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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Seminar 82/7

10:00 a.m., October 15, 1982

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

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	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	T. de Vries
A. R. G. Prowse	
	L. Vidvei
	Tai Q.

J. W. Lang Jr., Acting Secretary
J. A. Kay, Assistant

Also Present

J. Amuzegar, Consultant. African Department: J. B. Zulu, Director; R. J. Bhatia, Deputy Director; F. d'A. Collings, S. M. Nsouli, A. Tahari. European Department: L. A. Whittome, Counsellor and Director; B. Rose, Deputy Director; H. Vittas. Exchange and Trade Relations Department: S. Mookerjee, Deputy Director; H. W. Gerhard. External Relations Department: C. S. Gardner, Deputy Director; H. Hartmann, A. W. Hooke. Fiscal Affairs Department: G. Blöndal. IMF Institute: M. T. Dajani. Legal Department: G. P. Nicoletopoulos, Director. Middle Eastern Department: A. D. Crockett, Z. Iqbal, M. C. Niebling, J. W. Rose, S. von Post, M. Yaqub. Research Department: R. R. Rhomberg, Deputy Director. Secretary's Department: A. Wright, Deputy Secretary; A. P. Bhagwat. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. R. Abiad, S. El-Khouri, M. A. Janjua, G. Jauregui, P. Kohnert, H.-S. Lee, P. D. Péroz, F. Saraff, F. Yeo T. Y. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, H. Arias, A. R. Banaga, L. Barbone, L. E. J. Coene, T. A. Connors, I. Fridriksson, G. Gomel J. M. Jones, M. J. Kooymans, W. Moerke, V. K. S. Nair, Y. Okubo, J. G. Pedersen, E. Portas, D. V. Pritchett, M. Z. M. Qureshi, J. Reddy, C. A. Salinas, J. Schuijer, D. I. S. Shaw, H. Suzuki, O. Üçer, A. Yasseri, A. A. Yousef, Zhang X.

1. "THE ENERGY CRISIS" AND PAYMENTS IMBALANCES - A TWIN CHALLENGE: THE ROLE OF OIL EXPORTING DEVELOPING COUNTRIES

The Executive Directors, meeting in a seminar, considered a paper entitled "The Energy Crisis and Payments Imbalances - A Twin Challenge: The Role of Oil Exporting Developing Countries" (EBD/82/127, Revision 1, 10/1/82; and Supplement 1, 5/28/82). Mr. J. Amuzegar was present.

The Chairman recalled the background to the study that the Executive Directors were about to discuss. On a number of occasions in the past when Article IV consultation reports for oil producing countries had been discussed in the Executive Board, some Directors had raised the question whether such countries might themselves do more to help the process of global adjustment. Around mid-1978, Mr. Amuzegar had suggested that it might be useful for the Fund to undertake a study that would attempt to indicate for oil exporting developing countries how they might further contribute to the global adjustment process. His suggestion had been approved by the Executive Board, which had instructed the staff to undertake such a study. That study had not been started by the time that Mr. Amuzegar had left the Executive Board in 1980. It was for that reason that he as Managing Director had asked Mr. Amuzegar to undertake such a study, and work had begun in November 1980 with the aid of an internal task force drawn from staff members. Throughout his work, Mr. Amuzegar had been helped by staff from the Middle Eastern Department, the Research Department, and the African Department. The final draft of the paper had been submitted to him in December 1981, and the paper had originally been timed for discussion after the meeting of the Interim Committee earlier in the year. Subsequently, Executive Directors had asked for postponement of the discussion until the present time. Meanwhile, Mr. Amuzegar had taken the opportunity to bring the paper completely up to date.

Mr. Amuzegar made the following statement:

> The paper before the Board examines some internal development strategies and external adjustment policies of the major oil exporting developing countries in the context of the world energy balance, and the Fund's interest in that balance. The "energy crisis" as such, which lies at the root of this examination, is not of direct or immediate concern to the Fund. But related payments imbalances are.
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> The initial impetus for the study came from the Executive Board and its desire to be of assistance to oil exporting member countries in their development efforts. Oil importing industrial countries, and non-oil LDCs also, have a stake in the global energy prospects. As this study is only about the oil exporting countries, it is only a part of the larger picture.

The objective of the study and its presentation to the Board today is to outline some possible domestic and external options for the oil-reliant countries, and to seek the views and comments of the Executive Directors on the appropriateness and practicality of these options for the economies under review.

The study focuses on three main issues: the first dealing with the background of increasing world dependence on petroleum. The second is outlining some of the development alternatives for oil-country planners. And the last is pinpointing some of the international financial aspects of those alternatives, and the need for global cooperation in coping with them.

Executive Directors may thus wish to address themselves to these issues, particularly the last two. Of substantive interest to this Seminar, and especially to any plan for the possible publication of the study, will be the following topics:

1. Will the energy situation in the next two decades continue to give rise to major international payments imbalances of concern to the Fund?

2. Are development priorities of the major oil countries conducive to the fulfillment of the Fund's basic objectives?

3. Are the principal development strategies for oil exporting developing countries suggested in this study appropriate from the standpoint of (a) the oil countries' own national aspirations, and (b) the global adjustment process?

4. How do these strategies relate to the countries' experience in the past eight years or so? How does the Fund view their past performance?

5. Is "recycling" still a global problem? Or are substantial oil surpluses a thing of the past? If not, what would be the Fund's role in this process?

6. What type of consumer/producer cooperation will be needed to cope with the three-pronged problems of world energy security, oil countries' development efforts, and the non-oil LDCs' needs? What can the Fund do in this area?

Executive Directors are also welcome to comment on other aspects of the paper, i.e., its organization, its analytical framework, its basic conclusions, and its occasional recommendations.

Mr. Nimatallah commented that Mr. Amuzegar's paper contained a wealth of information and a balanced analysis. He also deserved high praise for the truly professional work that he had produced.

Although the energy crisis might have subsided temporarily, the problem of the payments imbalance was as serious today as it had been two years previously, Mr. Nimatallah observed. In fact, the world had focused so much of its attention in the past on the trend of rising oil prices and the current account surpluses of the oil exporting countries, that it had come to expect a dramatic improvement in the world economic situation with the reversal of those trends. However, financial developments in 1982 had shown that the strains on the international financial system had in fact increased at a time when oil prices had been declining in real terms. His observations would follow the layout adopted by Mr. Amuzegar.

Speaking first on historical developments in the oil market, Mr. Nimatallah remarked that the sharp increases in the price of oil that had occurred in 1973/74 and 1979/80 had been the result of the interplay between the forces of supply and demand. Oil prices had been depressed for decades, resulting in a slow growth of supply and a high rate of increase in demand. The real price of energy had declined more or less continuously from 1920 to 1973. As a result, the consumption of cheap oil had grown at a rate which, in retrospect, ought to be seen as quite unreasonable. Oil and natural gas had been substituted for other forms of energy. The substitution had however not reflected the high cost of prospective marginal oilfields, which meant that for exploration for, and supply of, oil had not kept up with the long-term demand. Briefly, the world was moving along a path of long-term energy imbalance, likely to bring about abrupt future changes in price. It was only after the large increase in oil prices that the high-marginal-cost fields of the North Sea, Alaska, and elsewhere had become economically productive.

Developments prior to the early 1970s had clearly been detrimental to long-term international energy prospects, Mr. Nimatallah considered. As far as the oil exporting developing countries were concerned, the result had been to deprive them of their fair share of profit. All that the exporting countries had received had been about 2 cents per gallon in 1960 and 2.5 cents in 1971. The producing countries had therefore been restricted to a low level of infrastructure and a limited ability to grow. When revenues had suddenly increased, the countries were unable sufficiently to absorb their revenue. If prices, and hence exporters' revenue, had responded earlier to long-term forces of demand and supply, imbalances and international adjustment difficulties would have been avoided. The present situation showed the generally negative consequences that followed from interference with market forces.

After the price increases, one of the most visible benefits had been conservation, Mr. Nimatallah considered. One manifestation of conservation was the rapid improvement in the mileage per gallon being achieved by automobiles, a process that was still far from complete. In addition, the energy coefficient of industrial production had declined quite strikingly. As a result, world oil consumption was estimated to have fallen at an annual rate of about 5 per cent, both in 1980 and in 1981. Higher energy prices had led to increased exploration in new areas and increased production by marginal wells, and they had also meant that the price of oil, on a BTU basis, was more in line with that of alternative sources of fuel. The consequence had been a discernible substitution of alternative sources of energy over the previous few years. In brief, restoring real oil prices to the level of 1920 had had long-overdue beneficial effects on demand and supply. It would have been better for all if nominal prices had been adjusted more gradually.

