations including the Arab Fund for Economic and Social Development the Arab Bank for Economic Development in Africa, the Arab Authority for Agricultural Investment and Development, the Arab Gulf Program for the United Nations Development Organizations, the Arab Monetary Fund, the Islamic Development Bank, and the OPEC Fund for International Development. In the IDB Saudi Arabia is the largest donor and has most influence over aid allocations as voting shares depend on financial contributions and also its successive presidents have been and remain Saudi Arabian nationals.

The preference for Arab aid being used to promote Sunni solidarity is also supported in the statistical work of Neumayer (2003): countries not maintaining diplomatic relations with Israel are more likely to receive a lot of aid. He also points to something else we emphasized, that much Arab aid is ‘untied’ - which is advantageous as recipients can shop around for lowest prices and best quality. At the time this was largely in contrast to Western aid that was most usually tied both to projects and source of supply, specifically firms in the donor country. Moreover, while Arab aid is usually given in the form of loans, terms and conditions are generous toward recipient countries. All of these features of Arab aid were still present many decades later as according to Hernandez and Vadlamannati (2014), Neumayer (2003), and Villanger (2007).

Interestingly, Neumayer (2013) finds that the amount of Arab aid varies positively with the level of oil prices and oil revenues. *Oil, Debt and Development*, concentrating as it did on the 1970s, described Arab aid as disbursed during the first peak years of real oil prices. He mentions that throughout the existence of the Islamic Development Bank Saudi Arabia has been the largest donor and, as a result, its aid allocations favor its preferences. Specifically, these are largely directed to low income Sunni Muslim countries especially in the Arab world, and in Africa south of the Sahara – for example, Niger and Mali.

OPEC and debt in developing countries

In our book we emphasized that increased oil prices were very deleterious for the NOPECs, worsening their balance of payment and increasing their international indebtedness. In the intervening decades this picture has hardly changed. IMF Research Department (2000) calculated the effects of a permanent $5 p/b oil price increase on developing countries for the year 2000. In particular, African oil importers' balance of payments deficits would increase by $2 bn, or, 0.6% of their gdps. The world oil price in 2000 was $27 p/b, rising to a peak of over $100 p/b in 2012. Dividing this more than $70 oil price increase by $5, the multiple is 14, costing the African oil importers an extra $28 bn, or, about 8% of their gdps. After the peak year, of oil prices they fell back to about $45 p/b in 2017, still substantially above the 2000 level.

While Arab foreign aid is generous it has never come close to plugging the African oil importers payments deficits due to spending on oil. Werker and Cohen (2008) use oil price fluctuations to measure the effect of aid transfers from Arab OPEC members to oil importing Muslim countries in the Middle East and North Africa. They investigated how this aid was spent by looking at its effect on the level of national spending and the balance of payments of recipient countries. Their main finding was that, unsurprisingly, aid has no noticeable effect on economic growth – 'unsurprising' because it was helping only to fill a hole in recipients' balance of payments. Their findings also point to a 'fungibility problem' – it replaced expenditures that would have been made anyway, say on capital goods, with actual spending on imported consumer goods rising. Moreover, Arab OPEC aid substituted for domestic saving and (probably) contributed to capital flight.

Migrant workers

In *Oil, Debt and* Development we reported that in 1975 the total number of migrant workers in the main Arab OPEC countries was 1.65 million. By 2013 there had been a massive increase with, in Saudi Arabia alone, there being 4.7 million foreign workers (De Bel-Air, 2014). Increasing reliance on foreign workers, mainly from South Asia, is also indicated by the fact that in 1975 migrant workers in Saudi Arabia made up 43% of the work force but this had increased in 2013 to 56.5% of overall employment and a massive 89% of the Saudi private sector workforce.

We also indicated the importance of migrant remittances to labour-sending countries. For example, in Pakistan at the time of the first oil shock in 1973 migrant remittances as a proportion of spending on imports was 11%; but as worker migration to Arab OPEC countries took off, this proportion increased to 21% in 1976; Jordan had a more marked increase – from 11% in the first year to 32% in 1976. And in the Yemen Arab Republic (North Yemen) the respective figures were 125% and 193%. However, for countries such as Egypt, Bangladesh and Sudan, workers' remittances were much less important.

