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Draft: J. Fall
1/18/74

N. Arab Investment in the United States

The following memorandum is a preliminary discussion of considerations which might be borne in mind regarding Arab investment in the United States.

Introduction

Public sources now estimate that total oil revenues for the 18 Arab countries, based on a combined output of 20 million barrels per day at an average price of $11 per barrel for Libya and $7 for the others, would reach $60 billion dollars in 1974, up from $6 billion in '71. (U.S. government estimates for non-Arab states may reach as high as $22 billion.)

Given this enormous increase by the Arab nations and the presumption that there are limitations on the extent to which such revenues can be invested for purposes of Arab industrialization, military weapons systems or external development assistance programs, it has been assumed that a substantial portion of these revenues would flow to the United States directly or indirectly in the form of direct or portfolio investments.

Background

It should be recognized that there are certain very basic differences in the various oil producing nations -- some Arab, others non-Arab. All these producers, with divergent histories and political loyalties, have some some significance to the U.S. in view of their growning oil revenues. For example, Indonesia, Venezuela, Iran and Nigeria can be expected to preserve considerable independence in the manner in which they deploy their oil revenues abroad. They can be expected to favor for the most part, Western economies. Iraq, on the other hand, given its ties with Eastern Europe can not be similarly predicable since she also maintains close relations with France.

At the present time Kuwait and Saudi Arbia are the only Arab states with substantial excess foreign currency holdings. These two nations, however, themselves have unique features which could alleviate fears that they might invest in unison in a way detrimental to the U.S. economy. Saudi Arabia is more conservative, religiously oriented and,

except for the royal family, has little private capital. Kuwait, though, has a considerable pool or private capital.

Status of Current Investments

While it is extremely difficult under current data-gathering procedures to fully record Arab private or government investments, certain estimates and indications of trends are available. Total Saudi Arabian, Kuwaiti and Libyan government investments in U.S. government securities, bank deposits, equity and real estate are estimated to be approximately $1 billion. Most Saudi royal family investments in the U.S. are thought to be in government securities. Kuwaiti private investments are less conservatively directed as evident in Kuwaiti interests in real estate in Minneapolis, Miami, Houston Atlanta, Sea Island (Georgia) and cattle feeding operations in Idaho. There are also reports that Iran is interested in purchasing certain U.S. firms for the specific purpose of transferring all or part of the facilities to Iran so as to provide the country with domestically based, defense oriented production capabilities. Apparently, export potential and in-country industrialization are important secondary considerations.

There is no evidence that Arab investors are poised for a major direct investment "invasion" of U.S. industry. There are, in fact, a number of reasons why the Arabs may hesitate to make massive direct investments in the U.S., foremost of which is a fear that the U.S. could freeze their assets. In an effort to reduce the impact or the effectiveness of such a freeze Arab investors may strive for a broad diversification of their investments so as to avoid presenting a large target to which internal political pressure could gravitate. For these reasons also we may witness a greater tendency toward portfolio than toward direct investments. In either case, given the strength of the dollar and the relative size of the U.S. economy, most notably our highly developed and open capital market, we should be the recipient of considerable Arab investment flows.

Safeguards

The United States maintains certain restrictions on investment by foreigners in specific sectors of the economy. These restrictions, frequently associated with national security reasons, vary from total exclusion to limits on maximum foreign participation. These restrictions

or prohibitions include: 1) domestic communications; 2) domestic air transport; 3) hydro-electric power production and utilization or production of atomic energy; 4) coastal and fresh water shipping; and 5) Federal mining claims and Federal oil or mineral leases.

Additional U.S. protection against any abuses by foreign investors, whether private or governmental, are found in SEC regulations which require full financial and intent disclosures in takeover bids. Protection against monopolistic and anti-competitive practices are afforded through the anti-trust laws.

Various individual states also maintain restrictions on foreign ownership of property, particularly agricultural land. In the event Arab investments are directed in considerable volumes to real estate it can be expected that certain states will promulgate review and reporting procedures for the express purpose of excluding such investments.

The establishment and ownership of financial institutions by foreigners are subject to several types of limitation. At the Federal level, only banks incorporated within the United States are permitted to become members of the Federal Reserve System. A number of states have restrictive legislation against foreign or foreign-owned banks operating in the state.

The Federal government also has a variety of review procedures regarding the transfer of technology associated with national defense which could possibley be tightly administered to discourage Arab investments in industries determined to be critical to the economy and at the same time not appear to be overdy discriminatory.

The ultimate protection against actual abuses to the U.S. economy by Arab investment resides in the location of the investment within the territorial and legal jurisdiction of the U.S. It appears that under most circumstances, Congressional authorization would be required for the U.S. to seize and expropriate such investment. Consideration should be given to determine whether such seizure could be accomplished under existing legislation. We can assume, however, that in an emergency or in response to unusual circumstances the appropriate statute would be quickly forthcoming from the Congress.

INTERNATIONAL ENERGY INITIATIVES

SUGGESTED ORGANIZATION

INTERDEPARTMENTAL TASK FORCE

I. Restraints on Effective Demand and Conservation

Lead Agency: Commerce with FEO (Chairman: Shepherd)

Participating Agencies: State/EB, Treasury, FPC

II. Cooperation among Consumer Countries on Oil Price Levels and Market Conditions: including assurance of supplies, production levels, pricing formulas for reference crudes and other provisions for consumer/producer cooperation

Lead Agency: State/EB and FEO (Joint Chairmen: Julius Katz and)

Participating Agencies: Treasury, Commerce

III. Cooperation among Consumer Countries on Sharing, Stockpiling of Internationally Available Supplies of Oil.

Lead Agency: FEO and State/EB (Joint Chairmen: Robert Ebel and George M. Bennsky)

IV. Development of Alternative Sources of Oil to Diversify Supply Away from Middle East: including accelerated exploration and development for oil in geologically promising areas.

Lead Agency: FEO (Chairman:

Participating Agencies: State (James W. Reddington), Interior, Commerce, Treasury, NSF

V. Development of Alternative Sources of Energy: research and development of fossil fuel (excluding oil) and non-conventional technology

Lead Agency: State (Chairman: Herman Pollack, State/SCI)

Participating Agencies: FEO, NSF, EPA, AEC

VI. Economic, Monetary and Investment Cooperation: the development of methods for dealing with producer-held surplus revenues, impacts on monetary system, long-term investments in consuming countries, sectoral policies concerning equity investment and LDC economic problems

Lead Agency: Treasury (Chairman: Jack F. Bennett)

Participating Agencies: FEO, Commerce, State (Sidney Weintraub), AID

VII. Development of Diplomatic, Political and Institutional Modalities for the Consumer Meeting and the Eventual Consumer/Producer Meeting and Their Work Programs

Lead Agency: State /S/PC (Chairman: Winston Lord)

Participating Agency: FEO

VIII. Long-Term Institutional and Legal Questions: involving permanent organizations or agreements on international energy cooperation

Lead Agency: State/L (Chairman: Carlyle E. Maw)

Participating Agency: FEO

S/PC:HCBlaney:lcf

INTERNATIONAL ENERGY INITIATIVES

TASK FORCE - I

Restraints on Effective Demand and Conservation

Lead Agency: Commerce with FEO - Chairman: Shepherd

Participating Agencies: State/EB, EPA, Treasury, FPC, Transportation, HUD

A. Objectives:

1. The development of a program of cooperation among consumer countries to reduce effective demand and to conserve energy.

B. Description of Tasks:

1. Comparative examination of price and allocation methods with a view to the formulation of a cooperative program to improve national conservation and demand restraint approaches.

2. Analysis of existing consumption patterns, and likely approaches on conservation.

3. Development of likely listing of US domestic programs which might be offered in an international cooperative program.

4. Examination of effective approaches to oil demand growth which can be implemented by industrial countries - i.e. smaller auto.

5. Examination of environmental quality standards and technology as an approach to efficiency in use of energy.

6. Proposals on the role of financial incentives which can be applied by industrialized countries and others to restrain demand and promote conservation.

C. Specific Results of Foreign Ministers Meeting

1. Agreement by Consumer Meeting on inclusion of demand restraint and conservation as an area for effective international cooperation.

2. Charging International Task Force to develop proposals for an Action Program.

D. Work Program and End-Product of International Task Force

1. Presentation of comprehensive proposals of an Action Program on demand restraint and conservation with a list of priorities in terms of short-term and long-term results.

