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| A. R. G. Prowse | |
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| | Tai Q. |

J. W. Lang, Jr., Acting Secretary
R. S. Franklin, Assistant

Also Present
J. Amuzegar, Consultant. African Department: J. B. Zulu, Director; A. Tahari. European Department: H. Vittas. Middle Eastern Department: A. D. Crockett, Z. Iqbal, S. von Post, M. Yaqub. Research Department: R. R. Rhomberg, Deputy Director. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. R. Abiad, E. A. Ajayi, S. El-Khouri, M. A. Janjua, P. Kohnert, H.-S. Lee, P. D. Péroz, F. Saraff. Assistants to Executive Directors: E. M. Ainley, H. Arias, T. A. Connors, I. Fridriksson, G. Gomel, J. M. Jones, M. J. Kooymans, W. Moerke, V. K. S. Nair, J. R. Novaes de Almeida, E. Portas, D. V. Pritchett, M. Z. M. Qureshi, J. Reddy, C. A. Salinas, D. I. S. Shaw, H. Suzuki, O. Üçer, J. C. Williams, 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 continued from the previous meeting (EB/Seminar/82/7, 10/15/82) their consideration of 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 Sup. 1, 5/28/82).

Mr. Prowse observed that the first paragraph of EBD/82/127, Supplement 1 made two key assertions: first, that the automatic adjustment mechanism was inadequate; and second, that deliberate actions were required to mobilize global energy resources. In his view, it was not certain that the effects of the increases in oil prices had been inadequately dealt with. Where performance had been less than satisfactory, it might be explained that the automatic adjustment mechanisms had of necessity been constrained in their action and that certain deliberate policies had in fact been misguided. In paragraph 3, the author had focused on the central point of the paper: the role of the public sector in the oil exporting developing countries and their development objectives. The final statement in that paragraph suggested that the accrual of export revenues to the governments of the oil exporting developing countries rendered the external adjustment process less automatic than in other countries and made the pace and pattern of development crucially dependent on the quality of each government's investment decisions. He could accept that statement so long as it was recognized that it could apply not only to the oil exporting developing countries but also to any economy in which income primarily accrued in the first instance to the government sector. In such countries it was hardly a surprising assessment that the market mechanism had perhaps not worked well.

The issue from which all others in the paper were derived concerned the ongoing balance between supply and demand for energy, particularly oil, Mr. Prowse continued. Unfortunately, the paper did not attempt to provide any answers about how that balance might develop, although it had indicated that increases in consumption would have to come mainly from OPEC countries. While personally accepting the assumptions of the paper about price developments through 1985, he recognized that there were some differences of view--particularly from the U.S. Administration--concerning the direction of real oil prices.

With respect to the development problems of the oil exporting countries, Mr. Prowse said that he had detected an interventionist flavor in the paper. For example, paragraph 11 on page 3 of EBD/82/127, Suppleement 1 stated that "since a common objective of OXDCs (oil exporting developing countries) is diversification and since macroeconomic policies cannot direct development into a particular sector or industry, they will need to consider the use of industry-specific policies." Even though macroeconomic policies did not direct resources into particular sectors, it was questionable whether there was a need for deliberate action on the part of governments toward that end. The real question was what broad economic structure and philosophy the oil exporters would or should adopt. Would they be controlled economies--as seemed to be the case at present--or would they be market economies or some mix of the two? The answer to that question would be a determining factor in the sorts of mechanisms that would be adopted to direct the development of individual economies.

If the choice were to move toward a market economy, Mr. Prowse commented, the resources accruing to the government sector would need to be channeled through the private sector into the investment and productive base, and a mechanism might then be employed that would encourage truly entrepreneurial development. However, he had noted from paragraph 16 of the supplementary paper that "in an ideal world, the adjustment paths for the oil and non-oil, surplus and deficit, rich and poor countries would be neither insurmountable nor enduring. The inexorable interplay of competitive market forces would operate toward an equilibrium, constantly rearranging and redistributing economic factors." The paper went on to state that "in the world as it is, forces may be moving away from such gravitational equilibria. The obstacles to sustainable growth, optimum productivity, and equilibrating adjustments are numerous--i.e., excessive internal structural rigidities, unfavorable institutional arrangements, domestic interest group pressures, a weak productive base in certain economies, bureaucratic timidity, external impediments to a free flow of goods and capital, an inclement international climate, and sheer time lags." Those obstacles should probably be the focus of the development process of the oil exporting developing countries, whether the ownership and control of resources were to remain in the public domain or not. However, such an approach would not necessarily be consistent with the suggestion that such countries should be considering the use of industry-specific policies, which included possible trade protection and tax incentives.

On the issue of recycling, the paper seemed somewhat pessimistic, Mr. Prowse remarked. The author appeared to be of two minds about the likely extent of recycling in the 1980s and about whether existing mechanisms could cope with the task. While noting uncertainties in the various projections, the paper had placed the cumulative OPEC surplus for the period 1980-85 in the range of $210-300 billion in 1980 prices and had noted that surpluses of the magnitudes seen in 1974-78 might not be easy to recycle because the two major mechanisms--commercial bank lending and the rapid reduction in current account surpluses--might be less effective in future. On the other hand, on page 139 of the main paper there was a reference to the unexpected ease with which surplus dollars had been recycled in the 1974-78 period, together with a statement to the effect that recycling in the 1980s might turn out to be equally trouble free because of the likelihood of smaller surpluses and because the expansion and increasing sophistication of Arab banks and investment corporations might facilitate the channeling of nonconcessional funds to potential users. And, as Mr. Nimatallah had noted at EB/Seminar/82/7, the absorptive capacity of the oil exporting developing countries had been greatly enhanced during the latter part of the 1970s. Still, the paper had cautiously cited new barriers that would have to be overcome--such as a reduction of aid flows, a slowdown in world trade, and increasing protection--if recycling was to be facilitated.

While there were obvious uncertainties surrounding developments in the oil markets and in the world economy as a whole, it could be said that the existing mechanisms had shown a capacity to evolve and that lessons had been learned in the 1970s, Mr. Prowse commented. Hence, in the absence of major shocks or disturbances, it should be possible to proceed on the assumption that the existing recycling mechanisms--including those operated through multilateral institutions like the Fund--would be able to deal with the prospective recycling task. In his view, the paper had perhaps underestimated the capacity of the existing mechanisms to handle recycling; he would prefer to reserve judgment on the potential need for special arrangements to deal specifically with large external debt problems.

Greater attention should of course be paid in any revision of the paper to the need for an appropriate combination of financing and adjustment, Mr. Prowse considered. The matter of adjustment was perhaps beyond the scope of the paper. However, there had been references in the text to the limits to what adjustment might achieve, as well as to the way in which it might have been more effective if there had been a clearer recognition by countries that unduly expansionary policies had been followed in situations in which more comprehensive adjustment had been called for. It was to be hoped that the lessons of the recent past would help to prevent governments from making similar mistakes in the future. From that point of view, one could easily agree with the statement made on various occasions by Mr. Finaish and Mr. Nimatallah that energy prices were only a part of a wider economic problem that had its roots as far back as the postwar period, when the industrial countries had begun to make choices with respect to social programs, for example, and other economic structures and policies.

Following logically from his view that the basic economic structures in the oil exporting developing countries were yet to be confirmed was the idea that there was no need for any great anxiety about shaping those countries into a final and mature industrial structure in the very near future, Mr. Prowse said. They had good prospects for a high level of income for many years to come, and it was essential at the present stage to decide only on the appropriate current balance between consumption--including investment in the population and its education--and investment in financial and real assets abroad that could be liquidated to finance the creation of the productive capacity that the oil exporting developing countries might need to put in place when their oil income began to diminish. His advice was that the countries concerned should retain as much flexibility as possible and not close off their options with respect to the pattern of their evolving development.

Finally, as to whether or not the paper under discussion should be published, Mr. Prowse observed that Executive Directors had barely scratched the surface of issues raised in the document and had obviously reached few if any conclusions about them. While he would have no objection if the paper were to be published as the author's contribution to an ongoing discussion, he would wish it to be made clear that the views contained therein were not necessarily those of the Executive Board or of the Fund.

Mr. Anson agreed that the necessarily brief seminar discussion would not exhaust the value of the paper as a provoker of thought; it was therefore sensible that the paper should be published as a research document--with whatever editing was thought to be necessary--for others to ponder.

