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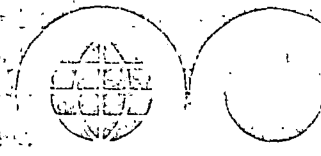

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The Cost of Oil to the Developing Commonwealth

The rapid rise in oil prices in the final quarter of 1973 will have a much more severe impact on the developing countries than on industrialised countries. This paper estimates the immediate effect of the higher oil prices on the import bill of non-oil-producing developing countries, indicates their ability to finance the additional costs out of foreign earnings, and evaluates the alternative solutions available. It will focus more particularly on the developing Commonwealth - the traditional 'constituency' for the British aid programme and the area where British initiatives and reactions will, consequently, be most significant.

The overall picture

Estimates of the import cost to developing countries have been made, in recent months, by various international agencies and in the news media. For the purposes of this paper, developing countries are assumed to be paying an average $11 a barrel for both crude oil and products ($78 a ton) - including freight and insurance costs.[1] Consumption is assumed to be held at estimated 1973 levels (developing country net imports are estimated to have been rising by 6% a year since 1970). The 1973 estimates use actual 1970 price levels. The results are given in the following table:

Table 1 Direct costs of net* oil imports by developing countries 1973 and 1974 ($ billion)

	1973	1974	Rise in bill
Net oil-importing countries in:			
Asia	1.1	6.2	5.1
Western Hemisphere	0.8	4.6	3.8
Africa	0.2	1.0	0.8
Middle East	0.1	0.4	0.3
Total	2.2	12.2	10.0

* Excluding bunker fuel and exports of petroleum products

On these estimates the developing countries as a whole will have to face a fivefold increase in their total oil import bill, directly attributable to higher oil prices. Whether, and how, they can finance this increase depends on a complex of factors peculiar to each country. How will the developing Commonwealth be affected?

The Commonwealth situation

Absolute figures of the oil import bill can be misleading: a large rich country might easily rank above a small poor one. It is necessary to express the bill in terms of the individual country's capacity to finance it. For simplicity and brevity, this capacity is expressed here in terms of each country's export earnings for 1972, the latest complete year available. The relevance of oil in the overall imports of each country is then indicated by showing the percentage share of the increase in 1974 in total imports in 1972. The figures for each country give the order of magnitude only: they are not exact since they use an average price for all crude and refined imports and so do not take into account the composition of each country's purchases.

1 For a discussion of prices see note at the end of this paper.

Table 2 Additional direct costs[1] of net oil imports by selected developing Commonwealth countries[2] in 1974

	$ million	Expressed as % of total exports 1972	Expressed as % of total imports 1972
Asia			
India	973	40	43
Singapore	517	24	15
Hong Kong	226	7	58
Pakistan	194	28	29
Sri Lanka	123	39	35
Bangladesh	70	...	...
Africa			
Kenya, Tanzania & Uganda	178	18	16
Ghana	56	16	20
Zambia & Malawi	42	5	5
Sierra Leone	13	11	11
Gambia	1	1	1
Mauritius	8	8	7
Western Hemisphere			
Jamaica	123	49	29
Guyana	42	31	30
Barbados	27	61	13
Leeward Islands	83	...	...
Middle East			
Cyprus	57	18	43

1 Assuming an average price of $78 a ton for both crude and products

2 Including Pakistan

3 Including intra-regional trade

... not available

Sources: for oil statistics, UN Energy Supplies 1968-1971; for trade statistics, IMF International Financial Statistics.

The additional bill for these developing Commonwealth countries will thus be $2.73 billion. This sum covers the fuel costs only. It does not take into account the higher cost of oil-based chemicals and fertilisers or the increase in the price of virtually all other imports because of higher energy costs. These additional costs could well approximate the total of the extra fuel import bill.

What can the developing countries do about it? What are the Arab producers likely to contribute in aid funds? What should the British aid programme do?

The options

In this situation there are three basic policy options before the governments of developing countries. They might cut the volume of oil imports to keep the value more or less stable (or reduce other imports by the required amount): they might increase export earnings to make

up the additional import costs: they might step up their external borrowing to finance the addition, or run down their reserves. Developing countries will clearly attempt all three, where feasible. But except in rare cases these policies will not be enough - unless the countries are ready to accept a drop in their overall economic growth and the already low living standards of their populations.