2. Specific organizational proposals on how such cooperation could be best undertaken internationally.

3. Proposals for possible inclusion of LDC consumer countries in programs.

E. Policy Issues and Problems

1. Task Group should consider questions of economic growth and activity as it relates to demand restraint.

2. International trade competition problems should be examined.

3. The role of private industry should be examined and specific recommendations developed.

4. Approaches which emphasize both environmental and energy savings should be given priority.

5. Examination of broad industrial sectors should be undertaken especially those that consume large quantities of energy.

6. Social factors common to industrialized societies should be examined both for conservation and larger quality of life goals.

7. Comparative economic cost figures should be developed for alternative approaches to conservation and reduction of demand.

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Consumer Cooperation on Prices and Market Conditions

A. Objectives

-- To constrain producer unilateralism in setting prices and production levels;

-- To discourage government-to-government bilateralism between consumer and producer countries;

-- To assure the required levels of production;

-- To preserve as much freedom of operation as possible for the international privately owned industry.

B. Description of Task

1. Draft the main elements of a multilateral consumer-producer agreement (in alternative versions, if desirable), which a consumer group could negotiate with a producer group (or with major producers individually), after agreement by the governments participating in the consumer group.

The agreement should cover:

-- Criteria and formulas for establishing the prices for reference crudes and other elements (e.g. quality and gravity allowances) determining world petroleum prices;

-- Legal provisions designed to assure security of supply and production levels;

-- Other provisions on which intergovernmental consumer-producer agreement would be desirable.

The international agreement would provide a global framework in terms of which producer governments would

deal with the industry or bilateral government-to-government agreements could be negotiated.

2. An analysis of the specific governmental measures and legal powers required to make the agreement workable, e.g. the possibility of internationally agreed ceiling prices for oil imports. (Incentives to make such an intergovernmental agreement attractive to producers are discussed under VI and VII below.)

C. Objectives for Foreign Ministers Meeting

-- Obtain commitment in principle from participating states to seek to negotiate such an intergovernmental agreement;

-- Direct international task force to prepare draft of an agreement to be tabled with producers.

D. Assignment of International Task Force

-- Work up series of production targets for key producing countries to be negotiated;

-- Prepare for consideration and ratification of consumer governments a series of specific negotiating objectives on pricing, production levels, and other provisions; the draft of an intergovernmental agreement incorporating these objectives; and a negotiating scenario for the consumer-producer conference;

-- Prepare recommendations for consumer governments desirable or required implementing steps to ensure viability of agreement.

E. Policy Issues and Problems

Examination of the broader public policy implications of such an intergovernmental agreement, including the role of the Federal Government to private industry; possible

forms of public oversight and regulation of the industry required; the adequacy of the Federal Government's legal powers; anti-trust aspects.

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TASK III

Cooperation Among Consumers on Sharing and Related Measures to Deal with Persistent Oil Shortages

A. Objectives

1. An arrangement between consuming governments for sharing oil under conditions of persistent shortage and emergency shortfalls on a mutually satisfactory basis.

2. To prevent the pressure of supply shortages from leading to unilateral actions to improve national positions that are detrimental to the broader multilateral relationship between oil consumers and producers.

3. To integrate the sharing arrangement with related actions in areas for conserving and producing energy resources, including rationing and stockpiling.

B. Description of the Task

1. Utilizing the considerable work already done in the OECD Oil Committee and in the U.S. Government, draft an arrangement for sharing oil that goes beyond emergency circumstances to conditions of persistent shortage.

2. Obtain USG agreement on an acceptable basis or range of bases for sharing (on imports, consumption or some combination).

3. Either as part of the draft arrangement or separately clearly state how it is linked with other necessary actions by consumers for conserving or producing energy resources.

C. Specific Objective of Foreign Ministers' Meeting

1. Instruct the International Task Force to draw up a consumers' arrangement for sharing oil in

conditions of persistent shortage that integrates with its action programs for conserving and producing energy resources.

2. Agree on a basis or bases for sharing the oil that will be satisfactory to consumers as a whole.

D. Assignment for International Task Force

1. Making use of the work already done by the OECD and the decisions and instructions of the Foreign Ministers, draft a sharing arrangement.

2. The action program on sharing should contain clear links with other relevant energy action programs and point up policy and implementation problems which consumer governments will have to address individually and collectively.

E. Policy Issues and Problems

1. There is still significant differences between the West Europeans and Japan on the one hand and the U.S. on the other concerning what the basis for sharing should be. Broadening the arrangement to go beyond emergencies will probably not reduce these differences. They will have to be resolved.

2. There must be adequate legislation and regulatory bases for any sharing arrangement agreed to. At this time the U.S. does not have satisfactory legislative authority. We are seeking appropriate language in the energy emergency legislation now under consideration on the Hill.

3. Since private oil companies, most of them U.S., will implement any sharing arrangement, it will be necessary to provide them with the legal right to work together within our anti-trust laws.

Accelerated Development of Alternatives to Middle East Oil

A. Objective

-- Seek accelerated development, to the maximum extent economically justifiable and technically feasible, of energy alternatives to the Middle East and other major suppliers;

-- Seek to continue reliance on the privately-owned companies and private capital markets, to the extent consistent with this objective;

-- Develop independent information base to permit assessment by USG of practical steps designed to accelerate development of energy alternatives;

-- Seek to stagger the development effort: short-term programs with immediate pay-off and longer-term efforts extending through the decade.

B. Description of Task

For each of the major energy forms -- petroleum, coal, natural gas, and non-conventional petroleum:

-- Prepare a list of specific target areas, i.e. major reserves where production could be accelerated through appropriate development investment, and the magnitude by which production levels could be increased in a given time frame;

-- Identify areas in which exploration activity to prove up reserves could be accelerated;

-- Formulate specific recommendations on governmental measures designed to open up reserve areas to accelerated exploration and development, including assistance to private industry as required and, possibly, a direct governmental role;

-- Examine forms of intergovernmental cooperation, including other consumer and producer governments useful for the attainment of this objective.

C. Specific Results of Foreign Ministers Meeting

Consumer governments would pledge themselves:

-- To cooperation in the accelerated exploration for, and development of, alternative energy sources;

-- An appropriate role (e.g. investment of incomes) of the existing producers so long as this would not lead to unacceptable control by the producers over these alternative sources;

-- Other governmental measures ready for implementation; possibilities include: declaration by US opening up Naval Petroleum reserve #4 for development; announcement of decision by Norway to open up Norwegian waters of North Sea for immediate development; announcement by Canadian Government to proceed with formation of international consortium for development of Athabasca ter sands; US declaration opening continental shelf to international joint ventures on a reciprocal basis; formation of an international energy development bank to work with private industry in the accelerated development of new deposits (producing countries might be permitted to take a share of the bank's capital subscription);

-- Directive to international task force to develop specific recommendations in this area.

D. Assignment for International Task Force

Same as section B above.

E. Policy Issues and Problems

Some of the central issues are:

-- To what extent does the USG wish to provide financial assistance and incentives to private industry

as against the possibility of setting up a US public corporation that would enter into partnership with private industry;

-- Do we permit foreign interests to buy into North American resource development;

-- Can producer countries be permitted a financial stake in the development of new sources; if so, to what extent should this be done through a) financing of the private companies or partnership deals between the industry and government corporations owned by the producing countries; or b) the use of financial intermediaries, such as an energy development bank.

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INTERNATIONAL ENERGY INITIATIVES

TASK FORCE - V

Development of Alternative Sources of Energy Research and Development: including fossil fuel and non-conventional technology

Lead Agencies: AEC and State (Co-Chairmen: Dr. Gorman Smith and Herman Pollack)

Participating Agencies: FEO, NSF, EPA

A. Objectives:

1. Development of a comprehensive negotiating package of international cooperation in Energy R&D.

2. Examination of present cooperative programs with recommendations on how they can be strengthened and accelerated.

3. Examination of US proposed Energy R&D and how it can be advanced by international cooperation.

B. Description of Tasks:

1. Development of a comprehensive proposal for international cooperation in Energy R&D including recommendations for acceleration of present cooperative programs.

2. Examination of fossil fuel R&D programs for possible opportunities for cooperative activities including:

   a. cooperative action to accelerate development of coal, including new technologies for mining;

b. development of non-conventional petroleum including:

i) coal gasification and liquidization

ii) oil shale and tar sands

iii) development of fluidized bed boiler

iv) pollution control technology -- to permit expansion of fossil fuel utilization

3. Proposals for joint development of new energy technology (non-conventional medium/long-term).

a. Development of nuclear energy:

i) nuclear enrichment and uranium supply

ii) present program nuclear power plants

iii) fast breeder reactors

iv) fusion

v) environmental and safeguard methods to speed the safe introduction of nuclear energy

b. Development of other non-conventional energy sources and technology through multinational action:

i) geothermal

ii) solar

iii) fuel cell

iv) other

C. Specific Results of Foreign Ministers Meeting

1. Agreement that International Task Force would examine and develop proposals for international cooperation in Energy R&D.