Discussing the policy options open to oil exporting developing countries, Mr. Nimatallah remarked that Part Three of EBD/82/127 contained an excellent discussion of the application of policy instruments in oil exporting developing countries. The discussion clearly showed that there could be no standard policy prescription for all oil exporting developing countries as a group. Not only was the group different from other groups; it was heterogeneous within itself, countries having different economic structures and problems of differing natures. Consequently, the usefulness of any particular policy instrument had to be considered on a case-by-case basis.

The analysis of the exchange rate was thorough and balanced, Mr. Nimatallah considered. One part of the analysis that could have received more attention was the impact of exchange rate changes on the budget and on the distribution of resources between the private and public sectors. In non-oil developing economies, the overall impact on the budget of an exchange rate change was thought to be generally neutral, with the effects on revenue and expenditure largely offsetting each other, at least in the short term. However, in oil exporting countries, where oil receipts, usually in dollars, constituted the main source of budget revenue, a change in the exchange rate could have substantial effects on fiscal receipts. Naturally, budget expenditure would also be affected, depending on the import component, the methods of payment for imports, and other factors. The budgetary impact of exchange rate changes in oil exporting developing countries represented an interesting topic for further analysis. For instance, what was there to prevent a country from depreciating its currency, thus being able both to maintain its revenue in terms of its national currency and to build up its foreign reserves?

A closely related issue was what relation existed between the distribution of resources between the private and public sectors on the one hand and the conduct of exchange rate policy on the other, Mr. Nimatallah said. Suppose, for instance, that the U.S. dollar was depreciating in the foreign exchange market. If an oil exporting developing country allowed its domestic currency to depreciate along with the U.S. dollar, its oil receipts in domestic currency terms would remain unchanged. On the other hand, if the country allowed its currency to appreciate vis-à-vis the dollar, its fiscal receipts would decline. However, the decline in revenue for the public sector could be easily offset by increased resources in the private sector in the form of lower payments for imports, or more imports for the same payments. In other words, the policymakers would have to decide how much emphasis to put on fiscal purposes and how much on other objectives when they changed the exchange rate.

Taking up the question of demand management policies, Mr. Nimatallah remarked that he agreed with Mr. Amuzegar that the conventional measures of the fiscal stance, such as the overall budget balance, had limited usefulness in countries where most of the fiscal receipts were derived from abroad. Mr. Amuzegar had gone on to say that in those cases the concept of the domestic budget balance might be more useful in short-run fiscal analysis, although it would have to be used with care. However, little space had been devoted to the concept. It would be helpful if Mr. Amuzegar could provide more insight into its usefulness as a tool of fiscal analysis.

As to monetary policy, Mr. Nimatallah observed that it was obvious that a major determinant of liquidity expansion in many oil exporting developing countries was the government sector. Indeed, the domestic budget deficit reflected the impact of government operations on the country's liquidity. On the other hand, the operations of the private sector could cause considerable fluctuations in the rate of liquidity expansion, particularly when those fluctuations were caused by sizable private capital flows. He agreed with Mr. Amuzegar about the difficulties involved in implementing an effective monetary policy in an open oil exporting developing country. One section in Part Three of the paper dealt with the experiences of oil importing developing countries in economic development. The analysis, while interesting and useful, could be expanded. For example, it would be interesting to make a comparison of the process of economic development in selective oil exporting developing countries in the 1960s and in the 1970s. With the oil price increases in the 1970s, the oil sector had become the lead sector in countries' economies, even when it had not been earlier. It might be interesting to look at the impact of that sectoral shift on the process of economic development, as well as at the linkages between the oil sector and other sectors of the economy.

Taking up the topic of the international adjustment process, Mr. Nimatallah said that he had found the analysis in the paper quite useful. Nevertheless, he would like to comment on the nature of the imbalances, the process of adjustment following the first round of sharp increases in oil prices, and the changes following the second round. On page 121 of the paper, there was a list of causes of the problems of the 1970s. He would like to add one other explanation, namely, the expansionary policies of the industrial countries before 1973. During the 1960s, deficit spending in the industrial countries had been the rule rather than the exception. Partly as a result of those policies, the problems of inflation and unemployment had been aggravated, causing higher costs of adjustment for the world as a whole.

On page 122, the author had referred to the probability that disturbances and imbalances would continue in the 1980s, and had mentioned the necessity of recycling the deficit counterpart of surpluses in the 1980s, Mr. Nimatallah observed. He did not understand what was meant by the word "recycling." His understanding of recycling was that it was a process additional to the adjustment process. The recycling operation had been created because of the low absorptive capacity of the oil exporting developing countries, as a means of complementing the adjustment process that would have been sufficient in normal circumstances. Accordingly, the imbalances of the 1970s had to be handled not only by adjustment but also by recycling. In the 1980s, the need for recycling would be substantially reduced, not only because the absorptive capacity of the oil exporting developing countries had been markedly enhanced, but also because the surpluses were likely to be much smaller.

Because of the changes in the patterns of supply and demand for oil that had occurred in the 1970s, OPEC countries were unlikely to accumulate the kind of surpluses that they had in the past, Mr. Nimatallah considered. There was one situation that could however trigger an energy crisis, and thus large imbalances in the future. If the present nominal price of oil declined sharply, the successful conservation efforts of the previous few years would be frustrated. Moreover, projects aimed at oil exploration and the development of alternative energy resources all over the world would be threatened or canceled. Financial institutions that had lent large sums for those purposes might experience liquidity difficulties. The best way to ensure that oil prices would be stable in the future was to ensure that they were stable in the present.

It was worth examining the financial consequences of the decline in the real price of oil, and the disappearance of the OPEC surplus in 1982, Mr. Nimatallah observed. Both developments had added to the strains on the international financial system. The reduction in the OPEC surplus had substantially reduced OPEC deposits with the international banking system, and the reduction had not been offset by an equivalent increase in the deposits of industrial countries. Consequently, the resources available to the international banking system had been adversely affected. Moreover, several financial institutions, as well as governments, had invested large sums of capital in energy development projects. With the present decline in the real price of oil, the projects appeared to be in difficulty, something that put still more strain on the global banking system. A conclusion to be drawn, especially with the need for adjustment by several important members of the International Monetary Fund, was that it was essential to maintain the Fund in a strong and effective position.

The recent events had only highlighted the importance of global cooperation in the energy field, Mr. Nimatallah observed. Saudi Arabia had consistently tried to keep the price of oil stable. It had cooperated both with the other oil exporters and with oil importing countries for that purpose. Without international cooperation, stabilization would be difficult, if not impossible, to achieve. For instance, deliberate actions during 1982 by some oil importing countries to reduce their inventories of oil so as to hold down the price had been quite unhelpful in maintaining long-term oil price stability. Any short-term gains from undercutting the current market price would be more than offset by long-term losses to the whole international community. It was essential to look not only at the short term, but also at the medium and long term.

It was perhaps worth asking what lessons were to be learned from the paper under discussion, Mr. Nimatallah remarked. He believed that there were at least two: first, that the principle of uniform treatment of members by the Fund did not and should not mean that the same policies should be prescribed for all countries at all times. The importance of the study was that it focused on the special characteristics of the oil exporting developing countries, just as an earlier study had focused on the problems of the centrally planned economies. Even countries that shared similar fundamental economic characteristics did have different problems requiring different solutions. Second, the oil crisis and the payments imbalances connected therewith were actually by-products of policies followed before the 1970s. While the energy crisis might have subsided, the payments imbalances still existed and would certainly continue. With the financial strains in the capital market, he was more certain than ever that the International Monetary Fund should be strengthened to play an effective role in the adjustment process. He was grateful to management for having taken the initiative of inviting Mr. Amuzegar to prepare the paper. The discussion would be helpful to Executive Directors in recommending to oil exporting developing countries policies that were based on a realistic assessment of their economies.

He would like not only Directors but also the public at large to benefit from such an important work, Mr. Nimatallah stated. He therefore proposed that the paper should be published, taking into account comments made by Executive Directors during the seminar, and subject to further coordination between Mr. Amuzegar and Executive Directors to incorporate additional suggestions.

