SYMPOSIUM

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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.

PETRODOLLARS—THE RECYCLING PROBLEM: SOME INTRODUCTORY REMARKS

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Whatever the actual size and volume of surplus funds that ultimately accrue to the oil producing countries as a result of the quadrupling of oil prices in late 1973 and early 1974, there is no doubt that a dramatic and unprecedented shift in financial resources from the oil importing to the oil exporting countries has occurred. This trend will continue for at least the immediate future and probably will not reverse before the end of this decade, when new or alternative energy sources and changes in consumption patterns may begin to show their effects. To be sure, early forecasts on the implications of the oil revolution painted a bleak prospect for the world at large, and particularly for the industrial world. It is now, however, generally accepted that the estimates of amounts involved were exaggerated by many in the early crisis days, and have more recently been revised downward. These new and more modest estimates are the result of various factors.

First, reduced demand has precipitated a substantial worldwide decrease in the consumption of Organization of Petroleum Exporting Countries (OPEC) oil. Overall production is reported to be down some 20 percent from 30 million to 25 million barrels a day, and in some countries, notably Saudi Arabia, the reduction is even more massive. Even further declines are forecast as a result of warmer weather and increased supplies from non-OPEC sources. In some instances, this reduction is apparently leading to lower prices for OPEC's crude oil (agreements to maintain price notwithstanding) and to sales on credit, which have the same effect. Witness the *volte face* in U.S. policy, which is now directed at obtaining an agreement on a minimum or floor price for oil, but which was originally directed at an all-out effort to reduce prices when the successive price hikes were first announced. Also indicative is the February 1975 surplus in the U.S. balance of trade due to a huge decline in the oil import bill.

Second, the OPEC nations have experienced unexpectedly large import costs, both in the magnitude or quantity of goods purchased or on order and in price terms, the latter because the original surplus estimates apparently ignored the escalation in costs for imported goods to the producing countries.

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Both of these factors have helped to reduce payment deficits in the industrial countries, virtually all of which have shown constant (and sometimes dramatic) improvement over the past several months. Quite apart from the various blessings in disguise that commentators now associate with the situation and the accelerated recession related thereto (for example, conservation efforts, an impetus to self-sufficiency in energy and in other resources, the anti-inflationary effects of the recession, etc.), the problem appears less severe and more manageable than it was assumed when the first dire estimates, predictions, and alarms of impending disaster were sounded.

The question which should be addressed, in my opinion, can be stated as follows: how do we best deal with the effect of the massive growth of funds that the small group of OPEC countries has attained and will most likely continue to accumulate? In other words, how do we ensure that the enormous growth in OPEC purchasing power will be handled in a manner least likely to disrupt the monetary and economic order of the world community at large?

Before attempting even a brief analysis of the problem and of some of the possible answers, two preliminary observations should be noted. First, the solution to this problem is of equal concern to all countries. Producers and consumers alike share a real interest in maintaining a world monetary and economic order and in preventing a chaotic situation which would only be detrimental to all. Herein lies the *realpolitik* notion that, notwithstanding preoccupations regarding the short term effects of the energy crisis (for example, issues relating to balance of payments deficits, the serious impact on the poorest countries, or the political and other implications associated with embargo, discrimination, and boycott policies), there exists, in the final analysis, a mutual interest between producers and consumers in solving the problems through cooperation rather than confrontation. Put in different terms, there is a growing recognition of the communality of interest in a longer term point of view. While the industrial world needs energy, the producing states need reliable sources of revenue for development to produce higher and improved standards of living, to expand and maintain growing and diversifying economies (toward the day when petroleum resources are depleted), and to establish more progressive and modern social infrastructures through the provision of health, education, welfare, and similar facilities or services which are still, at most, only marginally available in many of the oil exporting countries.

The second preliminary observation that ought to be made concerns the relation of the immediate problem under consideration to other problems which clearly are related to it. Most, if not all, of these other problems actually predate the explosion in oil prices. They include, for example, the increasing difficulty of the traditional banking channels to manage aggregate fund flows, galloping rates of inflation, high interest rates, and unstable exchange rates. All of these "hardships" were in existence before the final quarter of 1973 and were only aggravated by OPEC oil pricing policies. The strain on the private banking system and the collapse of certain large banks (Herstatt, Franklin National, etc.), though occurring last summer and preceded by the collapse of some 20 smaller banks all over the world, seem to have resulted more from the earlier disturbances mentioned than from the energy crisis itself. Therefore, the problem which concerns us is the means by which a mutually acceptable machinery, one that will not endanger the stability of the financial system of the free world, can be devised. If international cooperation is the suggested remedy to this sudden transfer of wealth, then ignoring for the moment the shift in political power, the questions are: what are we to cooperate about, what shape ought this cooperation take, and how should this cooperation manifest itself?