D. Work Program and End-Product of International Task Force

1. Comprehensive proposals for joint cooperation.

2. Recommendations on institutional modalities for future coordination of R&D international program.

E. Policy Issues and Problems

1. For nuclear energy, Task Force should fully consider safeguards, national security waste disposal and safety questions.

2. R&D package should consider balance of overall advantages and disadvantages of difficient technologies and note those which have greatest chance of early success.

3. The role of private industry should be examined with recommendations on how they can be involved more effectively in R&D acceleration.

4. When applicable, recommendations should include joint government cooperation through innovative inatitutions such as the model of ESRO or Intelsat, etc.

5. Examination will be needed on economic and legal constraints/incentives for recommended cooperations.

Task VI

Economic, Monetary, and Investment Cooperation

A. Objectives

In the short-term:

-- Management of oil revenues in a manner designed to offset the balance of payments effects of the recent price increase (immediate problem for 1974);

Main objectives:

-- To provide incentives for producing governments to permit production of oil in the required amounts;

-- To negotiate international arrangements designed to deal with the balance of payments effects through appropriate reflow and investment of funds in the consumer countries;

-- To channel oil revenues into internationally productive uses;

-- To maintain a stable international monetary structure by minimizing sudden destabilizing shifts of funds;

-- To forestall an unacceptable degree of financial control by the producer governments over key sectors of the consumer economies.

B. Description of Task

Develop proposals in the following areas:

-- Ground rules on how these revenues are held until they are committed to long-term loan and equity investment, particularly to minimize sudden large-scale shifts of funds;

-- Undertakings by producing governments to commit their revenues to long-term investments at a certain rate;

-- Types of assurances, investment instruments, etc. which consumers could provide to producing countries; possibility of special bonds and IMF deposits;

-- Technical and other assistance to producing countries to accelerate their industrial development;

-- Coordinated industrial policies to define sectors in which equity investment by producers would be desired;

Comment:

In practice, a combination of all these measures will be required to deal with funds of the magnitude likely to accrue to producer countries; a certain portion will be held in the form of short-term funds; some portion might be deposited under new arrangements with the IMF; part will go into financial investments in major capital markets in the US and a portion will be used for direct investment. The central task, therefore, is to develop proposals for broad understanding on how producers plan to use these funds so that monetary authorities can adopt appropriate arrangements and policies.

C. Specific Results of Foreign Ministers Meeting

Foreign Ministers would agree:

-- A working group under the responsibility of the finance ministers would develop a specific program covering the areas outlined under B;

-- A group of commerce and aid officials should develop guidelines and programs designed to assist in the accelerated industrial development of the producer countries;

-- To call on producer countries to provide development assistance to less favored LDCs, such as through a special fund under World Bank auspices and new development banks. Foreign Ministers could also call for special oil price recessions for LDCs.

D. Assignment for International Task Force

See section C.

Consult with IBRD, UNDP and regional development bank officials on new aid programs.

INTERNATIONAL ENERGY INITIATIVES

TASK FORCE - VII

Development of Diplomatic, Political and Institutional Modalities for the Consumer Meeting and Eventual Consumer/Producer Meeting and Their Work Programs

Lead Agency: State/S/PC - Chairman: Winston Lord
Participating Agency: FEO

A. Objectives:

1. Assure a comprehensive diplomatic and political strategy in preparation for Foreign Ministers Meeting and eventual consumer/producer meeting.

2. Preparation of an effective agenda and work program for Washington Meeting and necessary follow-on action including establishment of an International Task Force.

3. The creation of an effective mechanism for both consumer country and consumer/producer cooperation.

B. Description of Tasks:

1. Development of an administrative and organizational strategy relating to consumer meeting, including:

a. development of agenda for consumer meeting;

b. establishment of an international task force for implementation of results of first consumer meeting;

c. development and organization of working papers for first consumer meeting;

d. providing scenario for agreement on follow-on action;

e. organizing relationship to prepare for consumer/producer meeting (EAG);

f. formulation of broad legal forms for agreement (treaties, agreements, etc.), and possibly a charter for consumer group cooperation;

g. examination of question of representation of additional consumer countries.

2. Preparations for joint consumer/producer meeting -- the Energy Action Group (EAG)

a. development of a common position and strategy by consumers on substantive points and preparation of position papers and their circulation;

b. development of a strategy on part of USG and consumer countries on EAG meeting with respect to:

i) membership

ii) forum

iii) agenda

iv) follow-on modalities

c. development of a diplomatic and political strategy to work with producer nations:

i) US on our own

ii) with consumer countries

d. development of a scenario for joint formation with producers of EAG agenda and format;

e. development of proposals for organizational aspects of EAG meeting.

C. Specific Results of Foreign Ministers Meeting

1. Agreement on decision by Foreign Ministers on a comprehensive work program.

2. Establishment of International Task Force.

3. Agreement among consumer countries on "behavior" with producers in period before joint consumer/producer meeting.

4. Decision on future membership question.

D. Work Program and End-Product of International Task Force

1. Development of comprehensive recommendations and an action program on substantive items noted elsewhere.

2. Proposal for permanent consumer cooperative organization

E. Policy Issues and Problems

1. Examination should be made of question of a strategy on the part of OPEC countries in reaction to consumer initiative.

2. Formation of USG organizational structure for Washington Meeting - including place, support, funds, etc.

3. Coordination of domestic action which might affect diplomatic strategy.

4. The question of the future role of existing international bodies.

5. Development of a comprehensive information base for consumer countries.

INTERNATIONAL ENERGY INITIATIVES

TASK FORCE - VIII

Long-Term Institutional and Legal Questions: involving permanent organizations or agreements on international energy cooperation

Lead Agency: State/L - Chairman: Carlyle E. Maw

Participating Agency: FEO

A. Objectives

1. Creation of Agreement language on long-term cooperative institutions for international energy cooperation.

2. Presentation of alternative models for international energy cooperation among consumers and consumer/producers.

B. Description of Tasks

1. Examination of existing models of international cooperation as possible approaches in the energy field, i.e. Intelsat, ESRO, etc.

2. Development of alternative agreement/treaty texts for long-term permanent energy cooperation activities.

3. Examination of US laws and their impact on forms of US cooperative activities.

C. Specific Results of Foreign Ministers Meeting

1. Agreement to request International Task Force to examine approaches to permanent cooperation among consumer countries.

D. Work Program and End-Product of International Task Force

1. Development of specific proposals on institutional models for cooperation among consumers on energy matters.

E. Policy Issues and Problems

1. Examination of how a permanent consumer country organization would relate to already existing international organizations including EC, OECD, UN, NATO, and GATT.

2. The examination of decision-making models for a permanent organization and especially approaches which do not create permanent secretariat staff problems of existing organizations.

3. Examination of questions of possible institutional models for cooperation between consumers and producers.

January 16, 1973.

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POSITION PAPER
OF
INTERDEPARTMENTAL TASK FORCE VI
ON
MONETARY AND INVESTMENT COOPERATION

...tion

...n forecast levels of oil production in some ...ations and increases in forecast prices are ... in substantial changes in the pattern of ...ents flows and substantial impacts on the ... of different nations in the years imme- ...ring that period there will be larger pay- ... nations to producing nations for oil. ... 1974 have been roughly estimated to be ... from developed countries and about $9 billion ...sing, less developed countries. There will ... by the oil producers for increased imports ...ces, but in view of probable time lags these ... expected to reach $5 billion in 1974. And ...stantial increase in the international flow ...s. The oil producers have been projected to ...dings of foreign assets by approximately ... 1974.

...stimates are not unreasonable, they must ...d on tenuous assumptions as to the rate ... costs reduce patterns of consumption and ...n of alternative sources of energy; and ...come even more precarious for the years ...ver, the estimates relate to over-all ... uncertainty exists as to how the payments ... those for investment, will affect the ...ular countries.

...ultilateral Cooperation

...ternational economic situation presents ...ties for cooperative action on a broad ...l-consuming and oil-producing nations in ... Among the objectives of such cooperation

...n the impact of current uncertainty ...nomic activity and on the orderly ...rnational trade and investment;

...n of the increased potential flow ...nternational investment, so that

all areas of the world may have the opportunity to derive the greatest benefit from their specialized resources without fear that investments will be managed in a disruptive manner and without fear that investments will be treated unfairly; and

C. cushioning the impact of the new oil costs on those areas of the world least able to bear the shock of change in view of their existing extremely low level of economic well-being.