Mr. Kafka stated that he was indebted to Mr. Amuzegar for an informative, challenging, comprehensive, and indeed monumental study. It would certainly take more than one seminar to do it justice, quite apart from the additional studies that might flow from it. Part One of the paper gave an excellent general setting for the problems faced. Section II defined the problems faced by oil exporting developing countries in particular. There was, however, one aspect that he found somewhat puzzling. On page 13, Mr. Amuzegar had stated that the oil price rise since 1973 had been an inevitable result of the collision of demand with the inherently exhaustible limits of oil reserves. Such a statement seemed to imply that, irrespective of the organization of the market or, more specifically, of the formation of the commodity club, oil price increases since 1973 would have been the same as they had been. Surely that was not the case. In Part Two, Section I, there was an interesting description of similarities and differences between oil exporting developing countries and other less developed countries, although perhaps the similarities were overstressed. Section II referred to the effects of overrapid growth of domestic consumption out of oil revenues. He wondered how "overrapid" was defined, and also how such growth could lead to a real appreciation of the exchange rate. However, in the same section he found the analysis of the problems posed in bringing about a proper sequence of investment to be one of the most interesting sections of the entire paper.

In Section I of Part Three, Mr. Kafka noted, the paper made the point that, on the assumption that the oil sector was government owned, the oil exchange rate was irrelevant. He doubted whether that was true. Governments were not really monolithic, and the national oil corporations were generally competent, both in oil exporting and in oil importing countries, in defending their own sectoral interests. Hence, the oil exchange rate, which determined the division of that part of the national income that accrued to the public sector between the oil sector and the rest of the public sector, was not completely indifferent. Nor would its impact be indifferent with respect to the division of output between the private and public sectors themselves insofar as domestic sales prices of oil products were influenced by the oil exchange rate.

Nevertheless, the paper still underestimated the tremendous operational advantage--from the point of view of policy actions--for oil exporting developing countries deriving from the fact that their main exchange earnings accrued directly to the public sector, Mr. Kafka went on. In discussing fiscal policy problems, the author had made the point that it would be a mistake, for the purpose of directing a larger flow of resources to the private sector, for an oil exporting country to reduce taxation on that sector. It was of course possible for governments of oil exporting developing countries to continue to collect taxes from the private sector and direct oil revenue to that sector as a means of obtaining the same result as if private taxation had been reduced. There would be important consequences deriving from the particular way in which resources were made available to the private sector. A reduction in the taxation of enterprises could be replaced by government equity participation in their capital or by government loans to them. Such an arrangement would however reduce the autonomy of the private sector vis-à-vis the government sector, and the result might conceivably be less desirable than if a reduction in taxes had directly increased the resources at the disposal of that sector.

There might be similar results in choosing between government subsidies and private consumption and government services made available without cost to the private sector, compared to reducing the taxes falling on private consumption and private and personal incomes, Mr. Kafka said. In other words, it was impossible to rely on expenditure policies alone to bring about the desired allocation of national income between the private and public sectors. In the same section of the paper, the discussion of interest rate policy in the oil exporting developing countries seemed particularly helpful and correct.

In Part Three, Section II, the author discussed the experiences of oil exporting developing countries in economic development, Mr. Kafka noted. At that point there was a difficult methodological problem. Although observers knew in general terms what the priorities of developing countries were, they did not know what might be called the marginal rates of substitution between the priorities as perceived by the authorities of the several oil exporting developing countries, and without that knowledge they found it difficult to come to valid conclusions. Nevertheless, the before-and-after comparisons in the paper were still interesting.

Part Four contained a valuable discussion of world payments imbalances and the international adjustment process, Mr. Kafka went on. There was perhaps some underestimation of the causal link between some of the constraints that had made adjustment for importing developing countries more difficult, such as the inflationary climate and reduced growth rates or stagnation in industrial countries that had created the adjustment problems. The paper concluded, rightly he considered, that adjustment to the second oil shock would be more difficult than adjustment to the first. On the other hand, on page 139 the author said that recycling in the 1980s might turn out to be as trouble free as the recycling following the first oil shock. He would be inclined to question that conclusion. In the first place, adjustment to the 1973/74 oil shock had not been particularly trouble free, especially for countries without access to private capital markets. Second, the recycling process following the second oil shock would require continual flexibility and imagination by both national and international authorities if it was to be even as trouble free as the adjustment after the first oil shock. The discussion of alternative channels of surplus flowbacks was particularly interesting, and he wished to draw attention to the comments on the IMF substitution account as part of the mechanism that might facilitate recycling. The paragraph in question would merit greater elaboration. He also agreed in general terms with the increased role that the paper attributed to international financial institutions, in particular to the Fund, and to the support that it seemed to give to the possibility of market borrowing by the Fund.

Part Five contained a fascinating discussion of the range of options regarding the oil problem in the future, Mr. Kafka commented. While he was unable to answer Mr. Amuzegar's question, he was convinced that it would be safer for oil importing countries, developed or not developed, to formulate their policies on the assumption that there would be a recurrence of real oil price increases if growth resumed in the world, and that more international cooperation was urgently required.

He hoped that the paper would receive further discussion, study, and elaboration, Mr. Kafka concluded. He congratulated both Mr. Amuzegar for his work and the management for having commissioned the paper.

Mr. Finaish remarked that EBD/82/127, Revision 1 and the Supplement provided a fairly detailed look at the world energy problem and at the policy options open to oil exporting countries with respect both to their own economic development and to their role in international adjustment. The analysis was broad based, and the conclusions were generally balanced. It was impossible to cover the whole range of issues examined in the paper in a single intervention; he would therefore confine his remarks to a few of them, mostly of a relatively broad nature.

It should be clear, Mr. Finaish considered, that, given the wide diversity of economic and social features among oil exporting countries, recommendations for development strategies and policy choices for individual countries could emerge only from detailed country-by-country studies. Thus, a paper of the kind under consideration--which dealt with the whole group of oil exporting countries--could usefully study only certain relatively broad policy choices open to the countries, as indeed the author had done.

The problem of energy management, Mr. Finaish went on, had received little attention prior to the oil price adjustments of 1973/74. Indeed, as noted in the paper, "not until the early 1970s was there a national (or global) energy policy anywhere in the world, and certainly not in the major oil consuming countries." For years, the price of oil had been kept artificially depressed at low levels by the major oil concessionaires, so that the real price of oil had fallen by more than 60 per cent between 1960 and 1970 alone. So long as oil had been cheaply available, its relative scarcity had either remained masked by the artificially low price, or been ignored. It was only when the major consuming countries had suddenly been confronted with higher oil prices that the relative scarcity of energy had acquired the status of a serious global economic problem. A salutary effect of the adjustment in oil prices--so as to better reflect the real scarcity value of oil--had thus been to focus the attention of the international community on the exigencies of the global energy balance. Moreover, in discussions of the world energy problem following the first round of major oil price adjustments, especially at international economic fora, including the Fund, the phenomenon had been looked at mostly from the immediate viewpoint of consuming countries. Thus, attention had been focused mainly on the cost of oil to importing countries or on ways of speeding up the reclycling of surplus oil revenue to those countries. Thus, the role of oil price increases in the worsening global economic situation had been blown up out of all proportion. What had been explored less was such matters as the rate of depletion of oil--the main resource of the oil producing countries--and the effective use of oil revenue in the development of those countries themselves. To the extent that the present paper dealt with those issues, it was a welcome departure from the general practice of the past.

It was certainly true that the Fund had not completely ignored the issue, Mr. Finaish commented. The Managing Director had made an important speech in June 1980, and, in the summing up of the Executive Board discussion on March 19, 1980 (EBM/80/51), there had been specific reference to the fact that the oil exporting countries had problems of their own. The timing of the present discussion was of course interesting because, as Mr. Amuzegar had said in his introductory remarks, there was not at present any real "energy crisis." In a sense, therefore, it was interesting that the Fund was discussing the topic at a time when others seemed to think it had become less important.

Reflecting the heavy dependence of the oil exporting countries on a single depletable asset--a central feature that distinguished them as an analytical subgroup among developing countries--the principal goal of their development strategy had been to diversify their production and export bases, Mr. Finaish noted. Economic growth in those countries would in the long run be sustainable only if revenue from the sale of the depletable assets were transformed into other types of productive assets that could lay the basis for a viable non-oil economy. Of course, the particular pace of economic diversification and development differed among countries, depending upon their respective endowments and the pattern of comparative advantage, domestic absorptive capacity, and sociopolitical priorities. The transformation of oil revenue into a productive base for sustained long-term income growth was a difficult and long-drawn-out task. Clearly, the mere possession of oil reserves did not make either for immediate wealth or for rapid development. While it was true that the sale of oil provided a ready reservoir of savings and foreign exchange for the governments concerned, it represented only one of the ingredients of development. To convert the reservoir into a diversified and viable productive base also required other factors of production such as raw materials, skilled manpower, basic infrastructure, entrepreneurial talents, and technology. In those respects, the oil exporting countries were no different from other developing countries, and in many cases they were perhaps worse off. As a result, a substantial part of domestic investment expenditure financed by oil revenue had gone into building up the necessary infrastructure and skills, particularly in countries in which little non-oil industry had existed previously.

