

## SYMPOSIUM

### INTERNATIONAL PROBLEMS OF PETROMONEY: AFTERMATH OF THE ENERGY CRISIS

*Petrodollars—The Recycling Problem:  
Some Introductory Remarks*

*The Petrodollar Energy Crisis:  
An Overview and Interpretation*

*Recycling the Petrodollar:  
Current Problem, Future Opportunity*

*The European Community and the  
Recycling of Petrodollars*

## EDITOR'S PREFACE

The following four articles were prepared in anticipation of the Twelfth Annual Regional Meeting of the American Society of International Law, which was to have been held at the Syracuse University College of Law on April 5, 1975. Unfortunately, a paralyzing snowstorm on the weekend of the meeting forced a cancellation of the proceedings.

The four papers published in this issue outline the proposed discussion. The remarks of Mr. Sassoon were prepared as an introduction to a session on the necessary role of international financial institutions, while the article by Dean Alnasrawi which follows was scheduled as the keynote, presenting his overview of the petrodollar problem. Professor Pattillo, originally scheduled as a member of the panel discussing petromoney investment problems in the United States and elsewhere, subsequently submitted an analysis of balance of payments problems generated by the new petrofunds. Completing this section is the presentation scheduled to open the afternoon session, an analysis by Professor Herzog of the response of the "European Community" to the petromoney imbalance. The economic analyses of these articles, especially those of Mr. Sassoon and Dean Alnasrawi, are based upon data available at the time of conference.

The College of Law International Law Society would like to express its appreciation to those persons yet unmentioned who had graciously agreed to attend the Twelfth Annual Regional Meeting: Associate Professor Jon E. Bischel; Pierre De Ravel D'Esclapon, Esq.; James G. Evans, Jr., Esq.; Associate Professor George M. Frankfurter; Professor L.F.E. Goldie; Assistant Professor Douglass J. Klein; Professor Eric Lawson; Howard Mennell, Esq.; Lester Nurick, Esq.; and James E. Price, Esq.

## RECYCLING THE PETRODOLLAR: CURRENT PROBLEM, FUTURE OPPORTUNITY

Donald M. Pattillo\*

### I. THE BALANCE OF PAYMENTS AND THE PETRODOLLAR

The balance of payments (BOP) is a concept which is poorly understood by most Americans. While the news media report developments in the balance of international payments, the American public is unlikely to understand how it is affected directly. Most reports lead the public to believe that a BOP surplus is "good," that a BOP deficit is "bad," and that a decline in the value of the U.S. dollar in relation to other currencies is also harmful to U.S. interests. While none of these beliefs is necessarily correct, there is no question that present oil prices have had a significant impact on the international financial position of the United States. This leads to one aspect of the U.S. economy to which any citizen can relate, the high price of gasoline and other petroleum products. The American public is aware of the Arab oil boycott of 1973-74 and of the emergence of the "oil weapon" in international politics. It is also aware of the existence of the Organization of Petroleum Exporting Countries (OPEC) which, in the past two years, has quadrupled the price of oil to the present level of approximately \$11.50 per barrel.<sup>1</sup> The American public, despite a somewhat vague understanding of the balance of payments, may still perceive a relationship between what the United States pays for imported oil and the trend of the balance of payments.

In fact, have the U.S. balance of payments position and the value of our currency in relation to other national currencies been weakened by the increased petroleum prices? The answer is not self-evident. While increased imported oil prices have undoubtedly caused certain difficulties in the U.S. economy and in the BOP, it is entirely possible that over the long-term this situation could be economically advantageous to the United States.

### II. THE CURRENT SITUATION

Successive dollar devaluations and the emergence of a joint

---

\* Visiting Assistant Professor of Finance, Syracuse University School of Management; B.S., University of Alabama; M.B.A., Georgia State University.

1. *BUS. WEEK*, Oct. 13, 1975, at 34.

float or "snake" of major European currencies, occurring before the 1973 oil crisis, resulted in a U.S. dollar which was much lower in value in relation to most European currencies than in earlier years.<sup>2</sup> By 1975, most observers felt that the U.S. dollar had depreciated to the point that it was significantly undervalued in terms of purchasing power. Very advantageous prices of U.S. goods and services, reflecting the lower value of the U.S. dollar, have given the United States a strong trade position in recent months. Thus, the trade account of the U.S. balance of payments has shown a marked improvement in 1975.<sup>3</sup> International currency markets undoubtedly have taken note of the undervalued U.S. dollar, as it has risen sharply against other major currencies since July 1975. These developments have occurred even though the United States is continuing to pay the OPEC prices for imported oil.

