THE IMPACTS OF THE 1973 AND 1979 OIL CRISIS ON CENTRAL AND EASTERN EUROPEAN COUNTRIES

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\textbf{Abstract}

The 1973 and 1979 oil crisis had profound impacts on the global economy. As a result of the Yom Kippur War in October of 1973, world oil prices quintupled between 1973 and 1974. The crisis was structural in its nature and led to the end of postwar prosperity in Europe. In Western Europe and the United States, economic slowdown was coupled with persistently high inflation and rising unemployment rates. The situation of the world economy was further exacerbated by the collapse of the Bretton Woods system in 1971, which had widespread negative consequences. Additionally, the 1979 Iranian Revolution resulted in another “oil crisis” and caused a severe recession. Despite the harsh propaganda, based on Marxist-Leninist ideology, the Soviet bloc had to face a permanent economic crisis from the mid-1970s. The socialist countries postponed the introduction of structural reforms in their national economies and preserved their obsolete production and export sectors. Due to the lack of adjustment to the changed circumstances in the world economy, the structural crisis became deeper and prolonged more in Central and Eastern Europe than in the West.

This paper aims to highlight the impacts of fundamental changes brought by the oil crisis on the socialist countries. It also evaluates the main reasons of economic slowdown and growing indebtedness of the region.

\textbf{1 Introduction}

The 1973 oil shock that quintupled world oil prices had far-reaching consequences on the global economy. As a result of the Yom Kippur War and the decision of the Organisation for Petroleum Exporting Countries' (OPEC), severe oil price increases had devastating impacts for Western Europe. Most of countries were hit by double-digit inflation and growing balance of payments problems, which led to a recession [1]. Economic growth in the most advanced countries of the world’s economy slowed significantly: period of stagnation started in the first three years after 1973, which was accompanied by persistently high inflation and rising unemployment rates. The 1979 Iranian Revolution generated a second “oil crisis” in 1979–1980, when oil prices rose by tenfold [9]. These processes negatively influenced the economic outlook of Western Europe and the United States.

Whereas the most advanced countries of the world economy reacted appropriately to the dramatic and sudden changes of the structural crisis in the 1970s, the socialist countries could not modernize their production and export sectors. Based on old-fashioned technology and economic

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structure, Central and Eastern Europe followed the extensive growth policy within the framework of the rigid and bureaucratic centrally planned economy.

In this research paper the reasons of the structural crisis in the socialist countries will be analyzed by taking into account both external and internal factors during the 1970s. Emphasis will be placed on the consequences of growing disequilibrium and indebtedness of the Soviet bloc. It also evaluates the deficiencies of the command economy and the erosion of the Council for Mutual Economic Assistance (CMEA) trade.

2 Research method

In order to better understand the impacts of the 1973 and 1979 oil crisis and global recession on Central and Eastern Europe, an interdisciplinary approach will be applied based on literature overview. The assumptions of the essay are the following:
1. Both the 1973 and 1979 structural crisis had far-reaching consequences in the Eastern bloc, which resulted in a permanent and prolonged economic crisis.
2. The short-sighted policy followed by the communist leadership of the Central and Eastern European countries led to a dramatic backlash in the 1980s.

3 Literature overview

3.1 The crisis of the socialist regimes

The year 1973 was a watershed in the world economy, which forced the most developed countries to restructure their economies and adjust them to the challenges brought by the new wave of technological revolution. Berend stresses that the depression of the mid-1970s was a structural crisis. It was a cyclical phenomenon of the market economy. The significant slowdown and destruction played a positive role because they cleared the way for the new technologies and methods. The former leading branches of the economy became obsolete, and the new leading sectors (IT, telecommunications and R&D) emerged, and the whole process brought about a restructuring of the economy. Thus, energy-wasteful industrial sectors, such as iron and metallurgy, were phased out in the world's market economies and more attention was paid to innovation and technological renewal [10]. From the late 1970s, based on the concept of intensive growth, Western Europe and the United States successfully built up new leading sectors, which produced higher value-added products and services.

