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Oil and the Poor Countries: A Proposal

by Robert G. Hawkins and Ingo Walter, New York *

One of the more unhappy effects of the recent, massive rise in the price of crude oil has been its impact on those developing countries not fortunate enough to be oil exporters themselves. The authors offer a proposal for rechanneling some of the oil revenues to the impacted developing countries.

Recent estimates indicate that the oil import bill of the developing countries will rise from about US-\$ 5.2 bn in 1973 to about US-\$ 13.4 bn in 1974, assuming that about the same physical volume of oil is imported this year. Such an increase in their payments for oil would represent almost half of the total international reserves of the non-oil-exporting developing countries, or about 50 p.c. of their estimated 1974 total exports — a patently unsustainable amount. They exceed the total official aid flows to the poor countries. And it is a sad coincidence that, just as these higher oil bills come in, the world's major lenders and investors are pulling back from extending credits to some of the neediest among the developing countries. Their debt-service capability is already stretched to the limit, and the risk of default on any new debt is extremely high. Indeed, for some of the developing countries hit hardest by the oil crisis, default on additional external debt is almost a forgone conclusion.

Recent months have seen numerous proposals for rechanneling some of the incremental revenues of the oil exporting countries to the impacted developing countries. But none seems to satisfy the objectives of *both* groups, and at the same time places some of the burden on the advanced, industrial countries which have increasingly shirked their foreign assistance responsibilities to the developing world. We would like to offer a proposal that, in our view, meets these goals in an effective and cooperative way.

Limited Absorptive Capacity

The Arab oil exporters, Iran, and perhaps Venezuela, are currently earning oil revenues at an annual rate which far exceeds their ability to use them in a productive way to finance the import of goods and services for national development.

Quite simply, their absorptive capacity is limited. Yet all are very much concerned about the growth and modernization of their economies in the longer term, and are taking very definite steps to bring this about. Because of the time lag between the petroleum receipts and sensible disbursement for imports of goods and services, these countries must, in the interim, convert the excess revenues into secure, income-earning investments. In this way, the length of time over which they can finance their development needs can be extended into the indefinite future. The form in which the oil exporting countries hold their financial assets is extremely important to them. The yield must be attractive, and the security of the principal against default and other contingencies must be very high.

Preoccupation with this overriding objective does not deny a genuine concern by the oil exporters about the impact of the recent OPEC price action on the present dilemma and future prospects of the less fortunate developing nations. Their commitment of subscriptions to the OPEC Development Fund is a positive indication of this concern. Yet the overall resources allocated to the Fund are meager indeed, even when compared to the increased oil import bill of the developing countries in just *one year*. And the general unwillingness of the OPEC group to consider concessionary prices of oil for developing countries is a strong sign that the first priority of the oil exporters is their own development and long-term self-interest. Thus another mechanism is badly needed for rescuing the less developed countries left in the lurch.

The group of poor nations adversely affected by the recent oil-price change is a highly diverse

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one. Some will find real income per capita declining significantly below the already abysmally low levels. Oil is a major import, and it cannot simply be paid for by increasing exports (already at the limits of supply capability), or passed on to the rest of the world through higher prices of exports (constrained by international competition), or reduced imports (already at minimal levels consistent with prudent development). Countries in the severely-impacted category include India, Bangladesh, Ethiopia, the Philippines, Senegal and Uruguay. Other less developed countries are better able to live with the oil price changes. Their export structures are more able to generate increased earnings, and there is some slack in import needs. These countries include Malaysia, Singapore, South Korea, Taiwan, Colombia and Mexico. Still others — such as Brazil, Pakistan, Thailand and Turkey — fall somewhere in-between. Such diversity in the impact means that any plan designed to help the developing countries must embody considerable flexibility.

The objectives of the adversely-affected developing countries, of course, focus on minimizing the damaging impact of oil prices on growth. This requires imports, and the financial means to acquire them. Otherwise, both income per capita and the rate of growth of output will suffer. The immediate need, therefore, is increased international purchasing power, on an extended basis. The higher petroleum price will surely prevail indefinitely, and its impact on each country's oil-import bill must be considered permanent. The adjustment of each national economy to the new conditions should be made as gradually and as orderly as possible. Yet the adjustment should not be entirely costless, and the impacted developing countries should bear a part of the burden of adapting to the new environment — in order to be economically viable over the longer term. This requires that the surge in the oil bill be liberally financed now, but that the eventual repayment of such financing be expected as well. Thus long-term, manageable loans to ease the adjustment problem appear to be an acceptable (perhaps the only) option for the oil-importing developing countries.

Situation of the Industrial Countries

The advanced countries have fallen far short of the goal, expressed as part of the United Nations Second Development Decade, of 1 p.c. of GNP transferred in the form of loans, investments, and grants to poor nations. They have an oil import problem as well, as the current economic difficulties of the Netherlands, Italy and Japan, and the winter oil crisis in the US bear witness. They will not be nearly as hard-hit as the less developed countries. Their economies are more robust,

their exports and imports are relatively responsive to changing exchange rates, and their capital markets can finance necessary adjustment in a reasonably orderly manner. The reflow of "petrodollars" into the financial markets of some of the major capital markets in the advanced countries is likely to offset the balance-of-payments costs of higher priced oil. Still, they are in no mood to increase outright their foreign assistance to finance the higher oil bills of the developing countries.

