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VPD Director, Development Policy   McNamara file

Development Policy
Nov. - Dec. 1974

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819/7/12

VANDERBILT UNIVERSITY

NASHVILLE, TENNESSEE 37203

TELEPHONE (615) 322-7311

Graduate School of Management • 2505 West End Avenue • Direct phone 322-2534

December 20, 1974

IBRD/IDA WBG 819 ARCHIVES

Mr. Robert S. McNamara
President
International Bank for Reconstruction
and Development
1818 H Street, N.W.
Washington, D.C. 20433

Dear Mr. McNamara:

We have initiated a research program concerned with development assistance and project management. To date we have interviewed personnel and examined documents in the IBRD, UNDP, and USAID and have produced several monographs. We intend to continue this effort.

We are seeking financial resources from development assistance agencies because the output of these studies can have a significant impact upon their policies and operations. The results of our research will focus on suggestions for improving project planning and implementation procedures, organizational structures, staff training, and management practices of international assistance agencies and recipient governments.

Although internal review is taking place within the IBRD, UNDP, and USAID, we feel our study will yield valuable results because of our different and broader perspective on issues common to all three organizations. Because we are external to these organizations, we have the potential for greater objectivity and a wider base of information for comparative analysis.

We are enclosing a prospectus describing our research activities in more detail. Two monographs reflecting the results of our initial investigations are available.

We are requesting your advice as to the appropriateness of this effort for funding by International Bank for Reconstruction and Development.

Sincerely,

Dennis A. Rondinelli

Dennis A. Rondinelli
Associate Professor

Raymond Radosevich
Associate Professor

Raymond Radosevich

Enclosure

McN
819/7/11

Mr. Robert S. McNamara, President | December 6, 1974

Ernest Stern, Director, Development Policy

U.S. Recycling Proposal

After Chuck Cooper gets back from the Working Group meeting on the U.S. recycling proposal, he may call you to invite the Bank to attend the next meeting. If he does, we should accept. I had suggested that Carriere attend if the meeting is in Europe, but the U.S. had some doubts about that. Since I will not be here, I suggest we send Wouter Tims if a Washington official is necessary.

cc: Mr. Tims
EStern/ls

bcc: Mr. Chenery

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

Chron

819/7/10

OFFICE MEMORANDUM

TO: President's Council, Department Directors, Regional Chief Economists

DATE: December 6, 1974

FROM: Ernest Stern, Director, Development Policy

SUBJECT: New Financing Mechanisms for Developing Countries

Introduction

1. The increase in the price of oil has led to an increase in capital flows to the developing countries in 1974, including capital from new sources or facilities. The purpose of this note is to provide an overview of the existing mechanisms and to provide as much data as are available about the resources which have become available to the developing countries. In the context of the 1974 balance of payments problem, a separate group of countries has been identified by the UN Secretary General as being the most seriously affected. This group (Table 1) 1/ encompasses the bulk of the population living in countries with a per capita income of less than $200.

2. The data in the attached tables are tentative. First of all, most reporting systems have a considerable time lag so that the established systems have not yet produced 1974 information. Secondly, for some of the new channels of assistance, such as commitments from OPEC members, there is no formal reporting system and information has been compiled by the Bank and by the DAC from a variety of official and unofficial sources. A check of these commitment figures against information available to the recipients is now being attempted, although it is made difficult by the reluctance of both parties to report on these transactions. In the case of the IMF Oil Facility, the amounts shown are the upper limit of resource availability; there is no assurance that these amounts actually will be available to the individual countries.

IMF Resources

3. One of the principal mechanisms which was established in 1974 was the IMF Oil Facility. Members are permitted to draw on the facility in 1974 in amounts determined by a formula based essentially on the additional cost of oil imports. The facility has been financed by special borrowings, amounting to approximately SDR 2.81 million, the bulk of which has been from OPEC members. Drawings on the facility are not automatic but subject to staff and Board review of actual need and adjustment policies.

1/ With the recent addition of Rwanda to the United Nations' MSA List, the group comprises 33 countries.

4. The Fund staff has proposed an extension of the oil facility for 1975 which would be considerably larger. Tables 2 and 3 show, respectively, the maximum access to the oil facility for 1974 and 1975 for the developing countries as a group and for the most seriously affected countries. The figures for 1975 are still preliminary since they represent the current staff proposal which will probably be revised in the course of discussion. Moreover, the figures shown represent the maximum possible access, and actual utilization depends on whether the necessary conditions have been met.

5. Oil facility drawings are repayable in three to seven years, and the interest charge is about 7%, depending on the length of time the drawing is outstanding.

6. In addition to the oil facility, increasing use has been made by the developing countries of the Fund's general account. Countries can draw from the general account, but drawings are limited by quota, based on a careful analysis of proposed adjustment measures and are expected to be repaid in about three years. Table 4 shows the quotas, total amounts outstanding and purchases from all facilities in 1974. Table 5 shows the combined use of resources by MSAs from the Fund's various facilities.

7. The Fund, in September 1974, also established an extended facility on which a member can draw to help resolve a structural problem in his balance of payments which requires a longer period of resolution than is allowed for by drawings from the general account. Resources for the extended facility come from the general resources of the Fund and a country's use of the facility is limited by the Fund quota. Thus a member could draw up to 140% of the Fund quota under this program, (i.e. raising total holdings to 240% of quota), provided total Fund holdings of its currency do not exceed 265%. The drawings can be made available over three-year periods, and repayments are due in four to eight years after each drawing. This facility is highly conditional on specific measures; and while it can provide additional resources to the developing countries, it was not designed to deal with the problem created by rising oil prices.

OPEC

8. OPEC members have made substantial bilateral commitments to the developing countries in 1974. Data on these commitments are collected by P & B from a variety of official and unofficial sources. As of mid-November,

reported commitments meeting ODA criteria, i.e. a 25% grant element, totalled $7.6 billion. Disbursements are likely to be about $2.5 billion. Egypt and Syria account for the bulk of both commitments and disbursements. Table 6 shows reported bilateral commitments from OPEC members to the MSA countries.

9. In addition, OPEC members have made substantial commitments to existing and newly created multilateral agencies and international financial institutions. As already noted, they provided the bulk of the funds for the 1974 IMF Oil Facility. They have lent $2280.9 million to the Bank, consisting of $587.9 million in short term and $1693.0 million in long term loans. They have also contributed to the regional development banks; and have established new multilateral organizations, such as the Arab Fund for Africa. Total reported multilateral commitments are $7.4 billion, of which $2.6 billion are ODA.

UNEO

10. In response to the oil crisis, the United Nations General Assembly established an emergency operation which was launched by the Secretary General on July 31 with an appeal to potential donors to provide additional assistance to those countries most seriously affected by the abrupt change in world economic conditions. The emergency operation is managed by Dr. Raul Prebisch. The objective of the emergency operation is to obtain commitments of additional concessional resources disbursable within a 12-month period to the most seriously affected countries. The funds made available to the United Nations Emergency Operation did not have to be made available directly to the organization but could consist of additional bilateral commitments, provided they were reported. However, in practice it has been difficult to define additionality, both in terms of the resources from the DAC members and from OPEC countries, and to assess how quickly the funds will disburse. Table 7 shows the amount of resources officially reported as being committed to the United Nations Emergency Operation as of November 15. The commitments total $2.8 billion, of which $223 million have been made available directly to the UNEO (Secretary General's Special Account). As far as we know, the bilateral commitments from DAC members and other Western European countries are in addition to commitments to the MSAs in previous years, although they are not necessarily additional to total aid commitments. For the OPEC

countries, the bilateral commitments may duplicate amounts shown in Table 6; however, a number of bilateral commitments reported in Table 6 are not reflected in the UNEO data. In addition, OPEC members have committed $160 million to the Secretary General's Special Account, or about 70% of the total cash resources that are likely to be available to UNEO. Table 8 shows the commitments, receipts, and uses of the UNEO cash account to date.

