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COMMITTEE ON ECONOMIC AFFAIRS AND DEVELOPMENT

Preliminary draft report

on the role of petro-dollars in Western Europe
(European Economic Problems)

(Rapporteur: Mr VOHRER)

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I. INTRODUCTION

1. Since January 1975 when I proposed that the committee should study the problem of surplus funds of oil exporting countries (known as "petro-dollars"), the scenario has evolved considerably.

1974 was the year in which the four-fold oil price increases of late 1973/early 1974 (the so-called "oil shock") were strongly felt throughout the world; in that year OPEC countries enjoyed a record current account surplus of about $60 billion with the rest of the world; OECD countries, after having run a current surplus of $2 billion in 1973, supported a deficit of $33.1/4 billion (1).

2. As the major shock of the oil price increases was being felt, several organisations and research institutes made projections on the possible cumulative surplus of OPEC countries by 1980 (2)

The economists of the Morgan Guarantee Trust Company were among the optimists for oil consumers when they foresaw that OPEC collective annual surplus would turn into a deficit in 1979, after a cumulative total peak of $248 billion in current dollars in 1978; OECD, on the other hand, estimated that total OPEC accumulations by 1980 would be of the order of $250-$300 billion (in 1974 dollars) and that the OECD's current deficit could disappear by the same date (3). The World Bank also forecasted a cumulative surplus of about $300 billion by 1980 (in constant 1974 dollars) (4).

3. As 1975 progressed, the picture changed considerably. The current deficit of OECD countries, which was over $33 billion in 1974, has decreased to $6 billion in 1975.

Three-quarters of this improvement has been with OPEC countries. The remaining quarter has taken place with those who can least afford it: the oil importing developing countries.

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(1) For OECD Europe the figures were + $1 billion in 1973 and - $22.1/2 billion in 1974.

(2) G A Pollack: "Are the oil payment deficits manageable?" Essays in international finance/Princeton University, June 1975

(3) OECD Economic Outlook, July 1974 p.95

(4) H B Chenery "Restructuring the world economy". Foreign Affairs, January 1975 p.242

NB "billion" = 1000 million
$ = US dollars

The performance of OECD countries can be explained by the considerable increase of exports from OECD countries to the OPEC area, and by the limitation of oil imports. Of the two phenomena, the former will continue to play an important part in the medium and long term; with regard to the size of OECD oil imports, it will depend on the evolution of the recession (in the medium term) and on energy policy of OECD countries.

4. These new developments have led OECD to revise - in the July 1975 Economic Outlook - its forecasts concerning the 1974-1980 cumulative OPEC surplus from $250-300 billion to $200-250 billion (1). However, the very recent import behaviour of OPEC countries may well prove that even the July 1975 forecast was exaggerated.

On the financial front, it is also possible to detect a gradual change in the strategy of OPEC countries: as the first flow of oil income started to accumulate, OPEC countries proved to be prudent and conservative investors by favouring liquid assets in strong financial institutions and strong countries. In the more recent past, however, they have linked their investment policies closer to their development policies and, to the extent that financial surpluses were available after sizeable import increases, they have gradually diversified their investment policies.

5. The situation created by the "oil crisis" is, therefore, in a permanent state of flux and several elements will have an important bearing on the medium term evolution:

- the extent of the recovery already begun in Northern America and Japan and hopefully soon beginning in Western Europe (the resumption of the economic activity in the OECD area will certainly cause an increase of oil imports);

- the evolution of the external balances <u>within</u> the OECD area itself (at present the area as a whole is more or less in balance with the rest of the world, while most of the smaller European OECD countries run a sizeable deficit);

- the energy policy of oil importing countries (energy saving measures, development of alternative resources etc);

- the outcome of the north-south dialogue;

- the evolution of the external balance of non-oil producing developing countries (at present they bear most of the deficit vis-à-vis the OPEC area);

This tentative list of problems ahead clearly shows that there is no easy solution available which is consistent with acceptable levels of real income throughout the world.

(1) OECD Economic outlook, July 1975 p.78

6. Recent events seem, therefore, to shed a less dramatic light on the medium-term economic consequences for Western Europe of oil prices than was the case early in 1974. Temptations to take a strong line against the OPEC monopoly (suggested at the time by Dr. Kissinger) have given way to a more constructive approach to the oil problem exemplified by the resumption of the Paris Conference on 16 December 1975.

This, however, should not lead to too great an optimism and make us believe that the market forces alone can deal with the situation. The purpose of the present report is, therefore, to make a contribution towards the study of outstanding problems.

II. INTERNATIONAL PAYMENT CONSEQUENCES OF HIGH OIL PRICES

7. The problem created by the "oil shock" is essentially one of imbalance in international payments. Before this oil shock the imbalance was in favour of the OECD area; countries of this area were running a sizeable current account surplus (1) of the order of $10 billion. The balance was brought about by capital movements from the surplus to the deficit area in terms of private foreign investments, military expenditures, official development aid, and loans.

8. Without saying that the system was in balance - for clearly it was not the case (2) - at least it worked more or less "smoothly" and, what is more important, nobody seriously complained. The picture has changed dramatically since 1974 when the imbalance considerably swung in favour of the OPEC area.

