



OIL SHOCKS & THE DEBT CRISIS

Political Economy in the New Millennium

Week 8

2013 University of Wollongong

REVIEW

- Improvement / Development as a project rooted in Cold War logic
 - Communism spreads where economies and opportunities for a better life are weak.
- Major Institutions of Bretton Woods
- Main role of the International Monetary Fund:
 - Help with temporary balance of payment problems!
 - System of fixed exchanges
 - US dollar is tied to gold, other currencies are tied to the US dollar.



AGENDA

- The little known agreement
- From the Gold Standard to Fiat Currency
- The Faustian Bargain
 - Petrodollar recycling is officially born
- Bankers head to the ‘Third World’
- Debt as a technology of international power





ROOSEVELT AND IBN SAUD

THE FATEFUL BARGAIN
US CRUISER, SUEZ CANAL
15 FEBRUARY, 1945



FROM GOLD STANDARD TO FIAT MONEY

- Historical Context
- The Nixon Shock
- 1976 floating currencies
- Risk
- Viewed from American Power



THE FAUSTIAN BARGAIN

- Petrodollar recycling and capital controls
- The curious case of the oil price spikes
 - Oct. 1973 Yom Kippur War
 - \$3.01 to \$11.65 (287% increase)
 - 1979 Iranian Revolution
 - \$US 15.85 (426%)
 - American grand strategy?
- New sources – economical only at higher prices!
 - North Sea (Britain and Norway)
 - Prudhoe Bay (Alaska, USA)



OIL PRICE (PER BARREL)

■ - Nominal

■ - Real*

*At constant 2008 dollars

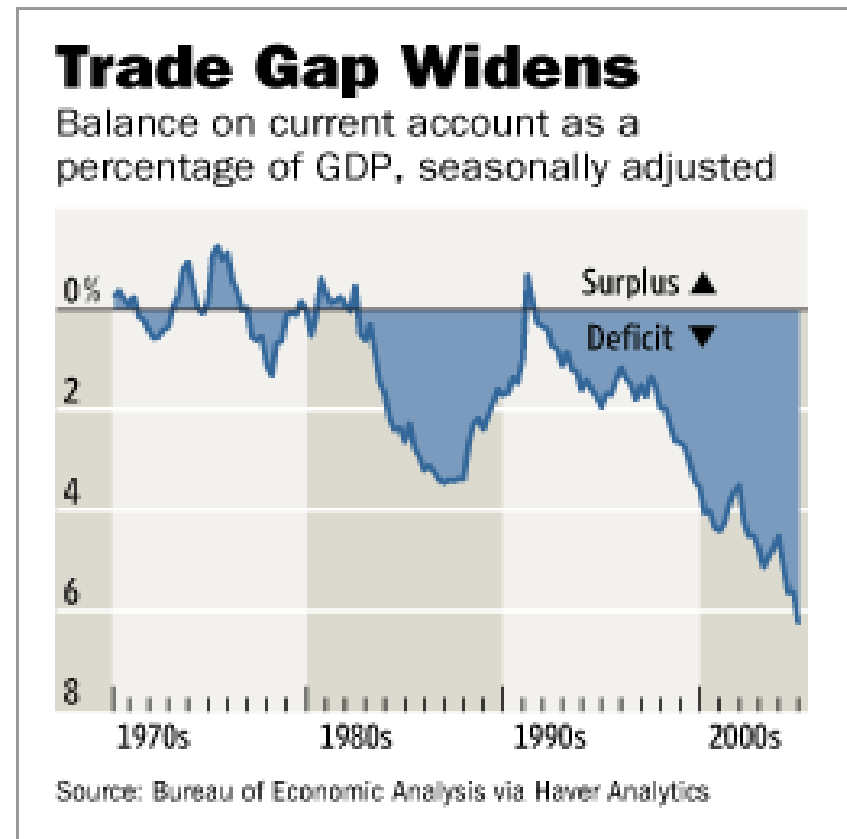
*Sources: 1861-1944 US Average
1945-1985 Arabian Light
posted at Ras Tanura
1986-2008 Brent spot
Photo © Shutterstock*