Contrary to the Western economies, the Central and Eastern European countries preserved their old-fashioned technologies and economic structures, based on heavy industrial branches, such as coal mining, iron production and metallurgy. The rigid and bureaucratic command economy was driven by forced industrialization, but innovation and technological development were completely neglected. State-owned companies regularly ignored market signals and entrepreneurial interests in state socialism. The Soviet economic model applied in the satellite countries of the region followed the general concept of extensive import-substituting industrialization, which focused on regrouping the “unlimited” and unutilized labour force from agriculture to industry. The model worked better in backward countries than in the more advanced ones until labour reserves were depleted and import substitution resulted in a major restructuring. Troubling signs began to emerge in the mid-1960s, when unutilized labour force completely dried up; therefore, fast economic growth could not be maintained in the long term. The constraints of forced industrialization were clearly visible in the region during the 1960s. Czechoslovakia and Hungary realized in time that “extensive” industrialization based on new excessive labour input had to replace with an “intensive” development, focusing on boosting efficiency and productivity. These were the main motivations of the economic reforms, implemented in the countries of the region in the years 1964–1968 [6]. The bulk of measures sought to improve economic efficiency by rationalizing the system of planning and management. They also wanted to grant more autonomy to enterprises in investments by abolishing compulsory plan indicators [14]. It must be stressed that the external circumstances changed significantly when five member states of the Warsaw Pact crushed the Prague Spring on 20 August 1968. The military intervention of the Soviet-led alliance meant the end of the reform process in
Czechoslovakia. In Hungary, the New Economic Mechanism (NEM) was suspended by the Central Committee of the Hungarian Socialist Workers’ Party (HSWP) in November 1972. The neo-Stalinist and conservative policy line adopted by Brezhnev had gathered strength following the ousting of Khrushchev in 1964 [20]. At the beginning of the 1970s, orthodox communists of Central and Eastern Europe – except Yugoslavia – rejected any move towards market economy with the support of Moscow.

The lack of adjustment to the changed circumstances had serious consequences on the Soviet bloc countries. The overwhelming majority of investments were concentrated in energy intensive and polluting heavy industrial branches. The countries of the region were unable to follow the technological revolution and could not build up new modern export sectors. Berend emphasizes the striking technological backwardness of Central and Eastern Europe compared to the most advanced West European countries and the United States. Telephone networks, which became the driving force in the period of communications and computer revolution remained obsolete in the Soviet satellite states. Due to the ban on technology exports under the so-called COCOM list, the socialist countries were cut from modern new items and equipment. As a result of general prohibition, the telecommunication sector remained antiquated: by the end of the 1970s telephone lines per 100 inhabitants was only 7.4, which was one-quarter coverage in Common Market countries, and less than one-tenth coverage in the United States. Personal computers, which signaled the mechanization of offices did not spread in the Eastern bloc. Even in the late 1970s altogether 650 computers were in operation in the entire region [4].

Occupation structure also reflected the increasing backwardness between free market economies and state socialism. Whereas at the beginning of the 1970s, more than two-thirds of gainfully employed people worked in the service sector in Western Europe and the United States, this figure was only 20-30 percent in Central and Eastern Europe. Thanks to the technological development and innovation, services gained ground in the most advanced countries of the world economy. The main problem was that services were completely neglected in centrally planned economies. Because of short-sighted policy based on ideological considerations, the gap between Central and Eastern Europe and the West further widened [16].

As a result of the oil shock, CMEA countries, which depended greatly on energy imports, had to face increasing difficulties in their economies. The most advanced countries reacted flexibly to the structural changes of the world economy, but the socialist bloc did not adjust to the new circumstances. Comecon, which served Soviet economic domination of the bloc countries, was a regional organisation focusing on intra-trade among its members. It was a non-competitive and isolated market, characterized by permanent shortages and fixed-state managed trade agreements, served to defend the economy of the Soviet bloc. Until the early 1970s, trade conducted by CMEA member countries varied between 66 and 75 percent within the economic organisation, led by the USSR. Commercial relations with free market economies were negligible [11].

As far as trade with Comecon was concerned, a slow erosion of the Soviet-led economic organisation became visible in the early 1970s. An unavoidable slowing down of production increased permanent shortages and pushed the socialist countries onto open, free trade world markets. Poland, Hungary, Romania and Yugoslavia built up closer relations with the West and reduced trade with CMEA countries to 40–50 percent. During the second half of the 1970s, more than half of their foreign trade was conducted with free market countries. The command economies of Central and Eastern Europe were sensitive to fluctuations in foreign trade: in the mid-1970s, exports comprised roughly half of the Hungarian and 20–25 percent of the Polish, Yugoslav and Romanian GDP. Under such conditions, a lack of adjustment resulted in a dramatic deterioration of the terms of trade [5]. In the first five years after 1973, the countries of the region suffered a 10 percent to 20 percent decline. In the mid of the 1980s, the deterioration of the terms of trade varied between 26 and 32 percent in the Soviet satellite states [7]. In the case of Hungary, the ratio of export and import prices declined by 20 percent in the years 1974–1975. According to Botos’ calculations, about an entire year of GDP was lost in this manner throughout a seven-year cycle after 1973 [13]. Gati notes that in 1974 Hungary could trade 800 Ikarus buses for 1 million tons of Soviet oil, but by 1981 2300 buses were required for the same quantity of oil [17].
Table 1. Distribution of the CMEA region’s trade with the West by countries (total exports and imports of the CMEA region = 100)