In more recent years, as Del Bel-Air (2014) reports, "The most striking indicator of the importance of remittances is their ratio to the amount of official development aid received by the emigrants' countries of origin ... For the Mashrek countries[13], the ratio stood at 76 percent in 1980, but increased to 100 percent in 1990 and reached 337 percent in 2003… the ratio of remittances to export of goods and services reached a peak of 47 percent for the Mashrek group in 1980 but declined to 27 percent in 2003.Despite this decline, however, the same ratio

[13] The *Mashrek* (or Mashreq) countries sending emigrant labour are Jordan, Lebanon, the Syrian Arab Republic, Oman, and the Republic of Yemen

(remittances to exports) for the Middle East and North African region as a whole was as high as that of Latin America in 2002; and for the Mashrek countries alone, the ratio was the highest among all the different regions of the world ” (p16).

Autobiographical note – Paul Hallwood

I worked for the Saudi Arabian Foreign Ministry in its London Embassy from early-1978 to late-1980 on leave of absence from the University of Aberdeen in Scotland. This was after answering a job advertisement in *The Economist*, an interview by a panel led by the well-known economist Edith Penrose in a UK Ministry building, and a further interview with a senior Saudi government official, called Mamoun __ _____ (he passed away aged 54 about 22 years ago). The interview with him was in an Italian restaurant in Beauchamp Place, Knightsbridge, London. The lunch was very fine, including wine, though he did not partake. An early wonderful occasion with Mamoun was when he took the 10 or so people in our economics research unit (mainly Arabs drawn from several countries) to lunch at a Lebanese restaurant on Brompton Road. I was unfamiliar with the menu and when the waiter eventually reached for it I said “but I need more time please”. To which the waiter replied, “Don’t worry, he’s ordered everything!” Thus began my acquaintance with Lebanese food. To mention two more stories about this Saudi Arabian generosity one is that my employment contract was stated in Saudi riyals but, unfortunately, sterling appreciated sharply soon after Mrs. Thatcher was elected in 1978. Without any word from me Mamoun readjusted my riyal pay upward so that I did not lose out. Another story is that Mamoun threw a party for assorted friends and colleagues at his house in Acton, the food was again generous, and it was there that I first came to learn of the wonderful rhythms of Arabic music – which were enhanced by one of the secretaries – an Egyptian named Susan, performing an impromptu belly dance! On no occasion did I see any woman wearing a burka in or around the Saudi Embassy, or, indeed, anywhere in London. A good question is why is the burka so prevalent today? One answer is the rise of Islam; but another suggested to me by a female professor recently back from Iraq (June 2017) is that over the last 40-years less westernized Arabs have made their way to the west bring with them more traditional values.

I wrote a number of position papers for the Saudis. One was on the likely impact of the European Currency Unit – the creation of which was agreed at the Bremen conference, June 1978 - on the desirability of the US dollar as a reserve asset. This, of course, was a subject of great importance to a country in the process of accumulating huge foreign exchange reserves. Questioning how well the *ecu* would perform the three functions of money I said that the impact on the dollar for many years at least would be minimal, which is how it turned out. Visiting our research unit, the Deputy Foreign Minister told me how much he liked the paper. This was my first writing on international finance and was followed some years later by joint authorship (with Ronald MacDonald) of three advanced books on the subject together with a large number of academic papers. Another paper I did for the Saudis was on the likely effectiveness of an Arab League boycott of trade with the People's Democratic Republic of Yemen which, at the time, had a Maoist government which Arab League members wanted to bring down. I concluded that as too many other countries would likely be willing to step in replace Yemen's imports from Arab League countries a boycott would be ineffective. No boycott was ever arranged.

Finally, how Stuart and I came to write *Oil, Debt and Development: OPEC in the Third World* was after a long, somewhat idle discussion, of what turned out to be its subject matter. When we wrote down a list of the topics we had covered we found that there were eleven in all, ten of which appear in the book as subjects of chapters. I don't recall what happened to the eleventh. We had the manuscript typed by a woman working in the US Navy building near the US Embassy. It's pretty obvious why we didn't have it done in-house.

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