Specific Possibilities Worthy of International Study

In pursuit of these objectives, the international community will wish to consider many different approaches. Among those which have been mentioned by various countries and institutions as worthy of study to determine if action is desirable are:

1. negotiation of a statement of general principles to guide governments in their conduct and regulation of trade and payments and in their management of flows of investment funds in current circumstances;

2. revision of the rules and expansion of the capacity of the International Monetary Fund to facilitate adjustment to unforeseeable developments in international economic affairs;

3. the proposal made by the IMF for the establishment of expanded arrangements to borrow resources from governments with increasing holdings of foreign assets in order to increase the Fund's capacity to provide temporary assistance;

4. re-direction of flows of official bilateral and multilateral capital, and technical assistance in the light of the relative changes in economic positions resulting from the revisions of oil prices;

5. creation of new mechanisms for the coordination of developmental assistance from a larger number of potential sources, both national and international;

6. the proposal to establish new arrangements for the multilateral developmental project lending agencies, including the IBRD, the Asian Development Bank, the Inter-American Development Bank, and the African Development Bank, to borrow resources on a long-term concessionary basis from governments with increasing holdings of foreign assets;

7. study of the possible desirability and feasibility of the various proposals to create a new multilateral institution to assist interested governments in their investment programs by providing disinterested advice on the selection of projects and securities both at home and abroad, and by increasing investment security through acting as a diversified financial intermediary or by providing the services of an insurer.

Possible Intermediary Steps

After review of the current situation at the meeting in Washington, the foreign ministers could endorse a statement of opportunities for multilateral cooperation in the economic area, such as that outlined above, and could request that the specific possibilities listed above, plus any others contributing to the same objectives, be reviewed by:

- a special meeting of the deputies of the ministers of finance and economy of those countries attending the Washington meeting; or

- a meeting of the OECD Working Party Three on international financial matters, supplemented as necessary by work of other committees within the OECD structure.

At an appropriate time the group chosen could be augmented by or meet with representatives of the non-oil producing less-developed countries.

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A. CURRENT FOREIGN AID ACTIVITIES OF OIL EXPORTING COUNTRIES

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The countries benefitting from higher petroleum prices vary considerably in the relative importance of petroleum exports in their economy and in the likely level of income in sight. Some like Kuwait, Saudi Arabia and Venezuela will now have very high per capita incomes; they will be truly wealthy countries. Others of which the clearest case is Indonesia will remain really quite poor with per capita income well below $200.

All of them are likely to have substantial liquid resources in the short run but in a longer time frame it is not realistic or reasonable to expect the poor countries to commit these resources for development elsewhere. All of the countries with sudden substantial windfall revenues are likely to have a short-run problem of making good use of liquid resources. Proposals and arguments for constructive use of both sorts of wealth are relevant, but they are not the same. This discussion looks mainly at the experience to date of how the really newly wealthy have moved to use some of their wealth to assist other countries.

All these countries may be interested in secure and renumerative ways of using their liquid assets. Efforts to develop mechanisms to facilitate their flow to those who need and can afford them can certainly make an important contribution. Over and above such mechanisms, however, the truly wealthy countries should be regarded as potential sources of aid over the future and efforts made to highlight their interest in development, encourage them to move in that direction, and assist them in making their programs as constructive as possible. For clarity these countrieswhich will benefit substantially from higher oil prices and enjoy per capita income above $1,000 are referred to hereinafter as "oil rich". They comprise mainly several of the middle eastern countries, Libya and Venezuela.

Oil rich country economic aid programs to date have been relatively modest except for their direct support to Egypt, Jordan, Syria and Iraq related to the burdens of Middle East tensions. This support is basically military rather than development oriented. Such support has been substantial. Kuwait appears to have devoted a total of over 5 percent of its GNP to all sorts of foreign aid in recent years.

The future of these large contributions depends very much on the evolution of political relations with Israel. If these relations are stabilized, these payments are likely to be rapidly phased out.

Meanwhile the oil rich Arab countries have evolved and are elaborating patterns and institutions which could be rapidly expanded to utilize additional resources.

Kuwait and Abu Dhabi have set up their own Development Banks and Libya and several others have also acquired some experience in providing bilateral development aid. Only Kuwait has made direct contributions to the IBRD and IDA. The African Development Bank and its soft loan fund have received only modest financial support even from the African oil countries. Joint Banks and Funds for Arab, African and Islamic development have been established or are in formative stages. To date the oil rich countries' ability to contribute to UN development programs in the UNDP is virtually untapped. END UNCLASSIFIED

BEGIN ~~SECRET~~

Government to Government Aid

By far the largest form of aid to date has been government grants from the Arab oil exporters to fellow Arab countries mainly designed to support the budgets of those countries. The incomplete information available is summarized below:

Table 1

Arab Oil Exporter Aid to Arab Governments 1/

Source	1968	1969	1970	1971	1972
Kuwait	103	113	148	115	145
Saudi Arabia	104	104	101	101	120
Arab Emirates			4	82	106
Other and Unspecified 2/	168	167	331	299	202
TOTAL	375	384	585	597	583

1/ Largely Budget Support, but also includes some development aid. May include some military equipment payments.

2/ Includes substantial amounts from Kuwait, Saudi Arabia and Libya.

Source: AID/ASIA Paper "Aid to the Middle East", 11/73.

* * * *

These large payments are very largely political/military in orientation. They are designed to support the military expenditures of the countries confronting Israel (Egypt, Syria, Jordan, Iraq) and to make up for the revenue losses as a result of closure of the Suez Canal. They are likely to phase down rapidly if peace is restored and the canal reopened. This possibility would accentuate the potential of these oil rich countries to support substantial aid programs relatively painlessly. END ~~SECRET~~

BEGIN UNCLASSIFIED

Bilateral Development Aid

Meanwhile the bilateral Kuwait Fund for Arab Economic Development has been functioning since 1961. Its total commitments through 1972 were $311 million of which about $200 million had been disbursed. Disbursements in 1971/2 reached $28 million. Its terms vary from highly concessional (grant element 84 percent) to near commercial and it has made small grants to its poorest clients for feasibility studies.

In 1971 Abu Dhabi established its own Arab Development Fund of $100 million to be paid in over six years. It is to funnel all Abu Dhabi's development aid to other Arab countries.

Libya has also provided significant amounts of economic aid to individual African countries on a sporadic basis. In 1971 Niger received $5 million for health, education and rural development and equatorial Guinea $1 million. In 1972 Uganda received $12 million.

Many specific possibilities for major aid/investment projects are in various stages of planning/discussion. The Egyptian pipeline is an important case. Port and shipping projects in the Persian Gulf area are also relatively advanced.

There has been some discussion of major investments which could serve in some degree aid purposes in facilities which would alleviate shortages of key development needs (e.g., fertilizer) and reduce LDC (e.g., India) capital needs. Such investments could be in the LDC's or could even be located in the oil and gas producing countries.

Contributions to International Development Finance Institutions (DFI's)

The chief contributor to date to the DFI's has been Kuwait although recently Libya and several other countries have moved toward greater activity. IBRD Kuwait dinar bonds outstanding now total over $350 million. During 1973 Kuwait provided 10 percent--about $125 million--of the new funds borrowed by the IBRD. IBRD management has explored investment by the oil rich countries in its securities and expects substantial success. In general, it is likely to be able to insist on investments at least offsetting credits to these countries which still find advantage in borrowing from the IBRD. These would apparently include Venezuela and Iran. In at least some cases in addition to Kuwait, e.g., Saudi Arabia, substantially larger borrowings seem assured. Other security

issues by the various IDFI's have no doubt been picked up in Arab portfolios, but statistics are not available. Libya and Nigeria are members of the African Development Bank and as such have subscribed to its modest capital, but not in substantial magnitude. Increased capital subscriptions should be encouraged, particularly to the IBRD and the African Development Bank./

Kuwait is the only one of the oil rich countries which has become a Part I member of IDA and has contributed about $23 million to its resources.

In addition to the foregoing contributions, the Arab States and other oil exporters have established or are considering establishing several new development finance institutions of their own. The Arab Social and Economic Development Fund has been established pursuant to an agreement of 1968. It began functioning in 1972. Its capital is $300 million of which Kuwait (30 percent) and Libya (12 percent) are the largest subscribers to date. It will finance social and economic development projects in Arab countries on easy terms.

In November 1973 the Arab Summit Conference reached agreement on the establishment of an Arab Bank for Industrial and Agricultural Development in Africa with an initial capital of about $125 million. Early in February an 18 nation preparatory committee is holding its second meeting to work out plans for an Islamic Development Bank. A total capital of as much as $1 billion has been mentioned. There has apparently also been some talk of a Development Bank which would bring in all the important OPEC members. Whether and if so when any or all of these will be established is not clear at this time.