11. Additional country detail on OPEC commitments can be obtained from P & B; additional details on other aspects of the material can be obtained from the Program Review Division.

TABLE 1

MOST SERIOUSLY AFFECTED and LEAST DEVELOPED COUNTRIES
(figures are 1972 per capita income estimates)

No.	Country	Income
1.	Chad	80
2.	Dahomey	110
3.	Ethiopia	80
4.	Guinea	90
5.	Haiti	130
6.	Laos	130
7.	Lesotho	90
8.	Mali	70
9.	Niger	90
10.	Somalia	80
11.	Sudan	120
12.	Tanzania	120
13.	Upper Volta	70
14.	Yemen, A.R.	90

OTHER MOST SERIOUSLY AFFECTED COUNTRIES

No.	Country	Income
15.	Bangladesh	70
16.	Cameroon	200
17.	Central African Republic	160
18.	El Salvador	340
19.	Ghana	300
20.	Guyana	390
21.	Honduras	320
22.	India	110
23.	Ivory Coast	340
24.	Kenya	170
25.	Khmer Republic	120
26.	Madagascar	140
27.	Mauritania	180
28.	Pakistan	130
29.	Senegal	260
30.	Sierra Leone	190
31.	Sri Lanka	110
32.	Yemen, P.D.R.	100

OTHER LEAST DEVELOPED COUNTRIES

No.	Country	Income
15.	Afghanistan	80
16.	Bhutan*	80
17.	Botswana	240
18.	Burundi	70
19.	Maldives*	100
20.	Nepal	80
21.	Rwanda	60
22.	Sikkim*	80
23.	Uganda	150
24.	Western Somoa	150

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* Not a Bank member

TABLE 2

MAXIMUM ACCESS TO THE IMF OIL FACILITY FOR DEVELOPING COUNTRIES, BY REGION
(million SDRs)

	1974	Proposed 1975
LATIN AMERICA AND CARIBBEAN	1,021.2	1,562.0
of which:		
Argentina	87.5	152.2
Brazil	330.0	550.0
Chile	118.5	159.5
Mexico	137.9	217.7
Peru	41.8	67.1
MIDDLE EAST AND NORTH AFRICA	441.9	730.6
of which:		
Greece	103.5	172.5
Morocco	80.1	89.8
Turkey	113.2	188.7
ASIA	1,553.6	1,855.9
of which:		
Bangladesh	51.5	51.2
India	644.5	671.1
Korea	60.0	100.0
Pakistan	125.0	146.0
Philippines	116.2	193.7
Thailand	100.5	167.5
AFRICA	429.8	466.8
of which:		
Ghana	38.6	40.6
Ivory Coast	39.0	41.7
Kenya	36.0	49.6
Sudan	36.6	32.2
Tanzania	31.5	41.2
Zaire	45.0	42.1
Zambia	37.8	35.4
OTHER	475.1	898.6
of which:		
Portugal	23.7	146.2
Spain	296.2	493.7
Yugoslavia	155.2	258.7
TOTAL	3,921.6	5,513.9

NOTES:

1. Only includes net oil importers. The Middle East and North Africa category includes the following countries: Afghanistan, Israel, Jordan, Lebanon, Morocco, Greece, Turkey, Cyprus, Malta, Yemen A.R., Yemen P.D.R.

2. For 1975 three proposals have been put forward in the Fund. The figures here are based on the middle option which limits access to 85% of the additional 1975 oil import costs or 125% of Quota, whichever is less. The proposal is still under consideration and the figures may well change.

3. The approximate exchange rate is SDR 1 = $1.20.

TABLE 3

MAXIMUM ACCESS TO THE IMF SPECIAL OIL FACILITY FOR MSAs
(million SDRs) /a

	1974	Proposed 1975 /b
TOTAL	1,237.3	1,337.4
Bangladesh	51.5	51.2
Cameroon	15.0	13.2
CAR	3.3	3.1
Chad	2.8	2.6
Dahomey	2.9	3.1
El Salvador	22.8	22.7
Ethiopia	16.9	26.4
Ghana	38.6	40.6
Guinea	7.6	7.4
Guyana	15.0	20.0
Haiti	4.8	5.2
Honduras	18.7	21.1
India	644.5	671.1
Ivory Coast	39.0	41.7
Kenya	36.0	49.6
Khmer Republic	7.9	8.9
Laos	3.5	3.7
Lesotho	1.8	1.6
Madagascar	14.3	15.3
Mali	5.0	4.7
Mauritania	6.7	6.3
Niger	0.3	3.1
Pakistan	125.0	146.0
Senegal	19.8	17.4
Sierra Leone	6.2	6.3
Somalia	1.5	3.7
Sri Lanka	43.5	42.8
Sudan	36.6	32.2
Tanzania	31.5	41.2
Upper Volta	--	3.1
Yemen, A.R.	2.5	6.8
Yemen, P.D.R.	11.8	15.3

a/ The approximate exchange rate is SDR 1 = $1.20.

b/ Three alternatives are put forward in the Fund. The 1975 figures are based on the middle option which limits access to 85% of the additional 1975 oil import costs or 125% of Quota, whichever is less. The proposal is still under consideration, and the figures may well change.

TABLE 4

IMF QUOTAS, NET DRAWINGS TO DATE AND NET DRAWINGS OF DEVELOPING COUNTRIES IN 1974
(million SDRs)

	Quota	Net Drawings or Net Fund Sales of Currency (-) As of Oct. 31, 1974	Net Drawings in 1974	
			Total To October 31	Of Which Oil Facility
EAST AFRICA				
Botswana	5	--	--	--
Burundi	19	--	-1.5	--
Ethiopia	27	--	--	--
Kenya	48	21.2	21.5	9.2
Lesotho	5	0.4	-0.1	--
Madagascar	26	8.5	8.5	3.5
Malawi	15	--	--	--
Mauritius	22	5.5	5.5	--
Rwanda	19	2.1	--	--
Somalia	19	--	--	--
Sudan	72	67.9	23.9	9.4
Swaziland	8	1.2	-0.1	--
Tanzania	42	16.8	16.8	6.3
Uganda	40	21.5	5.0	5.0
Zaire	113	28.2	--	--
Zambia	76	76.0	--	--
Regional Total	556	249.3	79.5	33.4
WESTERN AFRICA				
Cameroon	35	11.5	11.5	4.6
C.A.R.	13	2.5	1.2	0.6
Chad	13	3.9	1.1	1.1
Congo	13	--	--	--
Dahomey	13	--	--	--
Equatorial Guinea	8	1.0	--	--
Gabon	15	--	--	--
Gambia	7	--	--	--
Ghana	87	2.0	-4.0	--
Guinea	24	11.0	5.0	--
Ivory Coast	52	21.9	21.9	11.2
Liberia	29	2.8	-1.0	--
Mali	22	5.5	-1.0	--
Mauritania	13	1.0	--	--
Niger	13	--	--	--
Nigeria	135	--	--	--
Senegal	34	--	--	--
Sierra Leone	25	10.6	10.6	4.3
Togo	15	--	--	--
Upper Volta	13	--	--	--
Regional Total	569	73.7	45.3	21.8
TOTAL AFRICA	1,125	323.0	124.8	55.2