A difficult but central question of planning faced by the authorities in oil exporting countries was deciding on the rate of oil extraction, Mr. Finaish considered. The determination of the optimal rate of oil extraction had raised a number of complex questions, ranging from comparisons of expected yields on oil to those on domestic and foreign investment financed by oil revenue (or more generally on competing assets) to intergenerational comparisons of utility. A summary of such questions was provided in the technical annex to the paper. The OPEC had hitherto acted as a residual supplier of oil, meaning that it had made good the difference between the world demand for oil and oil supplies from non-OPEC resources. The returns on the OPEC's foreign financial assets had on average been much lower than the rate of appreciation in the real value of oil. In addition, because of the constraint imposed by the lack of capacity to absorb large amounts of capital productively over the short and medium term, domestic investments had in many cases involved considerable inefficiency and waste. It was difficult to foresee clearly whether the OPEC would continue to act as a residual supplier of oil, or whether it would opt for a policy that would subject oil supply rates more to the supplier's own financial, technical, and political considerations.

In order to understand the structure of the oil industry at present, Mr. Finaish considered, it was certainly useful to examine the history of the industry in the previous decade; the paper gave a relatively full account. The demand for OPEC oil had fallen by some 40 per cent between 1979 and 1982. In 1979, peak output had been about 30 million barrels per day, while in some months in 1982 it had been as low as 15-17 million barrels per day. The pressures on certain countries, like Nigeria and

Libya, had been considerable. Average production for 1982 would be in the neighborhood of 20 million barrels per day. For Libya, production had fallen from over 1 million to between 600,000 and 700,000 barrels per day.

In the past, Mr. Finaish observed, too little attention had been focused on the structure of the industry and too much on the price of oil to the consumer. In the early 1970s, the seven or eight major oil companies had controlled all five stages of exploration, production, transportation, refining, and marketing. At that time, there had been no talk of surpluses or shortages in the market because the companies controlled production; changes in demand had been met through changes in the rate of production in different areas, changes in inventories, and sometimes simply redirecting tankers in mid-ocean. In the mid-1970s, host governments had become more involved in economic decisions relating to investments, production, and marketing of oil. They had their own views on prices, and they negotiated contracts. In other words, a real market had begun to develop with buyers and sellers in the usual sense. On the buying side, until a few years previously the eight major companies lifted 80-90 per cent of OPEC oil exports; at present, there were some 150 entities lifting the oil. On the supply side, apart from the OPEC countries, there were also major oil producers like Mexico and the North Sea group, followed by smaller producers like Egypt and Angola. The number of market transactions had increased considerably, and a larger proportion than in the past was on short-term contracts or on a spot basis. Moreover, the large U.S. oil market had become linked to the rest of the world petroleum market. It was becoming increasingly difficult for the OPEC countries jointly to decide on a reference price and differentials for certain crudes and to hold the reference price of oil constant in current dollars when the oil market was slack. In March 1982, the OPEC countries had met to discuss production policies to suit the changed circumstances. However, to adhere to production quotas was difficult.

In the past, Mr. Finaish explained, the non-OPEC oil producers had been insignificant. However, they currently added some 2 million barrels per day to the market, and they wished to maximize their market share. At present, any price increase was blamed on the OPEC; and any fall in demand was absorbed by OPEC members. In those circumstances of depressed demand and increased competition, it was difficult for the OPEC to continue acting in the role of residual supplier. Naturally, in due course, demand was likely to improve, particularly with the change of the present world economic situation. Of course, if the price structure collapsed altogether, while consumers would have a short-term advantage, in the medium or longer term consumers and producers alike would suffer.

The paper contained an interesting discussion of the policy instruments available to the oil exporting countries, Mr. Finaish noted, as well as an account of their actual experience with the use of those instruments. He would comment specifically on exchange rate management only, which had been given prominent coverage. There were a number of special problems of exchange rate management in oil exporting countries. For instance, sustained surpluses might push the real exchange rate to a level where it could undermine the competitive position of non-oil activities both on the export side and in connection with import substitution. Output and export diversification being a major objective, the appreciation of the exchange rate due to oil sales might be a serious hindrance in oil exporting countries in which the sectors producing non-oil tradable goods were fairly large and in which the private sector played an important role in their activities. In some situations, the position could be corrected by adjusting a unitary exchange rate, introducing de jure multiple rates or actual multiple rates through a scheme containing both taxes and subsidies, or adjustments to financial policies affecting the rate of inflation. Which course was preferable could not be decided on a priori grounds alone, without regard to the nature of each individual case.

What seemed clear was that a broader definition of equilibrium exchange rates was needed for oil exporting countries, a definition that would adequately reflect the special characteristics of the countries, including the need to promote certain non-oil exports and the roles of the public and private sectors in external transactions. Moreover, real exchange rates were in practice likely to be governed more by decisions on expenditure of the oil revenue than by a choice of exchange regime or a nominal exchange rate, so that fiscal policy would have a focal role to play in exchange rate management. More specific questions with respect to exchange rate determination in those countries could best be tackled on a case-by-case basis.

In assessing the performance of oil exporting countries since the 1973-74 oil price adjustments, Mr. Finaish went on, certain qualifications needed to be kept in mind, as Mr. Amuzegar had noted. First, available data were often inadequate; second, sufficient time had not yet elapsed for some of the policies to have full effects; and third, any collective evaluation of the oil exporting countries was bound to miss certain significant differences in performance within the group.

The paper noted that while growth in the non-oil sectors had often been fairly rapid, only limited progress seemed to have been made toward the objective of diversifying the productive base, Mr. Finaish observed. While there was no doubt that certain domestic policy decisions were responsible for the outcome, other factors should also be taken into account. First, the task of diversification became more difficult in an oil-based economy where the oil industry itself was weak in backward and forward linkages. Second, as the proportion of imported goods was often high, the "learning-by-doing" effect was weak. Third, in many cases, investment in directly productive activities had to be preceded by the allocation of a large proportion of resources to the development of basic socioeconomic infrastructure. Only when the infrastructure was in position would it be possible to generate rapid growth in directly productive activities. Fourth, diversification had in some cases been held back by a lack of skilled manpower and farmland. Finally, a comparison of the share of non-oil sectors in GDP at current prices for a few years, such as had been incorporated in Table III-16 on page 104, was not very informative about development in the non-oil sectors because of the large increase in the price of oil since 1973/74 and the marked fluctuations in oil production. Progress in many cases did not seem to have been as slight as would appear from that table, especially in hydrocarbon manufacturing industries.

Rapid inflation and considerable inefficiencies in the use of resources, particularly in the mid-1970s, glaringly illustrated the perils of overrapid increases in expenditure in relation to domestic absorptive capacity, Mr. Finaish remarked, although it had to be said that an appreciable part of the acceleration in inflation had arisen from increases in import prices. Financial policies since the mid-1970s had been less expansionary, and had thus helped to contain inflation within a moderate range. Concern about the limits of domestic absorptive capacity and the need for careful development planning and project appraisal were now playing a greater role in policy formulation. It was being increasingly realized that, as development was being financed from the proceeds of a depletable asset, the stakes were much higher than had first been thought. Even more caution and more attention to planning in the formulation of public expenditure policies was still desirable. Moreover, as oil revenue accrued directly to governments, public expenditure policies were a crucial element in managing the economies in question.

Naturally, while it was interesting to discuss the effects of the various instruments of policy such as the exchange rate and interest rates, Mr. Finaish remarked, for the oil exporting countries the most important decisions were how much oil to produce and how to spend the revenue. Experience had shown that the control of public expenditure, always politically difficult, was even more so in the oil exporting countries. When revenue accrued to public authorities at a rate above immediate domestic financial requirements--because the countries extracted more oil than was necessary to meet their own needs--pressures were bound to build up both internally and externally to spend a large proportion of the surplus funds. Moreover, the heavy dependence of the countries on oil as a source of revenue made fiscal management vulnerable to the vagaries of the world oil market and the many uncertainties connected therewith. The recent fall in demand was a new phenomenon to which the oil producing countries were only now becoming accustomed. They had previously become used to a certain pattern of revenue and expenditure, and the dangers of being dependent on a single resource were only now becoming apparent to them. Nevertheless, most of the oil producing countries had adopted relatively moderate financial policies, and their reactions to the new situation ought thus not to make international adjustment more difficult. To the extent that the oil revenues exceeded the limits of efficient domestic absorption, the adjustment of external imbalances would and should take place on capital account.