While the U.S. position is basically sound, oil prices clearly have caused continuing and severe financial problems in many other oil importing countries. Even where the total volume of oil imports has declined, the present price levels have created sharp BOP deficits for these countries and heavy outpayments have been necessary.<sup>4</sup> Somewhat ironically, the decline in the value of the U.S. dollar since the beginning of the oil crisis has resulted in the oil exporting countries' receiving somewhat less in real purchasing power. (Oil exporters generally have been paid in U.S. dollars, due to the dollar's worldwide acceptability and its status as the standard international transactions currency.) Much of the justification for the recent OPEC price increase has been the decline in purchasing power related to the accepting and holding of U.S. dollars.<sup>5</sup> A related justification is that an increased price was necessary to offset the current worldwide inflation, even though quadrupled oil prices have been blamed for the inflation in the first place.

At the recent OPEC conference, the member states agreed to cease the pricing of oil in dollars and to begin pricing oil in units of Special Drawing Rights (SDR's) of the International Monetary Fund (IMF). The SDR, the so-called "paper gold" was created in 1969 to increase world reserves and add to international liquidity, and was established as equivalent to the 1969 U.S. dollar (1 SDR = \$1 U.S.).<sup>6</sup> With the two dollar devaluations, the IMF changed the

---

2. 1974 IMF ANN. REP. 47.

3. BUS. WEEK, Mar. 17, 1975, at 18; Wall St. J., May 28, 1975, at 2, col. 2.

4. Mayer, *A Bad Year for the Rich Countries*, FORTUNE, Aug. 1974, at 159.

5. Wall St. J., Mar. 17, 1975, at 15, col. 1.

6. M. KREININ, INTERNATIONAL ECONOMICS 160 (2d ed. 1975).

value of the SDR to the sum of specified portions of a "market basket" of 16 important currencies.<sup>7</sup> The current SDR value is around \$1.20 U.S. While OPEC oil will now be priced in SDR's (the current price should be about 1 bbl. = 9 SDR), actual payment will continue to be made in dollars, still the currency most preferred by the oil exporters.

In separate but related developments, several oil exporting countries have ended the practice of tying the value of their currencies to the U.S. dollar and now set their values by the SDR.<sup>8</sup> Saudi Arabia was among the producing nations making this change.

### III. WHAT RECYCLING MEANS

The importers' problems in paying for oil and the concern of oil producers about the value of their revenues lead to consideration of the ultimate disposition of these oil funds, now known as petrodollars, and to their subsequent use in trade and in investment. The term appears to have been coined by former Secretary of Commerce Peter G. Peterson in describing those dollars received by the OPEC members in payment for their oil. Thus, the term refers not to any special or unique feature of the funds, but to their origin. A dollar sent overseas in payment for oil becomes a petrodollar. For example, if Japan purchases oil from Abu Dhabi, using U.S. dollars as payment, these dollars become petrodollars. If Abu Dhabi then deposits these funds in a British bank, they are considered petrodollar deposits. With the current value of petroleum-based international transactions, petrodollars have become a major source of investment capital for the world, of which there is an overall shortage.

Since the OPEC members are all considered members of the Third World and are not highly industrialized outside the oil sector, their economies are very small in absolute terms. Their petrodollars have accumulated at a rate and magnitude far greater than their domestic economics can absorb. For the OPEC members, the problem is not a shortage of development capital, but rather how this capital can be used effectively.

While the petrodollar inflows have become a major source of domestic economic development capital, enabling most OPEC members to finance ambitious development and national defense programs, the volume of petrodollars has provided a major chal-

---

7. IMF ANN. REP., *supra* note 2, at 51.

8. Wall St. J., *supra* note 5.

lange for the international financial system, that is, the accomodation of surplus funds. Surplus funds refers to those funds which cannot be spent on imports or invested immediately in the local economy or in local financial markets.<sup>9</sup> With the worldwide petrodollar surplus estimated at over \$60 billion for 1974 and nearly \$40 billion for 1975,<sup>10</sup> the challenge to the financial system is not only the accommodation of the volume of deposits, but also the "recycling" of the petrodollars. Ways must be devised for the dollar surpluses to be spent in the importing countries, or otherwise to find their way back into the national treasuries to finance continued oil imports.

Even before the present impact of world oil prices, it had been recognized that those nations experiencing a balance of payments surplus should increase spending abroad, since the continued accumulation of surpluses is pointless and may lead to domestic inflation through expansion of the money supply. As stated previously, any two-way international transaction amounts to a recycling, since earnings from exports provide funds with which to purchase imports. The current problem, of course, was brought about by the sheer magnitude of the petrodollar surpluses. Before the 1973 oil boycott and the sharp increase in OPEC oil prices, surpluses could be accomodated easily by the international financial system.