Until 1974, it was generally accepted that the world's capital markets could combine to function effectively and flexibly in accepting and recycling capital flows. Since 1974, however, the concurrence of high oil prices, higher inflation, and recession in the industrial world has called this ability of the system into question, and has generated interest in developing recycling mechanisms which would replace or function in parallel with the traditional capital markets. I have mentioned the problems of inflation and recession in this context only because they have a direct bearing on the question under discussion. Under conditions of recession it becomes prohibitively expensive for industry to raise equity capital, while under conditions of inflation (calling for a monetary response through high interest rates) it becomes very costly to obtain debt capital. This combination of circumstances (that may now be changing, but which prevailed during the height of the energy crisis) is as bad for the oil or capital exporter who looks for security of investment as it is for the oil or capital importer. Because it was no longer possible for the traditional capital markets to borrow on short terms (as seems to have been the initial clear preference of the managers of OPEC funds) and to lend long in the amounts available, growing amounts of surplus funds began being absorbed by governments through the issue of short term obligations, thereby causing the governments to assume a role hitherto reserved for the private banking sector. With the simultaneous intervention of central banks in support of weaker banks in several of the industrial countries, governments were in effect playing an unprecedented and decisive role on both sides of capitalism's balance sheet, which they can expect to continue to do for some time to come. Thus, the first significant consequence of the recycling problem is the larger role that the central banks of the industrial countries have assumed in what used to be known as the private capital markets of the world.

To this development add the following considerations: a growing volume of direct government-to-government transactions (that is, direct borrowings by industrial and developing countries from OPEC countries); direct placing of oil money with borrowers by using the private banks as intermediary brokers only, rather than as direct depositories of funds (for example, the recent South of Scotland Electricity Board $100 million and the British Shell Corporation $200 million loans); the diversification of currencies (adding marks, Swiss francs, and guilders to dollars and sterling, the traditional oil currencies) in which oil surplus funds are being held; the direction of funds to deficit countries through the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (World Bank), the International Development Association, and their traditional lending channels and through the three regional development banks (the Inter-American, Asian, and African Development Banks), and existing and newly created multilateral and bilateral development lending institutions of OPEC countries, as well as through the United Nations Development Programme, United Nations Capital Development Fund, and the United Nations Emergency Operation machinery; and the closing of some of the traditional triangular capital markets or currency protection havens (by measures such as the penalties the Swiss recently imposed) to oil money.

By contemplation of all these factors, one gets a clearer idea of some of the recycling forces already at play. Even though these processes have been described in banking circles as of "great significance," it is not suggested that the problem is unmanageable. Quite the contrary, emergence of these processes indicates how versatile the system really is, in that it was strong or flexible enough to cope with the situation as it developed. Given certain adjustments and modifications, it was able to absorb the OPEC surplus without serious dislocations, even in a period of recession when private demand for capital was extremely low and unemployment in many industrial countries, including the United States, reached levels exceeded only in the Great Depression of the 1930's. Far from producing a disaster, the redistribution of petrodollars during 1974 may in fact be considered a success story. To be sure, the foregoing recycling mechanisms, plus the traditional investment channels (equity participation or purchase of other assets or property in the industrial world), may seem unsatisfactory to the oil producing countries because of their wish to eliminate or reduce the risks of default, currency depreciation, and even expropriation of assets, about which they exhibit growing apprehension. But these are the traditional risks associated with international capital transfers and flows, and there really is, in my opinion, no compelling reason why a special effort for ameliorating these risks ought to be mounted and new schemes devised for the special purpose of protecting oil exporters where others have had to accept exposure to them for so long.

There is little doubt that the most serious victims of the energy crisis have been the poorest countries. They have suffered the real brunt of the oil price rise and have been the hardest hit through a deterioration in their terms of trade caused by the enormous increase in oil prices and the economic recession in the industrial world. Although they have benefited to some extent from the recent rapid inflation, which has reduced the burden of their foreign debt to some extent, their overall capital needs and the cost of their development plans have increased appreciably. There is little doubt that the Third World has and will continue to pay the highest price in terms of widespread human suffering and misery for the energy crisis. The international organizations whose task it is to assist these countries (in particular the World Bank, and to some extent the IMF) have traditionally acted as cooperative institutions providing recycling mechanisms for the transfer of capital from surplus to deficit countries. The World Bank has over the past 25 years borrowed increasing amounts of money in surplus or capital exporting countries, relending the borrowed funds to the developing or capital importing countries. Drawings under traditional IMF facilities are of a similar nature. They are designed to enable the needy to utilize the resources of those countries that have something to spare. Most surplus oil funds could easily be recycled through these cooperative institutions.

As international institutions, the World Bank and the International Monetary Fund clearly provide the framework for cooperation; they are in a position to extend the technical know-how and assistance (the institution-building experience of World Bank projects) which the oil producing countries so urgently need in order to translate their new wealth into modern technology, and to provide a base for further growth in the future. The Bank and the Fund can borrow from the oil exporters and lend to the poor, who would then use the funds to purchase from the industrial nations the goods and services required for their development. The Bank and the Fund are in a position to provide security for the repayment of borrowed oil funds and to assume the risk of default of their own borrowers, for that is the manner in which they have operated in the past. Finally, they can best (on the basis of their vast and successful experience in development) ensure that the oil earnings are invested in the most economic and efficient projects, and so in large measure fulfill the needs and expectations of all.