The seminar had provided a welcome opportunity to hear from Directors with inside knowledge and experience of the problems of the oil exporting developing countries, and the paper had proved a useful framework within which to place those comments in perspective, Mr. Anson continued. His own remarks would be limited to the international financial aspects of the energy crisis and payments imbalances, with particular emphasis on the areas in which the Fund had a role to play. Few could predict with any confidence the outlook for the oil markets and for oil prices; the possible rundown of stocks and a resumption in world growth would tend to increase the demand for energy, but conservation and the substitution that had been encouraged by the earlier oil price rises should work in the other direction. For the next few years, it was possible tentatively to predict some decline in the real--but not in the nominal--price of oil, but there was obviously scope for wide variation from year to year, and the existing uncertainties tended to increase as projections looked further into the future. For the oil exporting developing countries, sharp fluctuations in prices could mean widely varying surpluses, and even deficits in some circumstances; other countries--both developing and industrial--would suffer as well, particularly those poorer developing countries with no indigenous oil resources. The broad question--which went well beyond the scope of the paper--was how to ensure that the balance between supply and demand could be adjusted smoothly so as to avoid abrupt changes in price; for that question to be answered, however, a number of fundamental issues of the sort referred to in the paper needed to be tackled first.

One conclusion to be drawn from the study was that both conservation and the search for new sources of energy should continue irrespective of short-term variations in the oil price, Mr. Anson said. The great danger was that concern about both matters might be switched on or off depending upon the supply and demand situation. There was also a continuing need for diversification of production by the oil producers, as well as by other countries severely affected by changes in the oil price. Approaches to diversification would of course vary widely from country to country among the oil exporting developing countries, although particular emphasis should be placed, in some cases, on the role of agriculture. The paper contained a number of references to an urban bias in countries with potential for agricultural development, and perhaps the World Bank could play a useful role in helping to reverse that trend. He also agreed with Mr. Prowse that the extent of government intervention in oil exporting developing countries' economies was a basic issue. Intervention in infant industries should be carefully controlled if those industries were to survive in a market economy in the longer run.

An interesting issue raised in the paper was whether it was, in fact, advantageous for the oil exporting developing countries or others to have the price of oil denominated and invoiced in U.S. dollars, Mr. Anson recalled. Such an approach could lead to rather haphazard variations in the effective price and seemed to argue for a more automatic formula. The paper had suggested that no automatic formula would be observed for long if market conditions dictated otherwise. While that might be true, the use of a basket of currencies as a basis for pricing did not preclude adjustment in light of market conditions. From the Fund's standpoint, the idea of using the SDR as the numeraire for price decisions might be worth exploring in the context of discussions on the future role of the SDR. Indeed, it might be worth exploring whether SDRs or SDR-denominated assets could be used for payment, although that would clearly require a greater development of the SDR than existed at present.

On another Fund issue, a brief reference had been made to the substitution account in the context of investment, Mr. Anson noted. Like Mr. Kafka, he hoped that the idea of substitution could be kept in mind, although not necessarily limited to the study of a substitution account of the kind examined earlier. Substitution through the creation of SDR-denominated assets might turn out to be a more desirable alternative--and perhaps an easier road to follow--than a deliberately constructed substitution account.

Remarking on other issues in the paper, Mr. Anson observed that the supply of funds to the international capital markets might not be much altered by variations in the surpluses of the oil producers. The reduction in payments imbalances in 1974-78 had been associated with a faster growth in the Euromarkets, but changes in either direction might result in important changes in the balance of asset preferences. Indeed, the oil exporters themselves might change their asset preferences over time between short-term and longer-term assets and direct investments. In the circumstances, the restoration of the previous supply of funds for the banking system could involve some adjustment in interest rates. If developing countries were to obtain the financing they required, adjustment might have to proceed somewhat further and faster than previously planned. That was not to deny the need for early and effective adjustment in the industrial countries as well, and he agreed with Mr. Prowse that the paper should have put more emphasis on the need for a more appropriate balance between adjustment and financing.

The paper provided a clear illustration of the pitfalls of classification, Mr. Anson considered. There were important differences among the oil exporting developing countries, with respect to both their oil resources and their absorptive capacity, and the attempt to treat oil producers as a single group could lead to problems. It might be better to distinguish those with high oil reserves and low absorptive capacity from those with higher absorptive capacity and relatively limited oil reserves. The latter group could then be expanded to include most of the net oil exporting developing countries that were not covered in the paper although adjustment for some of them had become an urgent matter. In that connection, it would be worth reviewing the IFS classification of countries.

The paper also did not pay sufficient attention to the distinctions among the oil exporting developing countries relating to exchange rate policy, Mr. Anson continued. While the conventional analysis of such policy might need to be modified for those in continual surplus with a highly dominant export price expressed in a foreign currency, exchange rate policy remained particularly relevant for those with a high absorptive capacity; and Article IV consultation reports would need to continue to make explicit judgments on the matter. He agreed with those Directors who had supported the arguments in the paper against the adoption of multiple exchange rate systems.

A matter deserving general discussion at some stage was the movement of some economies into or out of an oil exporting position, Mr. Anson remarked. The paper had made reference to the lively debate about the implications of oil and gas production in the Netherlands and the United Kingdom. The question was whether the resulting problems were due to the direct effect of production on the exchange rate or whether the effect was on the balance between revenue and expenditure through taxation receipts, which could give the mistaken impression that, for a time at least, government expenditure could be expanded. That issue--which applied in particular to the North Sea experience--was of more general interest.

With respect to the issue of direct investment by the oil exporting developing countries, Mr. Anson noted that the paper drew heavily on work prepared by the Development Committee's Task Force on Private Foreign Investment. It would be interesting in that respect to see the results of the further study that had been commissioned by the International Finance Corporation as a follow-up to the work done by the Task Force. He fully appreciated the reservations felt by both investing countries and host countries on the matter of direct investment by the oil exporting developing countries, but a liberal attitude to investment flows was an important aspect of international openness. Such flows provided support for development along with other forms of recycling and liberal policies on aid and trade. Article IV consultation discussions should focus as much on impediments to direct investment flows--whether created by the investor or the recipient countries--as on other flows.

A number of conclusions might be drawn from the paper about the exercise of Fund surveillance, Mr. Anson considered. Following the general principle of evenhandedness, attention should continue to be devoted to the energy situation and the international implications of decisions about oil pricing and production in both the Article IV consultations and the World Economic Outlook discussions. Rather than concentrating solely on the domestic policies of oil producing countries, staff papers should perhaps contain more information in four main areas: direct investment, the management of oil surpluses, the appropriate level of oil pricing in the domestic market, and the diversification of the tax base. On the management of oil surpluses, he endorsed the finding in the paper that oil surplus countries had, in managing their reserves, been careful to avoid sudden currency shifts; information about such matters was important if confidence in a multicurrency system was to be sustained, and it was unfortunate that Article IV consultation papers had not covered the matter sufficiently in the past. The appropriate level of oil pricing in the domestic market was also important to ensure suitable allocation of resources and to encourage conservation, and the tax base should be diversified to reduce the vulnerability of oil producers to swings in oil-related income when world oil demand and oil prices varied.

Mr. Abdollahi considered that EBD/82/127 was one of the most comprehensive studies ever to be undertaken on issues concerning the "energy crisis" and related payments imbalances. The paper would certainly be of interest to a wide audience--particularly those concerned with the economic development of oil exporting developing countries--and he therefore strongly recommended its publication. He particularly welcomed the opportunity to discuss the development strategies of oil exporting developing countries and the policy options available to them, matters which had not been given sufficient attention in the Fund in the past.

Because he was in broad agreement with the general analysis and recommendations contained in the paper, and because he was certain that due attention would be paid by others to important issues such as payments imbalances and recycling, he would concentrate his remarks mainly on the economic development of the oil exporting developing countries, Mr. Abdollahi continued. The world community--including the Fund--had always been very interested in the international responsibilities of those countries in terms of how much oil they produced, what they imported, and how they managed their reserves; but it had focused very little on what happened in their domestic economies. Since the adverse developments in the global economic situation two years previously, the oil exporting developing countries--even those with comfortable foreign reserves--had faced acute economic problems in varying degrees. Coping with those problems had been painful but had at least provided the countries with a new opportunity to re-examine their development strategies and to reconsider economic policies on the basis of what had been learned from experience over the previous few years. In passing, he noted that the present difficulties faced by the oil exporting developing countries were not simply the result of recent adverse developments in the world economy; indeed, their problems had been accumulating and intensifying over a somewhat longer period. While he agreed with Mr. Nimatallah that any assessment of the economic performance of the oil exporting developing countries should take account of each country's national limitations, characteristics, and priorities, he believed that there were sufficient similarities among those countries to enable him to view them as a group. On a collective basis, the economic performance of the oil exporting developing countries had generally been poor and, in some cases, totally disappointing.