The United Nations

Voluntary Contributions to UN programs, particularly the UNDP, should command high priority among the claimants for increased contributions from the oil rich countries. Those whose per capita income remains low may properly resist commitment to substantial continuing contributionsthough even these might consider some short term measures.

In fact to date none of these countries has stepped up its contributions notably and all are continuing to claim net assistance from the UNDP. The UNDP Governing Council has suggested that countries at the upper end of the LDC income scale should limit their claims and increase their contributions. The U. S. has strongly supported these suggestions and is pressing for progress in this direction in the current 17th Governing Council meeting.

UNDP Receipts and
Contributions of Oil Exporting Countries

	Per Capita GNP 1972 ($ U. S.)	UNDP Indicative Planning Figures ($ millions) 1972-76	1977-81 a/	UNDP Contributions 1973
Saudi Arabia	596	10	8.5	.35
Kuwait	3,906	1	2.3	.35
Qatar	2,603	1.5	1.0	.2
Iraq	376	15	15.5	.3
Iran	512	20	17.0	1.0
Algeria	394	20	9.0	.34
Libya	1,292	5	3.0	.315
Nigeria	151	30	42.5	.152
Indonesia	85	35	63.5	.13
Venezuela	1,110	10	7.5	.92

a/ 9.6 percent Growth Assumption.

* * * *

Contributions to the UNDP are not at best going to utilize significant oil revenues or substantially relieve the problem of development finance. They are a clearcut undisputable claim, however, and they have substantial political and modest practical importance. END UNCLASSIFIED

AID:PPC/IA:CSGulick :1/18/74

B COOPERATION BY THE OIL EXPORTERS IN DEVELOPMENT ASSISTANCE COORDINATION

There are several ways in which we could encourage the oil rich countries to channel their resources available for development assistance to ensure that they will be allocated in relation to relative need and used productively.

1. Appropriate contributions to the UNDP and capital borrowing and soft funds of the established Development Finance Institutions.

2. Participation by the oil rich countries and their individual and joint development finance institutions in consortia and consultative groups for selected countries.

3. Development by the DAC of OECD of carefully tailored relations with these countries and/or their joint development institutions.

4. Development of a new forum for coordination.

Only Kuwait has contributed significantly to IDA and subscribed to substantial IBRD borrowing. Recently the IBRD has discussed bond sales with several other countries, including Venezuela and Saudi Arabia. None of the oil exporting countries has made appropriate contributions on either ordinary loan or soft terms to the regional development banks. They have shown a strong preference to date for establishment of their own institutions.

It is U. S. policy to press for sharply increased contributions to the UNDP by relatively wealthy members. To date none of the oil rich countries have responded favorably, but the stmosphere for progress should now be improved.

Kuwait has been a member of the IBRD chaired consultative groups for Tunisia and Morocco for several years. Recently it became an observer and the United Arab Emirates became a member of the Sudan consultative group.

Full membership in the DAC would require membership in the OECD which is not appropriate for the near term. Participation on an observer or auxiliary basis in DAC deliberations could be arranged and might be useful in coordinating policies on terms, aid allocation, country performance and other general aid policies and priorities. Precedents for participation exist. The IBRD and the UNDP frequently attend DAC sessions and collaborate formally and informally.

Full equal membership in coordinating institutions would probably be more attractive to the oil rich countries and more effective than any limited, partial, "second class" status. This presents no problem in relation to switching to Part I status in IDA, membership in the appropriate boards of the regional development banks or in membership in appropriate consortia or consultative groups. It may well be difficult in relation to DAC, however.

The OECD has many functions besides those of its DAC; further diluting its economic, political ~~and cultural~~ homogeneity might undermine its utility in other areas. Yet an institution in which aid donors can consult with effective staff support may be particularly useful in relation to the evolution of aid programs of the oil rich countries. It may be desirable to consider developing a new forum in which these countries could be full equal members which could perform this functions--perhaps largely supplanting the DAC for a considerable range of its activities.

One possibility would be to build on the Part I membership meetings of the IDA. This approach might facilitate use of IBRD/IDA staff backstopping and minimize the not negligible disadvantages of having still another institution.

AID:PPC/IA:CSGulick 1/18/74

C. The Energy Crisis: LDC Economic Problems

I. Introduction

The increases in petroleum prices which were announced in October and December of 1973 will create severe balance of payments and economic growth problems for many of the developing countries. This adverse affect on the LDCs will be the product of several interacting economic forces including: 1) the phenomenal increase in the LDCs oil import bill which is a function of not only the increased price but also the heavy dependence which most LDCs have upon oil as a source of energy, the limited non-essential usage they can cut back to absorb supply reductions, and the limited technical and economic resources the developing world has available to adjust; 2) the increased scarcity and higher prices of petroleum-based primary inputs including fertilizers and synthetics which may adversely affect both agricultural and industrial production; and, 3) the vulnerability of LDC export earnings to a recession in the developed countries which would inevitably reduce demand and prices for LDC exports.

The discussion which follows outlines each of the preceding points in greater detail presenting estimates of the nature and magnitude of the impact where available. The effects discussed here are primarily

short-run and do not consider possibilities of substitute sources for energy which can only be brought to bear on the next three to four years. The discussion and estimates particularly for individual LDCs are by necessity preliminary in nature. As more information is collected pertaining to the situation faced by individual LDCs, updated estimates can be included in revised drafts of this paper.

II. The Magnitude and Nature of the Problems Faced by the Developing Countries

A. Implications for the Oil Import Bill of the LDCs

With the increase in the price of imported oil from a 1973 level of $3.40/barrel to an estimated 1974 price of from $8.50 to $10/barrel,[1] the cost of LDC oil imports will rise from $5.2 billion in 1973 to a staggering $13-15 billion in 1974.[2] In comparison, total 1972 exports of non-oil producing[3] LDCs were approximately $55 billion and reserves as of July 1973 were $28 billion. Thus, the increase in the LDCs oil import bill in 1974 would: 1) be equivalent to 28-35 percent of their total reserve holdings; 2) be about equal to the total official bilateral flows to the developing world in 1972 of $8.6 billion; and, 3) would

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1. $3.40/barrel is the average 1973 c.i.f. price calculated by the World Bank. $8.50/barrel is the OECD calculation of the implied c.i.f. price of the Tehran announcement. $10/barrel is the U.S. import price recently used in some Treasury estimates; at the same time Treasury used $8.70 as the c.i.f. price for other importing countries. Recent world Bank estimates have used an $8.77 figure.
2. Using 1973 volume levels.
3. Iran, Iraq, Kuwait, Saudi Arabia, Libia, Nigeria, and Venezuela were removed from LDC totals for this purpose.

increase the burden which oil imports placed upon export receipts from approximately 8 percent to over 20 percent.[4]

In terms of current account balances, both the Treasury and the IMF have estimated a significant deterioration for the developing world. The deficits which the LDCs have run in the past have been balanced for the most part by private and official flows from the developed world. The projected current account deficit for 1974 is $24 billion, up from $10.6 billion in 1973.[5] Not only does the increase in magnitude of the deficit make it difficult for the LDCs to balance their external accounts but the resource flows from the DCs have been possible, in part, because of the overall current account surplus of the developed world. The developed countries are now projected to run a current account deficit of $32 billion themselves in 1974 compounding the LDC problem in covering their deficit. It must be stressed at the outset that these estimates are based on the assumption that the volume of oil imports will remain constant at the 1973 level. This fact by itself might well have serious adverse effects on LDC GNP growth, which has been dependent on growing supplies. For such imports to be realized, the LDCs would require additional financing, in the amount of the imports. The paper does not discuss the possibilities that such financing would be forthcoming. Thus, the estimates can be interpreted as showing the magnitude of domestic adjustment plus increased

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4. Allowing for an increase in LDC exports in both 1973 and 1974 of 15 percent.
5. U.S. Treasury estimates.

financing required. Even if it was assumed that half of the additional import bill was financed through drawing down reserves or more short-term borrowing, the remaining adjustment required is likely to stagger the economies of a number of LDCs.

B. Oil Dependence

Given the clearly unfavorable position which the LDCs find themselves in terms of oil imports, it is clear the oil imports will have to be reduced whenever possible. Again, the LDCs face some major problems. First, because of a series of historical and geographical circumstances, the LDCs have become heavily dependent upon oil imports as their major source of energy. Out of 77 non-Arab LDCs, for which data were available, only 12 were net oil exporters in 1973, and 53 had no petroleum production at all.[6] In addition, it has been estimated that although for the world as a whole oil provides only 47 percent of the energy resources, for the LDCs in the Western Hemisphere, 74 percent of the energy comes from oil and for the Eastern Hemisphere LDCs oil constitutes 58 percent of total energy consumption.