	Quota	Net Drawings or Net Fund Sales of Currency (-) As of Oct. 31, 1974	Net Drawings in 1974	
			Total To October 31	Of Which Oil Facility
EAST ASIA & PACIFIC				
China	550	59.9	--	--
Fiji	13	2.6	2.6	0.3
Indonesia	260	--	-32.3	--
Khmer Republic	25	18.8	--	--
Korea	80	41.0	41.0	21.0
Laos	13	--	-0.5	--
Malaysia	186	--	--	--
Philippines	155	66.6	-48.5	--
Singapore	37	--	--	--
Thailand	134	--	--	--
Vietnam	62	--	--	--
Western Samoa	2	--	--	--
Regional Total	1,517	188.9	-37.7	21.3
SOUTH ASIA				
Bangladesh	125	134.0	70.8	40.4
Burma	60	39.0	9.0	--
India	940	573.2	573.2	200.0
Nepal	12	--	--	--
Pakistan	235	256.9	92.9	97.9
Sri Lanka	98	87.2	8.9	11.0
Regional Total	1,470	1,090.3	754.8	349.3
TOTAL ASIA	2,987	1,279.2	717.1	370.6

	Quota	Net Drawings or Net Fund Sales of Currency (-) As of Oct. 31, 1974	Net Drawings in 1974 Total To October 31	Net Drawings in 1974 Of Which Oil Facility
EMENA				
Afghanistan	37	14.0	-2.3	--
Algeria	130	--	--	--
Bahrain	10	--	--	--
Cyprus	26	6.5	6.5	--
Egypt	188	127.5	31.0	--
Finland	190	-16.2	--	--
Greece	138	70.7	70.7	--
Iceland	23	5.8	5.8	--
Iran	192	-175.0	--	--
Iraq	109	--	--	--
Ireland	121	-11.9	--	--
Israel	130	32.5	32.5	--
Jordan	23	--	-1.6	--
Lebanon	9	--	--	--
Morocco	113	--	--	--
Oman	7	-5.4	-5.4	--
Romania	190	95.0	--	--
Spain	395	-19.9	--	--
Syria	50	28.0	-2.4	--
Tunisia	48	--	--	--
Turkey	151	--	--	--
Yemen, A.R.	10	--	--	--
Yemen, P.D.R.	29	3.7	3.7	--
Yugoslavia	207	84.6	18.2	40.0
Regional Total	2,526	239.9	156.7	40.0
TOTAL EMENA	2,526	239.9	156.7	40.0

	Quota	Net Drawings or Net Fund Sales of Currency (-) As of Oct. 31, 1974	Net Drawings in 1974	
			Total To October 31	Of Which Oil Facility
LATIN AMERICA AND CARIBBEAN				
Argentina	440	164.0	-110.0	--
Bahamas	20	--	--	--
Barbados	13	--	--	--
Bolivia	37	23.2	-3.7	--
Brazil	440	-6.4	--	--
Chile	158	199.5	81.0	41.5
Colombia	157	--	-0.1	--
Costa Rica	32	13.4	5.6	5.4
Dominican Republic	43	--	--	--
Ecuador	33	-1.0	-2.6	--
El Salvador	35	13.1	4.4	4.4
Guatemala	36	--	--	--
Guyana	20	5.6	-0.5	--
Haiti	19	8.5	4.3	1.2
Honduras	25	6.3	6.3	--
Jamaica	53	39.0	12.5	--
Mexico	370	-3.9	--	--
Nicaragua	27	16.8	-2.2	3.3
Panama	36	16.4	15.4	7.4
Paraguay	19	--	--	--
Peru	123	--	-13.6	--
Trinidad & Tobago	63	9.8	-1.5	--
Uruguay	69	52.0	2.6	17.6
Venezuela	330	-89.4	--	--
Regional Total	2,598	466.9	2.1	80.8
TOTAL LAC	2,598	466.9	2.1	80.8
GRAND TOTAL	9,236	2,309.0	1,000.7	546.6

Note: A negative sign means that repayments exceeded drawings in the period January 1-October 31, 1974.

Source: International Financial Statistics.

December 11, 1974.

TABLE 5

MOST SEVERELY AFFECTED COUNTRIES: PURCHASES FROM IMF: JAN - OCT, 1974

	Oil Facility	Other	Total
Bangladesh	40.390	30.403	70.793
Central African Republic	.630	.574	1.204
Chad	1.110	2.800	3.910
Dahomey	---	---	---
Democratic Yemen	---	3.700	3.700
El Salvador	4.400	4.561	8.961
Ethiopia	---	---	---
Ghana	---	---	---
Guinea	---	8.651	8.651
Guyana	---	5.000	5.000
Haiti	1.150	3.700	4.850
Honduras	---	6.250	6.250
India	200.000	373.200	573.200
Ivory Coast	11.170	10.750	21.920
Kenya	9.210	12.300	21.510
Khmer Republic	---	---	---
Laos	---	---	---
Lesotho	---	---	---
Madagascar	3.450	5.032	8.482
Mali	---	---	---
Mauritania	---	---	---
Niger	---	---	---
Pakistan	97.940	15.000	112.940
Senegal	---	---	---
Sierra Leone	4.320	6.234	10.554
Somalia	---	12.900	12.900
Sri Lanka	11.000	17.000	28.000
Sudan	9.410	17.000	26.410
United Republic of Cameroon	4.620	6.897	11.517
United Republic of Tanzania	6.320	10.500	16.820
Upper Volta	---	---	---
Yemen Arab Rep.	---	---	---
SDRs	405.120	552.452	957.572
US$	486.144	662.942	1,149.086

Source: IMF Treasurer's Dept. Operations Div.