9. The reasons for this imbalance are manifold:

i. sharply higher prices for oil: the major oil exporters organised in the OPEC cartel have succeeded in imposing higher prices;

ii. low price elasticity of demand for oil in short run: in view of the fact that modern industrial processes have a high energy content (satisfied mostly by oil) industrialised countries have little margin - at least in the short run - for decreasing their oil consumption when the price increases;

iii. limited absorptive capacity (3) of a number of key oil exporters: these countries have at their disposal more financial resources than they can effectively use nationally. Their import increases therefore lag behind their oil revenue increases. In other words, the OPEC area will run a substantial current account surplus vis-à-vis the rest of the world for several years to come.

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(1) The balance on current account includes flows of goods (exports and imports) and services.

(2) Often confronted with decreasing export revenues, developing countries had little alternative but to compensate the trade deficit with capital inflows of some sort. Recently the borrowing of developing countries in the Euro-currency market has increased considerably.

(3) Rate at which export revenues are spent on imports.

10. In this situation the balance in international payments has to be brought about by capital movements from the OPEC surplus area to the deficit areas of OECD countries and of the oil importing developing countries.

11. The prospects for the OECD area are considerably less dim than those of the oil-importing developing countries for various reasons. Most of the additional OPEC imports are and will be satisfied by OECD producers; at the same time most of OPEC surpluses are and will be placed in one form or another in OECD financial markets. Then the major problem of this area is not so much its overall payments' balance with the rest of the world, but rather the balance among its member countries.

12. As regards oil-importing developing countries, most recent international economic events have turned against them. International emergency aid schemes need therefore to come to grips with their specific problems.

13. In order to have an idea of the order of the possible imbalance in international payments, it is useful to analyse the medium-term evolution of OPEC current balance; rather than looking at the forecasts of the possible cumulative current surplus of the OPEC area made by different institutions (1) (which could contain a large margin of error), it is more interesting to assess the likely import behaviour of the different OPEC countries.

14. In this respect, a recent OECD Economic Outlook (2) distinguishes two groups of countries on the basis of their absorptive capacity (ie the rate at which they spend their oil revenues on imported goods and services):

i. low absorbers: this group is made up of the desert countries of the Persian Gulf and Libya that have small populations, large oil reserves and limited natural resources other than oil. These countries, which have a total population of around 12 million people, experienced net capital outflows even before 1973.

ii. high absorbers: this group consists of the remaining OPEC countries which have relatively large populations (a total of 270 million people), more diversified resources and more articulated development programmes.

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(1) See Table I of the Appendix.

(2) Economic Outlook No. 17, July 1975, p. 78/85.

15. In 1974 imports of high absorbers amounted to 40% of their export revenues. In 1975 this proportion increased to approximately 60%. In the medium term the OECD Outlook in question assumes that the development needs of these countries are such that by about 1980 they will be spending almost all of their current export revenues, despite such constraints as inadequate infrastructure, shortage of technical skill etc.

In the early 1980s these countries could find that the momentum of import growth associated with development projects under way is producing a current deficit position which could deplete their accumulated reserves very quickly.

16. As far as low absorbers are concerned, their likely import demand is more difficult to project. The proportion of oil revenues spent on imports was 20% in 1974 and increased to 25% in 1975. Because of a series of limitations in their economic structure, low absorbing countries could raise the proportion of oil revenues spent on imports to only 40% by 1980. Their current account surplus could run at the annual average of $30-35 billion (1974 prices) until the end of the present decade and decrease thereafter. OECD also assumes that by 1980 high absorbers will account for some 55% of total oil production.

17. The financial policies of the two groups will most likely reflect the development of their import policies: high absorbers will have a higher propensity for liquid and semi-liquid investments, bond rather than equity investment.

The group of the low absorbing countries will, on the contrary, have at their disposal for investment oil revenue surpluses even during the next decade; they will therefore develop a more complex network of investments in equities, real estate and bonds.

III. INTERNATIONAL TRADE POLICIES

18. Among the more urgent international trade questions precipitated by the energy crisis are the use of trade measures in cases of balance of payments disequilibrium and the evolution of terms of trade among major trading areas of the world.

While both issues have an international, and even a worldwide dimension, I shall confine myself to analysing the first in the OECD context and the second in the OECD/OPEC context.

19. Because of the deterioration of the current accounts of most OECD countries, there has been and will be a strong temptation to resort to unilateral trade measures to improve national competitive positions. A case in point is the

unilateral action taken by Italy between May 1974 and early 1975 to require advance import deposits as a means of coping with its deteriorating payments position; another more recent, but more limited case is that of the United Kingdom which has just introduced quotas in some sensitive sectors with the agreement of its EEC partners.

20. Export controls, even though they have a different motivation, can also be classified under the heading of limitations to trade. In response to rising domestic meat prices, the USA have, for instance, instituted in 1973 a temporary embargo on soya bean exports, replaced shortly thereafter with a system of export licensing designed to reduce US exports.

It was with this kind of problem in mind that the OECD countries adopted in May 1974 a declaration that they would, for one year, avoid trying to deal with the consequences of the oil situation through unilateral trade measures. The OECD declaration, which was renewed in May 1975 for another year, has been altogether successful, the only minor exception being the import restrictions recently introduced by the United Kingdom (1).