Compounding this problem is the fact that the LDCs face two additional barriers to reduction in oil exports: a) there is very little non-essential consumption, similar to that present in the developed world, which can be curtailed without appreciably reducing output; and b) there are limited technical and economic resources in the developing countries

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6. State Department/INR estimates.

which can be employed in the development and utilization of alternative energy sources even in those cases where alternatives may exist in some limited form. Whereas the U.S. can shift at the margin between coal and oil and can devote large sums to further exploration and development of energy sources, the LDCs cannot.

C. Petroleum Related Primary Inputs

Two major petroleum products have undergone major adjustments as a result of both the increase in petroleum prices and the recent shortages in supply. Possibly the most critical of these items is fertilizer. The current international market in fertilizer is characterized by limited availabilities and rapidly rising prices. A major ingredient in nitrogen fertilizer is either natural gas (U.S.) or oil (Europe). A capacity problem in the U.S. and oil shortage in Europe have combined with a rapidly rising demand to yield the current international situation.

The rapidly rising demand is closely related to both the recent worldwide shortage of food and the increased use of miracle grains in the developed world. For example, in the U.S. the high price of grain encouraged increased production and resulted in an 8 percent increase in domestic fertilizer consumption in 1973, 6 percentage points above the historical average growth. The adoption of new strains of wheat and rice have correspondingly increased the demand for fertilizer in the developing world. The new strains require major inputs of fertilizer,

far greater than the traditional varieties and in fact the absence of fertilizer may result in lower yield from these new varieties than from the old.

As an example of the increase in fertilizer cost, Urea which 18 months ago was selling for $50/ton has recently been quoted as high as $225/ton. Non-petroleum based fertilizers have risen in price in sympathy with the nitrogen based ones. The price of phosphate rock has recently increased by up to 185 percent. Coupled with the increased prices are shortages. Japan, a major supplier of fertilizer to the Asian region, has recently announced a 30 percent reduction in export shipments. Several Asian countries have recently had difficulty in finding any bidders on tenders for fertilizer. Thus, a reduction in agricultural production as a result of the fertilizer situation may be one of the most important and hardfelt impacts of the current crisis. Exacerbating this food problem is the limited availability of surplus commodities for the major donors. Recent reports indicate a potential shortage of grain, particularly wheat, in the U.S. this year. Shortages of fertilizer in Japan this year would add to this problem. The picture for the food scarce LDCs is thus quite bleak with a possible shortfall in their own production due to the high price and scarcity of fertilizer and a limited availability of relief supplies or alternative sources because of the tight market conditions.

D. Recession

A third major "if" in the LDCs picture, in addition to the increased oil bill and the shortage of fertilizer, is the potential for recession in the developed countries. The LDCs are heavily dependent upon the DCs as a market for their exports. The rapid expansion in the last two years in both the U.S. and Europe has yielded a rapid growth in LDC export commodities. This growth has made possible a rapid increase in foreign exchange holdings and has provided a significant stimulus to economic growth. The current estimates of DC performance in 1974 threaten to reduce demand for many LDC commodities, and to reduce the export earnings potential necessary to finance oil imports.

The most current estimates available from Treasury and independent forecasters project an actual decline in DC industrial production in the first quarter of 1974 with gradual recovery over the next three quarters yielding virtually no increase in industrial production for the year. Compared with previously projected growth for 1974 this represents a reduction in real income growth of 8 percentage points for Japan, 5 for the United Kingdom, 7 for Germany, and 4 for other DCs. For the U.S. real income is expected to grow by only 1.2 percent in 1974 compared with 6 percent in 1973.

The effect of a slowdown will clearly be unevenly distributed among products and countries. Certain primary materials, tropical products and industrial exports may be adversely affected while others

such as cotton and jute may benefit as substitution takes place in spite of reduced overall demand.

E. Ameliorating Factors

There are several factors which will help cushion the impact of increased oil prices. Growth in exports and high prices for many of the commodities of importance to the developing countries have combined to greatly expand LDC reserve holdings. Table 1 presents the recent price changes which have occured in major LDC export commodities while Table 2 gives the recent performance of LDC reserves. The increase in reserves in the last two years provides a short-term financial flexibility to some of the LDCs to absorb the increased oil costs while fundamental adjustments are made. The reserves are not equally distributed, however, with 40 percent of the total reserves of the 20 major AID recipients held by Brazil. Those developing countries which have not benefited from the rapid growth in the export market in the last few years will face major difficulties as reserves rapidly dwindle to pay for high cost petroleum imports.

In addition to petroleum, several other commodities are likely to benefit from the increased oil prices. Two of these products are cotton and jute. The increasing price of oil-based synthetic fibers is likely to further stimulate demand for these raw materials substitutes. Cotton prices are already high and will likely withstand even an economic

slowdown. For those countries who are major producers of these products such as Sudan, Egypt, Turkey, Pakistan, and Bangladesh, the adjustment to higher fuel costs will be eased. The market for rubber is similarly likely to be stimulated to the benefit of Malaysia and to a lesser extent Thailand and Sri Lanka.

For some of the rapidly growing or more developed LDCs, some short-term relief may be available through borrowing. There are two clear problems with such an option. First, those most able to borrow are likely to be those in relatively better position to adjust to the crisis. Secondly, the practice of borrowing for immediate consumption purposes poses potential danger for the long-term indebtedness of the country.

F. A More Disaggregated Look at the Impact on the Developing World

Tables 3 through 6 contain disaggregated estimates of the impact which the oil crisis will have upon the developing countries. The estimates 7/ contained in the Tables and in the subsequent discussion are based on the following basic assumption: a) a 1974 volume of oil trade equal to the 1973 level. This is not to say that these countries will actually import the same volume but rather is used to illustrate the cost of trying to import that volume, i.e., the effect of the price increase alone, and b) a c.i.f. price of oil of $8.50/barrel. This price is on the lower range of currently discussed prices but at this

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7. Given the limited availability of data, the uncertainty regarding prices and supplies and the incomplete knowledge of the precise economic interrelations which exist in each of these countries, a quantitative estimate of the impact of the current crisis on GNP growth or agricultural output is unfortunately not possible at this time. Thus, only the direct cost estimates of oil and discussion of general economic pressure faced by these countries are given at this point.

point it is not clear what price for 1974 would be most representative given current Arab statements of both increasing and decreasing the price of oil. $8.50 clearly provides the order of magnitude calculation necessary for the discussion.

III. Non-Arab Oil Exporters

A. Major Gainers

The three major recipients of benefits from the current moves by OPEC are Nigeria, Indonesia, and Venezuela. A conservative estimate of the increase in oil export earnings in 1974 for these three countries would be over $11 billion moving from $6 to $17 billion. This inflow of resources represents approximately $20 per capita for Indonesia, $100 per capita for Nigeria, $900 per capita for Venezuela. Given the relatively low level of development of Indonesia and Nigeria,[8/] it is clear that these inflows will be useful in the continued development of these two countries and do not represent non-investible resources over the medium term. Although Venezuela has significant development problems to solve, given the size of these inflows in the short-run it may be more difficult to generate the necessary additional internal investment opportunities to absorb the increased revenue.

Other countries which will benefit on a smaller scale include Bolivia, Ecuador, and Tunisia, with Bolivia receiving on the order of

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8. 1970 GNP per capita for Indonesia was $80, for Nigeria $120, and for Venezuela $980.

$20 per capita and Ecuador $10 per capita in oil receipts. Tunisia will also benefit from the major price increases in phosphate rock, its second largest export.

LDC Oil Importers

In looking at the net importers, the question often raised is who among these is likely to be most severely hurt. It is generally agreed that, except under the most unusual circumstances, net importers will be worse off as a result of the current oil situation. The increased oil import burden will inevitably tend to lead to reductions in imports of other products, including capital goods vitally needed for continued development. Some countries, however, face economic conditions which partially offset the detrimental impact of the crisis or are in a better position to at least withstand or absorb the short-run shocks of the market. The list given below is a preliminary attempt to separate the net importers into those who will suffer major harm and those which in the short-run while facing considerable difficulty may be able for a variety of reasons to in part withstand the costs of higher oil prices. As more information becomes available, a more exact reading of the impact will be possible.

