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Where the High Oil Price Really Hurts

By Kofi A. Annan

Oil prices are often treated as an issue between producers and the industrialized world, but there is a third party for which they are of decisive importance, although its interests are often overlooked. I mean, of course, the great majority of developing countries that are net oil importers.

For those countries, unlike the industrialized ones, the effects of high oil prices are more severe today than they were in the 1970s, for several reasons.

In the last 20 years, these countries have expanded their manufacturing industries, which are energy-intensive; they have urbanized; they have switched from traditional, non-commercial energy sources to modern fuels; and they have seen a big expansion in motor vehicle ownership. As a result, they now use more than twice as much oil as industrialized countries do to produce each unit of output.

Their scope for replacing oil with other energy sources is limited, as is their capacity, both technical and financial, to introduce more energy-efficient processes.

Oil accounts for a larger share of their import bills, and can cause balance-of-payments problems for many of them. Their foreign exchange reserves are limited, and it is not easy for them to raise short-term finance. Therefore, even temporary oil-price increases can force them to reduce their imports of other goods, with the result that domestic consumption and investment also shrink. Their debt-servicing costs are likely to increase, if higher oil prices lead to higher international interest rates.

These are cruel blows to land on developing countries. Those that are just beginning to recover from the 1997 financial crisis may see their hopes dashed. Those that are struggling with marginalization and the impact of AIDS may be plunged even deeper into despair. And, as usual, it will be the poorer people in poor countries who are hardest hit, as prices of fuel, food and transport rise beyond their reach.

Of course, most oil exporting countries are developing countries, too. For them, higher oil prices come as a welcome relief, at least in the short term, from their recent financial constraints. And they argue with some justice that price increases are caused by rising demand, not falling supply. Twice recently they have increased supply, with little impact on the price.

But the experiences of the 1970s and 80s suggest that oil prices are unlikely to remain far above the trend for very long. The impact on other sectors of the economy and on consumers' welfare will slow down economic activity. In the past this has even led to recession. If it happens again, the effects will be bad for everyone, including the oil producers. And once again developing countries, which depend on exports and on world prosperity as their only hope of growth, will suffer worst.

Clearly it is not for the United Nations to say what the oil price should be. But I would make two observations.

First, there is need for a fair and stable balance between the interests of consumers and producers. Wild swings in the price are damaging to both.

Second, and most important, the interests of non-oil-producing developing countries must not be forgotten. If they are expected to pay higher prices for oil, their need for the more generous treatment promised at the recent Millennium Summit - more open markets, enhanced debt relief, more resources for development - will be greater than ever. There is a corresponding obligation for the more prosperous world - including those who benefit from higher oil prices - to do more to help them.

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