Following the long overdue first oil price adjustment in 1973/74, the oil exporting developing countries--after finding themselves with large surpluses and subject to various external pressures and internal temptations--had undertaken major development efforts generally based on a massive industrialization policy, Mr. Abdollahi observed. The basic common objectives of those efforts had been to develop or expand the nonoil productive base of the economy, to reduce the heavy dependence on oil, and to increase the level of welfare and improve the distribution of income within each economy. Unfortunately, the oil exporting developing countries were at present no less dependent upon oil than in the past; at the same time they were more dependent upon both consumption and capital imports than they had been in the early 1970s. Generally speaking, the diversification effort had not led to an increase in the share of manufacturing and other industries in GDP; indeed, in some countries with relatively large industrial and infrastructure bases, the share had declined, despite the large and rapid increases in industrial investment. Although those countries had recorded some real growth in manufacturing, it had mainly been the result of massive investment expenditure. Moreover, the composition of the industrial sector that had developed was heavily biased in favor of light consumer industries with no substantial links to the national economy. An additional common side effect of the industrialization policy in most of the oil exporting developing countries was the almost total neglect of the agricultural sector. The share of agriculture had declined significantly in most of those countries while remaining at the same level in a few of them. The only sector of the economy that had grown extensively in the past nine or ten years was the nonproductive services sector.

While measures for improving social welfare had been undertaken in the oil exporting developing countries, income distribution had undoubtedly worsened, Mr. Abdollahi remarked. Old distortions had been exacerbated and new ones had been created, massive population movements had taken place, and social tensions had intensified. Such problems had been accumulating for a relatively long period, although they had gone unnoticed while the surpluses continued. Adverse developments in the external situation in 1976-78 had brought some of the problems to the surface and had, in turn, forced a number of the oil exporters to adopt appropriate adjustment measures. Unfortunately, a second round of price adjustments had created the opportunity for those countries to adopt a new wave of expansionary policies, albeit somewhat less expansionary than in the past, and had postponed the need to face the real problems inherent in their economies. In that regard, the recent adverse developments in the world economy might be a blessing in disguise.

The policy instruments used by or available to the oil exporting developing countries had been well presented in the paper, Mr. Abdollahi considered. While specific recommendations had been put forward in some instances, care had been taken in the paper to present the pros and cons of different policies and to emphasize the appropriateness of each with respect to individual countries in the group. However, he tended to agree with the premise in the paper that no policy instrument was as essential and effective as fiscal policy in the economies of the oil exporting developing countries.

The major question for the oil exporting developing countries--given their absorptive capacity--was what proportion of their oil revenues would be spent at home and how the renevues would be spent, Mr. Abdollahi commented. As global demand for oil improved, the foreign currency difficulties of the countries would gradually wither away. However, it was not likely that they would be able or willing to change their development policies rapidly or even to continue to adhere to the contractionary measures that had been adopted over the previous two years. Given the number of projects already under way--together with the deterioration in the agricultural sector--the existing distortions in their economies made the task of correcting past mistakes both painful and time consuming.

Commenting on oil production and export policies in the oil exporting developing countries and their relationship to the global adjustment process, Mr. Abdollahi noted that, in the short run, there were signs that the oil glut was gradually coming to an end. However, any major improvement in the demand for oil would depend on an improvement in the global economy, which might itself lead to increased oil revenues for the oil exporting developing countries, particularly those short of cash. That in turn could be translated into an increase in demand for imports, which would be conducive to economic recovery in a global sense. Still, the increased oil revenues did not necessarily imply a new substantial surplus for the oil exporting developing countries, and he therefore found it difficult to accept the estimated aggregate surplus for those countries for 1982-85 that was suggested in the paper.

Longer-term prospects could of course be quite different, Mr. Abdollahi conceded. With economic activity picking up, the demand for oil would certainly increase unless there were new major discoveries of oil or substantial technological breakthroughs that would make alternative sources of energy more economical and more readily available. In view of the dim prospects for substantial new discoveries of oil and of the limited supply of oil from non-OPEC oil exporting developing countries, despite tremendous achievements in conservation, the OPEC countries, particularly those in the Middle East, were bound to continue to play a major role in filling the increased demand for some time to come. In the process, and contrary to the belief in certain major oil importing countries, the price of oil would once again increase, and substantial surpluses would accrue to OPEC countries. In that regard, it was essential for the smooth functioning of the world economy that abrupt adjustments in the price of oil be avoided, perhaps through some long-term oil pricing mechanism such as the indexation of oil prices to increases in the price of imports.

On the matter of recycling, Mr. Abdollahi noted that, although the energy "crisis" might be over for the present, the problem of payments imbalances would continue, despite expected deficits in some of the oil exporting countries. The most important question in the short term was how the new surplus countries would respond to the situation; of more long-term importance were questions concerning the mechanism through which recycling would take place. At a time when non-oil developing countries were running historically high deficits and facing large external debts, and when traditional recycling mechanisms seemed unlikely to play as large a role as in the past, the burden of responsibility for adequate recycling fell on the major oil importing countries and the international financial institutions, particularly the Fund. The oil exporting developing countries, which had already done their share in the area of recycling, would continue their efforts, but the International Monetary Fund should play an increasing role in the recycling process. A much larger and stronger Fund was essential if adequate recycling was to be achieved; the major oil importing countries would therefore have to change their attitude toward international institutions like the Fund and adopt economic policies that would facilitate global economic adjustment and the recycling process.

Mr. Erb noted that the past, if properly interpreted, could often provide answers to questions about the future. An important question raised in the paper and in the course of the discussion was whether the energy situation over the next two decades would continue to give rise to major international payments imbalances of concern to the Fund. Of the greatest concern to the Fund and to the world economy in the previous decade had been the two large oil price increases in 1973/74 and 1979/80 and the large payments shifts that had occurred during the period. The fluctuations in surpluses had been a complicating source of instability in the world economy. From a historical perspective, it was important to ask whether the oil markets had, in a way, become like other commodity markets and whether continued fluctuations in the price of oil were to be expected in future or whether there would be a return to the postwar era of relatively stable prices. In his view, the stability of the oil markets in the postwar period had been the result of unique circumstances that were unlikely to be repeated, so that the world might well have to face continued fluctuations in the real price of oil in future.

In the analysis provided in the paper, the postwar period had been only briefly discussed, Mr. Erb recalled. However, he wished to take issue with the suggestion that, until the early 1970s, there was nowhere in the world--certainly not in the major oil consuming nations--a global energy policy. A review of the postwar period through the early 1960s would show that the dominant source of stability in the international oil markets had been the large excess capacity in the Texas Gulf region, rather than in the Arabian Gulf as at present. During that period, the Texas Railroad Commission had, through its regulation of production, achieved some price stability, despite periodic shocks during the 1950s--such as the shutdown of production in Iran in the early 1950s and the Suez crisis--which had caused price disruptions in the Middle East.

Moreover, Mr. Erb continued, the United States had maintained import quotas to keep oil prices at a higher level than they might otherwise have achieved, and those controls had remained in effect throughout the 1960s, despite criticism at the time from the oil producing economies in the Middle East. It had been during the 1960s that the large oil finds of the immediate postwar period had been rapidly developed. Contrary to the suggestion by Mr. Finaish, the sharp decline in the landed price of crude oil had not been caused by the seven major oil producing companies controlling 70 per cent of oil production; rather, it had been due to the dramatic increase in oil production in the Middle East and the rise in competition. Moreover, there had been a major institutional change after 1973 whereby governments rather than oil companies took responsibility for decisions about prices and production.

While prospects for oil prices in future would depend in part on continued conservation efforts in the major consuming nations, they would also depend on the oil price and production decisions of the major producers, particularly Saudi Arabia and others in the Gulf region, Mr. Erb remarked. Those decisions would be taken on the basis of how much excess capacity was retained to enable Saudi Arabia and some other producers to increase production during the periods of sharply growing world demand, and on their ability to cut back on production when demand was slack. There were many uncertainties regarding the future course of oil prices and production; however, even though fluctuations might not be as sharp as those witnessed during the 1970s, he doubted that there would be any return to the sort of price stability that had existed during the 25 years of the postwar period.

Like a number of other Directors, Mr. Erb said, he had been attracted to the analysis on pages 20-31 of the paper, which examined decisions relating to oil prices, production, and investment in an asset management framework. In that regard, however, he agreed with the indication by Mr. Finaish that there appeared to be a gap between that framework and the ensuing analysis. As had often been noted in individual Article IV consultations with the oil producers, one of the main issues to be dealt with in managing the oil asset was the trade-off between investment and consumption, and the paper might have done better to focus more clearly on the difficulties of that trade-off. The paper had of course cautioned the oil producers--especially those with low reserves and large populations--against using too much of their oil revenues for consumption purposes; but the problem was one to be faced even by small oil producers with large revenues. Also, with respect to the investment question per se--i.e., the trade-off between keeping oil in the ground and investing it both at home and abroad--the paper had paid little attention to the liability side. The rise in the price of oil had enabled a number of oil exporters significantly to increase their external borrowing, and many had responded by doing so. While an analysis of the liability problem might not be particularly important for countries like Saudi Arabia and Kuwait, it should be a matter of concern for most of the other oil producing countries. If in future there were indeed fluctuations in either oil prices or oil demand, the way in which the liabilities of the oil exporting countries were managed would have an important impact on the course of domestic economic development in those countries.