LDC oil - wp 1

Countries Which are Major Losers

Korea	Chile
Philippines	Uruguay
India	Ethiopia
Sri Lanka	Kenya
Viet Nam	Sahel
Cambodia	Senegal

Countries Facing Significant Difficulties

Bangladesh	Morocco
Pakistan	Costa Rica
Turkey	Honduras
Thailand	Dominican Republic
Sudan	Jamaica

Brazil

Borderline Countries

Argentina
Colombia
Mexico
Peru
Malaysia

Asia

Korea

Korea will hurt from two areas. Korea's principal source of energy is imported petroleum. To maintain 1973 oil import levels the Korean oil import bill would have to increase from $311 million to $777 million, and this does not allow for increases in volume which are critically important for industrial expansion. Much of Korea's phenomenal expansion has

depended upon the ability to expand exports and correspondingly industrial production.[9] A recession in Japan would also have major repercussions on Korea because of Korea's dependence upon Japan as an export market. Korea is well accustomed to borrowing on the world market, but a major reduction in export potential will inevitably cause both borrowing and debt service problems. Korea also imports much of its synthetic yarns for its textile industry from Japan. Japan, however, has recently announced a 15 percent reduction in industrial fuel use which could result in reductions in the supply of synthetic fibers available for export, thus limiting Korea's inputs for its textile exports.

Philippines

Reports from the Philippines indicate a 25 percent reduction in oil supplies and a 30 percent decline in domestic fertilizer production as a result. The Philippines produces one-half of its fertilizer supply while importing the remainder from Japan, but supplies from Japan are clearly in doubt at this time. The implications for agricultural production of a shortage of this magnitude are enormous. In addition, the increase in the oil import bill of approximately $400 million represents 45 percent of available reserves. At the same time, while they have been able to borrow in the past, their capacity to service increased borrowing is fairly limited and there are no prospects for offsetting gains in the rest of the economy.

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9. Korea's noted ability to adjust and adapt to changing market forces will be a major element in the longer term impact of the current crisis. The more outward looking, dynamic countries are in general in a better position to cope with this major economic situation after the initial shock.

India

India's oil import bill is currently projected to increase from $400 million in 1973 to close to $1 billion in 1974. In addition, India is a heavy net importer of both fertilizer and synthetic yarns both of which have increased in price as much as 200-300 percent. Add to this situation an estimated debt service payment of $550 million and you have the foundation for a severe balance of payments problem. In addition, India's ability to borrow short-term is notably limited. An initial reaction by India has been to reduce fertilizer imports, with the corresponding adverse implications for Indian agricultural production. It is not clear at this point whether the reduction in fertilizer was a policy decision or reflected the scarcity of fertilizer in the international market.

Sri Lanka

The estimated increase in Sri Lanka's oil import bill of $67 million is greater than their total foreign exchange reserves in July of 1973, which were only $62 million, and is close to 40 percent of total foreign exchange earnings. Sri Lanka has already adopted energy conservation measures, including major increases in the price of petroleum products. Recent efforts to obtain crude imports "at any price," however, have come up short. It is clear that the level of economic production will be severely affected by the shortage, given the very limited non-essential usage. Their chances of borrowing are extremely poor as they would be considered uncreditworthy.

Indochina

Vietnam

South Vietnam will be hard hit by the energy crisis. South Vietnam does not produce petroleum or chemical fertilizer and as a result will suffer: a) an increased cost of energy resources; b) a shortage and price increase of fertilizer and other petroleum-related primary inputs including electrical power; and, c) a further loss caused by inflation whereby the cost of nearly all its imports will rise. South Vietnam will have a difficult time financing the added costs from its already shrunken foreign exchange reserves and its limited export earnings.

Fertilizers represents a severe problem since one-third of all rice acreage is currently in the high yield varieties dependent upon fertilizer. It is projected that fertilizer imports could jump from $25 million in 1972 to over $100 million in 1974. Petroleum cost could reach $150 million even assuming substantial reductions in volume. The 1973 bill for petroleum was $80 million.

Cambodia

The energy crisis will add to the heavy burden of a depressed economy and spiralling inflation imposed by the war. Reduced import of oil products and higher prices will further impair the production capacity of Cambodia and aggrevate the inflation. However, production

of most items has already been severely depressed by the war and in the case of some agricultural items such as rice production, areas are cut off from marketing areas.

Laos [10/]

The third of the Indochina countries will be least affected by the current energy crisis. The current consumption of petroleum products is very low. In 1972, total imports were less than $10 million. The cost of these petroleum needs were covered under the Foreign Exchange Operations Fund which is financed by the U.S. and other donors. The increased price of fertilizer will also have limited impact due to the very small quantity which is imported.

Latin America

Chile

In addition to all of its other current problems (Chile's precarious financial position is well known), the increased price of petroleum is likely to put additional pressure on Chile. Oil import costs are likely to rise by $200 million. A critical factor for Chile will be its ability to earn foreign exchange from copper sales. The current price of copper is high, but the consequences of a recession in the developed world on the demand for copper is an open question at this point. Recent GSA moves to sell surplus U.S. copper stocks add an additional uncertainty in this market.

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10. Laos is not a major loser but is included here as part of the discussion of the Indochina region.

Uruguay

Uruguay imports most of its oil requirements. Recent reports indicate that major shortages have developed with a corresponding government increase in prices to conserve consumption. The projected increase in oil imports of approximately $70 million is equivalent to 35 percent of 1972 export earnings and close to 30 percent of reserves. An increase in wool prices may partially offset this increased cost, given the importance of wool as a petrochemical fiber substitute.

Africa

The absence of reliable data and the large number of small countries make discussion of individual countries difficult. In spite of the relatively small quantity of oil imports into Africa, the importance of the price increase is likely to be great. Imported oil is the primary source of energy and is a critical input in the development programs of these countries. In addition, these countries are extremely poor, with little room for the absorption of additional shocks. Their dependence upon Europe as a major export market will add further uncertainty into their ability to earn foreign exchange. The following discussion on Kenya, the Sahel countries, Ethiopia, and Senegal is illustrative of some of the problems.

Kenya

Kenya is a relatively large African importer of oil, totaling $40 million in 1973 and potentially $104 million in 1974. An additional major problem faced by Kenya is the impact of increased air fares and

a European recession on one of its major foreign exchange earnings, tourism. Forecasts by the Kenya government indicate a major decline in tourist trade; there have already been cuts in airline service, with the corresponding foreign exchange and income effects this implies.

Sahel

The countries least able to cope with further economic shocks are those of the drought stricken Sahelian region. The implications for transportation costs to the interior or the landlocked sectors are enormous with many side effects, including the cost of supplying relief.

Senegal

Senegal is a clear case in point of the problems of the Sahel. Reserves were down to $28 million in July, 1973, yet the increase in projected fuel costs would be $60 million.

Ethiopia

Ethiopia currently has relatively high levels of reserves which were accumulated in the last year as a result of the high price of coffee. Although having some short-term leeway, the importance of transportation to the movement of agriculture into the commercial phase is well perceived in the development community. Major shifts in the cost of transportation will impact on this development process and Ethiopia's export potential. The dependence of Ethiopia's exports earnings on coffee prices makes the country vulnerable to rapid changes in export earnings. Estimated 1974 oil import costs of $48 million, for example, represent over 25 percent of 1972 export earnings.

Countries Facing Significant Difficulties

Asia

Bangladesh

The increased petroleum prices will represent a significant burden for Bangladesh, particularly in the short-run, given the low level of reserves, recent inability to procure necessary short-run fertilizer needs, and the critical need for food which is also high priced. The precariousness of the situation could quickly push them into the major loser category particularly if there is a shortfall in food production.

Bangladesh, however, has two positive forces going for it in the medium term. First, Bangladesh has abundant natural gas resources, part of which is currently being used to produce half of its urea fertilizer need. The IBRD is moving to finance further expansion in fertilizer capacity, the output of which will be important in several years. Secondly, Bangladesh's major export is jute whose demand and price is likely to rise as the price of the competitive synthetic fibers jumps upwards. The potential for increased export earnings is substantial.

Pakistan

The increased oil import bill coupled with the debt service payments of Pakistan represent a significant load on its export earnings. The fact that Pakistan is a major exporter of cotton, which is a petro-chemical fiber substitute, is currently enjoying high prices, may provide some relief to the oil problem.

Turkey

In addition to its high level of reserves, over $2 billion by November 1973, Turkey is also a major cotton exporter. Its principal fear is a recession in Europe since $1.2 million of its $2.5 billion in 1973 earnings came from worker remittances. One of the first reactions in Germany to the unemployment implications of the oil crisis was to embargo further immigration of foreign workers.