21. However, in view of the possible payments difficulties of some OECD member countries, it would be unrealistic to expect countries to agree to an absolute prohibition of the use of trade restrictions. Under a system of flexible exchange rates, the case for the use of trade measures is diminished, but countries can still choose to have recourse to them because they have a shorter time lag than exchange rate changes and also because, under certain circumstances, currency depreciation can be more inflationary. An effort should therefore be made for introducing commonly agreed norms (to be applied by GATT and IMF) that regulate and limit recourse to trade restrictive measures.

22. The issue of the terms of trade (2) among trading groups is considerably more complex; the evolution of prices between 1950 and 1974 exemplify for instance that developing countries have witnessed deteriorating terms of trade throughout the period except for the early 1950s, in conjunction with the Korean War, and around 1973, in conjunction with the strongest boom of the OECD area since World War II and the oil shock (3).

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(1) Italian restrictions had been imposed prior to the adoption of the declaration.

(2) The terms of trade express the relationship between the evolution of prices of exports and the prices of imports (an index of export prices divided by an index of import prices). If a country's export prices have increased more than its import prices, its terms of trade are said to have improved.

(3) See Table II of the Appendix.

23. In 1974/75 only oil exporting countries have succeeded in maintaining their lead, since the prices of most other commodities have now fallen to their pre-boom level. With regard specifically to oil, its 1973 realised price in constant dollars was lower than its 1950 level (1); in other words the terms of trade of oil exporting countries had deteriorated between these two dates.

24. Further to the successful attempt of OPEC countries to shift the trend in their favour, developing countries are increasingly determined to avoid any future deterioration of their terms of trade (2): in international conferences they have put the fluctuation of supply, demand and prices of commodity exports at the centre of their suggestions for revising the international trading system.

25. How they are going to accomplish this aim depends very much on the response of industrial countries: priority attention can be given to price support schemes through either producer cartels (such as OPEC) or commodity agreements (such as the cocoa and tin agreements) to which both producers and consumers take part; conversely attention could be focused on trade expansion schemes such as the GSPs (Generalised System of Preferences) which would increase the volume of traded commodities (3).

26. It is the belief of your Rapporteur that more positive attitudes towards commodity agreements and GSPs on the part of OECD countries may help to deter the present tendency towards the formation of producers' cartels. Multilateral

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(1) See Table III of the Appendix.

(2) Terms of trade are a central element in developing countries' investment strategies. Confronted with limited possibilities to generate domestic savings these countries finance to a great extent their development policies out of their export earnings. However, during the period 1960-73 of sustained growth and fairly good performance of exports from developing countries, these countries covered only 80% of their import expenditures with export receipts. In this situation developing countries have to revise downwards their development plans, and/or attract capital inflows, and/or borrow abroad, and/or beg for more official aid.

(3) The World Bank has estimated that the liberalisation of trade in primary commodities by OECD countries might yield an additional $6-12 billion in earnings for developing countries by 1980, mainly by expanding volume rather than by increasing prices. See W Tims "Possible effects of trade liberalisation on trade in primary commodities" World Bank, January 1975.

agreements on certain internationally traded commodities with balanced representation of importing and exporting countries may indeed prevent sharp fluctuations in prices and arbitrary interruptions of supply. At the same time, a freer access of developing countries' exports to industrial markets would provide developing countries with needed additional earnings through trade expansion rather than price increases.

27. As for oil, which is at present the most important internationally traded commodity, I suggest specifically to use the relation between oil prices and prices of industrial exports as a guideline for setting an agreement between OECD and OPEC countries. The suggested terms of trade guideline would not introduce a fixed relation (direct indexing) between the price of these two sets of commodities but simply lower and higher limits beyond which the terms of trade would not be allowed to float.

As major new events occurred, the two limits could be moved by agreement on both sides.

28. This scheme would not introduce any more rigidity or "dirigisme" in international trade than already exists: the oil market is not a market with pure competition, neither on the supply nor on the demand side.

The merits of this approach would consist of proving to OPEC countries that the industrialised world does not want to break up their cohesion and of obtaining in return their accrued co-responsibility on financial matters.

At the same time the industrialised countries could count on fairly stable oil prices in real terms and be in a position to develop more reliable medium- and long-term energy policies.

29. It is interesting to note that my suggestion of terms of trade guidelines differs considerably from the principle of minimum safeguard price as suggested by the International Energy Agency of OECD. According to this latter scheme, oil prices would fluctuate freely in international markets, but would be prevented from falling below a minimum level within the OECD area so as to maintain the competitivity of OECD energy investments.

IV. INTERNATIONAL FINANCIAL POLICIES

30. Oil importing countries should take whatever steps are necessary to reduce their energy deficit by conserving energy and developing alternative resources. At the same time their current deficit will steadily decrease on account of import increases by OPEC countries.

For the next few years however, the absorptive capacity of OPEC countries is such that oil importing countries will run a deficit on current account to be met by corresponding capital inflows from the OPEC area.

a. Short- and medium-term policies

31. The basic problem of international financial movements or "recycling" is to ensure that the pattern of capital flows matches the internationally accepted distribution of current account deficits among oil importing countries (1).

Except for investments in real property and equities, the recycling mechanism is a credit device, ie to be used on a temporary basis for allowing a gradual structural reconversion of the world economy.