1869 1879 1889 1899 1909 1919 1929 1939 1949 1959 1969 1979 1989 1999 2009



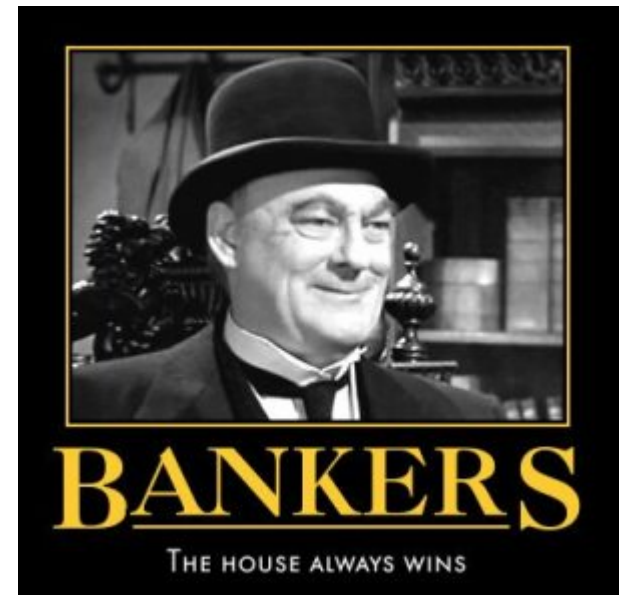
THE US TRADE DEFICIT IS STRUCTURAL

- The *current account deficit* was \$473.4 billion in 2011.
- This means that US has to take in about US\$ 1.3 billion in finance every day of every year to service its debt on imports.



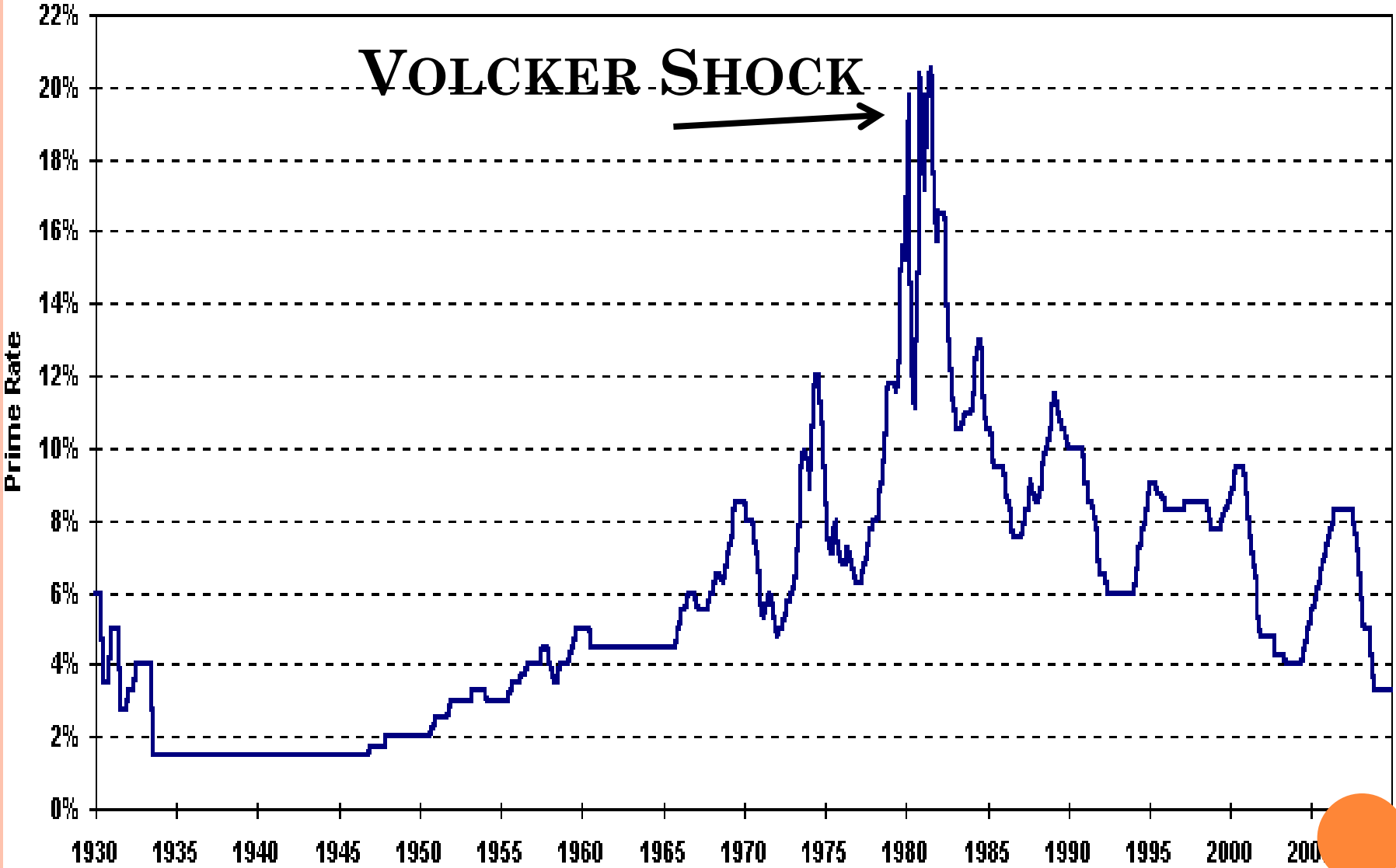
BANKERS HEAD TO THE 'THIRD WORLD'