TABLE 6

COMMITMENTS OF BILATERAL FINANCIAL ASSISTANCE FROM OIL EXPORTERS TO THE MOST SERIOUSLY AFFECTED COUNTRIES IN 1974
(in US$ millions)

Country	Amount
Bangladesh	137.2
Cameroon	--
Central African Republic	--
Chad	--
Dahomey	--
El Salvador	--
Ethiopia	1.1
Ghana	--
Guinea	1.2
Guyana	35.7
Haiti	--
Honduras	20.0
India	1050.9
Ivory Coast	--
Kenya	--
Khmer Republic	--
Laos	--
Lesotho	--
Madagascar	--
Mali	6.2
Mauritania	169.1
Niger	--
Pakistan	798.7
Senegal	53.5
Sierra Leone	--
Somalia	113.5
Sri Lanka	95.0
Sudan	62.2
Tanzania	--
Upper Volta	--
Yemen, A.R.	67.8
Yemen, P.D.R.	22.9
GRAND TOTAL	2,635.0

Source: IBRD data as of November 20, 1974

TABLE 7

OFFICIALLY REPORTED COMMITMENTS UNDER THE UN EMERGENCY OPERATION AS OF NOVEMBER 15, 1974

(in US$ million)

Donor	Commitment		Assistance		Comments
	Amount	Of which in Grants	Direct	Through UNEO	
Algeria	51	43	31	20	Additional to $107m. contributed to Arab Regional Funds and Af. D.B.
Australia	49	49	49	-	Excludes contribution tc Papua New Guinea.
Canada	101	85	101	-	Excludes contribution to Jamaica.
Denmark	1	1	1	-	Additional to EEC contribution.
EEC	150	150	120	30	First tranche of the qualified commitment of up to $500 million.
Finland	11	0	11	-	
Iceland	.04	-	-	.04	
Iran	1,577	not reported	1,577	20	Our monitoring shows total commitments of $867 million with a grant element of $367 million. Possible untied credit of $400 million to India, but terms not known.
Japan	100	not reported	100	-	Possible additional commitment of up to $100 million.
Kuwait	...	not reported	-	-	Contributed $65 million to Arab Regional Funds and over $500 million bilaterally.
Netherlands	16.35	16.35	-	16.35	Additional to EEC contribution.
New Zealand	9	9	9	-	To FAO fertilizer pool and conditional on others contributing.
Norway	17	17	14.2	2.8	
Saudi Arabia	30	30	-	30	Also contributed $90 million to Arab Regional Funds
Sweden	37	34	26	11	
United Arab Emirates	127	not reported	117	10	Bilateral assistance, largely grants to Sahel countries, Yemen A.R., Tunisia, Syria and Somalia.
United Kingdom	48	19	48	-	Additional to EEC contribution.
Venezuela	100	80	20	80	
Yugoslavia	7	3	3.8	3.2	In local currency.
Arab Funds for Eco. and Social Dev.	72	not reported	72	-	
IDA	150	129[1/]	150		Board approved IDA program credits to India, Sri Lanka and Bangladesh
League of Arab States	121	not reported	121	-	
	2,774.39		2,551	223.39	

1/ Grant equivalent

Source: UNEO Secretariat

PRD/11/15/74

TABLE 8

SECRETARY-GENERAL'S SPECIAL ACCOUNT AS OF NOVEMBER 15, 1974
(in US$ Millions)

A.	Contributors	Commitments in 1974	Receipts to date	Observations
1.	Algeria	20	-	Of which $10 million is earmarked for specified countries
2.	European Community	30	-	
3.	Iceland	.04	.04	
4.	Iran	20		
5.	Netherlands	16.35	6.	
6.	Norway	2.8		
7.	Saudi Arabia	30	30.0	
8.	Sweden	11	11	
9.	United Arab Emirates	10	9.5	$0.5 million earmarked for Honduras
10.	Venezuela	80	30.0	$50 million promised for early 1975
11.	Yugoslavia	3.2		
	TOTAL	223.39	86.7 1/	

1/ Includes receipt of $0.16 interest on deposits.

B.	Recipients	Disbursements Actual	Disbursements Committed	Observations
1.	Bangladesh	7.35 4.95		Covers shipping of cereals granted by EEC.
2.	India		7	Maintaining essential imports.
3.	Mali		2.5	" " "
4.	Central African Rep.		1.0	" " "
5.	Sierra Leone		0.75	" " "
6.	Chad		0.5	" " "
7.	Kenya		1.75	" " "
8.	Malagasy Republic		1.00	" " "
9.	Sri Lanka		2.0	" " "
10.	Tanzania		4.5	For purchase of feed stock for fertilizer plant.
11.	Honduras		1.5	
		12.40 1/	22.50	

Note: Unexpended Balance $86.7- $12.4 = $74.3
Uncommitted Balance $74.3- $22.5 = $51.8

1/ Includes $0.1 other disbursements.

Source: UNEO Secretariat.

Mr. Robert S. McNamara, President — December 5, 1974

Ernest Stern, Director, Development Policy

IBRD/IDA WBG 819 ARCHIVES

819/7/9

<u>CED Discussion on Energy Conservation</u>

Attached is a statement by the CED on energy conservation and a list of participants at a meeting last night to discuss it. The recommendations in the paper seem commonsensical to us, but the CED seemed to be very pleased that it could be this bold. Despite the notables which attended, the discussion was uninteresting. Roy Ash had little to say, Bennett nothing, and the private enterprise representatives went no further than to argue that the price mechanism had to be given free reign.

Attachment
EStern/ls

bcc: Mr. Chenery

Mc N.

FORM NO. 75
(7-73)

ORLD BANK GROUP 819/718

ROUTING SLIP	DATE December 5, 1974

NAME	ROOM NO.
Mr. Stern	E 1243
Chernick	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
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	COMMENT		PER OUR CONVERSATION
	FOR ACTION		PER YOUR REQUEST
	INFORMATION		PREPARE REPLY
	INITIAL		RECOMMENDATION
	NOTE AND FILE		SIGNATURE

REMARKS

I believe this is for you to handle. We would appreciate a copy of your reply. Thanks.

Pls handle directly.

ES

FROM	ROOM NO.	EXTENSION
L. Peter Chatenay	E 823	3643

UNITED NATIONS NATIONS UNIES

POSTAL ADDRESS—ADRESSE POSTALE UNITED NATIONS, N.Y. 10017
CABLE ADDRESS—ADRESSE TELEGRAPHIQUE UNATIONS NEWYORK

REFERENCE: FI 323 741

27 November 1974

Dear Mr. McNamara,

I should like to refer to resolution 3202 (S-VI) of the General Assembly and in particular to section X, paragraph 2 of that resolution concerning the provision of emergency assistance to the most seriously affected developing countries with the aim of maintaining unimpaired essential imports for the duration of the coming twelve months.

You will recall that on 16 August 1974 a questionnaire was distributed to industrial countries and other potential contributors of emergency assistance with a view to obtaining information on the assistance being provided or contemplated to give timely relief to the most seriously affected developing countries.

Information of a general nature drawn from the replies to the above questionnaire was circulated to the meeting of donor countries held on 27 September 1974. Updated information along these lines has also been provided to the General Assembly in the Secretary-General's Report entitled Progress of the United Nations Emergency Operation (A/9828).

It has now become necessary to seek additional information for three main purposes. In the first place it will be recalled that section X, paragraph 6 (b) of the above-mentioned resolution provides for the monitoring of the various measures being taken both bilaterally and multilaterally to assist the most seriously affected countries. Information on such measures would be indispensable in enabling the General Assembly to form a view as to the progress of the Emergency Operation and as to any steps that might be necessary in the light of developments.

.../

Mr. Robert McNamara
President
International Bank for Reconstruction
and Development
1818 H Street, N.W.
Washington, D.C. 20433

Rec'd in IRD
12/4/74

A second reason for the assembling of such information is to provide a factual basis for decisions by each donor agency regarding its own distribution of emergency assistance. Finally, the information is also necessary to provide a basis for distributing resources contributed by the donor countries to the Secretary-General's Special Account.

Accordingly, it would be greatly appreciated if the attached ... questionnaire could be completed and returned so as to reach this office by 1 January 1975.