32. As far as OECD countries are concerned, the recycling can take the form of:

i. primary recycling, ie tapping funds directly from the oil exporting countries;

ii. secondary recycling, ie leaving the oil surpluses to fall where they may in OECD financial markets and then re-channelling them within the OECD area according to the needs of its member countries.

International organisations, such as the IMF and the World Bank, can also act as intermediary in the recycling function.

33. Little official information is available from OPEC countries themselves on their investment policies; the EEC Commission and the US Department of the Treasury have, however, compiled a breakdown on how OPEC countries deployed their surplus in 1974 and during the first six months of 1975.

34. As Table IV of the Appendix shows, in 1974 about 67% of OPEC surplus revenue flowed into liquid investments in the Euro-currency market (2) and the traditional money markets of New York and London. These markets have served as intermediaries for recycling oil money to deficit countries. In the first half of 1975 the flow of oil money has been estimated at around $23 billion, of which $10 billion went to the Euro-currency market, $2 billion to the USA and $760 million to the United Kingdom.

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(1) The recycling mechanism is therefore purely financial. Describing as "recycling in real terms" the increase of OECD exports to OPEC countries - as does O Emminger - only confuses the issue. See O Emminger: "International financial markets and the recycling of petrodollars"; the World Today, March 1975.

(2) An international pool of bank deposits denominated in foreign currencies that are held in European commercial banks, including European branches of US banks. The dollar remains the predominant currency, accounting for 70% of total funds.

35. The Euro-currency market has been the largest single market handling petrodollars: an estimated 36% in 1974 and 43% for the first six months of 1975. Thanks mainly to oil money, the Euro-currency market has considerably increased in size in the last few years: the net size of this market grew by $40 billion in 1973 and by $45 billion in 1974, bringing the total to $177 billion by the end of 1974 (1).

36. On the supply side of the market, the volume of new funds injected by the OPEC countries in 1974 may be estimated at around $24 billion; on the users' side, many oil importing countries borrowed heavily from the market.

37. Against the background of an exceptionally rapid expansion of the Euro-currency market, apprehension began to arise in the spring of 1974 about the potential dangers for the Euro-currency market. These fears were subsequently confirmed by large foreign exchange losses incurred by a few banks and by the failure of the Herstatt Bank (Federal Republic of Germany) and the National Franklin Bank (USA).

38. The Euro-currency market, as well as the other intermediation markets have been confronted with the two main problems inherent with recycling, ie the risks of maturity transformation and those of solvability (2). These risks are assumed by intermediation markets or institutions in lieu of creditors.

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(1) 45th annual report of the Bank for International Settlements, Basle, June 1975, p. 130.

(2) Up to now OPEC countries have shown a preference for rather liquid investments, while the financial needs of deficit countries have a longer time horizon. At the same time OPEC countries have shown a marked preference for placing their funds in strong OECD countries rather than weak ones. Intermediation markets are therefore called upon to transform short-term deposits in medium- and long-term loans and to re-channel funds from strong to weak oil-importing countries. The maturity risk is likely to decrease overtime as an increasing proportion of OPEC funds are attracted into less liquid investments. With regard to the solvency risk, it is worth noting that intermediation function of the Euro-currency market raises a delicate political question: private financial institutions are judging the credit-worthiness of a country, a judgement which belongs more to the realm of politics than that of finance.

39. Steps must therefore be taken so that oil producing countries themselves assume these risks, inter alia, through the direct granting of credits to debit countries (for example the Saudi Arabian loan of $1 billion to Japan) and through investment of funds on a long-term basis. Moreover, according to current opinion more oil funds should be channelled to international bodies; the credit and repayment risk would thereby be distributed among a larger number of countries and it is more likely that the charges of debitor countries would be met.

40. Up to now three international recycling mechanisms have been introduced; the IMF oil facility has lent 1.5 billion SDRs to developed countries during its first year of operations in 1974. The next year the oil facility has been devolved only to developing countries.

At the beginning of 1975 the countries of the European Economic Community have agreed on a plan under which they can jointly borrow up to $3 billion from oil producing countries. The loans, which are jointly guaranteed by the nine EEC governments, are made on a case by case basis.

41. The third system is the so-called OECD Financial Support Fund (Kissinger Fund). It is an assistance fund for OECD countries themselves acting as a lender of last resort (safety net) and amounting to some $25 billion. Unlike the IMF oil facility, the OECD arrangement does not involve any direct dealings with OPEC countries; thus these countries continue to take their chances in lending and investing their surpluses in OECD financial markets.

42. It is obvious that these kinds of recycling mechanisms have well-defined limits since in practice the risks are borne by hard currency countries.

43. The participation by oil-producing countries in concerns of industrialised countries (in the Federal Republic of Germany, for example, in the Daimler-Benz and Krupp Works) have provoked sharp criticism. Here the principle of freedom of international capital flows, which cannot be a one-way street, and the fear of excessive foreign domination confront one another. It is assumed that direct participation in industries by OPEC countries is not always motivated by purely economic considerations. These conflicts can only be overcome by flexible solutions. On the one hand, legal defensive regulations raise difficult problems - and are moreover bound to have gaps - and, on the other hand, under a laisser-faire policy, undesirable developments from an economic and security standpoint cannot be excluded.