In view of the weakness of automatic mechanisms in maintaining balance between the financial surpluses and deficits associated with oil price adjustments, Mr. Finaish observed, the paper had noted the importance of special arrangements for recycling oil-related surpluses and bringing about the requisite adjustment. While the problem did not seem to be as pressing currently as it had been earlier, due to the rapid disappearance of oil exporters' surpluses since 1980, it might again become significant in the not-too-distant future. The paper noted that while the names of the surplus countries had changed, the names of the deficit countries had not. Accordingly, a larger burden of assisting in the process of international adjustment and financing ought to be shouldered by the current beneficiaries of surpluses. The paper concluded that the recycling of oil-related surpluses had so far been quite effective, although the cost of adjustment had not been small. In addition, the burden of adjustment had fallen largely on the poorer developing countries. They had suffered not only from increases in oil prices but also, and to a much greater extent, from stagflation in the industrial countries. Naturally, the adjustment required by oil price changes would have been far less abrupt and disruptive if the price of oil had not been prevented in the past from rising steadily in line with its real scarcity value, a policy that led to an inevitable major collision of expanding demand with the limits of the inherently exhaustible oil reserves.

The policies followed by the oil exporting countries had served to ease international adjustment and financing, Mr. Finaish considered. Not only had they followed liberal trade and immigration policies, but they had managed their own surplus funds with care. Indeed, a large part of the surplus had been recycled in the form of aid to other developing countries. The OPEC's aid performance as a group had been found by UNCTAD in recent years to have surpassed that of DAC members by 10:1. The oil exporting countries had behaved responsibly in the management of their international reserves, thereby contributing to international monetary stability and a smooth channeling of funds to deficit countries through the financial markets.

The future magnitude of oil revenue and its role in financing development in the oil exporting countries, as also the size of the oil-related external imbalances and the associated need for recycling, would of course depend in large part on the course of the world market for oil in coming years, Mr. Finaish observed. It was clear from Part Five of the paper that it was difficult to forecast any trends in the oil markets because of the many uncertainties connected therewith. However, the author seemed to consider that the share of oil in total world energy consumption would remain substantial; that a considerable proportion of world total oil supplies would continue to come from the OPEC; that the maintenance of a global oil balance would depend on keeping oil prices at levels reflecting the real scarcity value of oil; that oil prices in the next few years could begin to rise if the world economy were to expand in a normal fashion; and that the combination of high exports and rising prices was likely to give major oil exporting countries new payments surpluses.

As to the short-run outlook, from 1983 to 1985, there was agreement that the present significant decline in demand had been caused by recession, conservation, substitution, and inventory policy, Mr. Finaish commented. However, there was no agreement regarding the relative importance of each of those factors. If, for instance, the main cause of the decline in demand had been the recession, it would certainly be reversible and the demand for oil would increase rapidly. On the other hand, if the decline in demand was mainly due to conservation, the outcome might be different. What was certain was that if there was any economic recovery at all, demand for oil was likely to increase.

Moreover, although the conservation effort had been impressive, it seemed unlikely that the same sort of result would continue, Mr. Finaish remarked. For instance, proportionally, sales of larger cars had been increasing in the United States, and a great number of houses had already been insulated. There had been considerable substitution of coal and nuclear power for oil, but now that the price of fuel oil had fallen, it was doubtful whether coal was still very competitive. Moreover, coal was comparatively difficult to handle and did cause environmental problems. It seemed unlikely therefore that the program put forward by the International Energy Association (IEA) for producing the equivalent of 1 million barrels per day of oil in the form of coal would bear fruit. As for nuclear power, even those countries that had been most enthusiastic seemed to be rethinking their attitude, largely on grounds of cost. If the winter of 1982 was normally cold, the increase in the demand for oil might be in the neighborhood of 4 million barrels per day.

Commenting on the question of oil stocks, Mr. Finaish observed that in the past it had been considered normal for entrepreneurs to replenish stocks at a time of surplus and to draw them down at a time of shortage. However, recently what had happened had been exactly the opposite: oil companies had been purchasing stocks on a large scale in 1980 and 1981 during the Iranian revolution, when supplies of oil had been in short supply. The amount of oil purchased for stocks had been between 1.3 million and 3 million barrels per day. In 1982, however, there had been a continuous outflow from stocks, so that the gap between actual consumption and the demand for oil from the producers had been wide. Currently, however, people had begun to consider that stocks were too small, and it seemed likely that demand would increase as purchases were made to replenish stocks to a more normal level.

On the question of the price of oil, Mr. Finaish said that some officials in certain Gulf countries seemed to expect that the price of market crude would remain at about $34 per barrel in the near future. Some stability would surely be useful to both producers and consumers. There was no way in which an orderly retreat from the $34 price could be undertaken. If the OPEC reduced its official price, in so doing it would give signals to investors in alternative sources of energy, something that would be quite unwise. If the price were frozen in nominal terms, the implication would be that the price in real terms would fall, thus stimulating demand and helping recovery. Any increase in the nominal price could impede recovery, something that nobody wanted. Whether the decline would be sufficient in real terms was a matter that depended also on the exchange rate for the U.S. dollar in Europe and Japan.

The paper concluded by highlighting the degree of economic interdependence in the world at the present time, Mr. Finaish commented. Developments in the world economy in recent years, including those in the energy field, had brought the case for international economic cooperation into sharper focus. The paper had particularly emphasized five points on which greater cooperation between groups of countries was needed: the pricing of oil at its real replacement cost or scarcity value; increased efforts at energy conservation and the development of new sources of energy; assistance to poorer developing countries to expand their export capacity and to develop their own sources of energy; the transfer of technology; and the opening up by industrial countries of their markets to the increasingly diversified products of developing countries. Many observers would consider cooperation in those fields as necessary elements in any scheme of international cooperation leading to a steadier and more harmonious growth of the world economy. Hitherto, the various colloquies intended to lead to greater cooperation had not been very successful.

Continuing, Mr. Finaish made two points of a technical or terminological nature. First, despite the emphasis placed by the paper on oil as an asset, it failed to treat oil as a true asset that was being liquidated and transformed into other assets. Instead, the paper had followed the standard approach adopted by the Fund in country analyses of treating the extraction of oil as if it were a productive activity, generating value added. The study contained some international comparisons of GNP per capita, savings ratios, investment rates, capital/output ratios, sectoral shares in GDP, and the like, all of which were based on treating oil extraction as a productive activity, and not--as the paper contended throughout--as an asset to be replaced by other assets. Such calculations were distorted and the comparisons vitiated, unless the income content of the oil extraction activity was properly reckoned. Such reckoning would depend on the life expectancy of the resource and on the rate at which oil revenue was invested in order to produce lasting streams of income. The income estimates used in the study were distorted by the inclusion of the proceeds from the sale of an asset that was essentially capital. There was a need to recalculate the true income of the oil exporting countries, difficult though it was, in order to bring the various tools of macroeconomics to bear on those countries as well as to avoid exaggerating the level of income imputed to those countries, many of which remained poor and underdeveloped. By the same token, their external surpluses should not be treated as if they were surpluses on current account in their balance of payments with the same implications as surpluses emanating from current production. Second, the accrual of oil export receipts was sometimes described in the paper as a resource transfer or a transfer of wealth to the oil exporters. Such expressions were clearly inappropriate; they created a false impression and should be avoided. The purchase of oil was an exchange of value in the form of oil for other types of real assets or financial claims. It was not a transfer of resources in the sense in which the term was generally understood in economic jargon, meaning an unrequited transaction or lending at concessional terms.

In conclusion, Mr. Finaish stated that he hoped the paper would receive due attention from the Fund staff working on oil exporting countries. At the same time, since it could not go into detail on all of the many issues addressed, some of the more important topics could perhaps be studied in greater depth by the staff in shorter papers in the future.

Mr. Grosche joined other Directors in thanking Mr. Amuzegar for the well-written, comprehensive, and informative paper and his opening remarks. He would limit his comments to some of the international financial issues. Naturally, he was convinced that the oil exporting developing countries as a group would continue to play an important role in the world economy and in international adjustment. First, they would continue to be important as suppliers of oil. Second, their absorptive capacity, particularly for manufactured goods, would no doubt continue to increase. Third, they would continue to be important for the management of their external reserves, including cooperation with international organizations. Many oil exporting developing countries had been following prudent economic policies. They had been well aware of the responsibility that they had been bearing in the present difficult world situation; he hoped that they would continue to pursue a policy in line with their international responsibilities.

Taking up the topic of the most appropriate internal development strategy for oil exporting developing countries, Mr. Grosche said that he agreed with most of what was said both in the paper and in the supplement. He had, however, some doubts about the conclusions in paragraph 8, which appeared to advocate the possible use of multiple exchange rates in certain circumstances. His chair had repeatedly expressed concern about the use of multiple currency practices as instruments of economic policy. While there might be a few instances in which multiple currency practices could play a successful role, in most cases they were likely to lead not only to an inefficient allocation of domestic resources but also to detrimental effects on the international trade and payments system. For the same reason, his chair felt that a development strategy that relied too heavily on policies like selective subsidies and taxes would be inappropriate. While he could see that there might be some merit in adopting policies of that sort at an early stage of development, the countries concerned should ensure that they did not create industries that could survive only by receiving permanent subsidies.