It is recognized that the definition of "emergency assistance" given in the accompanying text is somewhat complex and that difficulties may be encountered in deciding whether any particular programme is to be regarded as coming within the category of emergency assistance or not. ... There will be found in the Instructions attached to the questionnaire certain explanations that may be found useful in this context.

Yours sincerely,

Raúl Prebisch
Special Representative
of the Secretary-General for
the United Nations Emergency
Operation

... Encls.: a/s

UNITED NATIONS NATIONS UNIES

INSTRUCTIONS FOR COMPLETING QUESTIONNAIRE E.O.2

... 1. The attached questionnaire (E.O.2) is designed to obtain information on emergency assistance provided to the most seriously affected countries under General Assembly Resolution 3202 (S-VI). The information obtained from replies to the questionnaire will be used for monitoring the progress of the Emergency Operation in accordance with section X paragraph 6 (b) of the above-mentioned resolution. The information may also be found useful by bilateral and multilateral donors to the extent that it throws light on the extent of resources made available to individual recipient countries in relation to their assessed needs. The questionnaire is circulated to all industrial countries and other potential contributors.

2. A commitment is a firm obligation by a donor to make resources available in the form of grants or concessionary loans to recipient countries. A disbursement is the placement of resources at the disposal of a recipient country.

3. It is important to emphasize that the attached questionnaire relates solely and exclusively to commitments and disbursements of "emergency assistance" provided by donor agencies and not to their total external aid programmes. Emergency assistance as defined by the above-mentioned resolution of the General Assembly should, in principle:

(a) be scheduled to be disbursed by 30th June 1975;

(b) finance essential imports of the recipient country. In general, project aid is not regarded as "emergency" in character: emergency assistance consists rather of cash, general programme assistance, aid in the form of supplies of essential commodities (including food, fertilizer and fuel) or debt relief;

(c) be provided as grants, but if as loans, on concessional terms;

(d) be "additional" to normal aid programmes in the sense of constituting assistance over and above the amounts that the contributing country would in any case have made available up to 30th June 1975; and

.../

(e) be channelled to the most seriously affected countries provisionally listed by the Secretary-General of the United Nations as per Annex A attached.

4. As regards the degree of concessionality required for loans under paragraph 3 (c) above, International Development Association (IDA) terms (50 years' maturity, 10 years' grace period, 0.75 per cent per annum interest) are preferable. A loan that would not be considered official development assistance may not be recorded as a contribution to the Emergency Operation; official development assistance loans have a grant element of at least 25 per cent at a discount rate of 10 per cent. The following are some examples of loans with a degree of concessionality of about 25 per cent:

Examples	1	2	3	4	5	6
Interest Rate (per cent)	1.75	3.50	4.25	5.75	6.00	6.50
Interval to the first repayment (years)	1	1	3	5	7	8
Maturity (years)	7	10	10	15	15	20

For any of the interest rates shown above, shorter grace periods or maturities would imply a degree of concessionality below the required standard, while longer grace periods and maturities would imply a higher degree of concessionality than the minimum required.

5. The detailed information supplied in questionnaire E.O.2 will be treated in strict confidence. It is however, intended to publish the following data:

- Total contributions and disbursements of each donor agency (bilateral and multilateral) but with no breakdown of individual recipient countries.
- Total receipts of each recipient country (bilateral and multilateral) but with no breakdown of individual bilateral donors.

6. In view of the urgency of this matter, it would be appreciated if the questionnaire could be completed and returned to the United Nations Emergency Operation, United Nations Headquarters, New York, N.Y., by 1 January 1975. If complete data cannot be made available by that time, it would be appreciated if

.../

partial data could be supplied, to be supplemented later as appropriate.

7. It will be noted that some of the information requested in this questionnaire is similar to that requested in the questionnaire sent to agencies on 20 August 1974. Attention is, however, drawn to the fact that the present enquiry seeks an updating of the information previously requested as well as new information on quarterly disbursements. In addition, certain countries have been added to the provisional list of those most seriously affected, and the data supplied should therefore be adjusted accordingly.

EMERGENCY OPERATION

Report to: United Nations Emergency Operation

By:

A. Reporting Agency ____________

B. Exchange rate used ____________

FORM E.O. 2 COMMITMENTS AND DISBURSEMENTS (in $U.S. mil.)

I) Total Commitments to date ____________

- Grants ____________
- Loans ____________
- of which commodity aid (grants and loans) ____________

II) RECIPIENTS

	Committed to Date	Disbursements in 1974 during quarter ending 31/3	30/6	30/9	Intended Amount of Disbursement during year ending 30/6/75
A. U.N. SPECIAL ACCOUNT FOR THE EMERGENCY OPERATION					
B. COUNTRIES OR AGENCIES (specify)					
1.					
2.					
3.					
4.					
5.					
6.					
7.					
8.					
C. UNALLOCATED					
D. TOTAL					

III) Observations[1/]

IV) Name and department of respondent ____________

____________ date form completed ____________

1/ In the case of loans, details should be given on interest rates, first interest dates, and dates of first and last repayment of principal.

UNITED NATIONS NATIONS UNIES

ANNEX A

Provisional list of severely affected countries under General Assembly resolution 3202 (S-VI)

List 1 - countries with a per capita GNP of $200 and below in 1971

Africa	Asia and Middle East	Latin America
Central African Republic	Bangladesh	Haiti
Chad	Democratic Yemen	
Dahomey	India	
Ethiopia	Khmer Republic	
Guinea	Laos	
Kenya	Pakistan	
Lesotho	Sri Lanka	
Madagascar	Yemen	
Mali		
Mauritania		
Niger		
Sierra Leone		
Somalia		
Sudan		
United Republic of Cameroon		
United Republic of Tanzania		
Upper Volta		

List 2 - countries with a per capita GNP of $201 to $400 in 1971

Ghana		El Salvador
Ivory Coast		Guyana
Senegal		Honduras

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

Oil Fac
McN

OFFICE MEMORANDUM

819/7/7

TO: Mr. Robert S. McNamara, President

DATE: November 27, 1974

FROM: E. Stern, Director, Development Policy

CONFIDENTIAL

DECLASSIFIED
JUL 02 2012
WBG ARCHIVES

SUBJECT: Meeting of the Deputies of the Group of Ten

1. As you know, the Group of Ten met on November 20 and 21 in Paris. Attached for your information is the report Mr. Polak made to the IMF Board on his return.

2. The principal proposals on recycling are discussed on Page 3 of the attached. As far as I know, the OECD proposal had been prepared independently of the U.S. proposal, but the two are not basically different. At present, the main difference lies in the fact that the OECD proposal would rely on the BIS to borrow funds and then relend them with a joint guarantee to OECD members, whereas the U.S. proposal envisages a mini-IMF in which a country's drawing capacity would be limited by a quota and the drawings would be financed by calling on the resources of surplus countries up to the limit of their quota. Both proposals seem to envisage a considerable degree of conditionality in regard to conservation policies. As Mr. Polak notes in his report, a composite plan is intended to be ready by the time the Interim Committee meets in January although that is probably optimistic.

