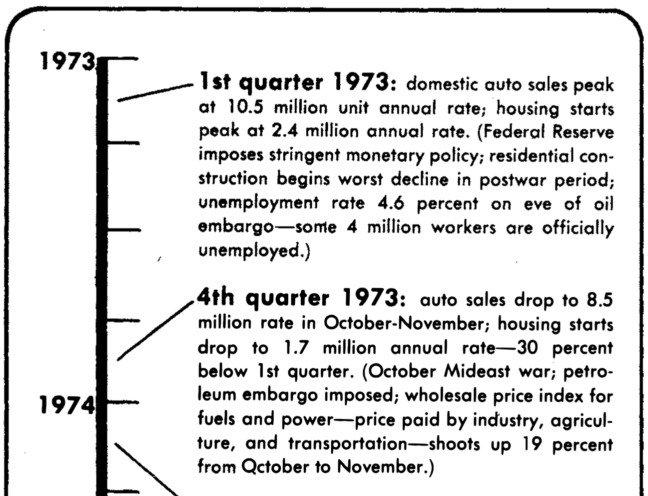
What the 1973 oil hoax did to the U.S. economy

When the last oil price hike hit in late 1973, few were the economists who foresaw that its effect would be to catapult the world into the worst economic collapse since the Great Depression of the 1930s. None of the existing econometric models, which were and are based simply on historical correlations and linear projections, were equipped to gauge the catastrophic impact of the quadrupling of world oil prices within the space of a few months on current consumption and production and on longer-term capital investment trends.



The 1973 oil hoax was the coup de grace to a steadily worsening world economic picture. The years leading up to October 1973 were rocked by successive international monetary crises and the unraveling of the International Monetary Fund-centered Bretton Woods monetary system, as IMF low-growth policies, fathered by British life insurance executive John Maynard Keynes, succeeded in undermining the potential for Third World industrial development *and* in stiffling advanced sector exports and concomitant real economic growth—as opposed to GNP. In the U.S., the year-and-a-half period leading up to October 1973 was marked by grain and other commodity speculation at the Chicago Board of Trade, developing capacity shortages in basic industries, and burgeoning inflation. In the first half of 1973, food prices were rising at a more than 17 percent annual rate.

The Federal Reserve, under the chairmanship of "conservative" Arthur Burns, fueled the flight into short-term speculative investments through its policy of highinterest rates—exactly as Fed Chairman G. William Miller is doing today. By the second quarter of 1973, interest rates had begun their steep ascent to the double-digit levels reached later in the year—and housing starts and residential construction began their tumble into the worst collapse of that sector in the postwar period.

After the October Mideast war and the petroleum embargo, the U.S. wholesale price index for fuels and power—the prices paid by industry, agriculture, transportation industries, etc.—surged 19 percent between October and November 1973. During 1974, when the quadrupling of world oil prices went into effect, the fuels and power index jumped by another 30 percent. Coming on top of food price inflation, the initial impact of the oil hoax was to stymie consumer purchases, and auto sales and commitments to build new homes plunged accordingly beginning in late 1973.

However, industrial production continued, buoyed by a massive buildup of inventories by business as a hedge against inflation and shortages.

It was Federal Reserve policy which finally pulled the plug on this inflationary spiral—and brought the economy crashing down in late 1974. By mid-summer, the Fed had hiked the federal funds rate—the key interbank, overnight interest rate—to 13 percent, while simultaneously cutting back on supplying reserves—the source of new credit—to the banking system. Then in August, Burns reportedly sent a letter to the large commercial banks instructing them to cut back on loans to commerce and industry to "cool down" the economy.

With credit availability curtailed, the auto industry led the way in the second half of 1974 in closing down production in an effort to liquidate the huge pileup of inventories. The fourth quarter of the year was marked by widespread plant shutdowns and heavy layoffs in auto, which shortly spread to steel and other feeder industries. The evaporation of consumer demand, uncertainties about the future price and availability of energy supplies, and historically high long-term interest rates together took their toll on investment plans and slashed capital goods orders. In the first half of 1975, the numbers of officially unemployed workers reached 8 million, compared with some 4 million unemployed on the eve of the oil hoax.

Then starting in the spring of 1975, the U.S. economy was administered artifical resuscitation through a more stimulative monetary policy: a tax cut aimed at getting consumers to increase their purchases of autos and other goods, and a series of changes liberalizing the terms of consumer credit The hyping of the economy in these ways, however, did nothing to change the economic "fundamentals" and merely set it up for another crash—which will be triggered by the Carter administration's oil price hike.

—Lydia Schulman

How the oil hoax will affect world oil bill

	1978 consumption (millions of barrels)	Oil bill ($ billions) 1978	1979
Total (non-Communist)	17,260	230.00	339.00
U.S.	6,723	76.95	113.25
Western Europe	4,070	59.00	87.30
Japan	1,870	27.00	40.00

Except for the U.S., consumption figures are projections based on CIA estimates for 1977. U.S. consumption data is derived from the U.S. Energy Department's "Monthly Energy Review." The oil bill for 1979 is based on an oil price hike of 48 percent.

The world oil bill: up by $109 billion

The U.S. population is being billed $53 billion for the Great Oil Hoax of 1979. But what is the cost to the world economy?

Rough calculations by our economics staff indicate that $109 billion could easily be added to the world's oil consumption bill alone, estimating that the average world price of crude oil rises 48 percent over the 1978 average of $14.50 a barrel to $21.50—or to $19.00 plus $2.50 in shipping and other additional charges.

This figure does not take into consideration the sale of oil at below OPEC prices or the increased cost of other energy sources such as coal and natural gas that have tended to rise in tandem with oil prices in the past.

While the advanced industrialized nations will bear the brunt of the increased oil tax simply because they consume most of the world's oil, the price hike will have the most devastating impact on Third World economies. According to figures compiled by Morgan Guaranty, imported oil represents 30 percent of total imports for such countries as Brazil and Turkey, and 20 percent for Korea, the Philippines, India and Thailand. Even a moderate rise in imported oil pices can easily wipe out a Third World country's foreign exchange reserves—which haven't recovered from the 1973-1974 oil price hike—forcing these countries to bring desperately needed development projects to a halt.

Take, for example, Kenya, whose Vice President and Finance Minister Mwai Kibaki reported in a May 30 interview with the *Wall Street Journal* that this year's oil crisis has already "eliminated the import of many consumer goods and has limited imports of motor cars, clothing and some other items. We have had to postpone development projects which haven't started, such as roads, and one or two industries. ... There are already no nonessential items imported. The higher oil prices will mean a 20 percent cut in what (foreign exchange) was available for other uses. Whatever we cut from our June budget must be essential items." Kibaki also noted that soaring oil prices have contributed to "a severe recession in all of Africa," including in Zaire, Zambia, Tanzania, Uganda, Rwanda, Burundi, Mozambique, and Rhodesia.

—Alice Roth