On the first option, purchases of oil would have to be cut by around three-quarters. In developing countries the margin for fuel economy is very narrow. They would therefore have to accept a cut in their economic activity which would lead to acute suffering. Furthermore, any cut in energy consumption must affect their ability to increase their export earnings - and thus reduce the scope for the second option. While the prices for some major developing country commodities (coffee, cocoa, timber, sugar, oilseeds) are presently at high levels, demand for many products exported by these countries is likely to grow only ~~slowly in 1974,~~ because of the difficulties being experienced by the industrialised countries who are the major markets. Most countries therefore cannot expect to attain the high export growth rates implied in Table 2, and in any event an increase in exports cannot be achieved overnight.

The third option - an increase in external (commercial) borrowing - is available only to those countries which are considered creditworthy: broadly those whose foreign earning capacity is considered to be dynamic (in general, producers of minerals and manufactures) or whose debt servicing capacity has improved with the overall commodity boom. Those countries which can increase their commercial borrowing - through the Eurodollar market, for example - will certainly do so. Those which cannot, and whose reserves do not give them a breathing space, may have to default on their foreign debt - unless concessional funding is available to them at substantially higher levels than in 1973. The developing countries will certainly seek such funds. Who will provide them?

One proposal that is attractive to industrialised countries facing a substantial deficit on their current account is that the oil producers - as the beneficiaries of the situation - should fill the gap. Some Arab oil producers have shown interest in proposals to channel a proportion of their additional oil earnings to aid - for example, through the agency of the World Bank or via a separate development fund. But it would be unrealistic to expect even those with small populations and high earnings per caput - Saudi Arabia, Kuwait, Abu Dhabi, Qatar, and Libya - to commit a fifth of their GNP in 1974 to grants and concessional loans. Yet this is what would be needed if the oil producers were to make up the extra import cost.

This leaves the traditional donors - the countries of the Development Assistance Committee of the OECD. To fill the $10 billion gap this year would entail a more than doubling in their aid spending. It is ironic that if they were on course for the UN target of 0.7% of their GNP in aid by 1975 - which some have approved - developing countries would be receiving $8-9 billion more this year than they are likely to receive. At present aid is running at only around 0.35% of DAC countries' GNP. It is essential that these countries not only maintain their aid flows but increase them. It is in the OECD countries that the additional oil revenues will largely be spent - either on goods (by those oil producers with considerable import capacity - such as Iran) or on assets (by those producers looking for good returns on investment). By recycling a part of these revenues, in the form of grants and concessional loans, to the developing countries least able to finance the extra oil import bill, the industrialised world will be ensuring that development does not come to a grinding halt for one billion people.

Recommendations for the UK

In this situation the British government should:

(1) At the very least maintain the planned increase in its aid programme

(2) Concentrate more bilateral aid on those countries hardest hit (these include India, Bangladesh, Pakistan, Sri Lanka, and the countries of the Caribbean).

(3) Relieve the debt burden of those countries now eligible for interest-free loans (notably India) by waiving payment of interest on loans granted on hard terms in the past, and putting all loans on current concessional terms.

A Note on Prices

In discussions of the cost of oil, reference is made to four sorts of prices - posted, buyback, auction and landed (import). The four are separate, but related.

The posted price is a tax-reference price only, which is used as the basis for calculating tax and royalty payments to producer governments by the oil companies (normally referred to as the government 'take'). This is not a market price. Thus when the posted price of Saudi Arabian light crudes rose from $2.59 a barrel at the beginning of 1973 to $11.65 in January 1974, the oil revenues of the Saudi Arabian government rose by the same percentage. The rate of increase in the amount paid to the producer government is passed on to the consumer. Hence the 350% rise in the posted price of Saudi Arabian light crude - which is a statistically significant type of oil - will be at least reproduced in crude oil and petroleum products in general.

The buyback price covers that part of production sold to the oil companies by the producer government. It is over and above that which the companies own through their participation in production of crude.

The auction price is that paid for supplies of crude, sold at auction by the producer governments, which they have not sold under buyback arrangements to the companies.

The landed, or import, price (which is the one used in the cost estimates in this paper) includes the government 'take' (which is determined by the posted price), the costs of production, freight and insurance, and oil company profit. It is affected by the proportionate share in supplies of the three types of oil mentioned above - i.e. equity (company), buyback and auction.