3. Although the U.S. willingness to recognize the need for a recycling mechanism is an important step forward, I think it unfortunate that this has to take place at the expense of the IMF. No matter how often it is said that the IMF should play a central role, establishing a facility outside of it which is roughly 2.5 times the proposed size of the 1975 Oil Facility is not consistent with that objective. There is also a risk, it seems to me, that the conditionality of the U.S./OECD proposals regarding conservation will be seen as a confrontation by the OPEC countries. This might be reinforced if they came to believe that the richer countries are moving their financing needs outside the IMF precisely at the time that OPEC countries are getting an increasing share of the decision making power in the IMF through the increase in their quotas.

cc: Messrs. Cargill, Chenery

Attachment
EStern/ls

Record Removal Notice

File Title	Barcode No.
VPD - Director, Development Policy - McNamara File - November-December 1974 - Folder 7	30124196

Document Date	Document Type
November 25, 1974	Statement

Correspondents / Participants

Subject / Title
Statement by the Economic Counselor at Executive Board Meeting 74/149 on Meeting of the Deputies of the Group of Ten, Paris, November 20 and 21, 1974.

Exception(s)
Information Provided by Member Countries or Third Parties in Confidence

Additional Comments

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FORM NO. 75
(7-73)

WORLD BANK GRO P

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	COMMENT		PER OUR CONVERSATION
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	INFORMATION		PREPARE REPLY
	INITIAL		RECOMMENDATION
	NOTE AND FILE		SIGNATURE

REMARKS

Of interest.

FROM	ROOM NO.	EXTENSION
Ernest Stern	E1243	5451

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IBRD/IDA WBG ARCHIVES 819/7/6

THE IMPACT (OF THE OIL PRICE INCREASE) ON THE INTERNATIONAL ECONOMY

John Williamson

University of Warwick

A paper to be discussed at a Brookings Institution Conference on November 18th - 20th, 1974, and included in the volume stemming from the conference.

THE IMPACT ON THE INTERNATIONAL ECONOMY

There is no doubt that the oil price increases of late 1973 have resulted in major changes in payments positions: the size of this impact is reviewed in the first section of this chapter. There is considerably more room for disagreement about the intractability of the problems that these changes pose for the operation of the international economy. A number of the problems that have provoked public discussion are analyzed in the second section of the chapter, which leads to a fairly sanguine assessment of the prospects for the advanced countries. The third section of the chapter considers the responses which international policy has already made, and the further changes which should be made, if the international economy is to adjust successfully to a permanent increase in the price of oil.

1. The Size of the Impact

The increase in the oil revenue of the eleven major oil exporters (hereafter referred to as O.P.E.C.) as a result of the price increases has been estimated as some $70 b. to $75 b. by the I.M.F. and the O.E.C.D. (1)

It can be expected that all the O.P.E.C. members will tend to expand their imports in response to their increased revenue, but the size and speed of this response will vary greatly. At one extreme are Indonesia and Nigeria, where

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(1) I.M.F., Annual Report, 1974, and O.E.C.D., Economic Outlook, July, 1974.

per capita income is low and development possibilities are enormous: hence there is a strong presumption that imports will increase rapidly by enough to prevent large and prolonged reserve accumulation. At the other extreme lie Kuwait, Libya, Qatar, Saudi Arabia, and the United Arab Emirates, where per capita income is high and absorptive capacity is low relative to the size of oil revenue. Although their imports can be expected to expand rapidly in percentage terms, there is no prospect of these countries ceasing to run very large current-account surpluses unless and until the production cutbacks designed to maintain price levels become huge. In between lie Algeria, Iran, Iraq and Venezuela: these are middle-income countries with substantial development possibilities, but oil revenues that are so large that it will be some years before their current-account surpluses can be expected to disappear. In total, O.E.C.D. has assumed that O.P.E.C. imports will increase some 30% more (in volume) than would otherwise have been the case, as a result of the increase in oil revenue, in 1974 [1]

Both the I.M.F. and the O.E.C.D. have published figures for expected current-account positions for 1974. These are shown in the final two columns of Table 1, together with I.M.F. statistics for actual outcomes in the previous two years. By historical standards the reversal of the U.S. deficit in 1973 marked a sudden and sharp change in current-account positions, but the Table demonstrates that the changes between 1972 and 1973 were modest compared to those expected between 1973 and 1974. In fact, it is doubtful whether there have ever before been such abrupt and dramatic changes in current-account positions as those which have resulted from the oil price increase.

Early estimates of future oil revenues were sometimes made by combining the new price levels with the volume projections made prior to the oil price increase. This procedure is clearly erroneous, since it makes no allowance for substitution in production or consumption. It

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(1) Ibid., p.39

TABLE 1

Current balances ($ b)

	1972	1973	1974	1974
U.S.A.	-7.1	3.3		-1
E.C.	9.3	5.9		-19
of which France	1.0	0.5		-6
Germany	2.8	6.6	-28	7
Italy	2.4	-1.3		-9
U.K.	0.7	-2.3		-10
Japan	7.0	0.2		-8
Other developed countries	1.6	2.1		
O.P.E.C.	2.0	4.8	65	
Other L.D.C's	-8.6	-7.9	-20	
Total (errors and asymmetries)	4.2	8.4	17	

Sources Cols. 1 - 3: I.M.F., Annual Report, 1974, Tables 8 - 10, and supporting detail from I.M.F.

Col.4: O.E.C.D., Economic Outlook, July 1974, Table 23; these figures are not entirely consistent with the I.M.F's current balance measure, so the change from 1973 to 1974 should be regarded as only illustrative of orders of magnitude.

now generally believed that the peak O.P.E.C. current-account surplus will not greatly exceed the $65 billions expected in 1974, and that after the peak is reached the surplus will decline fairly rapidly as a joint result of a relative reduction in oil consumption, increased production in non-O.P.E.C. countries, the pressure that excess supply may exert on oil prices, and the rise in imports in the O.P.E.C. members.[1] The financial problems resulting from the oil developments - as opposed to the resource waste involved in exploiting higher-cost sources of energy - can therefore be expected to recede over time.

2. The Problems

(a) National Bankruptcy

It has periodically been suggested that the current level of oil prices is such as to threaten some of the oil-importing countries with "national bankruptcy". The obvious interpretation of this phrase is that the country's net worth has been reduced to zero, i.e. that the whole capital stock becomes directly or indirectly owned by foreigners. In order to examine the probability of such an occurrence, it is appropriate to compare the size of the oil deficit with the size of, and rate of increase in, the capital stock.