44. Up to now, recycling has functioned quite smoothly. This does not mean, however, that it is bound to do so also in the future. All existing recycling channels, and above all the Euro-currency market will, presumably, make their contribution also in the future. However, the functional ability of the "safety nets" in the form of international assistance systems, should not be weakened but should be strengthened further.

b. Long-term policies

45. I will deal briefly with only two concepts. They are differentiated by the fact that one of them is based on the fundamental idea of recycling and the other is aimed precisely at departing from this system.

46. The first proposal - also known as "Roosa-Plus-Plan" - was formulated by an international group of experts (including the former American Under-Secretary of State to the Treasury, R Roosa).

The plan distinguishes between three problem areas. In the forefront are the requirements of the developing countries which do not have oil resources. They suffered a particularly hard blow. It is therefore proposed that the leading OPEC and industrialised countries create a pool for long-term low-interest loans and administer it jointly. Steps would have to be taken to ensure co-ordination of this pool with the activities of the IMF, the World Bank and the United Nations Development Programme.

47. The second concept concerns the institutionalisation of the granting of credit to industrialised countries to enable them to cover their economy's oil requirements during an initial phase. Contrary to the principle of the OECD Fund, it is proposed that the OPEC countries assume some responsibility and share directly in the credit risk. This is intended to be achieved by means of an OPEC fund for governmental bonds. The OPEC countries would invest in this fund; their capital would be invested exclusively in public bonds of the industrialised countries issued specially for the purpose.

48. The most important proposal of the group of experts is that a major part of the surpluses of the oil-producing countries be devoted to productive investments in petroleum-importing countries. (This is intended to enable them, by means of increasing exports, to gradually meet themselves the additional cost of oil imports.) This objective is to be achieved through an OPEC investment fund which would invest the financial resources in shares of private concerns and convertible bonds. By means of an appropriate diversification policy, it would be possible to build up a qualitatively sound and profitable portfolio. It is the OPEC countries which would bear the investment risks.

49. The authors base themselves on the assumption that such a procedure would prevent individual oil-producing countries from exerting a direct influence on industries in other states. In addition, the OPEC investors would have the guarantee that (thanks to the fact that the investment fund would be administered by experts) their participations would be handled exclusively according to investment criteria rather than political criteria.

50. The second proposal (recommended by the German economist Hankel) (1) puts forth a solution without recycling, as the author holds the view that the latter bears the germs of a collapse. This collapse would occur at the latest when the OPEC countries would require their provisionally-invested surpluses for the development of their own national economies. The breakdown of the OPEC countries' creditor role should be prevented.

51. In his view, the petro-dollar problem can only be solved on a trilateral basis, ie jointly by the creditors (OPEC), debtors (Europe) and the two reserve countries (USA and Federal Republic of Germany). The commercial petro-dollars should be turned into monetarily registered reserve securities deposited outside markets or stock exchanges in secure central banks (OPEC bonds) and should be interest-bearing and repayable. The two reserve countries (USA and the Federal Republic of Germany) would have to assume full liability for these reserve securities. The OPEC countries should receive from them a convertibility and exchange guarantee based on a special-drawing-rights clause. In the case of external transactions, this guarantee would be secured by the European debtors giving a firm promise to the two guarantors that they would redeem their promissory notes when due in dollars, deutschmarks or SDRs.

52. Hankel believes that thanks to an "American-European" monetary union with mutual assistance provisions and obligations, it would be possible, subsequently, to arrive at a concrete system having its own bodies, a kind of European payments union at Atlantic level, a virtual world central bank as conceived by Keynes.

V. ENERGY POLICY OF INDUSTRIAL COUNTRIES

53. It is commonly agreed that pre-1973 oil prices were underestimated as compared with long-run replacement costs; the ensuing OPEC increases (2) have had the positive effect

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(1) See his article "OPEC als Mephisto" in: Wirtschaftswoche, 1 August 1975, p. 42.

(2) I shall abstain here from expressing a judgment on the size of the increases.

of reducing the consumption of a scarce, non-renewable resource. In consumer markets the adjustment has been brought about by price increases rather than by cumbersome rationing schemes.

54. Even though market forces have worked fairly well in this case, they need to be supplemented by deliberate governmental action in order to adapt our economic system to high energy costs. The financial policies analysed in the previous chapter are to be considered only as temporary devices for allowing a gradual adaptation. Action is necessary both on the demand side (energy conservation) and on the supply side (the development of alternative energy supplies).

a. Energy conservation

55. The OECD report on "energy prospects to 1985" (1) points out that there is fairly good room for manoeuvre with regard to energy conservation without endangering growth prospects: the total potential for energy conservation in 1985 is now estimated at about 15-20% of the consumption levels forecast before October 1973. The breakdown for potential savings by 1985 is estimated to be some 15% for industry (process heat), 15-25% for transportation and 20-25% for the residential/commercial sector (space and water heating and cooling).

56. Differences in climate, population density, industrial and economic structures of OECD countries are such that an effort of policy co-ordination is rather limited.

International co-operation for energy conservation would probably be most effective in the field of conservation targets rather than policies, exchange of information and conservation research. With regard to this last point, much is still to be learned about possible efficiencies in the use of energy.