On the investment side, Mr. Erb observed, most of the oil producing countries with large surpluses and extensive foreign financial assets had been conservative in diversifying their portfolios. Still, it might be helpful in future studies as well as in Article IV consultations to look in depth at the international repercussions of different diversification strategies. Given the magnitude of investment, the portfolio composition of a country's reserves--for example, in relation to its future import requirements--could have an important impact on exchange rates. The same could be said on the borrowing side: when countries borrowed in different currencies in large amounts, the decision of whether to borrow in dollars or whether to borrow in other currencies--depending upon the individual strengths or weaknesses of those currencies--could have a significant impact on exchange rates. Also, he could agree with those who had emphasized the importance of maintaining open financial markets--particularly in those countries where there were major financial centers--and of avoiding quantitative restrictions, special taxes, or political actions that would restrict those markets in any way.

Finally, on the matter of recycling, Mr. Erb considered that there had been a tendency in the past to focus too narrowly on the recycling of petrodollars rather than viewing those dollars in the context of the larger global financial situation. It was for that reason that he had never placed particular emphasis on the recycling question per se; rather, he preferred to look at the importance of investment decisions and borrowing decisions by the oil exporting developing countries for the international system.

Mr. Nimatallah, responding to requests by Mr. Anson and Mr. Erb that more information about the management of oil surplus funds should be included in Article IV consultations, stated that he was unclear what relevance such information would have for the consultation process.

Mr. Anson, noting a point made by the Governor for the United Kingdom at successive Annual Meetings, observed that, if the aim was to have a workable multicurrency system, if those countries whose currencies made up the SDR basket could be said to have a special responsibility for the working of the system, then it was also true that those countries with large sums of money to invest had a responsibility for the smooth functioning of the system. In that respect it could be said that a certain degree of stability in investment decisions could improve the functioning of the system. The paper had pointed out that the investment decisions of the oil exporting developing countries had in fact avoided sudden shifts from one currency to another, a point that he had been happy to note; he only regretted that such a finding could not have been made earlier, perhaps in the context of Article IV consultation discussions.

Mr. Erb remarked that, in making his request, he had not had in mind any detailed investigation of particular investments. It was simply that, looking at the magnitudes of exchange market intervention by the major currency countries in the short term, he was led to ask how those magnitudes compared with other large international flows and adjustments in stocks. Decisions on the investment strategy of both the reserve side of a country's portfolio and the liability side could have an influence on exchange rates, and it might be useful in the context of Article IV consultations with countries like Saudi Arabia to indicate on each occasion what broad investment policy or strategy they were following, without discussing investments in any detail. The same approach should be followed by any government with a large international portfolio.

Mr. Nimatallah said that it was clear that portfolio management by the oil exporting developing countries--particularly Saudi Arabia--had been quite prudent and helpful to the rest of the world. His authorities had always indicated their intentions to continue to follow a prudent policy, and such an indication should be sufficient. There were, of course, certain items that might need shifting in any given period of time, and members should be free to make investment decisions that they felt were in the best interest of the international system as a whole. However, if the request was limited to an indication of general strategy on the occasion of Article IV consultation discussions, he could go along with it.

On the matter of oil pricing in the domestic markets, another issue raised by Mr. Anson, there was no secret that subsidies were employed in many of the oil exporting developing countries, Mr. Nimatallah commented. It was difficult to understand what further information could be provided on that matter in the Article IV consultations. It was to be hoped that the seminar discussion could go beyond specific requests for more information, which might be misinterpreted by some members as a signal that they had been withholding information or in some way not following a prudent course.

Mr. Anson responded that his request for information on oil pricing policy had been directed at all countries, and not merely the major oil producers. Domestic pricing policy had implications for the allocation of resources and the conservation of oil, and it seemed only reasonable that the matter should be discussed in the context of Article IV consultations with all members.

Mr. Sangare stated that, like others, he could support publication of the paper, which raised important issues and might provoke comments that could be of assistance to the oil exporting developing countries in the conduct of their economies.

Taking up a few points of interest, Mr. Sangare said, with respect to the title of the paper, that he had some difficulty in being able to discover--either in the historical presentation or in the follow-up analysis--what constituted the "crisis." Specifically, he was unclear whether the crisis was meant to refer to the likelihood that world energy demand would outpace supply; to the increases in oil prices in 1973/74 and 1979/80; to the associated payments imbalances; or to the fear that proven oil reserves would be exhausted. Clarification of that point would be helpful.

As noted in the paper, the oil exporting developing countries were faced with a number of dilemmas, not the least of which was deciding which policy options should be followed, Mr. Sangare continued. Should they try to maximize production and invest the surplus proceeds in financial instruments abroad with negative real rates of return, or was it better to produce only enough oil to meet current domestic development requirements? The dilemma was compounded by expectations emerging on two fronts, neither of which had received sufficient attention in the paper. First, at the national level, the expectation that the government concerned should be able to deal with development requirements had been heightened as a result of oil revenue. It seemed on the surface that no government should be able to ignore domestic expectations while continuing to finance foreign economies through the accumulation of reserves and other assets, which might partly explain the temptation of many governments to undertake ambitious development programs at home. Second, externally there was the expectation of the international community that oil producers should keep the wheels of the international economy moving by maximizing oil production in order to meet global demand. The paper had focused on the extent to which the economies everywhere had become dependent upon oil, but it had perhaps not taken sufficient account of the various pressures that such dependence brought to bear on the oil exporting countries. There was also the expectation--and in some cases the demand--by other members of the international community that the oil exporting countries should contribute to the international adjustment process, inter alia, through the rapid expansion of imports. He would appreciate further elaboration on those expectations and their implications.

Another point to be highlighted was the stability in nominal oil prices and the decline in real oil prices before 1973, Mr. Sangare commented. The paper had made a passing reference to the earlier stability by noting that it had arisen as a result of the control over production and prices exercised by a tightly knit group of oil companies. It would be interesting to see, through statistical quantification, the extent to which the pre-1973 oil prices had been eroded in real terms. He had also observed that the non-oil developing countries had always been in deficit on current account, both before and after 1973. However, after 1973, the industrial countries as a group had also experienced payments deficits, while the deficits of the non-oil developing countries had increased. An assessment of the contribution of the oil situation to the payments problems of the developing countries was, in his opinion, necessary. At present, most oil countries were in deficit, and the industrial countries were once again taking over their traditional role as surplus countries. The imbalances that had emerged since 1973 had often been characterized as structural. A structural shift of imbalances in favor of a particular group of countries could not be regarded as a healthy situation, although that was precisely what had been happening for some time. Perhaps the author of the paper could offer some suggestions on how the situation could be corrected.

The paper seemed to imply that performance by the oil exporting developing countries in meeting their set development objectives had been poor, Mr. Sangare noted. However, the paper covered only the period 1974-80, which was perhaps too short a time frame for development objectives to be translated into specific programs that could be executed.

It was true that, despite the oil money, remarkable economic development had eluded a number of oil exporting developing countries; it was equally true, however, that many of them had made significant gains in the provision of infrastructure facilities and in the development of human capital, without which appreciable diversification of economies could not be achieved. For example, there was one oil producing country in his constituency that had increased the number of universities from 5 in 1973 to 17 in 1982, with courses offered in almost every conceivable discipline. There was evidence elsewhere as well that diversification had met with some success. Furthermore, as could be seen from Table III.17 on page 105, the rate of growth of non-oil exports between 1973 and 1980 had been high in most OPEC countries; unfortunately, from a presentational point of view, the performance of the non-oil sector appeared less than satisfactory because it had to be compared to the astronomical rate of growth of the oil sector during the period. That was not to say that what had been achieved could be regarded as satisfactory, and he agreed that more needed to be done; but the foundation for better performance in future had certainly been laid in most of the oil exporting developing countries.

On a related matter, Mr. Sangare noted, the strategy suggested in the paper for meeting the development goals of the oil exporting developing countries was the "traditional" Fund prescription aimed at removing distortions in those economies. He was uncertain whether such a simple prescription would be particularly effective. For instance, if government spending was reduced, did that mean that oil production should be reduced as well, or should the oil exporting developing countries accumulate rapidly depreciating reserve assets?

The sharp turnaround in the external position of the oil exporting developing countries should serve as a reminder not to lose sight of the important role that developed countries had to play in the adjustment process, Mr. Sangare said. The only really stable element in the world economic situation since 1973 had been the persistent rise in the external payments deficits of the non-oil developing countries; at present, they had a greater need than in the past for capital flows from the developed countries in order to assist in the adjustment effort. The Fund also had a role to play in the adjustment process, and it was extremely important to strengthen the financial base of the institution for that purpose. Regional and global development institutions, too, had a role to play, if adjustment and economic development were to take place pari passu; and it had to be stressed that the capacity of those institutions to complement short-term and medium-term financing by the Fund would depend on the extent of the resources at their disposal.