The advent of quadrupled oil prices, without offsetting conservation programs or effective energy substitutes in the importing countries, resulted in the "pileup," or surplus, of petrodollars that exists presently. The OPEC members are dealing with the problem of absorbing the petrodollar in payments, and the importing nations have faced the pressing problem of financing continued oil imports at present price levels. The international banking system, which found petrodollar deposits escalating rapidly, feared for the stability of the financial markets, and many industrial countries feared massive takeover attempts of major industries by OPEC members. Sudden withdrawals or shifts of petrodollar deposits, with resultant instability in the foreign exchange market, led to widespread concern of major banking failures and chaotic economic conditions in Western importing countries. In addition, the borrowing facilities of the International Monetary Fund were inadequate to provide deficit nations the funds needed to finance oil imports. Default on international loans to such severely affected nations as Great Britain and

---

9. BUS. WEEK, Jan. 20, 1975, at 34.

10. Stabler, *Estimates of Petrodollar Surplus Are Cut; Some Predict Additional Downgradings*, Wall St. J., May 23, 1975, at 4, col. 2.

Italy became a recognized possibility.<sup>11</sup>

Compared with most other industrialized countries, the United States is in a secure position. While the OPEC oil prices have had a severe impact on the U.S. economy and are felt to have increased the severity of the current recession, the United States possesses great advantages over Western Europe and Japan in that it is far less dependent on imported oil, and has highly-developed financial markets with which to attract and hold foreign investment.<sup>12</sup>

Other industrial nations, however, still possess advantages when compared with the less-developed countries, which have been more severely affected. Industrialized countries have diversified and productive economies with which to generate increased exports and provide development assistance to the OPEC members, while simultaneously developing alternative energy sources and reducing dependence on imported oil without regard to future oil prices. These alternatives seldom exist for the poorer oil importing countries. These poorer countries face severe difficulties in financing necessary imports even in the best of years and have not yet received a price break from OPEC.

It should now be seen that the petrodollar recycling question involves consideration of several viewpoints, including those of the OPEC members, the industrialized importing nations, the less-developed importing countries, and the international institutional framework in which solutions would be implemented.

#### IV. PROBLEMS OF THE OPEC MEMBERS

While much of the discussion of the petrodollar problem has focused on the means oil importers would use to pay for oil, there are very pressing problems facing OPEC members as well. Most of these nations have relatively small economies in terms of industrial diversity and developed infrastructure. The massive increase in petrodollar inflows to the oil producing countries was not preceded by adequate planning on the part of the recipients for the effective utilization of their wealth. Many importers faced with the burden of meeting the rising oil prices of a unified OPEC cartel have turned to recycling petrodollars. This recycling has most often taken the form of loans by the oil exporters to the importers, which would be used to finance continued oil imports. The problem with this ap-

---

11. *BUS. WEEK*, Oct. 12, 1974, at 40.

12. Mayer, *Oil, Trade, and the Dollar*, *FORTUNE*, June 1974, at 197.

proach was, of course, the necessity of eventual repayment of the loans. Such an arrangement, without a fundamental change in the relationship between supplier and consumer, could only postpone the eventual reckoning. Not surprisingly, most OPEC members have been unenthusiastic about large-scale unsecured government-to-government loan arrangements, and therefore remain faced with the problem of finding the most effective means to use their oil riches.

Since all OPEC members are still classified as members of the Third World, oil exports at the higher prices represented the opportunity to move toward a prosperous future. Massive economic development programs were undertaken; those already underway in such nations as Kuwait and Iran were expanded further under the impetus of these surplus funds. Any national development plan is necessarily long-range, involving decades rather than years, and projects must be undertaken in the most effective sequence. These large amounts of funds would remain idle until they could be utilized effectively in the development program. This, then, leads to the problem of petrodollar surplus. OPEC members can and have increased outlays for such development-related programs as national defense and increased imports from the industrial countries. But, these expenditures cannot be made in a short-term context either, and likewise must be phased over several years.

There has been a visible increase in foreign business investment, especially by Saudi Arabia, but indications are that such Arab investment will not be of the magnitude once expected (or feared), as Arab investors appear to be rather conservative and have shown little interest in any takeovers of major Western corporations.<sup>13</sup> It appears, for the short-term, that most Arab investments will be in the area of financial instruments rather than into industry. Foreign purchases of U.S. treasury bonds are on the increase.