The "oil deficit", as correctly conceived and most frequently interpreted, does not refer to the deficit on oil account, but to that deficit minus an allowance to cover exports to oil-exporting countries. In aggregate this allowance is simply total O.P.E.C. imports, which is unambiguous, and yields the expected aggregate oil deficit of some $65 b. for 1974. It is therefore this sum which should be compared to the size of, or increase in, the

(1) *Ibid.*, pp.94 - 6

capital assets of the oil importers. One approach to such a comparison involves assessing the size of financial markets, i.e. the market value of all the financial assets in the oil-importing countries: admittedly this involves some double-counting, but on the other hand it omits some real assets altogether. It has been estimated that the total size of the financial markets of the 7 leading countries alone was over $4,000 billions in 1971; [1] although equity values have fallen sharply since then, other asset values have presumably increased more or less with the nominal growth rate of the economy. The same author has estimated the level of new financial borrowing for the same countries in the same year as some $340 billions. The O.P.E.C. members are therefore in no position to acquire in any year as much as 1½% of the total financial assets in the rest of the world even when their surplus is at its peak, nor as much as 20% of the increment in financial assets. If the O.P.E.C. surplus were to be maintained indefinitely at the same size relative to other economic aggregates as in 1974, the proportion of the financial assets owned by the O.P.E.C. members would approach a limit of under 20% of all financial assets generated in the rest of the world. This may instructively be compared with the 48% of the Argentine capital stock that has been estimated to have been foreign owned in 1914. (2)

In aggregate, therefore, the oil importers face the prospect of losing the title to under 20% of the increment in their capital stock, rather than to a progressive absolute reduction in net worth. It remains possible that there might be some individual countries which face the latter prospect. A relevant comparison for a selected list of countries that have been particularly hard hit by the oil price increase is shown in Table 2. The comparison is biased in the pessimistic direction, since it shows the initial oil deficit and makes no allowance for increased O.P.E.C. imports and since it compares investment in 1972 dollars with an oil deficit measured in

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(1) T.R.Stauffer, "Oil Money and World Money: Conflict or Congruence?", Science, April 1974, pp. 323 - 24.

(2) C.Diaz Alejandro, Essays on the Economic History of the Argentine Republic, 1970, p.30.

TABLE 2

A Comparison of Capital Accumulation and Oil Deficits

	Net Capital Formation,1972 ($b)	Oil Deficit, 1974 ($b)
Denmark	2.7	0.8
Italy	13	5
Japan	57	11
Korea	1.3	0.8
Philippines	0.6	0.6
U.K.	14	5

Sources Col.1 : International Financial Statistics, Aug.1974
Col.2 : O.E.C.D. Economic Outlook, July 1974, pp. 47 - 49; Monthly Foreign Trade Statistics, Republic of Korea, Nov. 1973; Foreign Trade Statistics of the Philippines, 1973; and an estimate of the oil price increase as one of 300%. Note that the "oil deficit" is the initial impact of the oil price increase, i.e. before making any allowance for increased O.P.E.C. imports.

1974 dollars. It will be observed that none of the industrialized countries face the prospect of having to borrow a sum approaching the size of their new investment, but that some of the less developed countries are in a much less happy situation.

Rough as these comparisons are, they suffice to demonstrate conclusively that the prospect of oil deficits alone driving some of the oil importing developed countries to a position of national bankruptcy, in the sense of zero net worth, is non-existent. There is, however, a second - if less dramatic - sense in which the term "national bankruptcy" might be interpreted: namely, a situation in which some oil-importing countries were unable to attract a sufficient capital inflow to finance their oil deficit, and were therefore faced with a liquidity constraint on their ability to pay their import bills. This is a problem which cannot arise for the oil importers in aggregate, since all the important methods by which the OPEC members receive payment involve their acquisition of some form of claim on one or more oil-importing countries. It could, however, arise for individual countries, if the process of financial intermediation needed to enable the OPEC members to acquire their title to an average 10% to 20% of the new investment in the oil-importing countries were to operate in a way which denied adequate access to credit to certain countries. This possibility is discussed, under a less sensational and more appropriate heading, in the next section.

(b) Financing

The question at issue is whether the financial mechanism will be capable of recycling the oil revenues in such a way as to finance a "desirable" set of current account deficits (see 2(d) below) on the part of the oil importers. Failure to achieve this would involve at best a misallocation of resources, and at worst a major slump or acute liquidity shortages.

Oil payments are made almost entirely by countries drawing on their foreign exchange reserves and transferring foreign exchange to the OPEC members: the use of primary reserve assets (gold and SDRs) is minimal and seems likely to remain so, in view of the financial sophistication of the oil exporters and the low interest rate on the SDR. Some countries, principally less-developed countries (LDCs) with close ties to certain OPEC members and industrialized countries which have concluded barter arrangements, have

lines of credit which avoid or reduce the need for transfers of foreign exchange, but these are not large enough to influence significantly the conclusions that come from assuming that all oil payments are made in terms of foreign exchange.

Up to now the principal recycling mechanism has been the Euro-currency market. If an oil importer draws on reserves held in a reserve centre, while the OPEC country places its new reserves in the Euro market, the Euro bank acquires additional funds which can be lent to the oil importers. If public or private-sector borrowers in each oil-importing country borrow funds from the Euro banks equal to the size of each country's oil deficit, and convert these funds into domestic currency, and if the central banks then place their additional reserves in the same way that they held their previous reserves (i.e. in the reserve centre), global reserves will rise by the size of the aggregate oil deficit and oil importers' reserves will remain unchanged. No liquidity problem will arise so long as this process continues.

Since the increased oil payments started, global reserves have risen by SDR 15.4 billions (from SDR 152.8 billions in December 1973 to SDR 168.2 billion in July 1974) while the reserves of 10 principal oil exporters have risen by SDR 15.7 billions.[1] The outcome so far is therefore very close to that which is predicted by the basic model of the recycling process. However, there are a large number of other ways in which the intermediation process could work, and some of these lead to different conclusions.

1. The oil exporters may invest directly in the oil-importing countries, rather than in the Euro-currency markets. Failure to use the Euro market as an intermediary changes nothing essential, although, if the assets acquired do not have the status of reserve assets, global reserves will not expand. The important point, however, is that oil importers' reserves will still remain unchanged, both in aggregate and, to the extent that capital inflows match current deficits, for individual countries.

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(1) International Financial Statistics, Oct. 1974 .

2. The oil exporters may invest their reserves in the issuing country rather than in the Euro market. If the reserve centre were surrounded by an effective exchange-control fence which prevented capital outflows, this would result in the reserves of oil importers (other than the reserve centre) declining by a sum equal to their oil deficit, and world reserves would remain constant. At the other extreme, if there were perfect capital mobility, the decision by the oil exporters as to where to place their funds would make no difference: oil importers which were unable to borrow from the Euro market would simply borrow directly from the reserve centre instead. In between lies reality: because of imperfections in capital mobility, and because the placement of reserves in the reserve centre will provoke monetary contraction by the authorities insofar as these determine their actions in the light of domestic conditions, the result would be a capital outflow which would <u>partially</u> replenish the reserves of the other oil importers.

3. The oil importers may draw down their reserves held in the Euro markets rather than those held in the issuing country. If the oil exporters placed their reserves in the Euro markets, the Euro banks would have no change in the funds available for lending, and hence there would be no change in global reserves and a fall in the reserves of the oil importers. If the oil exporters placed their funds in the issuing country, the lending power of the Euro market and the level of world reserves would decline, and the reserves of the oil importers would decline by twice the size of the oil deficit. Once again, however, such reserve declines in the oil importers would prompt them to borrow more from the reserve centre, with a consequent mitigation of the decline in reserves.

4. Some oil importers - the reserve centres - may pay the oil exporters by issuing additional reserve liabilities rather than by transferring reserve assets. If the oil exporters hold these reserves in the issuing country, the result is the same as in the basic model or varient (1): the reserves of the oil importers remain unchanged. If the OPEC members place the reserves in the Euro markets,

the lending potential of the Euro markets would rise and the reserves of other oil importers would rise also. This effect would tend to be mitigated by a capital flow toward the reserve centres.