He could agree with the views expressed in Part Four of the paper to the effect that, even at a time when some oil exporting countries were again becoming net debtors, reserves should be managed in a way that would cause as little disturbance as possible in exchange markets, Mr. Grosche commented. The prudent behavior of the oil exporting developing countries in the past should not be overlooked; he hoped that they would continue to act in the same way in the future. He had four suggestions for authorities concerned with the conduct of financial investments. First, bilateral financial arrangements between oil exporting countries and other developing countries could be intensified in view of the difficulties of obtaining access to international capital markets. Second, the oil exporting countries could consider providing even more financial resources for multilateral financial institutions. Third, investments in industrial countries could be of a longer-term nature. A sudden switch between investments of different maturities should be avoided, especially in countries with relatively small domestic financial markets. Close contact with the authorities involved in those transactions would help to avoid impairing the achievement of domestic policy targets in the countries concerned. Fourth, industrial countries should certainly encourage oil exporting countries to diversify their assets. On the other hand, oil exporting countries should avoid switching between banks and currencies if they wished to maintain orderly exchange and financial market conditions.

The desire of oil exporting countries to diversify their assets was certainly legitimate, Mr. Grosche said, but their investment plans ought to be compatible with the economic targets of the countries in which investments took place. Reciprocal contracts should help greatly to harmonize such plans. Industrial countries should not discriminate between investors from oil exporting countries and domestic investors. In passing, the fears about nationalization expressed on page 133 of the paper were not really justified. Many bilateral contracts of the sort discussed already existed, and the laws of most industrialized countries provided for fair compensation.

Germany had tried to support the recycling process by maintaining free access for foreign investors, both to the capital market and to direct investment, Mr. Grosche stated. His Government welcomed all investment provided that the investors did not interfere with the general political and economic interests of Germany. In that connection, he welcomed the intention of a number of oil exporting countries not to purchase more than 5 per cent of any German company without informing the German authorities in advance. Germany was interested in concluding bilateral agreements with any countries as a way of promoting foreign direct and financial investment at home. The authorities would however not consider the use of special instruments such as the indexation of interest, which would guarantee a specific real return on investment, as a means of attracting capital inflows from oil exporting countries.

Mr. Schneider commented that he agreed with the author that the current energy problem was of vital concern to all, and that the implications would have a profound effect on the way of life of people everywhere. It seemed unavoidable that sooner or later the world would have to overcome problems related to energy. He therefore welcomed the paper as the start of a discussion which should take place not only in the Executive Board of the International Monetary Fund but also in political circles concerned with the formulation of energy policy. The present energy problem was the result of abrupt changes in the oil price over time. In other words, the price of oil had been kept artificially low until the first large increase in 1973/74. It was of course difficult to say what would have happened if there had been a slow but steady rise in the price of oil, but it did seem evident that such far-reaching dependence on one depletable energy source could have been avoided, at least to a certain extent.

The paper, for which Mr. Amuzegar and his collaborators deserved commendation, addressed itself to a number of interrelated aspects of the oil world, Mr. Schneider noted. The analysis concentrated mainly on the experience of oil exporting developing countries, as a means of shedding some light on the future from the standpoint of the adjustment process. The study would therefore be of great help in the Fund's explorations of the issues related to oil.

It was striking that it had required two oil shocks to persuade countries to consider the issue of energy management on a global scale, Mr. Schneider commented. The paper clearly demonstrated that one of the most important requirements for a viable economic order was the prudent use of oil reserves, together with a realistic pricing mechanism and a careful management of oil-based revenue.

Heavy dependence on oil exports and the depletable nature of oil were the key determinants of the problems of oil exporting developing countries, which had to be seen in combination with the projections for world energy requirements in the coming decade, Mr. Schneider observed. Consequently, it would be valuable if a set of common policy goals could be agreed upon and implemented as a way of achieving a sustainable balance between supply and demand. A realistic pricing mechanism by which sharp fluctuations could be avoided would be of great value, not only in establishing an orderly oil market, but also in encouraging exploration for alternative energy sources. Sharp fluctuations had rather negative effects on exploration attempts and led to misallocation of resources, since a number of new projects had been stopped regardless of funds already spent. It was also possible to take the view that matters should not be left entirely to market forces because those forces simply did not take a long-term view of events.

It would be advisable for oil exporting developing countries to maintain a certain cushion of monetary reserves to enable them to cope better with problems related to oil price fluctuations, Mr. Schneider considered. For that reason, it might be interesting to know more about the price elasticity of the demand for oil. More could certainly be said on that point than he had been able to find in the paper. In addition, the oil exporting developing countries should be encouraged to intensify their investment in domestic real capital formation. On the question of mobilizing domestic real investment, he broadly agreed with the view that integration of the oil industry into national economies, followed by its integration into the international economic structure, clearly required concerted action in designing the proper development strategies.

Taking up the sections in the paper dealing with policy options and policy instruments, Mr. Schneider said that he was glad that the various exchange rate policies were being discussed. Technically speaking, exchange rate policies would require more study than other oil-related issues, in particular the so-called equilibrium exchange rate. The treatment of several items arising from petroleum sales was open to different interpretations, which in turn might have significant consequences for deciding on the proper policy stance. The promotion of non-oil sectors and efforts to balance the requirements of the absorptive capacity with the concerns of the international community made the whole matter even more complicated. He was not convinced that a multiple currency practice represented a reasonable solution. It could certainly not be denied that the oil exporting developing countries were under strong pressure in their search for the proper balance between rapid adjustment and realistic exchange rates commensurate with the general trend of oil demand. In the search for a stable economic order, it was important to learn more about the behavior of the demand for oil, to have realistic projections for oil supply, and to upgrade the absorptive capacity of the oil exporting developing countries. The crucial issue was how to choose the best policy mix for optimizing the depletion of oil reserves, increasing economic and absorptive capacity, and managing financial assets.

Mr. Polak said that the Executive Board ought to be profoundly grateful to Mr. Amuzegar for preparing so formidable a paper. He would, however, speak only on some of the questions that Mr. Amuzegar had raised at the end of his introductory remarks. The fifth topic, for instance, on recycling, had been discussed by the Executive Board in the context of the World Economic Outlook and the Eighth General Review of Quotas, and would no doubt be discussed again. Consequently, it would not serve the Board best to discuss recycling only in the context of oil surpluses. The sixth question dealing with cooperation between consumers and producers was something on which other agencies had spent a great deal of effort, often without notable success. He was unconvinced that useful results would be achieved by Fund discussion of the point, or, consequently, of Part Five of the paper.

He would concentrate particularly on the question of the exchange rate policy for oil exporters, and the related question of diversification, Mr. Polak went on. As he was concerned with the medium-term and longer-term issues, nominal prices and nominal exchange rates were of little importance; inquiry would have to be focused on real variables, including real prices and real exchange rates. Such an approach would fit with the theory of comparative advantage, with one important difference: that theory had always been based explicitly or implicitly on a balance in the current account, whereas an important element in the entire picture for the oil exporting developing countries was precisely the disequilibrium in the balance of payments and the possibility of a persistent current account surplus. Looked at in that light, the oil exporting countries were countries with a strong comparative advantage in the production of oil over the production of all other tradables. For the major oil exporters, the comparative advantage was so great that any reasonable outflow of oil was sufficient to enable them to finance all the debit items in their balance of payments, while accumulating reserves or acquiring assets abroad. Not only did those countries not need to export anything but oil; many of them did not even need to export all the oil that they could export. Consequently, any equilibrium price mechanism would make it impossible for them to export anything else.

There were many other countries that were oil or surplus energy exporting countries, for which the comparative advantage was not quite so great, Mr. Polak mentioned, but which had many of the same characteristics as oil and gas exporting countries. Countries in that group included: the United Kingdom, Norway, Canada, and the Netherlands. It was rather a pity that no reference had been made to work that had been published on their problems.

The question of diversification in oil exporting developing countries ought to be discussed against the background that he had just sketched, Mr. Polak considered. Rather than speak about the need for diversification, he would prefer to speak about the scope for diversification; there was no point in aiming for diversification beyond what was possible or beyond the scope that other elements in the economy would allow. Clearly, any diversification would be in the direction of non-oil exports and of the domestic production of import substitutes. A country wishing to diversify would by definition be interested in producing tradables other than oil. On a theoretical level, the scope for diversification in a major oil exporting country was determined by two variables, the production and export of oil, and the current account surplus. It was the export of oil, to the extent that the profits were not accumulated in the form of foreign capital assets, that determined the extent to which a country's demand for non-oil tradables could be met from abroad, and the proportion that would have to be provided at home. The question of the exchange rate was in a sense subsidiary to the basic principle that he had just mentioned.