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<tr>
<td>USSR</td>
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<td>32.2</td>
<td>41.0</td>
<td>37.0</td>
<td>44.8</td>
<td>45.4</td>
<td>53.9</td>
<td>47.7</td>
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<td>4.0</td>
<td>6.3</td>
<td>3.4</td>
<td>4.7</td>
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<td>Czech.</td>
<td>10.8</td>
<td>12.8</td>
<td>10.4</td>
<td>11.1</td>
<td>8.3</td>
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<tr>
<td>Poland</td>
<td>16.2</td>
<td>13.9</td>
<td>15.4</td>
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<td>16.1</td>
<td>19.9</td>
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<td>Hungary</td>
<td>7.1</td>
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<td>7.8</td>
<td>8.9</td>
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<td>6.7</td>
<td>6.1</td>
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<tr>
<td>GDR</td>
<td>14.7</td>
<td>17.2</td>
<td>13.9</td>
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<td>9.9</td>
<td>11.2</td>
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<td>Romania</td>
<td>7.3</td>
<td>9.2</td>
<td>8.1</td>
<td>10.0</td>
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Maintaining full employment and higher living standards were among the declared goals of the communist regimes in Central and Eastern Europe. The CMEA countries wanted to maintain their forced rapid growth, which led to increasing trade deficits. The recurring balance-of-payments deficits could be offset by obtaining loans from international financial markets. The main reason for that was East-European currencies were non-convertible, and payments in these denominations were not acceptable to Western exporters, who demanded hard currency. This prerequisite meant that East European governments were compelled to seek credits from Western countries and banks [2]. The financial markets were flooded with cheap “oil dollars”, as a large portion of the tremendous income of oil-exporting countries was exported as credit. It was cheap and easy to borrow during the early 1970s and the governments of the region did not hesitate to bridge the trade deficit gap with loans.

The second oil crisis of 1979 was coupled with the worsening of relations between the two main superpowers, the Soviet Union and the USA. The deployment of intermediate-range ballistic missiles in 1979 by the Soviet invasion of Afghanistan in 1979 signaled negative developments in the international economic and political environment [12]. Additionally, a deep financial crisis arose in 1979 with the rise of oil prices following the Iranian revolution, which forced the US government and Western countries to introduce austerity measures to curb inflation and reduce the budget deficit. The US Federal Reserve (FED) conducted a tight monetary policy by rising interest rates. At the end of the 1970s, cheap credit disappeared, and interest rates rose to 14–16 percent. It became difficult to obtain new loans from international money markets. As a result, almost all countries of the region fell into the trap of indebtedness. At the beginning of the 1980s, Hungary, Poland, Romania and Bulgaria had accumulated huge amounts of debt, which varied from 10 to 30 billion dollars. The net value of debt in the region increased from 6 to 79 billion over the period 1970–1980. Indebtedness became a self-generating process from the 1970s, which hindered any adjustment since 5–6 percent of GNP was leaking out of the national economy. On per-capita basis, Hungarian indebtedness was the highest, USD 2,585 compared to the Polish USD 1,100 and the Bulgarian USD 1,068 debt level. At the end of the eighties, the debt service consumed between 40 and 75 percent of the hard currency income of the socialist countries. From the USD 20 billion in debt incurred by Hungary, only USD 4–5 billion was invested in the economy [8].
The impacts of the 1973 and 1979 oil crisis on Central and Eastern European countries

Table 2. East European indebtedness in the 1970s: gross debt in billions of current dollars