On the matter of direct investment in the LDCs by the oil exporting developing countries, Mr. Sangare said that he hoped that countries would look beyond the impediments to such investment that were detailed in the paper and search for ways to improve the situation; in recent years, private foreign investment had been relatively safe in the LDCs. He welcomed the emphasis that had been placed on international cooperation for finding solutions to the problems associated with the global energy situation. For such cooperation to be productive, however, it must be based on an appreciation of the genuine interests and concerns of all parties. As pointed out in the paper, the oil exporting countries had indicated their willingness to cooperate. But the problems facing the international economy were not confined to energy; they included the protection of the purchasing power of oil earnings through possible indexation, the stabilization of commodity prices through an integrated commodity scheme, and the problems of raw materials generally. Other countries--particularly the industrial countries--would have to share in a spirit of cooperation if those difficulties were to be overcome. More important, there was an urgent need for increased cooperation among all oil and non-oil developing countries, particularly in the field of finance. Such cooperation could foster, inter alia, the needed confidence for investment, either from government to government or on a private basis.

Mr. Joyce agreed with others that, given the importance of the issues explored in the paper, it should perhaps be made available to a broader audience. If the paper was to be published, however, account should be taken of comments put forward during the seminar.

Remarking on a few of the issues highlighted in the study, Mr. Joyce observed that it was difficult to know whether the energy situation over the next two decades could be expected to give rise to major international payments imbalances of concern to the Fund. He had been impressed by the forecasts in the recent World Energy Outlook published by the International Energy Association. If those turned out to be correct, the situation through the 1980s could be serious. He recognized, of course, that the forecasts were based on a number of uncertainties, including those related to the production and development decisions reached by the oil producing countries, the rate of growth of the world economy itself, developments in oil prices, and, more generally, the costs of supply and demand for other forms of energy. However, he agreed with those who felt that the interests of all countries would best be served if a greater measure of price stability in oil prices could be achieved. Operating on the assumption of a gradual but fairly steady increase in the real price of oil over the medium term would allow all countries to plan their future growth efficiently, while facilitating a steady development of other energy sources.

The recent fall in the real price of oil--which he believed would prove to be only transitory--had unfortunately already delayed a number of investment projects and decisions about new energy developments, Mr. Joyce observed. For example, in his own country, it had led to the postponement--and possible abandonment--of a number of important projects in the energy field that would have brought additional oil and natural gas resources to the market. The fall in the real price of oil was also likely to delay or abort the development of alternative sources of energy. Greater stability in oil prices in future, allowing for the possibility of further increases in the real price of oil, would be essential if the world was to make adequate progress in conservation and efficient use of energy resources in both oil producing and oil consuming countries. If such progress were to occur, it might in turn lead to an easing of the widespread fluctuations in balance of payments surpluses and deficits that had been seen in recent years and might even make the recycling process more manageable. Unfortunately the assumption of a stable price rise did not promise such stability; if fluctuations in price were to occur, the world should search for ways of reducing them, even if that were to require some interference in market forces.

Another matter deserving of attention in the paper was the management of the surpluses of the oil exporting developing countries, Mr. Joyce continued. He understood that the magnitude of the surpluses and the national priorities that dictated how they might best be used would differ from country to country, although the paper had suggested that--at least in the short term--most oil exporting developing countries would want to direct a large proportion of their investments to foreign financial assets. The paper went on to note that the investment policies pursued to date had been basically prudent and conservative, emphasizing liquidity, safety, and attractive returns. While he had no quarrel with the description of what had been happening thus far, and while he appreciated the reasons for the marked hesitancy on the part of the oil exporting developing countries to increase their direct investments overseas, he believed that the time was ripe to look toward a greater diversification of asset holdings and a greater degree of direct investment abroad.

Confidence in the ability of the oil exporters to conduct investment policies had improved, Mr. Joyce noted, and there was at present a greater receptivity in host countries generally--both industrial and non-oil importing countries--to such investment flows. It might even be argued that direct investment could become an important part of the development strategy of some OPEC countries; for example, in connection with the development of oil-related industries at home, significant downstream investments elsewhere could usefully be made. Equally, the oil exporting developing countries might find that, in the interests of ensuring stability or security of supply of both needed industrial inputs and food that could not be grown at home, they might wish to participate directly in investment in other countries toward that end.

On another matter, Mr. Joyce agreed with Mr. Prowse that the paper seemed somewhat negative on the prospects for effective recycling. Indeed, the paper had implied that new institutions would have to be created or that existing institutions--particularly the international financial institutions--would need to play a more active role in the intermediation process. Even if both assumptions were correct, there seemed little reason to believe that the main recycling role would not continue to be played either by the oil exporting developing countries themselves, as a result of direct investment, or by the existing capital markets. Those markets had served well in the past, and he was not persuaded that the sorts of institutional changes outlined in the paper were likely to be necessary or that they offered greater promise for successful recycling. Despite recent concerns about the banking community and about its lending--particularly to some of the oil importing developing countries--it had to be recognized that the continued support of the private capital markets would be necessary to achieve the objectives of renewed growth and greater stability in energy prices.

He could also agree with Mr. Nimatallah that greater adjustment might be necessary in future than had occurred in the past, Mr. Joyce said. The adjustment process tended to proceed with a certain lag, and the world was only just beginning to see the full effects of the adjustment that had flowed from the first oil shock. However, the process was likely to be speeded up because the world currently had a greater awareness of the process and was unlikely to be deceived into believing that the problem could be taken care of simply through recycling. Finally, he agreed with those who felt that there was a clear need for all countries to cooperate more closely in future to deal with the world's problems.

Mr. Jayawardena said that he would limit his remarks to the international aspects of the payments imbalances arising from the energy crisis. As noted earlier by Mr. Feito, the automatic adjustment process had not worked well in alleviating those imbalances. It had been necessary in 1973/74 realistically to adjust oil prices from their historically depressed levels, especially since oil represented the primary hope for a better future for those countries in which most of the tradable oil reserves of the world were concentrated. However, because oil was a primary source of energy and loomed large in world trade, sharp changes in the price of oil tended to alter the international payments balances in a substantial manner. It was obvious that the oil price adjustment must therefore lead to a transfer of income from energy importing countries to energy exporting countries, and it was futile to believe that such a transfer could be accomplished without some sacrifice. The process of adjusting to the changes brought about by that transfer of income could take several forms. Importing countries could reduce dependence on energy imports through conservation and through the development of new or alternative energy sources; and such adjustment could be helpful to the oil exporting developing countries as well, because it would allow them to reduce the pace of production and thus extend the life of the asset. Another way of adjusting would be to promote more trade, services, and investment with the oil exporting countries, which would help to reduce the payments imbalances. The remainder of the trade and payments transactions would then represent the necessary transfer of income.

The industrial countries, because they had had the technology and the resources initially needed by the oil exporting developing countries, had been able to promote much trade and investment, Mr. Jayawardena said. Some of them had passed on the higher oil prices to consumers and had induced considerable domestic energy saving through the price system, but some others had hesitated and had been forced to finance the internal deficit through borrowing, thus fueling inflation and engendering exchange rate instability. Long-standing structural rigidities in technology and wages had compounded the issue, and many major industrial countries were at present faced with unprecedented inflation, recession, and high unemployment.

For the non-oil developing countries, too, the options had been difficult, Mr. Jayawardena considered. Some had adjusted quickly to higher oil prices, although many--particularly those whose populations had a very low standard of living--had found it difficult to do so. A purely fortuitous circumstance--the strong commodity boom in the mid-1970s --had helped somewhat, although the payments deficits had generally been financed through borrowing or recycling, with mounting debt servicing problems. At present, access to capital markets for the non-oil developing countries was difficult. While the exodus of labor to the oil exporting countries had provided some relief to the payments imbalances through remittances, the situation was generally bleak. Trade and investment prospects had declined, largely because demand in the oil exporting developing countries for the commodities produced by the non-oil developing countries was highly inelastic. Moreover, except in a few cases, the non-oil developing countries had not displayed the venturesome attitude of the industrial countries in attempting to meet the emerging needs of the oil exporting developing countries.

The oil exporting developing countries had found it difficult to invest directly in the non-oil developing countries, Mr. Jayawardena observed. Of course, they had proved to be munificent in aid transfers, without which the non-oil developing countries would have been in an extremely difficult situation. Generally, however, the non-oil developing countries were forced to adjust to energy prices on the one hand and to a long-standing recession in the industrial countries--where most of their markets existed--on the other. It was interesting to note that the deterioration in the terms of trade faced by many non-oil developing countries in relation to industrial country imports had been higher than that in relation to oil imports.