There are, regardless of risk, some government-to-government loans involving OPEC and importing nations, with petrodollars being used to finance foreign aid programs to less-developed importing nations. Therefore, surplus petrodollar funds which cannot be used elsewhere tend to become short-term deposits in large European banks. Most of these deposits are accepted only on a short-term basis because of their potential volatility, and often at somewhat unfavorable interest rates.<sup>14</sup>

---

13. Wall St. J., Mar. 19, 1975, at 5, col. 1.

14. BUS. WEEK, *supra* note 9.



Another problem faced by many OPEC members is that of inflation, induced by both rapid expansion of the domestic money supply and mushrooming demand for goods and services on the part of private citizens and governments. The oil producers are finding that not all aspects of their new oil riches are positive.

#### V. *PROBLEMS OF DEVELOPED IMPORTING COUNTRIES*

For reasons already stated, the problems of the United States in financing oil imports or in attracting petrodollar investments are not so severe as those faced by other industrialized nations, principally Japan and those in Western Europe. These nations have been forced into emergency borrowing to pay for current imports. While such borrowing helps in the initial period, it does nothing to alleviate their dependence on imported oil or improve their ability to pay.

For the immediate future, it appears that the most effective policy for the industrialized countries to follow is the enforcement of strong conservation programs reducing their import requirements, as well as increased exportation to the OPEC countries, attraction of petrodollar-financed foreign investment, and development of some type of emergency international financing facility in order to enable necessary imports to be made until a permanent adjustment to high-priced oil is made.

Significantly, the OPEC members have assured the Western industrialized countries that they do not wish to force them into bankruptcy, since OPEC's long-range prosperity depends on that of the developed world. OPEC is not unaware of the financial strait in which many nations have found themselves, and may be expected to cooperate in devising new methods for the importing countries to finance their imports.

#### VI. *PROBLEMS OF THE LESS-DEVELOPED IMPORTING COUNTRIES*

Although the less-developed countries, as a group, have sided with OPEC on international political issues and with Arab policy toward Israel, this has not resulted in any financial benefit to these countries in the way of discounted prices for oil or special payment terms. While less-developed countries do not have the massive oil requirements which industrial nations have, they have proportionately less ability to pay for oil at present prices. They do not have the potential to increase exports to OPEC, and have less flexibility

in reducing oil requirements than do the United States and other industrial countries. The less-developed nations also have little borrowing power due to their limited repayment capabilities.

Many less-developed countries are interested in large scale foreign aid financed by OPEC, which would alleviate the capital shortage and would enable needed oil imports to be financed. The need for these nations is less for gasoline and similar products than for petroleum-based fertilizers and chemicals, critical for the maintenance of existing economic output. The OPEC members are increasing foreign aid to these nations, but the outlook for them remains gloomier than for the rest of the world. The recent 10 percent increase in OPEC oil puts a further burden on the Third World importers.

### VII. INTERIM FINANCIAL MEASURES

Several measures are now in effect as a result of the oil crisis, many involving the cooperation and participation of OPEC. The most important of these arrangements is the International Monetary Fund's oil facility. This facility was created in June 1974, to assist IMF members in meeting the initial impact of the increase in oil costs, and is supplementary to the Fund's existing borrowing arrangements. Conditions for use of this facility are that the borrowing country must have a balance of payments problem as a result of the increased cost of petroleum imports and must be following domestic conservation policies which are not inconsistent with solution of the problem. Initial financing for the facility has been provided by loans from several OPEC members. The initial amount available for loan was approximately SDR 3 billion (\$3.6 billion), and, while originally considered only an interim measure, the facility is being expanded.<sup>15</sup>

Many Third World oil importers, who are primarily commodity producers, are attempting to organize strong cartels, similar to OPEC, for their export commodities, so that they can become more able to finance oil imports as well as able to stabilize earnings from their most important resources.<sup>16</sup> There are also demands from importers that world prices for these commodities be indexed to oil prices, so that the terms of trade for those exports and oil imports will remain stable.

---

15. IMF ANN. REP., *supra* note 2, at 52.

16. Martin & Ricklefs, *'Third World' Presses to Stabilize the Prices of its Raw Materials*, Wall St. J., July 3, 1975, at 1, col. 6.