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<tbody>
<tr>
<td>Bulgaria</td>
<td>0.7</td>
<td>1.0</td>
<td>1.0</td>
<td>1.7</td>
<td>2.6</td>
<td>3.2</td>
<td>3.7</td>
<td>4.3</td>
<td>4.5</td>
</tr>
<tr>
<td>Czech.</td>
<td>0.5</td>
<td>0.6</td>
<td>0.8</td>
<td>1.0</td>
<td>1.1</td>
<td>1.9</td>
<td>2.6</td>
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<tr>
<td>GDR</td>
<td>1.4</td>
<td>1.6</td>
<td>2.1</td>
<td>3.1</td>
<td>5.2</td>
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<td>7.1</td>
<td>8.9</td>
<td>10.1</td>
</tr>
<tr>
<td>Hungary</td>
<td>1.1</td>
<td>1.4</td>
<td>1.4</td>
<td>2.1</td>
<td>3.1</td>
<td>4.0</td>
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<td>7.8</td>
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<tr>
<td>Poland</td>
<td>1.1</td>
<td>1.6</td>
<td>2.8</td>
<td>4.6</td>
<td>8.0</td>
<td>11.5</td>
<td>14.0</td>
<td>17.8</td>
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<td>Romania</td>
<td>1.2</td>
<td>1.2</td>
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<tr>
<td>Yugoslavia</td>
<td>3.2</td>
<td>3.9</td>
<td>4.7</td>
<td>5.4</td>
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<td>7.9</td>
<td>9.5</td>
<td>11.8</td>
<td>15.0</td>
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<tr>
<td>Total</td>
<td>9.3</td>
<td>11.3</td>
<td>14.4</td>
<td>20.8</td>
<td>29.6</td>
<td>37.4</td>
<td>46.2</td>
<td>58.7</td>
<td>68.7</td>
</tr>
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</table>


Based on relevant data, it can be stated that at the end of the 1970s, the Central and Eastern Europe countries accumulated huge amounts of debt. From the early 1980s, Western banks started to follow a cautious credit policy, which meant that unlimited and cheap credits were no longer available on international money markets. Poland and Yugoslavia's balance of payments crisis further deteriorated the creditworthiness of the debtor countries. Hungary could not obtain loans and during 1982 more than USD 1 billion in short-term deposits were withdrawn by foreign investors from the Central Bank of Hungary. Economic collapse could have been avoided by Hungary’s accession to the International Monetary Fund (IMF) and the World Bank. Thanks to the USD 3 billion loan offered to Hungary by the IMF, it succeeded restoring investor confidence in the country’s financial markets and default was avoided [19].

Romania chose the most extreme way to escape from the indebtedness trap. In December 1982, the Ceaușescu regime decided to pay off the large foreign debt as quickly as possible. Its main aim was to prevent Western countries and their financial institutions from interfering in the national economy. Imports were drastically cut, but at the same time, steps were taken by the communist leadership to boost exports. The latter was achieved through reducing domestic supplies of foodstuffs and energy. As a result of draconian policy, there was a general scarcity of basic commodities. In November 1983, energy consumption of households was cut by 50 percent by the government. At the end of the 1980s, Romania was able to repay the Western loans, but the country had to face a deep economic and social crisis and increasing poverty [18].

Inflation was the concomitant of the global economic crisis during the 1970s. Under state socialism, prices were set by central authorities; therefore, inflation was kept under control. In centrally planned economies, foreign trade prices became hermetically isolated from domestic prices. This price mechanism could not be maintained in the second half of the 1970s, when inflationary pressures were clearly visible in the socialist countries. The more open Yugoslav economy, which had closer ties with the West was hit by inflation from the early 1960s. The problem was especially acute over the period 1973–1979. In the years 1971–1977, consumer prices increased roughly 18 percent in the Balkan country. As Aldcroft and Morewood rightly stress that Eastern Europe as a whole could not entirely escape from being contaminated by capitalist inflation, which greatly increased the cost of imported Western technology. Poland also imported inflation with the purchase of machine tools and equipment from the West [3].

The phenomenon was not unique because consumer prices also increased in Western economies, but thanks to restrictive monetary policy, inflation was curbed successfully and was kept under control. In Central and Eastern Europe, despite the efforts to suppress hidden inflation by state subventions, consumer prices started to accelerate at the beginning of the 1980s, which could not be stopped by bureaucratic means of the command economy. In the mid-1980s, it became increasingly open in most of countries in the region, fueled by fiscal deficits. The situation was the worst in Poland and Yugoslavia, which were hit by a wave of hyperinflation.
Taking into account both internal and external circumstances, all Central and Eastern European countries had to face a deep and prolonged structural crisis. The short-sighted policy of the communist regimes led to a dramatic backlash. Instead of introducing overarching reforms, policymakers insisted on maintaining full employment and increasing the standard of living of the population. Due to the scarcity of sources, a fast-growth policy could only be maintained by turning to the international money market for loans. As a result, structural crisis was coupled with growing indebtedness and disequilibrium.