Thailand

Thailand faces an increase of over $300 million in its oil import bill which is equivalent to 30% of 1972 export earnings and slightly under 25% of July reserves. The high level of reserves gives some short-term cushion for the Thai economy. In addition, the use of fertilizer in Thailand, although increasing over the last decade, is quite limited compared to other Southeast Asian countries. This reflects the limited adoption of high yield varieties to date, and certain domestic pricing policies which have discouraged the use of fertilizer. Hydro-electric projects and oil potential are two possible long-range pluses for Thailand.

Africa

Sudan

Sudan's position as a major cotton exporter may in the short run be partially offset by the extremely low level of reserves, $31 million in October, and the ramifications of the recent drought.

Morocco

The picture for Morocco is mixed. The oil import bill is expected to rise by $80 million or 25 percent of reserves. Two of the major foreign exchange earners for Morocco are tourism and receipts from Moroccans working in Europe. Both of these will decline with the onset of a European slowdown. On the positive side, phosphate rock is a major export item which is currently paying well. An additional unknown is the future relationship of Morocco with Libya.

Latin America

Costa Rica, Honduras, Dominican Republic, and Jamaica

The increased oil import bill, although small relative to export earnings of Costa Rica and Honduras, is large relative to their current reserves. Although Costa Rican reserves had risen from July to October from $31 million to $45 million, the increased oil import bill would still constitute 50 percent of reserves. For Honduras, reserves had actually fallen to $38 million in October, yielding a ratio of increased oil import bill to reserves of close to 50 percent.

The Dominican Republic also faces severe balance of payments constraints with current holdings of reserves of less than two months. The increased oil bill of $21 million represents close to 40 percent of its foreign exchange reserves.

Jamaica also faces major increases in oil costs. The net impact on the Jamaican economy, however, is critically dependent upon the bauxite industry, whose future performance is unknown at this time,

and the tourism industry which is likely to decline.

The remaining Central American countries are in a much stronger reserve position to cope with the increased energy costs.

Brazil

The oil import bill of Brazil is expected to increase from $800 million to over $2 billion. This represents the largest increase and the largest estimated oil import bill of any developing country. Brazil, however, is blessed with a large and diversified industrial sector and a large natural resource base. In addition, Brazil has extremely large reserves, over $6.4 billion in September 1973. Because of the strength of the Brazilian economy, its capacity to borrow in the international market in the short term is very large. Brazil has already indicated that it will absorb much of the increased cost of petroleum without passing it along to the consumer. This move by the Brazilians already reflects an optimistic assessment of their economic position, at least in the short term.

Borderline Countries

A small group of countries which are not major exporters produce most if not all of their own petroleum needs. Included in this group are Argentina, Colombia, Mexico, and Peru. These countries find themselves in a comfortable position, as their relative self-sufficiency may create significant competitive advantages over their neighbors who are net importers.

Malaysia, although not a significant producer of petroleum, still classifies as a borderline country. Given the current strong

market for both tin and rubber, Malaysia is in a relatively strong position and may actually gain from current developments.

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Table 1

COMMODITY PRICE INCREASES

Commodity	Percentage Change in Price 1971 - Third Quarter 1973 1/
Petroleum	+267.0%
Sisal	+244.9%
Cocoa	+170.5%
Rubber	+118.1%
Coconut Oil	+115.2%
Sugar	+112.8%
Cotton	+ 60.2%
Coffee	+ 56.4%
Tin	+ 53.5%
Groundnuts	+ 47.8%
Palm Oil	+ 39.1%
Copper	+ 22.4%
Jute	+ 8.6%
Tea	+ 4.0%

1/ approximate price for January, 1974.

Source: International Financial Statistics

Table 2

LDC Reserves

	July 1973 Reserves (billion $)	Increase in Reserves December 1971 - July 1973	Reserve to Import Ratio a/
DCs	145	35%	.46
LDCs	40.3	73%	.57
LDC non-oil exporters	28.5	80%	.46
Oil exporters b/	11.8	57%	1.30
20 major AID recipients c/	15.1	165%	.74

a/ July 1973 reserves divided by 1972 imports.
b/ Iran, Iraq, Libya, Kuwait, Saudi Arabia, Nigeria, Venezuela
c/ These countries account for over 75% of AID non-SA commitments in 1972-73. Brazil alone accounts for $6.2 billion of these reserves in July 1973.

Source: IMF, International Financial Statistics

Table 3

The LDCs and the Energy Crisis
(US $ billion)

	1973	1974[a]	Change
All LDCs	5.2	13.0	7.8
Oil Importing LDCs[b]			
Asia	1.711	4.151	2.440
Africa	.348	.850	.502
Latin America	1.328	3.290	1.962
Export Earnings			
Non-Arab Oil Exporting[c]			
Asia	1.034	2.473	1.439
Africa	1.881	5.820	3.939
Latin America	3.786	9.981	6.195
Balance of Payments on Current Account			
Oil Exporting Countries	6.1	65.8	+59.7
Less Developed Countries	-10.6	-25.6	-15.0

a/ estimated oil imports or exports using 1973 volume and a 1974 price of 8.50/barrel
b/ 37 oil importing countries
c/ 9 oil exporting countries

Source: AID and IMF

Table 4

Asia

Net Importers

	Estimated Oil Imports 1973 $3.40/barrel	Estimated Oil Imports 1974 $8.50/barrel	Estimated Debt Service 1974	Exports 1972	Reserves July 1973
Bangladesh	37	92	na	432 c/	200
Burma	9	22	23	117	89
India	394	967	550	2,413	1,403 a/
Korea	311	777	332	1,624	919
Malaysia	84	201	87	1,716	1,206
Pakistan	110	267	278	737	460
Philippines	224	520	128	1,105	850
Thailand	211	512	52	1,063	1,287
Turkey	134	332	203	882	1,978
Singapore	152	347	23	2,181	968 b/
Sri Lanka	45	112	48	315	62
Cambodia					
Laos					
Viet Nam					
	1,711	4,151			

Net Exporters

	Estimated Oil Exports 1973 $3.40/barrel	Estimated Oil Exports 1974 $8.50/barrel			
Brunei	139	393	na	149 c/	na
Indonesia	895	2,080	144	1,549	764
	1,034	2,473			

a/ June 1973
b/ December 1972
c/ 1971

Africa

Net Importers

	Estimated Oil Import Bill 1973 $3.40/barrel	Estimated Oil Import Bill 1974 $8.50/barrel	Estimated Debt Service 1974	Exports 1972	Reserves July 1973
Ethiopia	19	48	16	168	181
Ghana	25	62	49	389	183
Ivory Coast	24	58	13	553	100
Kenya	40	104	30	314 a/	300
Liberia	11	27	18	244	na
Malagasy Republic	10	25	10	164	68
Morocco	58	139	102	633	304
Mozambique	22	56	na	180	na
Senegal	46	106	15	215	28
Sierra Leone	10	25	10	118	58
Sudan	41	96	39	357	40
Tanzania	21	53	23	320	150
Zaire	21	51	82	690	145
	348	850			

Net Exporters

	Estimated Oil Exports 1973 $3.40/barrel	Estimated Oil Exports 1974 $8.50/barrel			
Nigeria b/	1,820	5,649	64	2,146	558
Tunesia	61	171	52	311	300
	1,881	5,820			

a/ 1971
b/ World Bank Volume Figures

Net Importers

	Estimated Oil Imports 1973 $3.40/barrel	Estimated Oil Imports 1974 $8.50/barrel	Estimated Debt Service 1974	Exports 1972	Reserves July 1973
Costa Rica	16	37	15	275	31
El Salvador	14	35	11	273	103
Guatemala	26	64	16	290 a/	227
Honduras	12	30	11	206	46
Nicaragua	16	40	21	237	126
Panama	80	203	11	127	932 b/
Jamaica	50	112	24	379	180
Argentina	70	169	512	1,740	817 a/
Brazil	800	2,000	329	3,991	6,158
Chile	147	362	312	962 a/	- c/
Paraguay	6	15	13	86	56
Peru	45	108	174	943	542
Uruguay	46	115	30	197	241
	1,328	3,290			

Net Exporters

	Estimated Oil Exports 1973 $3.40/barrel	Estimated Oil Exports 1973 $8.50/barrel			
Mexico	42	91	517	1,845	1,192
Bolivia	32	90	33	269 a/	68
Colombia d/	-	-	135	743	465
Ecuador	27	75	39	311	197
Venezuela	3,685	9,618	122	3,029	1,847
	3,786	9,981			

a/ 1971
b/ first quarter 1973
c/ No reserve figure for Chile after 1971 available.
d/ It is currently estimated that Colombia will cease crude oil exports by mid-1974.