The EEC Commission has been instructed at the recent Roman meeting of the nine heads of government to submit early proposals in the field of energy conservation and utilisation.

b. The development of alternative energy resources

57. The co-operation between oil importing and oil exporting countries in terms of trade guidelines (mentioned in para. 27) would allow the former to plan with more reliability their own energy policies. The prospects for energy self-sufficiency of OECD countries (2) vary considerably. At present the only

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(1) Paris 1974, vol. 1, p. 14.

(2) See Table V of the appendix.

self-sufficient countries are Canada, Australia and Norway. The United Kingdom is likely to become independent by the end of the present decade, while other countries have varying degrees of energy deficit.

58. The major issue facing individually and collectively energy deficit OECD countries is to define to what extent they want to pursue a policy of greater energy independence and what price they are willing to pay for it. The issue is related to the possible price trend of OPEC oil vis-à-vis the likely cost of alternative OECD energy production. If the latter turns out to be higher than the former, an attempt to increase the energy self-sufficiency of the OECD area will be a waste of resources from the point of view of the world economy. This economic waste is the cost that OECD countries will have to pay for higher independence from the OPEC cartel. This fundamental (but often overlooked) issue should be put clearly to the fore and discussed in public and in national parliaments.

59. Once the choice is made with full conscience of its costs, OECD countries can then pursue their own energy policies accordingly. It is worthwhile recalling that a co-operative and constructive approach with OPEC countries should reduce the rationale for excessive investments in the energy sector.

VI. OIL DEFICIT DEVELOPING COUNTRIES

60. The recent international economic turmoils have affected developing countries in different ways. After the recent reshuffling of cards, the third world can be distinguished in three main groups:

i. High-income countries

Twenty-one countries, whose per capita GNP exceeds $640, fall in this group. They account for only 10% of the total population of developing countries, ie 170 million people.

High-income developing countries have, in most cases, a fairly sophisticated economic pattern or are major exporters of key commodities or oil. In view of their special situation, these countries are also able to obtain the capital necessary for their development either from the countries with which they maintain special links or from financial markets at commercial terms.

ii. Medium-income countries

The thirty-six medium-income developing countries have a per capita GNP ranging between $220 and $640 (average $330) and represent 26% of the total population of developing countries ie nearly 450 million people. Due to the 1973 world commodity boom, countries of this group have increased their exports of basic commodities or semi-manufactured goods and improved slightly their terms of trade. If this trend had continued, their long-term economic outlook could have been good, although they would have had to face serious problems of adjustment to the new conditions.

This group which includes Algeria, Turkey, Taiwan, South Korea, Brazil, Zambia, the Philippines should be able to borrow much of what it needs on the world capital markets if recycling mechanisms are designed and managed with its needs in mind. A further liberalisation of world trade and a further improvement of present schemes of tariff preferences would essentially benefit the medium and high income group of developing countries.

iii. Low-income countries most seriously affected by the recent price developments for oil, (other raw materials), food and fertilisers

For the poorest forty-two countries - countries representing more than 64% of the total population of the developing world, ie over 1,100 million people, and with an average per capita income of below $220, the situation is desperate. This group includes not only the twenty-five least developed countries mentioned in my previous report but also densely populated countries like India, Pakistan and Bangladesh.

The lowest income countries hardly benefited from the temporary boom in the commodity prices and - as food importers - they have been particularly hard hit by spiralling world food prices. Export expansion has no near-term relevance and there are virtually no non-essential imports to be reduced.

As Mr McNamara recently said (1) "Almost every element in the current economic situation has turned to their disadvantage, and has been compounded even further for many of them by the natural disasters

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(1) Address to the Board of Governors, September 1974, p.24

of flood, drought, and crop failures. These countries then, need additional assistance on concessionary terms, and they need it promptly, $3,000-4,000 million more per year in the remaining years of the decade."

61. In 1975 the last two categories of developing countries - which interest us in this section - have been able to maintain in the aggregate their imports thanks to heavy borrowing on international markets and to emergency aid from different sources; their current deficit vis-à-vis the rest of the world has increased from $2.5 billion in 1973, to $17.5 billion in 1974 and to $27 billion in 1975.

The Euro-currency market and the emergency aid supplied on a bilateral and multilateral basis by OECD and OPEC countries have succeeded in staving off a major disaster, particularly for the least developed countries.

62. The multilateral aid mechanisms set up in the aftermath of the oil crisis and mainly designed for oil importing developing countries are:

i. The IMF oil facility

In 1974 the IMF established a special fund for balance of payments support mainly financed by OPEC countries. Oil deficit developing countries drew about 1 billion Special Drawing Rights (SDRs) (1) or 40% of the total in 1974 and some 500 million SDRs up to August 1975.

ii. The IMF Special Trust Fund

On the initiative of the USA, a special Trust Fund of the order of $2 billion is to be established this year for providing highly concessionary resources to low income developing countries. Sales of gold now held by IMF would be used to provide resources of half of this total, supplemented by other contributions, especially from oil producers.

iii. The World Bank "third window"

This new lending facility, established in July 1975 for a trial period of one year in the framework of the World Bank, consists of an interest rebatement fund which will allow making loans at 4.5% interest rates instead of the 8.5% rate ordinarily charged by the World Bank. To date contributions to the fund have set its lending potential at $500 million, this being at half of its expected size. This facility is meant for oil importing countries with a per capita income of less than $375.