The dismal picture he had painted had not been fully reflected in all its gravity in the analysis in the paper under discussion, perhaps because of the paper's preoccupation with the problems of the oil exporting countries, Mr. Jayawardena said. Unfortunately, references in the paper to the high growth rates experienced by the non-oil developing countries might lead readers to conclude that those countries had successfully overcome their problems. However, aggregate figures of the sort referred to in the paper, which reflected increases from a very low base, seemed high because of the successes of a few countries in the group. For the remainder of the countries, the situation was certainly grim. In the circumstances, the Fund would have an important role to play in the adjustment process for a long time to come, and it might be worth considering whether conditionality should not be liberalized, given that adjustment for the non-oil developing countries was at present more difficult than it had been when the Fund's facilities had been established. There was also an important role for the World Bank in promoting investment in the non-oil developing countries that would involve trilateral cooperation between the industrial countries--with their technology and markets--the oil exporting countries--with their capital--and the non-oil developing countries--with their natural resources and labor. Such cooperation could contribute substantially to the international adjustment process. In that regard, he had found the suggestions in Part Four of the paper to be deserving of serious consideration.

Mr. Hirao, remarking first on the policy options available to the oil exporting developing countries, observed that the major source of money supply in those countries had been domestic government expenditures, and the financial markets had not been developed sufficiently to enable the authorities to absorb cash surpluses from the private sector. As a consequence, the scope for effectively controlling the monetary aggregates through monetary policy was limited, and fiscal policy played a dominant role. Since most government revenues were produced from the sale of oil, the stance of fiscal policy in the oil exporting countries was best reflected in the domestic budget balance rather than in the aggregate balance. As stated in the paper, it was important to keep the domestic budget deficit within the economy's absorptive capacity in order to avoid demand-pull inflation. It was encouraging to note that the oil exporting developing countries had in general adopted more cautious fiscal policies following the second round of oil price increases than they had after 1973/74. On the revenue side, he agreed with the author of the paper that non-oil revenues should be encouraged in the long run. A gradual increase in such revenues through taxation would reduce the volatility of government revenue that was due to the heavy dependence on oil at present, and would enable the authorities to manage fiscal policy in a more stable manner.

With respect to development policies, Mr. Hirao considered that the best long-term strategy for those countries with low reserves and a sizable population lay in the development of agriculture and labor-intensive industries. The paper had indicated that commercial and trade policies aimed at protecting import-substituting industries during the 1970s had had adverse effects on the development of the agricultural sector. In that context, he welcomed the recent shift by some countries, for example, Algeria and Nigeria, toward the agricultural sector.

Commenting on the various elements involved in the recycling of cash surpluses, Mr. Hirao commended the authorities of the oil exporting countries for the prudent and conservative approach that they had taken during the recycling process in managing their portfolios by restraining sudden shifts in assets from one currency to another. He had been happy to hear that such an approach would be continued, since it would help to stabilize the international exchange markets. As to the actual investment pattern of cash surpluses that had been presented in Table IV.4 on page 120 of EBD/82/127, he noted, first, that the share of bank deposits in the total cash surplus had declined sharply from 34 per cent in 1980 to 7 per cent in 1981, while the share of short-term government securities and other capital flows had increased. He would appreciate some clarification of the factors that had led to those shifts. Second, as the overall surplus of the oil exporting developing countries had been declining and interest rates had been falling in recent weeks, he wondered whether there would be any change in the investment pattern of cash surpluses of the oil exporting developing countries if those trends were to continue. On a related matter, he noted that the paper had mentioned several possible new channels of recycling, including direct investment by the oil exporting developing countries in the non-oil developing countries. He would appreciate comment on the recent progress of, or future prospects for, capital flows of that sort.

Finally, on the imperatives of energy interdependence, Mr. Hirao observed that recent developments in the oil market had reduced export earnings of the oil exporting developing countries and had thus slowed down their government domestic expenditures. At the same time, market developments had had favorable effects on the terms of trade in the industrial countries, although those might have been partly offset by the depreciation of major currency values. From a long-term perspective, the paper had made the interesting point that, if energy demand in non-centrally planned economies grew by 2.6 per cent annually, it could be readily accommodated by the corresponding growth of the available energy supply. It was encouraging to note that such a scenario was based on the assumption of GDP growth of 3.5 per cent for OECD countries, 6 per cent for OPEC countries, and 4.5 per cent for non-oil developing countries. He would appreciate it if the author of the paper could provide the assumed energy elasticity figures for each group of countries and some indication of how the target figure of a 2.6 per cent growth in energy use could be achieved through various conservation measures.

Miss Le Lorier, remarking on the recycling process and the role of the Fund, said that it had been amply demonstrated that the energy problem was not one that any conceivable set of policies was likely to be able to solve over the short to medium term. On the contrary, if only for purely physical reasons, the energy situation would probably remain tight, under whatever assumptions, at least until the end of the twentieth century. The broad issue was therefore not so much whether the oil exporting and oil importing countries would be able to resolve the problem of their symmetrical dependence on energy, but whether they would be able to establish policies that were consistent with the maintenance of an adequate rate of growth and with the continuation of a tight energy situation. The most obvious way in which consistency between policy objectives and constraints on the supply side could be measured was by looking at the manner in which energy-related surpluses and deficits were absorbed over time and the extent to which imbalances emerging over a given period in the energy importing countries could be considered as sustainable. It was perhaps not easy to assess the experience thus far; however, she was tempted to say that, while the world economy as a whole had proved more resilient and adaptable than might have been imagined, serious doubts appeared to be warranted both about its capacity to perform adequately and about the adjustable character of certain types of external imbalances. Such weaknesses might not have been as evident following the first oil shock as after the second one, a point that could affect judgments about the possible consequences of a third oil shock.

On the positive side, it was fair to say that the financial crisis that many had been forecasting in the early 1970s had not occurred, Miss Le Lorier continued. Recycling had been successful thus far, at least with respect to most of the industrial countries, although that success had had its counterpart in lower growth, higher unemployment, a reduction in foreign transactions, and--at least until recently--higher inflation. Unfortunately, for the great majority of the non-oil developing countries, recycling might not have provided the same opportunity to "buy time" as it had done for the industrial countries, although the reasons were not necessarily closely related to the development of the energy crisis. Sharply reduced commodity prices, protectionism, and the burden of interest rates had not been without their effects.

The fact that the external debt of the non-oil developing countries had increased between 1971 and 1982 by almost the same amount as the increase in foreign assets held by OPEC countries was perhaps more than mere coincidence, Miss Le Lorier remarked; at any rate, it should help to focus on what appeared to be the main obstacle to smooth recycling over the next few years. Part Five of the paper clearly indicated the likelihood of further increases in the real price of oil over the next 20 years, on the basis of present energy constraints and prospects for alternatives to oil and natural gas. It was difficult to know precisely how oil prices would evolve, although the scope for a continuation of the long-term upward trend begun in 1973 seemed almost unavoidable, and the risk of future oil shocks remained. A new oil shock would imply a new piling up of external debt by the non-oil developing countries at a time when it was unlikely that commercial banks would be willing to undertake new commitments toward many of them.

Both retrospectively and prospectively, it was difficult to avoid the conclusion that further international cooperation and increased involvement by multinational institutions was a necessity, Miss Le Lorier commented. She therefore joined other Directors in supporting a more active contribution to the recycling process by the International Monetary Fund. Under some assumptions about future absorption levels in the oil exporting developing countries and about the balance between energy supply and demand, it was conceivable to envisage that surpluses of the magnitude observed in the past might not recur in future; at the same time, it was evident that balance of payments difficulties would remain acute, particularly among some categories of Fund members. Recycling in the forms employed in the past might have reached a limit and, for the time being at least, might prove to be a risky proposition. One inescapable conclusion of the seminar discussion would therefore be that there should be a prompt increase in Fund resources.

With respect to the Fund's policy recommendations for the oil exporting developing countries, Miss Le Lorier reiterated the importance of fully recognizing the risks and limits of an effort to aggregate oil producing countries into one homogeneous group for which uniform or general policy recommendations could be made. It was important to make distinctions with respect to fundamental economic factors such as the size of the non-oil sector, the level of per capita income, and the size of the population; however, distinctions of a noneconomic nature--between different social and political choices by the authorities or different types of societies and cultures--should also be given consideration, not only for the oil exporting developing countries but for other country groupings as well. It was well known that the broad concepts of "developing countries" and "industrial countries" covered a wide spectrum of situations and levels of development, so that the same diversity in policy recommendations applicable to the oil exporting developing countries in general should also be considered for oil importing countries. Adaptations and responses to the energy crisis and payments imbalances could not be envisaged as independent from the precise nature and characteristics of each country concerned.

Mr. Tai considered that the experience gained by the oil exporting developing countries from the 1973/74 "oil shock" had had far-reaching historical significance. The substantial changes in the long-standing relationship between oil exporting governments and their former oil concessionaires had changed the overall pattern of oil pricing and its marketing; more important, the right of determining oil price and production levels had been restored to the oil exporting countries and had paved the way for them to achieve rapid economic development with their own resources, thus changing the relative position of the oil countries as a whole within the world economy. From a historical point of view, the changes had also made a contribution to the effort to establish a new international economic order.