- New York, New York and the City of London
 - Most developed financial system
- Surplus dollars come piling in to US/UK banks but due to stagflation in the advanced industrial economies, bankers have to look elsewhere for profit
- Enter the 'Third World'
 - Money extended at variable interest rates
 - 1979 Volcker Shock



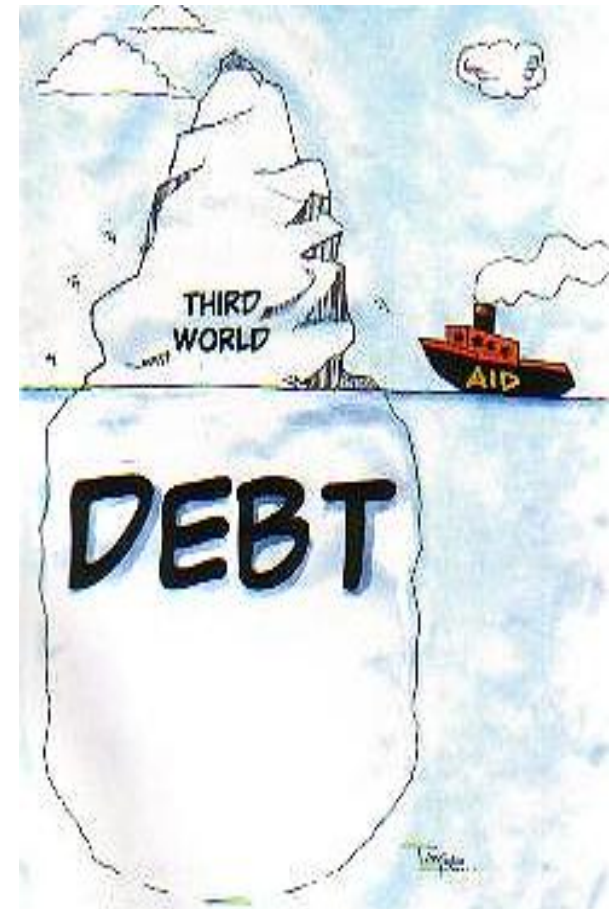
Prime Rate History (1930 - 2010)

VOLCKER SHOCK



BANKERS AND THE THIRD WORLD

- What was the money lent for?
 - Infrastructure, military hardware, oil!
 - Loads of corruption too – Suharto's private fortune was roughly equal to Indonesia's public debt.
- Odious Debt
 - An argument in legal theory that if a regime borrows and accumulates a national debt and this money is not used in the service of the people, repayment is not enforceable.



DEBT AS A TECHNOLOGY OF POWER

- The Third World Debt Crisis
- IMF enters the scene on behalf of the bankers
- New loans to repay old debts= conditionality
- Entire states are reconfigured as debt repayment machines
 - Example: privatization of state assets to pay creditors.
- Guess who's next?