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(1) One SDR corresponds to roughly US $1.18.

63. The emergency measures introduced in the last two years have put off a crisis in oil importing developing countries, but have left unsolved the longer term problems of development and of adjustment to the new situation of high prices for oil, food and industrial products.

In Chapter III I pointed out the necessity for industrial countries to show more understanding of the problem of terms of trade of oil importing developing countries. In the long run a less asymmetrical relationship in the trade field has to be established in order to allow third world countries to finance their development efforts with export earnings.

64. Trade measures, which will mainly benefit middle and high income developing countries, need however to be complemented by larger and easier financial assistance.

In this context the OECD and the OPEC countries clearly have a common responsibility. It is hoped that the north/south dialogue pursued at the Paris Conference will bring about an agreement on the respective roles and share of responsibility of these two groups of countries towards the rest of the developing world (1).

65. As for OECD countries, it is desirable that the oil bill increases paid by them be one of the elements to be taken into consideration. Without being official development assistance, the recent oil bill increases do represent a transfer of real resources from the industrial world to the oil exporting developing world.

66. The special assistance resulting from the recent special emergency measures should be consolidated in overall aid programmes while regular development programmes from bilateral

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(1) OPEC countries have made a considerable effort in helping oil importing developing countries; the total disbursements of official assistance have more than trebled in 1974: from $1.1 billion in 1973 to $3.4 billion. Their ODA represented 1.9% of their combined GNP, as compared with only 0.30% for DAC countries. Saudi Arabia now ranks above the United Kingdom as a donor of official assistance, and Kuwait above Canada. These two Arab countries are now fifth and seventh respectively in the 1974 list of concessional aid givers after the USA, France, the Federal Republic of Germany and Japan.

and multilateral sources must be expanded. The needs of these countries are such that they require both increased financial resources at market and near-market terms, as well as at concessionary terms. The first function can be accomplished by the IMF oil facility and by the World Bank proper (1).

67. Both these institutions have increased heavily their borrowing from the OPEC countries (most of the funds of the IMF oil facility have been drawn from this area which has also supplied 57% of new World Bank funds in 1975). OPEC countries, however, might be reluctant to channel in the future their funds through organisations which escape their control (2).

The World Bank has temporarily solved this problem by financing projects jointly with OPEC countries. Only a revision of the power structure within international finance institutions however can ensure a full and effective participation of this newly emerged financial group.

68. The provision of adequate amounts of more concessionary aid for the poorest and the least credit-worthy developing countries is much more difficult. Some OPEC countries have made a substantial start in committing funds to this group, mostly on a bilateral basis. On a multilateral basis the World Bank "third window" and the International Development Association (IDA) should play a central role in helping the poorest and least credit-worthy countries to adapt their economic structure to the new situation.

The "third window" should therefore have a less provisional character, and contributions to its fund should be made in a way similar to IDA's replenishments with commitments on a three year basis by donor countries.

VII. CONCLUSIONS

69. The next version of the report will pull all the strings of the previous chapters together and draw some conclusions.

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(1) Since the World Bank finances the foreign exchange costs of development projects, this institution is at the same time a development bank and an export bank for industrial countries; it can thus expand its operations almost without limit, the only constraint being the repayment capacity of the borrowing countries.

(2) At the end of July 1975 the countries of the Persian Gulf controlled 2.7% of the votes of these organisations, ie the same as Taiwan, as opposed to 9.2% for the United Kingdom.

APPENDIX/ANNEXE

TABLE I/TABLEAU I

FORECASTS OF POSSIBLE PETRODOLLAR SURPLUSES OF OPEC COUNTRIES

PREVISIONS DES EVENTUELS EXCEDENTS DES PAYS DE L'OPEP EN PETRODOLLARS

Date of the forecast date de la prévision	Organisation	Estimate at 1980 Evaluation en 1980
		$ US billion $ milliards E.U.
7/1974	World Bank/ Banque mondiale	411
7/1974	OECD/OCDE	250 - 300
1/1975	Chenery (World Bank/ Banque mondiale)	300
1/1975	US Department of Treasury/département du Trésor	200 - 250
1/1975	Morgan Trust Co.	179
1/1975	Brookings Institute	139 - 211
5/1975	Prognos A.G.	110
6/1975	Deutsche Bank	216 - 221
7/1975	OECD/OCDE	200 - 250
7/1975	World Bank/Banque mondiale	122 - 244

Source : Jonas and Minte, "Petro-dollar, Chance für die kooperative Weltwirtschaft", Verlag Neue Gesellschaft GMbH, Bonn, 1975, p. 95.

TABLE II

Changes in the "real" price of the commodity exports of developing countries, 1950-1974 a/

Indexes 1973 = 100)

Year	35 commodities (including petroleum)	34 commodities (excluding petroleum)
1950	127	125
1951	117	124
1952	111	115
1953	115	113
1954	126	127
1955	123	121
1956	121	119
1957	111	110
1958	107	103
1959	99	102
1960	96	99
1961	90	91
1962	88	90
1963	88	93
1964	90	101
1965	89	101
1966	89	101
1967	85	93
1968	85	95
1969	85	97
1970	82	95
1971	83	83
1972	81	81
1973	100	100
1974	198	116

a/ The price series in each index have been weighted by the value of each commodity concerned from developing countries in 1967-69 and each index has been "deflated" by the World Bank's index of prices of manufactured goods in world trade.