Given the existing global payments imbalances and the forecasts for their development in the near future, it was clear that the pressing need for recycling would continue for some time, Mr. Tai remarked. Part of the surplus of the oil exporting countries was currently shifting to the industrial countries, and they would have to share the burden of recycling surplus funds. The present-day strains in the international financial system--characterized by increasing hesitancy in the private banking community with respect to lending activity--would eventually result in a weakening of the role played by international private banks in the recycling process. In the circumstances, the Fund and the World Bank--whose purpose it was to promote international economic cooperation--would have to assume greater responsibility in future recycling. For the Fund, a substantial increase in quotas was the most urgent task; the institution would have to play a more active role in financing balance of payments needs and in promoting adjustment, while taking fully into account the needs of individual members in tackling their energy problems. The World Bank would have to explore new ways and means of financing the need for energy investment--such as the Energy Affiliate--as well as other devices for energy lending.

Of concern to all countries, the world energy problem was a strategic issue with a vital bearing on economic, political, social, and other factors, Mr. Tai commented. The dynamics of global interdependence called for meaningful and comprehensive cooperation between oil exporting countries, major oil importers, and the non-oil developing countries in meeting world demand for energy, technology, and development finance. The rights and interests of the oil exporting countries should be duly respected in the effort to find solutions to the world energy problem. Moreover, investment for exploration of oil resources or substitutes in developing countries should be expanded and assisted by the industrial countries; greater efforts should also be made in energy conservation.

Mr. Finaish observed that oil prices were basically a reflection of supply and demand, and the only way for a government to impose pricing was to act as part of a successful cartel and raise prices by curtailing production. OPEC had attempted just such an approach in 1964 and again in March 1980 and had not been successful. The members of OPEC in fact attempted to agree on a certain reference price and then accepted whatever demand was available; they had been able to maintain the reference price in a weak market in the past by avoiding competitive undercutting of prices, but they were unable to operate that way at present.

On another matter, he shared Mr. Nimatallah's concern that the seminar should not be taken as an opportunity to introduce too many one-sided innovations into Article IV consultations with the oil exporting developing countries. There was already a reference in the staff reports for Article IV consultations to the behavior of the authorities of individual countries with respect to the mangement of reserves. Conservation of energy and the prices paid by consumers were of course important and could be part of consultation discussions.

On the matter of financial policies, Mr. Finaish agreed with those Directors who had suggested that the oil countries should be encouraged to increase non-oil revenues. The paper itself had suggested that, even in countries where revenues were not needed at present, meaningful taxation should be initiated, because it took time to develop the habit of producing revenues through taxation. He recognized that there would be resistance among many governments because of domestic pressures, but he personally believed that such an approach was a wise one.

Mr. Erb said that his references to innovations in Article IV consultations had been made on the basis of his understanding that one of the purposes of the seminar was to provide some guidance to Executive Directors in approaching discussions on Article IV consultations with individual oil producing countries. With respect to his earlier remarks concerning shifts in responsibility for price and production decisions, it was true that the multinational corporations in the international oil market had not had absolute control over production or price. However, following changes in 1972/73, the governments of OPEC members had taken responsibility for the more fundamental production and price decisions. The Government of Libya had been the first to move, followed by others. At the time, critical decisions had been made about production levels in a number of OPEC countries that had helped to sustain the oil price increase. Oil companies in the early 1970s had been planning to expand Saudi Arabia's oil production to more than 16 million barrels a day, a move that would have meant a production level in 1973 of twice what Saudi Arabia had actually produced in that year. If the oil companies had been allowed to pursue their plans, the 1975 price rise would have been much smaller. However, the decision on oil production had been taken by OPEC countries at the time, and similar decisions were taken at present, which helped to sustain at least the nominal price of oil. It was for that reason that he had suggested that the key forces in the oil markets were in fact the governments of the major oil producers.

Regarding the prospects for price fluctuations in future, Mr. Erb considered that much would depend on the way in which the governments of the major oil producing countries managed production in the face of shifts in demand over time. If they were unable to lower production at a time of declining demand, there would be a sharp decline in price; if they were unable to increase production to match demand increases, then there would be very sharp price increases.

Mr. Finaish noted that, in the area of production, oil exporting countries--particularly Saudi Arabia and those countries in his constituency--were very cooperative, and most of the time they produced oil at a rate that was much higher than required for their domestic needs. With respect to prices, it should be noted that OPEC had offered to discuss the matter of potential variations in prices and had proposed, inter alia, to maintain prices in real terms in line with inflation and the consumer price index, perhaps allowing for real increases that would match GNP growth rates in the industrial countries. Such an approach was one way of avoiding extreme price fluctuations. In his view, the oil exporting countries were behaving in a responsible way; they always gave due consideration to the interests of the international community at large.

Mr. Joyce considered that the full responsibility for stable oil prices could not be borne by the oil producing countries alone. While they had an important role to play in the effort to achieve greater stability in prices--and, indeed, some of the key oil producing countries had been effective in that role--a certain responsibility also devolved upon the oil consuming nations to ensure that their consumption and import practices did not contribute to undue fluctuations in world prices. In many countries, of course, decisions about consumption and import practices were made by bodies in the private sector; but, in cases where private sector decisions were inimical to longer-term price stability, the governments concerned should perhaps become involved.

Mr. Amuzegar, consultant and principal author of the paper, recalled Mr. Nimatallah's request for further analysis of the impact of exchange rate fluctuations on the budget balance and on domestic government expenditures. The exchange rate referred to in the paper was the official rate and did not reflect fluctuations in the value of the U.S. dollar, in which oil prices were determined. The analysis could be expanded to show, at least historically, how developments in the value of the dollar had affected government revenue, in domestic currency and foreign exchange terms, as well as expenditures, particularly on imports. The suggestion had also been made that the analysis should include a comparison between performance in the economies of the oil exporting countries in the 1970s and that in the 1960s, when oil had played a much smaller role. While such a comparison could be made, he was uncertain how useful it would be, since many factors other than the role of oil had affected performance.

With respect to Mr. Kafka's request for an explanation of what was "too rapid" an appreciation of the real exchange rate, Mr. Amuzegar remarked that the term referred to a pace that was rapid enough to introduce difficult economic problems; for example, appreciation of the real exchange rate would have a dampening effect on the exports of non-oil items. It would not be an easy matter to go further in attempting to define a particular pace for the appreciation of the real exchange rate that would create economic problems or would have political consequences.

Executive Directors had expressed various views on questions regarding the exchange rate, Mr. Amzuegar observed. Some had felt that the exchange rate was not relevant; others considered that it was not irrelevant; and still others believed that it might be relevant in certain circumstances. There had been some strong reservations about the use of a multiple exchange rate regime, and Mr. Polak had been correct in noting that, on balance, the paper did not advocate a multiple exchange rate policy as a viable option for the oil exporting developing countries, although it had been mentioned as an alternative. If multiple exchange rate regimes and any type of tax incentives, subsidies, or other industry-specific measures were all proscribed, given the exchange rate that those countries had to follow and their comparative advantage in oil production, the only options would be inflation or an appreciation of the exchange rate; and the tradable non-oil sectors would not develop. The Executive Board had requested the study under discussion with the hope that it might show the oil exporting developing countries how they could develop by being good members of the Fund and by not directly intervening in free market resource allocation. Having concluded the study, he was forced to confess that he knew of no other way in which the tradable sectors of the oil exporting developing countries could develop--given the structure of the exchange rate and the large oil surpluses--if all the aforementioned measures were to be avoided.

In response to those who felt that the paper had taken an ambivalent approach to the prospects for recycling in the 1980s, Mr. Amuzegar commented that much depended on the magnitude of oil surpluses in future. If those surpluses were as large as they had been in 1974-78, recycling would not be easy; if the surpluses were somewhat smaller, recycling could be accomplished through existing international institutions and arrangements.

Important conceptual questions about the nature of oil and oil income had been raised by Mr. Finaish, who had remarked that GNP comparisons were not meaningful because the oil exporters did not receive income so much as a change in assets, Mr. Amuzegar continued. While GNP comparisons might be defective in the analysis to which Mr. Finaish had referred, the defect was not a matter of kind but only one of degree, since all countries with exhaustible resources--copper, uranium, gold, and so on--also had their GNP figures distorted. Mr. Finaish had also taken exception to what he considered an improper suggestion in the paper that the transfer of resources from the industrial countries to the oil exporting developing countries had been unrequited. There had been no intention to suggest that such transfers had not been in payment for oil or other resources; however, he would review the text with an eye to removing any possible suggestion of a free transfer.