Apart from taking a decision on the amount of oil produced, Mr. Polak observed, oil exporting developing countries had to decide how much of the proceeds to accumulate or, to put it differently, how much of the proceeds from oil to spend at home. As was mentioned in the paper at various points, the decision on spending the revenue from oil was far more important than any decisions on the exchange rate. If countries wished to avoid entirely the negative effect of the strong comparative advantage that oil had on the production of other goods, they would have to save all the proceeds from oil. While that was a general proposition not limited to oil, it was more applicable to oil than to other goods in the sense that a large proportion of the oil proceeds was rents that for the most part accrued directly to governments; it was in theory possible to save a large proportion of the rents in the form of assets held abroad. Clearly, no country would wish to go so far as to accumulate all the proceeds of its oil sales, or the full rent component of the oil proceeds, in the form of assets abroad. If a country did so, the result would be that it would have no immediate benefits from oil production and that its development would be just as difficult as that of a country with no oil. The country would be able to adhere only to its traditional lines of production, and its consumption level would remain what it had been before the discovery of oil.

Many oil producers did of course make an effort to save part of the proceeds on their oil exports abroad, Mr. Polak noted. Even so, none of them had entirely succeeded in preventing a proportion of oil proceeds from leading to the establishment of a domestic leisure class of people who could be kept at a reasonably comfortable level of income without engaging in economic activity. In the Netherlands, too, the expansion of welfare payments resulting from the oil bonanza had been one of the problems bedeviling economic policy.

The distinction made in paragraph 12 of EBD/82/127, Supplement 1 between different types of oil exporters could become important, Mr. Polak considered. At one extreme was a subgroup that could be characterized as having relatively short-lived oil reserves, a large population, a significant non-oil sector, a relatively good agricultural potential, limited state intervention, and small holdings of international reserves. Countries in that subgroup were in a position to conduct economic policy in such a way as to bring about a relatively low exchange rate for their currencies in order to make the export of non-oil tradables and the domestic production of import substitutes profitable. The Executive Board had been discussing the matter in connection with the lack of agricultural exports from Nigeria, Algeria, and perhaps Indonesia.

At the other end of the spectrum was a subgroup of countries with large oil reserves, small populations, little non-oil industry, relatively poor agricultural potential, substantial state intervention, and large holdings of international reserves, Mr. Polak remarked. For those countries, the author had stated, probably correctly, that diversification of assets would be more important than the diversification of production. One of the interesting forms of diversification, which deserved great attention, was the building of human capital, something that would give the country much greater flexibility in the use of its assets than the construction of industries that were supposed to become economical 25 or 50 years hence, when oil would have been exhausted. He was not persuaded by the argument that large investments in oil-based industries were clearly desirable for countries with little population and poor agriculture. Oil-based industries seemed unlikely to survive the disappearance of the oil on which they were based.

The development problems of oil exporting countries were similar to those of other developing countries, Mr. Polak considered. Development required, in a sense, changes in the dividing line between tradables and nontradables, all of which would require a great deal of effort. Consequently, successful diversification was a matter partly of setting the basic macroeconomic conditions, and partly of controlling the impact of the many microeconomic conditions needed for development. Thus, diversification went far beyond the setting of the exchange rate. While it should not be "wrong," a correct exchange rate was far from being a sufficient condition for bringing about either development or diversification. He completely agreed with the author that the impact of the exchange rate on oil production would not be large. In the absence of basic supply and demand conditions, relative price differences that might be created by large exchange rate actions were unlikely to remain.

In 1980, in DM/80/33, two staff members had reached what seemed to him a valid conclusion when they had said that the sustained impact that an exchange rate policy could have on resource allocation was limited, and that the use of exchange rates to achieve the objective risked aggravating other problems experienced by oil importers, in particular high rates of inflation, Mr. Polak concluded. He also agreed with the comment by the present author to the effect that the exchange rate was too aggregative a weapon to affect the relative international competitive position of specific export industries. "Exchange rate policy is not a substitute for development policy," as Mr. Amuzegar had written. He had also been pleased to note that, on balance, the author seemed to have come out against a multiple exchange rate. A separate oil/non-oil rate was quite clearly irrelevant. Among the non-oil tradables, the case against multiple rates for oil countries was no different from the general case against multiple rates, which--quite apart from the Articles of Agreement--was that they were an ineffective way of assisting domestic activities. They were even an ineffective way of subsidizing the value added of domestic industries.

Mr. Nimatallah wished to qualify the meaning of the word "diversification." There could after all be diversification of sources of income; diversification of tradables, which meant exports; and diversification of assets. It would be helpful in discussing diversification if speakers would say which type of diversification they had in mind. Oil proceeds were in fact assets that were exchanged for oil. Some countries, like Saudi Arabia, could not move directly to convert the assets that they received in exchange for oil into productive real assets as a means of adding to the real income of future generations. They had to wait for certain factors of production to become more productive, particularly in the agricultural and industrial sectors. However, in talking about the diversification of assets, Directors should take into account certain factors other than comparative advantage, such as security and the return to capital. The principle of comparative advantage did not seem to enter into play. When the time came, the temporary assets could be moved into real productive assets in the agricultural sector, by developing, for instance, more water resources or more management skills, all of which were assets of the country.

As to Mr. Polak's doubts about the desirability of oil exporting developing countries' establishing oil-based industries, if those countries did have a comparative advantage in the production of the final output, he saw no objection, Mr. Nimatallah went on. For instance, many developing countries had the comparative advantage of having oil as a raw material for petrochemicals. Consequently, if they could develop the necessary skills and management and acquire machinery at a reasonable cost, he found it only reasonable that they should establish a petrochemical industry.

Mr. Polak said that he agreed with Mr. Nimatallah's observations. He had been talking of the diversification of production, a point mentioned at some length in the paper.

Mr. Feito commented that the study was full of penetrating insights that bore out the author's practical experience and knowledge in the field. It touched upon important issues not only for the oil exporting countries but also for the international community and the Fund itself. A single seminar would give insufficient time in which to do the study justice. He would therefore concentrate on energy-related payments imbalances and the world adjustment process.

Regarding the proposed options for the economic policy of oil exporting countries, Mr. Feito stated, he could agree in particular with Mr. Nimatallah, Mr. Kafka, and Mr. Finaish. He agreed in general with the analysis of economic policy strategies available to oil exporting countries and with the general policy recommendations drawn from that analysis. He would like to echo two general points of considerable importance made in the study. First, it was important to take into account, in any analysis or policy recommendations for countries covered by the study, the broad diversity of societies with very different economic problems, often lumped under the general heading of oil exporting countries. Second, he wished to endorse the careful analysis of the well-known failure of the price system to achieve optimal intergenerational resource allocation. The failure was all the more evident in connection with renewable resources, for which the social rate of return was considerably higher than the private rate of return. The conclusion to be drawn was that if the current generation of oil exporting countries wished to leave a stable stream of resources for later generations, the economic base must be broadened beyond dependence on a perishable resource; for so doing, well-designed interventions in the various markets and activities that made up the economy would be required. The conclusion, which had substantial implications for the Fund's relationship with those countries, had not always received due attention, at least in the case of some exporting countries in Mr. Buira's constituency. The principle of uniform treatment should not be interpreted as meaning the same treatment for all members, particularly insofar as market intervention was concerned.

He had found the part of the paper on the international aspects of the energy crisis particularly illuminating, Mr. Feito stated. Not only was the analysis of world payments imbalances associated with the energy crisis thorough and well balanced; it was one from which the logical policy implications had been drawn, however far-fetched they might seem. The author had correctly pointed out that the world payments imbalances in the previous eight years had been radically different from any that had occurred in the past, because of the concentration of the imbalances and of the economic nature of the surplus countries. The current situation seemed to represent a unique combination of an absence of automatic forces for payments adjustment, and a large and apparently far from transitory surplus. Neither flexible exchange rates nor other traditional adjustment mechanisms had operated as expected.