The willingness of most advanced countries to support humanitarian development objectives, within reason, has been amply demonstrated over the past two decades. What is needed is a device to permit this, but without the current balance-of-payments or budgetary outlays that most previous proposals require.

Our proposal attempts to draw the diverse objectives of the three groups of nations, outlined above, into a single scheme, and to utilize existing institutions for its implementation — the latter hopefully to enhance its acceptability to those nations which must agree to participate.

Change in the Lending Priorities

The World Bank (International Bank for Reconstruction and Development) would act as the intermediary and administering institution, and would issue a special series of bonds for purchase exclusively by the oil *exporting* countries. The maturity of these bonds would be tailored according to the interests and dictates of the OPEC purchasers. They would carry a "market" rate of interest, perhaps linked to an agreed-upon yield prevailing in a major financial center (the Euro-bond rate on long-term issues of Aaa corporations, for example). The bonds would have an exchange guarantee, so that any risk of exchange-rate variation would fall on the World Bank. The issuance of such bonds — in amounts necessary to finance a major part of the incremental oil-import bills of designated developing countries — would be agreed upon in advance by the OPEC countries, which would consent to share in their purchase according to a predetermined formula, based (for example) upon percentage changes in their international reserves from quarter to quarter. This type of investment might be viewed as the "first call" on excess oil revenues.

The World Bank would use the revenue from the sale of these bonds to make extended-term loans to developing countries, based upon induced changes in their aggregate oil-import bill as the first-priority criterion, and the ability of each country to absorb and adjust to the changed oil

costs. This would require a very definite change in the overall lending priorities of the World Bank and in the criteria for loans, although the funds raised via the special bond issues described above could be channeled through a special account for this purpose. This would permit the traditional lending function and criteria of the World Bank to remain undisturbed.

Contingent Liability Needed

The advanced member-countries of the World Bank would absorb a *contingent liability* for any default or rescheduling of the debt incurred by developing country borrowers under the scheme. The World Bank has a narrow capital base, and must rely on assured repayment of past obligations to retain solvency and reliable sources of funds for additional lending. This proposal would change this procedure, and give precedence to loans to countries most severely impacted – to those *least* likely to be able to repay. Thus, a critical element of the plan is the prior agreement of the industrial countries to absorb the risk of default, or to contribute additional capital to the World Bank in case of defaults or debt reschedulings. This might be undertaken according to a mutually acceptable formula, such as the share of IMF quotas or World Bank capital subscribed by each advanced-country member. Alternatively, the formula might be geared to reflect also the impact of oil price changes on the import bill of the advanced countries.

Whatever the formula, the provision would remove the risk of default from the World Bank (insuring its solvency) and from the oil exporting countries (insuring the safety of their investment). The burden which this transfer places on the advanced industrial countries depends on the probability of default, which will vary greatly among borrowing countries; the discount rate, representing the time-value of money to the guaranteeing countries; and the length of time before default occurs. The higher the discount rate, the longer the time before expected default, and the lower the probability of default, the smaller will be the effective cost to the guaranteeing industrial countries. An important point is that the obligation of the advanced countries is a *contingent liability*, and therefore would not necessitate a *current* governmental appropriation for most of the participants.

The terms at which the loans would be extended to the borrowing developing countries could follow one of two models, depending on the outcome of negotiations to establish the plan.

☐ If it were decided that the loans should be on "hard" terms, the repayment schedules and interest rates would be dictated by the borrowing

costs and terms negotiated between the World Bank and the oil-exporting countries. If this option were adopted, the lending and/or guaranteeing countries would have no obligation to subsidize concessionary interest rates or grace periods. The borrowing countries would have obligations directly corresponding to those of the World Bank.

☐ If the option were chosen to subsidize the borrowing costs of the developing countries under the scheme, a grace period (10 years), low interest rate (3–4 p.c.), and extended maturity (25–30 years) would seem appropriate. But any mismatching of financial inflows of the Bank (via new bond issues), and loan extensions to the borrowing developing countries, as well as the concessionary interest differential, would be the responsibility of the participating industrial countries to defray.

Enhanced Community of Interest

One of the principal advantages of the scheme, as we see it, would be the enhanced community of interest that it would generate between oil-exporting, industrialized and developing countries. All three groups would be forced to work together closely in an international forum to make it work. The oil exporters would provide the money *now* – from funds which they cannot currently use. The developing-country oil importers would obtain desperately needed funds on extended and easy terms. The oil price impact would be cushioned. The industrial countries would guarantee the loans – a contingent liability without current commitment. Both the oil exporters and industrial-country guarantors would thus have a fundamental financial stake in the growth and development of the poor countries. The cooperative spirit could spill over into other areas as well, including traditional development assistance programs and the building of permanent negotiating machinery between oil exporters and importers.

There are, of course, several problems. Are the industrial countries really willing to accept the contingent liability required by the plan? If so, how could they handle it in fiscal terms? Will the oil exporters be willing to invest the required amounts of funds in the guaranteed bonds, and will they trust the guarantees of the industrial powers? Would the poor countries be encouraged to default, since the cost of doing so is limited? If they do, what sanctions may be adopted? The problems are many and intriguing, but not insurmountable. On balance, the plan deserves serious consideration. The alternative to such a plan is for the gap between the advanced and the truly poor countries to widen still further.