The recommendation for heavy investment by some oil exporting countries in oil-based industries had been criticized by Mr. Polak as not particularly persuasive, especially since the viability of oil resources could not be guaranteed, Mr. Amuzegar noted. While the point was well taken, two factors should be recognized: first, the waste involved in burning the associated gas and the profitability of using natural gas in petrochemical industries; and second, the nonexportability of certain items, such as electricity, which could be produced with natural gas. Those factors tended to force countries into petrochemical industries, aluminum smelting, and so on, for which immediate benefits could be accrued even if they might not lay the foundation for viable non-oil economies once the oil was exhausted. During the time that the oil was in fact being extracted, such industries were relatively cheap and therefore attractive for investment.

Doubt had been expressed by Mr. Lovato about whether the real price of oil would remain stable until 1985, Mr. Amuzegar recalled, although it was unclear whether he felt that prices in real terms would rise or fall. From all indications, it was unlikely that the nominal price of oil would change in the next year or so; given the rate of inflation in the industrial countries--albeit smaller than in the past--one had to conclude that the real price of oil would continue the trend begun in 1982 by falling in the following year or so.

The performance of some of the oil exporting countries during the 1974-80 period had been characterized by one Director as totally disappointing; others had taken a more positive view, Mr. Amuzegar noted. The assessment of performance depended crucially on which criteria were used. The indication in the paper was that, given the particular goal of the oil exporting countries of reducing their dependence on oil and diversifying their economies, some members of the group had a long way to go, but most had begun to realize that agriculture had been neglected for too long. Those who had found performance to be particularly disappointing had been focusing mainly on the choice of industries and the inducements to develop what might be called nonproductive sectors.

Regarding the suggestion by some Executive Directors that the paper had not properly reflected the plight of the non-oil developing countries, Mr. Amuzegar observed that the study had been focused only on the oil exporting developing countries. That was not to say that a study should not be made of the implications of the energy situation for other groups of countries, particularly the poorer non-oil developing countries that had borne much of the burden of adjustment.

Regarding Mr. Hirao's question about the factors involved in shifts in asset placement by the oil exporting developing countries, Mr. Amuzegar noted, first, that the information in the paper had been taken directly from the World Economic Outlook studies. The information showed that, each time there had been an oil shock, assets had been placed immediately into the banking system. As time passed, those assets had been moved into other areas. Of course, countries in the Gulf region, in particular, had gained much experience over the years since the first oil shock and were currently investing their assets in a variety of ways, something they had not done in 1975/76. On a related matter, Mr. Hirao had asked about the effect of smaller surpluses on investment policies. The question could best be answered by the oil exporting countries themselves, although he would guess that reduced surpluses would affect domestic development efforts, foreign assistance, and foreign contributions to international financial institutions.

Mr. de Vries recalled that Mr. Amuzegar had raised the interesting question of how major oil producers could diversify while applying the sorts of policies that would allow them to remain members in good standing in the Fund. His own office had made a special effort to answer that question, and he had been struck by the fact that Mr. Polak's theoretical answer was identical to the practical answer provided by Mr. Nimatallah in his earlier remarks. Mr. Polak had concluded that the only option available to those countries was to place most of their oil receipts abroad by investing them in foreign capital; and he had noted that such an approach would not be practical for a country that was likely to be an oil producer for a long but indefinite period. It would be difficult for a country to define a long-term development strategy without a clearer idea of when its oil resources would be depleted. From a practical point of view, Mr. Nimatallah had defended the need for diversifying the investment of financial assets by noting that it was impossible to invest those assets in agriculture, infrastructure, education, and so on without further research into those areas. Hence, the scope for prudent diversification by the major oil producers was quite limited.

Mr. Suraisry remarked that there were at least three factors involved in the issue raised by Mr. de Vries. First, no one had any idea when oil reserves would be depleted, so that the argument against setting up oil-based industries was perhaps unwarranted. Second, some of the oil exporting countries with large financial capital and a small population should perhaps look to a capital-intensive strategy rather than a labor-intensive one; and, for those countries, it might be best to begin with oil-based industries. Finally, the concept of industrialization was new to many of the oil exporting developing countries, and the best way to introduce the concept to their society and to ensure that it was accepted might be to begin with industries that were closely related to the existing major source of revenue.

The Chairman then made the following summing up in concluding the discussion:

> This has been a very interesting discussion on the basis of a comprehensive and important report, whose quality has been recognized by all the Executive Directors who spoke today.
>
> Given the broad range of very complex issues covered by the study and the short time available for their discussion by the Board, this summary of Directors' remarks can perhaps best be

organized under two main headings: the economic strategies of the oil exporting developing countries; and the international aspects of the energy problem.

Economic strategies of oil exporting developing countries

With respect to the choice of proper development strategies, there was a general consensus that the oil exporting developing countries do not constitute a homogeneous group and that no uniform set of development options or policy recommendations can apply to all of them indiscriminately. Indeed, the need for a case-by-case study of each oil economy was stressed. Several Directors recommended a further disaggregation of the categories of countries currently used for the purposes of the World Economic Outlook as a way of allowing for a more penetrating approach to the individual cases.

On the specific policy options presented in the paper, there was a variety of comments and requests for further clarification. The treatment of oil assets as income in the current account of the balance of payments of the countries concerned for the purpose of international comparisons was questioned by some Directors. Also, the oil exporting developing countries' need for deliberate diversification of their production base was acknowledged, although views differed on the precise "scope" of such diversification, particularly with respect to the choice of particular investment projects. Due to the existence of factoral constraints in some oil exporting developing countries, preference was shown for a slower pace of industrialization in favor of investment in the agricultural sector--where scope for development exists--and in social, human, and technological capital.

On the choice of policy instruments, some Executive Directors expressed strong reservations about the use of a multiple exchange rate regime and, to a lesser extent, about the propensity to resort to subsidies, taxes, and other industry specific incentives on the grounds that these could lead to economic distortions and to a buildup of industries that might not be fundamentally competitive. Other Directors underlined the prominent role of fiscal policy in determining the course of development strategies in a number of oil exporting developing countries, particularly given their stage of development and the structure of their society and oil sector.

The role of the exchange rate as an economic policy tool was also commented upon by Directors. A number of them stressed the limitations of exchange rate policy in the determination of public and private expenditures domestically; many felt that the solution to the major policy question of the appropriate balance between consumption and investment relied heavily on a correct strategy for production and on the stance of monetary and fiscal policy, particularly the latter.

On the experience of the oil exporting developing countries with internal economic development, Mr. Nimatallah, Mr. Finaish, and Mr. Abdollahi made thoughtful contributions to the discussion. The suggestion was made to broaden the section of the paper dealing with internal development to include a comparison of domestic performance during the 1970s with that in the 1960s when oil did not play such a prominent role in government receipts and foreign exchange revenues. Also remarked upon was the need to define the tempo of economic development--its "rapidity"--and its concomitant social repercussions.

International aspects of energy problem

Frequent references were made to the obvious and substantial uncertainties surrounding future market conditions, oil prices, and output imbalances. A number of Directors argued that, with the expected recovery in the industrial countries, the demand for oil and energy might rise again, thus opening the door for somewhat firmer oil prices and possible new oil surpluses.

The necessity for further studies of the peculiarities of recent surpluses and deficits and their resistance to automatic correction was emphasized. In that context, the need to define a new equilibrium situation in domestic exchange rates and the importance of adjustment were singled out.

A number of Executive Directors stressed that recycling mechanisms should function adequately, even though they might be dealing with smaller magnitudes than in the past. In that respect, clear emphasis was given to the role of the Fund and the need for strengthening both its resources and its active participation in the international adjustment process.

In the area of global cooperation, attention was drawn to the need for bilateral deals--particularly in the form of joint ventures--between OPEC members and non-oil LDCs, larger contributions by surplus countries to multilateral agencies--the IMF in particular-a lengthening of the period of investments in host countries, and the avoidance of disruptive "diversification" of banks and currencies where surpluses are kept. In this regard, speakers stressed the responsible attitude of the oil surplus countries in the management of their reserve portfolios. There was also an important comment on the need for nondiscriminatory treatment of OPEC investment in industrial countries. In general, Executive Directors were in agreement on the need for global cooperation among the three main groups of countries, with different and distinct actions and orientations to be assigned to each group. They hoped that such cooperation would result in the avoidance of large fluctuations in prices and related balance of payments consequences.

Directors stressed that the energy problem should be viewed in a longer-term perspective; from that standpoint, it was underscored that oil supply constraints continued to be a major factor. Thus, efforts to address the fundamental elements of the energy problem had to be pursued in particular through conservation, substitution policies, and research policies, irrespective of short-term price developments on the oil markets. More generally, given the scarcity of energy and the related balance of payments problems, all countries should pursue broad adjustment policies that would allow for viable solutions to the basic elements of the energy problem, including the financing of related imbalances.

Finally, I have noted the suggestion by a number of Executive Directors to publish EBD/82/127, Revision 1 as a research study, which, of course, would not commit the Board. Executive Directors' comments and suggested revisions would be taken into account before publication.

JOSEPH W. LANG, JR.
Acting Secretary