The circumstances in which oil was sold and the role it played in the economic system had broken the linkages that had traditionally connected deficit countries to surplus countries, so that there were, at present, no major automatic forces working in the direction of permanent adjustment, Mr. Feito went on. After all, the oil exporting countries, like most other exporters of primary products, received their export revenue in foreign exchange, mostly U.S. dollars. Unlike most others, however, they did not have to provide the local currency counterpart to domestic residents. Consequently, the demand for, say, OPEC exports was not matched by a demand for OPEC currencies, so that an increase in the export receipts of the countries concerned put no upward pressure on the exchange rate of OPEC currencies. Thus, the operation of a system of flexible exchange rates by a number of oil importing countries had produced no forces making for the adjustment of OPEC current account surpluses, although they had had major effects on the distribution of the oil-induced current account deficits among oil importing countries.

Neither did the other two mechanisms of adjustment--increases in cash balances and incomes brought about by a rise in export receipts--function in the way conventionally envisaged in a conventional balance of payments adjustment, Mr. Feito remarked. Because the level of absorption of oil importing countries was in aggregate still very low, and because it was governments that received the increased oil revenue, the increases in income and money balances of the oil exporting countries were not at all equilibrating. The burden of adjustment thus fell largely on the deficit countries in the sense that there was only one way in which adjustment could take place, namely, through recession in oil importing countries. The shift brought about by such a recession would lead, however, only to a temporary, unstable equilibrium, which would vanish when recession gave way to economic recovery.

Those limitations, which considerably narrowed the scope and efficiency of conventional balance of payments adjustment mechanisms, ought to be taken into account in formulating and implementing Fund programs, Mr. Feito considered. The nature of the underlying world payments disequilibrium imposed considerable restraints on the efficiency of relative price adjustments and on other adjustment tools for achieving external balance. The limitations were all the more severe in non-oil developing countries where, short of starvation in some of them, there was very little room for further adjustment of revenue, and where the deterioration in the terms of trade vis-à-vis the industrial and oil exporting countries made devaluation redundant, useful only for exporting their problems to one another. The choice of instruments for the strategy of adjustment embodied in Fund programs should take account of such considerations.

He agreed with most of what the author had said on the channels of recycling or financial adjustment in the present circumstances, Mr. Feito observed. In particular, he agreed with the remarks on the role of the international financial institutions. Borrowing by the Fund in private markets would be an effective way of improving the health of private banks' portfolios by minimizing sovereign risk and allowing them to comply with the emerging regulatory requirements in the field of international finance. More important, borrowing would allow the Fund to play a proper and indeed crucial role in international adjustment. He hoped that the many useful observations made by the study in that field would be dealt with in more detail in the forthcoming paper and discussion on current strains in the international financial system. In conclusion, he generally agreed with the policy implications set out in the paper and supported its publication.

Mr. Lovato stated that, like other Directors, he welcomed the discussions of the energy crisis and the related payments imbalances. While he appreciated the broad analysis of the many interrelated issues involved, the format chosen for discussing them was not appropriate. A one-day seminar could not be expected to deal with all the topics adequately. It would have been more fruitful to divide the discussion into at least two separate sessions, one dealing with what oil producers could do in their own national interests to manage optimally their resources and the related revenue, the other dealings with the implications of those policies for the world economy, and the issue of global cooperation.

At least one general presumption seemed to be underpinning the paper, namely, that in assessing the energy issue it was essential to realize how interdependent the oil producing and oil consuming countries had become, and how necessary it was to implement policies of convergence and cooperation on a global scale, Mr. Lovato observed. The practical problem to be resolved was that of reconciling the oil exporters' interests with the energy-using countries' needs, and a degree of domestic autonomy for oil producers in managing their own resources with the desire to ensure an internationally balanced world economy. As both sides could gain from a cooperative solution, the aim of policymakers should be to devise a multilaterally agreed solution that could be considered workable by all parties.

He also held the view that the world economy had managed to adjust fairly quickly and effectively to the first round of oil-related imbalances, Mr. Lovato noted. By 1978, the combined OPEC current account surplus had been reduced to $2.9 billion; conversely, industrial countries had been able to convert the initial deficit following the oil price increases in 1973/74 into surpluses surprisingly quickly, while non-oil developing countries had incurred a total deficit of about $195 billion. At present, on the other hand, the world economy was marked by a pattern of international payments that could be regarded as out of balance. It was clear that large oil-generated imbalances continued to plague the world payments system, with the combined current account deficit of the industrial countries for 1979-82 amounting to more than $48 billion. The non-oil developing countries in the same period were likely to achieve a cumulative deficit exceeding $340 billion, while the oil exporters' surplus was expected to be in the neighborhood of $280 billion or more.

Second, while the industrial countries' payments position had improved--they had achieved a surplus in 1982, and it was expected to increase in 1983--the developing countries continued to run huge deficits, Mr. Lovato stated. It was therefore necessary to see why the same adjustment and financial mechanisms that had been relatively successful after

1973/74 were proving to be less effective in dealing with the second round of oil-related imbalances. The paper offered detailed answers to the question. The oil-dependent countries had in fact developed effective shock absorbers in response to the 1973/74 oil price increase: energy use had been reduced as a reflection of sluggish economic growth and energy conservation programs; exports to OPEC countries with large absorptive capacity had been increased to offset, at least partially, the increased oil bill; non-oil imports had largely declined as a consequence of restrictive domestic policies and worldwide stagnation; the real price of oil had decreased, reversing the unfavorable terms-of-trade trend set in motion by the dramatic increase in 1973/74. Finally, despite the large and growing burden of external debt, in adjusting their economies, non-oil developing countries had benefited from fast-growing world trade and, in financing their oil and non-oil deficits, from an effective recycling mechanism provided mainly by private financial markets that made available to them low-cost lending facilities.

At present, however, Mr. Lovato observed, the recycling process had been jeopardized by a collection of concurrent, seemingly adverse developments. As listed in the paper, oil prices in real terms were not expected to fall in the near future; oil exporters' propensity to spend and capacity to import were lower than they had been in the growth period of the mid-1970s; world trade was being stifled by episodes of protectionism and widespread stagnation; the large outstanding debt and high debt service ratios of developed and developing countries alike had undercut their borrowing capacity from private capital markets. The size of one factor moving in the opposite direction, namely the demand for oil, was largely uncertain. The prospective trend in the demand for oil depended on the industrial countries' economic growth, the advance of energy-saving techniques, and the massive development of oil substitutes. Consequently, any projections about oil related balances were bound to be risky. It might well be asked whether in fact large oil surpluses would persist in the coming years. Demand for oil would certainly not pick up as long the world economy remained stagnant, and prices in real terms could drop still further in 1983. Hence, it was unwise to assume, as the author had done, that real oil prices would remain constant through 1985. Even with smaller oil surpluses, however, international arrangements would be needed to help oil-dependent developing countries to manage their trade deficits and the debt services from their accumulated external debts. There would still be a need to recycle the revenue generated by the second oil shock. The world economy could not rely solely on the adjustment process, whether automatic or policy determined.

Such conclusions led him to comment on the means of cooperation between surplus and deficit countries, Mr. Lovato stated. The first step ought to be to identify areas in which the interests of the parties concerned could converge. Oil producing countries' aspirations lay mainly in seeking to develop a viable non-oil economy, to diversify their income-generating sources, and to manage their oil reserves. Non-oil developing countries were concerned with achieving a high growth rate for exports so as to ensure a strong supply of imported oil and capital goods needed for their medium-term development strategy, and with securing for themselves steady foreign aid and financial inflows. Industrial countries were interested in recovering high rates of growth and employment with low inflation.

One important area for cooperation therefore seemed to be that of energy conservation and the search for oil substitutes, Mr. Lovato pointed out. In both those fields, each of the groups had its own useful task and its own interest in the medium and long run. The industrial countries should embark upon a massive program of research and development for non-oil energy sources; the developing countries should be allowed to benefit from new inventions in the field through technological transfers; the oil producing countries could contribute to the effort by recycling their oil proceeds through direct investment in industrial companies, despite the disincentives listed in the paper. In the transitional period, which might be rather long, before alternative energy sources became available on a satisfactory scale, oil prices should remain fairly attractive and possibly stable. If they did so, they would exert a positive and stabilizing influence on the concerted effort to reduce energy consumption and develop competitive oil substitutes.

In the meantime, the oil exporting countries should be encouraged to increase their financial assistance, both concessional and nonconcessional, to the less developed countries, Mr. Lovato concluded. The private recycling process of surplus to deficit countries, which had worked well in the mid-1970s, could still be helpful. Nevertheless, taking into account the large outstanding debt of many countries on the one hand and the institutional limits of the international financial system on the other, private recycling could turn out to be insufficient. The need to strengthen the process while assisting structural adjustment seemed to call for the development of wider functions on institutions like the International Monetary Fund and the World Bank.

The Executive Directors agreed to continue their discussion at 3:00 p.m.

JOSEPH W. LANG, JR.
Acting Secretary