In addition, the Organization for Economic Cooperation and Development (OECD), composed of 24 industrialized countries, has established an energy agency to promote more efficient oil usage among nations and to assist those experiencing shortages.<sup>17</sup>

### VIII. POSSIBLE SOLUTIONS

There remains the long-range question of a permanent solution to the oil and petrodollar situation. There is no lack of plans to recycle petrodollars and to establish facilities for deficit nations to finance oil imports. The international banking system appears to have withstood the initial challenge of accomodating the massive flows of petrodollars and has in fact limited the growth of Eurodollars (largely created by petrodollar deposits) in recent months.<sup>18</sup>

It may develop that the oil payments crisis will cease to be a crisis, and it may develop that petrodollar surpluses will decline as oil producers step up spending for development. Hishman Nazer, Minister Without Portfolio in the Saudi government, recently stated: "[A] petrodollar recycling problem doesn't exist [in Saudi Arabia]."<sup>19</sup> Estimates of the eventual size of the petrodollar surplus are being reduced by many observers, and a significant amount of excess productive capacity has emerged in most OPEC countries.<sup>20</sup> While the financial problem is still severe for most importers, existing institutional arrangements, in combination with restraints on demand, have prevented disaster and disruption in the deficit countries.

Perhaps the major need today is for effective coordination and consultation within the existing international organization, avoiding a "go-it-alone" approach to oil problems. No approach should be based on the expectation that OPEC can be persuaded to lower prices. As Iranian Oil Minister Jamshid Amouzegar stated prior to a recent conference of oil producers and consumers: "If the dialogue starts with arguments that the price of oil must come down, the meeting is doomed."<sup>21</sup>

Effective consultation and coordination can be helped, how-

---

17. Farmanfarmaian, Gutowski, Okita, Roosa & Wilson, *How Can the World Afford OPEC Oil?*, 53 FOR. AFF. 217-19 (1975).

18. BUS. WEEK, *supra* note 9.

19. Vicker, *The Saudis Look to the Future*, Wall St. J., Mar. 28, 1975, at 4, col. 4.

20. Stabler, *supra* note 10, at 4, col. 4; Tavner, *Country Oil Price Rise is likely to be Small; Goal is Saving OPEC*, Wall St. J., June 27, 1975, at 1, col. 1.

21. BUS. WEEK, *supra* note 1, at 35.

ever, by the realization that oil exporters and importers have many areas of joint interest. Most serious proposals for handling the oil financing and recycling problem are based on this cooperation. For the short term, British Chancellor of the Exchequer Denis Healey advocated the existing IMF oil facility be expanded to \$10 billion to be loaned by the OPEC members and reloaned to importing countries with unmanageable debts.<sup>22</sup> While only an interim solution, it would allow OPEC members more input into IMF management, and concern has been expressed about the potential political leverage this would give OPEC in deficit countries.

A more comprehensive, but still interim, plan is the Kissinger proposal for a \$25 billion mutual support system, involving borrowing guarantees to the industrial nations and OECD borrowing in financial markets on the behalf of member countries.<sup>23</sup> This plan required nations to adhere to conservation of energy as a condition of the guarantee, and would still allow the price mechanism to operate.

Among more permanent solutions, there are proposals for an International Commodity Agreement on oil, involving both exporters and importers, which would involve stability of prices and output, to the benefit of both parties.<sup>24</sup> Guido Carli, the recently retired Governor of the Bank of Italy and a leading international financial expert, has proposed a program based on the conviction that no country would import more goods and services than it could export. This plan requires extensive international cooperation and planning, in which OPEC petrodollar surpluses would be used to finance needed goods and services for the underdeveloped world.<sup>25</sup> If implemented, this plan would be reminiscent of the postwar Marshall Plan, and should allow oil importing nations to escape permanent indebtedness.

Perhaps the most far reaching plan is that for a permanent institutional structure, based on joint interests of the producers and consumers, which would be a recycling bank to provide loans to oil importers by using OPEC surplus funds. An OPEC trust fund would be created to invest in Western government securities, or an OPEC mutual investment trust could be created to invest in equities.<sup>26</sup>

---

22. BUS. WEEK, Jan. 27, 1975, at 132.

23. BUS. WEEK, *supra* note 9.

24. N. JACOBY, MULTINATIONAL OIL 277 (1974).

25. BUS. WEEK, *supra* note 11.

26. Farmanfarmanian, *supra* note 17, at 216-17.

This would allay fears of massive takeovers of Western business, while providing OPEC with a permanent stake in the industrial world. This proposal is designed to stabilize relationships with the industrial world. The United States, for example, would gain both capital inflows from increasing international earnings due to participation in large-scale development programs in such nations as Iran and Saudi Arabia, and a greatly increased demand for U.S. goods and services in expanded OPEC markets. Even the recent change to pricing OPEC oil in SDR's rather than dollars could benefit the United States, as the recent strength of the dollar compared with other currencies in which the value of the SDR is determined could result in a somewhat lower dollar cost of OPEC oil.