4 Results

Based on literature overview and relevant data, it can be stated that both the 1973 and 1979 crisis had profound impacts on Central and Eastern Europe. The energy shock exerted negative influences on the economies of the region. The main problem was that the Soviet bloc countries did not respond adequately to the oil crisis because instead of applying energy-saving methods, the majority of investments were concentrated on heavy industrial branches, which had to be fed largely by imports. Central and Eastern Europe preserved its obsolete economic structure and could not built up modern export sectors. State socialist governments reacted belatedly to the changed international economic environment in the 1970s. In Poland, the administration of Edward Gierek followed the “import-led” growth strategy, which became the most important element of the fourth Five Year Plan (1971–1975). The objective of this strategy was to obtain Western imports of investment goods, essential for the modernization of Polish industry and agriculture, but consumer goods had to import from the free market economies to improve the living standard of the population. During the first half of the 1970s, an artificial economic boom took place: investment in 1975 was 124 percent above its 1970 level (in real terms) and its share in the national income rose from 22 percent in 1971 to 32 percent in 1975. The investment boom was not accompanied by the modernization of the production structure and export sectors. Increased imports of Western consumer and investment goods undermined the forced growth strategy and contributed to the increasing disequilibrium in the Polish economy. Whereas the value of imports from Western countries nearly quadrupled between 1971 and 1975, that of exports doubled during this time. This misguided economic policy had serious consequences because Poland’s net foreign debt to the West increased from USD 1.3 billion to 7.6 billion in the years 1971–1975 [21].

In Hungary, the communist leadership attempted to curb import and boost export with socialist countries. Although exports were subsidized heavily, production structure hardly changed. During the 1970s, several investment projects had to be financed from imports, placing an additional burden on the national economy. The period 1971–1975 was characterized by overstrained investments and twice as many new projects were planned than over the last ten years in the 1960s. Growth rates of income slowed down, but industrial energy needs further increased [22]. Large industrial complexes relied heavily on raw material imports from the Soviet Union. Therefore, the volume of imports grew substantially, while exports declined continuously throughout the decade, which led to increasing balance of payments deficits and rising level of debt. At the end of the 1970s, Hungary’s hard currency debt reached USD 9.5 billion [15].

To make matter worse, structural crisis was accompanied by economic slowdown in the Soviet bloc countries. According to the World Economic Survey of the United Nations, during the first half of the 1980s, the rapid growth of the previous decade came to a standstill. The annual rate of expansion of aggregate output in Central and Eastern Europe dropped from 3.9 percent in 1976–1980 to 2.2 percent in 1981–1985. In all countries of the region, performance remained well behind the plan targets between 1981 and 1985. As national income in Hungary and Czechoslovakia grew by only 1.2 and 1.8 percent over the same period, the increase of the standard of living of the population could not be maintained. In Poland, national income decreased by 0.8 percent in the years 1981–1985 [23].

At the end of the 1980s, all macroeconomic indicators worsened significantly in the Central and Eastern European countries. The deepening crisis of the 1980s was further exacerbated by internal and external disequilibrium, coupled with growing indebtedness.
5 Conclusions

The energy shock and the global economic crisis of 1973 and 1979 had negative impacts both on the advanced countries of the world economy and the Soviet bloc. The leading Western economies responded adequately to the challenges brought by the depression of the 1970s. Energy-wasteful industrial branches, such as iron and metallurgy were gradually phased out and emphasis was placed on innovation and technological renewal. Thanks to the modernization of their production structure and export sectors, Western Europe, the United States and Japan could overcome the economic difficulties of the early 1980s and achieved a sustainable growth.

The turn of the 1970s to 1980s was devastating for the Central and Eastern European countries, which could not keep up with the revolutionary advanced technologies. In the mid-1970s, more than two-thirds of investments concentrated on building up large heavy industrial conglomerates. To maintain full employment and fast-growth policy, the governments of the region did not hesitate to seek credit from Western countries and banks. The short-sighted policy followed by communist leaderships led to dramatic consequences because increasing balance of payments deficits could be offset by obtaining new loans. This process led to severe indebtedness in the region. The main problem was that servicing the debt seriously hindered any adjustment and significantly weakened investment possibilities at the national level.

The rigid and bureaucratic steering mechanism of the command economy was not overhauled and any move towards modernizing obsolete production structure was also postponed. An additional problem was that in the early 1980s, the dynamic annual growth (3.9 percent) of the previous decade started to slow down and in the second half of the 1980s, Central and Eastern Europe entered a period of stagnation. At the same time, full employment, and wellbeing of citizens, which were the declared goals of state socialism were unsustainable in the long term. By the end of 1989, the deepening structural crisis was accompanied by internal and external disequilibrium. All these factors undermined the pillars of command economies and finally contributed to the collapse of the communist regimes in the region.

References