SOURCE : Report by the Secretary General of UNCTAD on indexation (TD/B/563) of 7 July 1975.

TABLE III

TABLEAU III

PETROLEUM (Saudi Arabian) (U.S. §/ Barrel) — PETROLE (Arabie Saoudite) (§ E.U./ Baril)

Year Année	(Posted Price)/1 (Prix Affiché)/1 Current § § Courants	 1967-69 Const. § 1967-69 Const.	(Realized Price)/ 2 (Prix Effectif) / 2 Cur. § § Cour.	 1967-69 Const. § 1967-69 § Const.
1950	1,71	2,31	1,71	2,31
1951	1,71	1,93	1,71	1,93
1952	1,71	1,91	1,71	1,91
1953	1,84	2,14	1,84	2,14
1954	1,93	2,29	1,93	2,29
1955	1,93	2,25	1,93	2,25
1956	1,93	2,18	1,93	2,18
1957	2,01	2,19	1,86	2,03
1958	2,08	2,32	1,83	2,04
1959	1,92	2,16	1,56	1,76
1960	1,86	2,05	1,50	1,65
1961	1,80	1,94	1,45	1,56
1962	1,80	1,94	1,42	1,53
1963	1,80	1,92	1,40	1,50
1964	1,80	1,90	1,33	1,40
1965	1,80	1,87	1,33	1,38
1966	1,80	1,83	1,33	1,35
1967	1,80	1,81	1,33	1,34
1968	1,80	1,83	1,30	1,32
1969	1,80	1,76	1,28	1,25
1970	1,80	1,65	1,30	1,19
1971	2,21	1,90	1,65	1,42
1972	2,47	1,95	1,90	1,50
1973	3,30	2,21	2,70	1,80
1974	11,59	6,36	9,76	5,36
1972 Jan.-June	2,46		1,85	
1972 July-Dec.	2,48		1,95	
1973 Jan.-June	2,69		2,25	
1973 July-Dec.	3,91		3,14	
1974 Jan.-June	11,65		9,42	
1974 July-Dec.	11,52		10,10	
1975 Jan.-June	11,25		10,46	

/1 Light Crude oil, 34°-34.9° API gravity, f.o.b. Ras Tanura.
/1 Pétrole brut léger, 34°-34.9° API, f.o.b. Ras Tanura.

/2 Light Crude oil, 34°-34.9° API gravity, average realized price, f.o.b. Ras Tanura.
/2 Pétrole brut léger, 34°-34.9° API, prix moyenne effectif, f.o.b. Ras Tanura.

SOURCE : WORLD BANK : Commodity trade and price trends, August 1975, p.84
BANQUE MONDIALE : tendances du commerce et des prix des produits de base, août 1975, p. 84.

TABLE IV

THE RE-CYCLING MECHANISM

a. How OPEC countries invested their surplus in 1974

	$ US billion
United States	
short-term government securities, bank deposits and other money-market paper	10.5
United Kingdom	
short-term government securities, bank deposits and other money-market paper	6.0
Eurocurrency Market	
basically in bank deposits	20.5
Liquid investments	37.0
IMF Oil Facility	2.0
Loans to the World Bank and to other International Organisations	2.25
Loans to developing countries	2.5
Loans to industrial countries	6.5
Direct investments, property and others	4.75
Middle and long-term investments	18.0
TOTAL	55.0

TABLE IV continued

b. How OPEC countries invested their surplus during the first half of 1975

	$ US billion
Eurocurrency Market	10
USA	2
United Kingdom	0.76
Other industrial countries	2.50
Loans to International Organisations (including the IMF oil facility)	1.75
Concessionary aid to oil-importing developing countries	3.50
Others	2.50
TOTAL	23.00

TABLE - V
TABLEAU - V

Degré of total energy self-sufficiency of OECD countries in 1972 (1)

Degré d'autosuffisance totale en énergie des pays de l'OCDE en 1972(1)

	%
Canada	120
Australia / Australie	108
USA / Etats-Unis	86
Norway / Norvège	72
Netherlands / Pays-Bas	70
U.K / Royaume-Uni	51
Germany / Allemagne	50
New Zealand / Nouvelle Zélande	42
Turkey / Turquie	31
Austria / Autriche	30
Iceland / Islande	24
France	23
Greece / Grèce	21
Spain / Espagne	21
Switzerland / Suisse	21
Sweden / Suède	17
Belgium /Belgique	16
Portugal	16
Italy/ Italie	15
Japan / Japon	10
Finland / Finlande	7
Ireland / Irlande	2
Luxembourg	2
Denmark / Danemark	-

(1) The ratio of total indigenous supply to total primary energy.
(1) Rapport de l'offre intérieure totale au besoin total d'énergie primaire.

SOURCE : energy prospects to 1985, OECD, 1974 Vol. I- p.184

SOURCE : perspectives énergétiques jusqu'en 1985 OCDE, 1974 Vol. I- p. 223