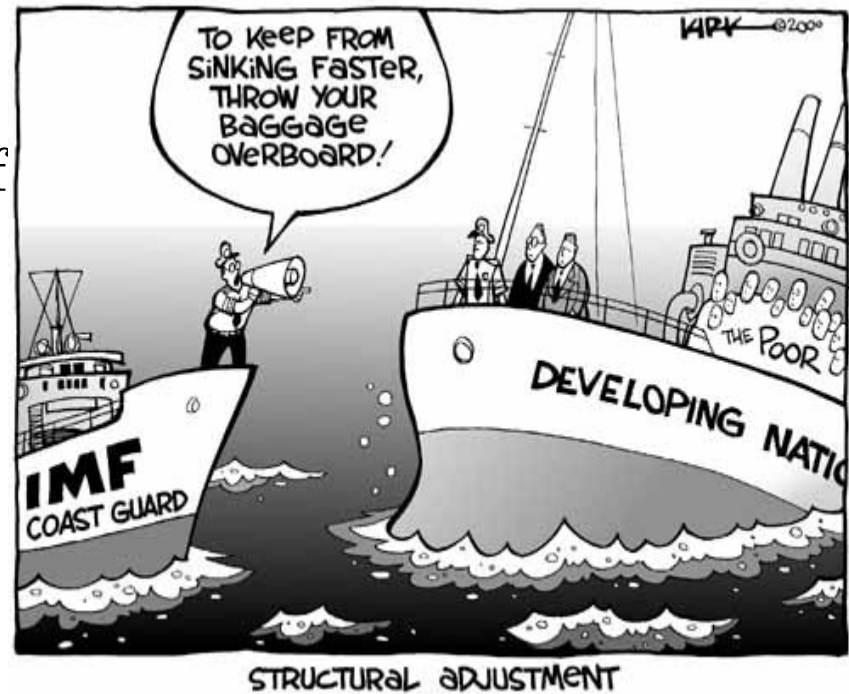
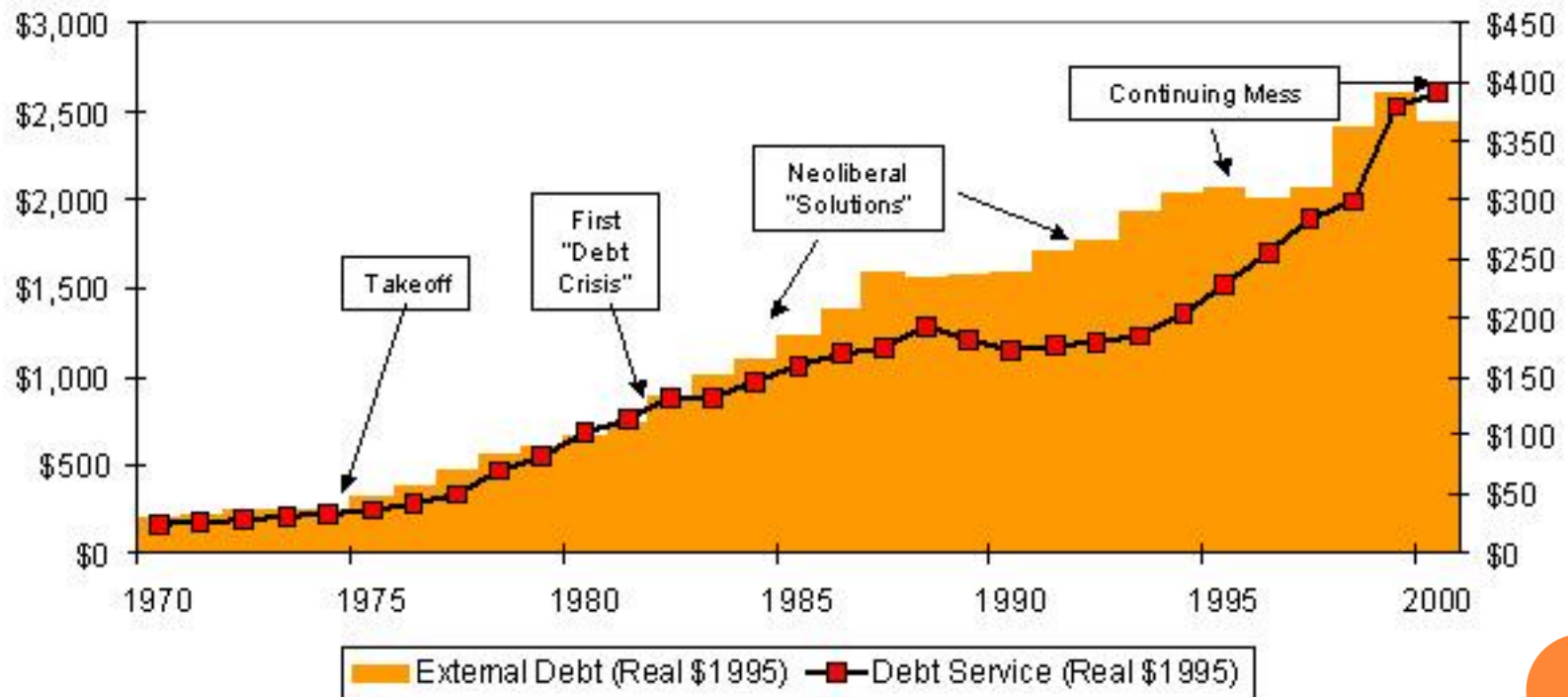


Chart 1.1. Third World Foreign Debt and Debt Service, 1970-2000

(Real \$1995 Billions)



Source: World Bank (2002) data, JSH analysis

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KISSINGER'S FAMED QUOTE

- “Control oil and you control nations; control food and you control the people.”