5. The borrowers in the oil-importing countries may not convert the entire proceeds into domestic currency. If they continue to hold some of the borrowed funds in the Euro markets, or if they use them to pay those who deposit their funds in the Euro markets, this will give rise to a Euro-currency multiplier in excess of unity. Reserves will not, however, increase as a result of this, since borrowing in the Euro market leads to a reserve increase only when the proceeds are converted into domestic currency. The principal reason that the Euro-dollar multiplier has in the past slightly exceeded unity is that a number of central banks redeposited reserves in the market: this indeed leads to an increase in the level of reserves. This factor implies that any decrease (or increase) in the reserves of the oil importers as a result of the preceeding considerations will be slightly magnified.

The above analysis points to a reasonably clear conclusion. Where the OPEC members place their increased revenues, and where the oil importers draw their reserves from, will have some impact on the ease with which the oil importers can finance their deficits. However, so long as capital is reasonably mobile as between the oil importers, including the reserve centres, there is no real danger of a credit-worthy country that is prepared to borrow facing the prospect of an inability to do so as the consequence of a global liquidity shortage.

There remain a number of crucial questions about the intermediation process. The first is whether all countries will remain sufficiently credit worthy to be able to borrow the sums that they will require. The preceding section showed that oil deficits are substantially less than net capital formation: hence there is no reason for supposing that incurring sufficient debt to cover the oil deficit alone would create an expectation of ultimate default. On the other hand, the superimposition of the oil deficit means

that countries with substantial non-oil deficits must be markedly less credit worthy than would otherwise have been the case.

A second possible source of difficulty that is often mentioned relates to the ability of the Euro market to continue playing the dominant intermediary role. It is feared that the market may collapse, or, less dramatically, that it may be unable to continue expanding at an adequate rate. The danger of collapse would arise only if central banks were unwilling to step in to stem any run that might develop. It is true that the central banks have been hesitant to give assistance to some banks whose unwise activities have got them into trouble, and that this has created difficulties for the smaller Euro banks; but none of the problems so far have threatened to precipitate a cumulative run on the 1931 model, and it is difficult to believe that such a threat would be allowed to develop. A somewhat more real danger is that the market may run into constraints on its expansion. It has, for example, been asserted that the size of the capital base of the Euro banks will soon start discouraging them from accepting new deposits. Obviously such constraints are not absolute: a widening in the spread between borrowing and lending rates would raise the profitability of Euro banking, and hence help attract the equity capital necessary to finance a further expansion in the market. It is equally true that a lowering of the borrowing rate would intensify the pressure on the OPEC members to lend directly to the oil importers rather than use the Euro market as an intermediary: as previously noted, this can provide an equally satisfactory method of recycling.

A third asserted difficulty concerns the danger of a mismatch in maturity preferences. Specifically, the oil exporters like holding short-term assets, while the oil importers would prefer to borrow long. This situation is a classic example of one which the price mechanism can be expected to resolve: short-term rates will

fall, and long-term rates will rise, until the lenders and/or borrowers are induced to modify their preferences by enough to overcome the mismatch in preferences. [1] The process will no doubt be facilitated by the continued enterprise of the international bankers, whose invention of rollover loans and floating rates has gone a long way to satisfy simultaneously the desire of borrowers for an assurance of long-term credit with that of lenders for an avoidance of long-term commitments unaccompanied by indexation.

The sanguine tone of the preceding analysis should not be taken as arguing against the invention of new forms of intermediation, e.g. through an expanded IMF oil facility. It does, however, argue that such developments are not of critical importance, except perhaps for those countries with large non-oil deficits and therefore circumscribed creditworthiness.

(c) Global Demand Management

It has frequently been pointed out that, insofar as the oil revenues are not spent by their OPEC recipients on additional imports, the increase in oil prices will have effects analogous to those of an increased excise tax. These effects are to increase

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(1) Another fear which seems minimal in current circumstances is that such a decline in short-term interest rates will provoke OPEC members into restricting oil production. Such restrictions would be rational only if oil in the ground were expected to be a more profitable investment than paper assets. In view of the near certainty that the relative price of oil will decline in the future unless output constraints are progressively tightened, the present value of oil in the ground is markedly less than its current price, and therefore less than the present value of the financial returns that can be expected from present production even if the real rate of interest on financial assets proves to be slightly negative.

prices (at least in the short run, when the cost inflationary effects are dominant), and to decrease real demand.

OECD has estimated that on average the direct effect of the oil price increase will be to increase prices, as measured by GDP deflators, by 1.5%.[1] This needs to be increased to allow for the effect of the oil price increase in pulling up the price of other fuels in sumpathy, and for the repercussions via the wage-price spiral. The total impact on the price level is therefore likely to be quite sizeable by historical standards, but it can hardly be considered the principal cause of the present global inflation.

The direct deflationary impact on demand stems from the increased saving being undertaken by the oil exporters, and is therefore related to the increase in the OPEC current-account surplus of some $60 b. This direct impact is increased by the usual multiplier effect, which is normally calculated on the assumption that monetary policy is directed to the maintenance of a constant interest rate, and - under any other assumption about monetary policy - is further modified by the monetary repercussions of the tax change. These monetary repercussions depend (in the domestic context) on the use to which the increased tax revenue is put: if it is used to reduce debt, interest rates will fall and stimulate a rise in spending that will partially offset the initial decline in demand, whereas if it is used to reduce the money supply, interest rates will rise and so intensify the initial decline in demand. It is therefore relevant to consider whether in the international case the increased oil revenue will lead to a monetary contraction. The analysis of the previous section implies that while some decline in reserves (and therefore in domestic money supplies, insofar as oil importers do not sterilize but instead follow the traditional rule of linking changes in the money supply to reserve changes) may occur, it is unlikely to be major. Hence

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(1) OECD, op.cit.,p.30

the correct analogy is to an increased excise tax whose proceeds are used to retire debt rather than to reduce the money supply. The increase in oil funds seeking investment outlets will create some offset to the reduction in demand produced by the fall in real income, even in the absence of deliberate reflationary measures.

There is another and, in the long run, considerably more important difference to the case of an excise tax. Excise tax increases rarely (if ever) create large new investment outlets in industries producing close substitutes; the oil price increase undoubtedly has done so. It has been estimated that the additional capital spending in the energy industries of the U.S.A., the E.E.C. and Japan is likely to total something of the order of $200 billions per annum (in 1973 dollars) in the late 1970's.(1) This estimate, which was based on the stated intentions of the governments in question, implies an increase in total capital expenditure of over 50%, and an absolute increase in investment something like three times as large as the increase in the savings of the oil exporters. The medium run prospect would therefore seem to be for a further intensification of demand pressures, even if governments fall short of achieving their targets by a substantial margin.

While there may be a case for some reflationary measures in the short run in order to limit the decline in output that will otherwise occur before investment programs are implemented,(though even that would be disputed by some, in view of the generally excessive pressure of demand and extremely rapid rate of inflation in late 1973), the longer-run need would appear to be for additional measures of restraint in order to free the resources for higher energy investment. Any recession is unlikely to be very deep and will probably be short-lived,

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(1) T.M.Rybczynski, "Capital Requirements for Energy Development in the Main Industrial Countries", paper presented to the British-North American Association, April 1974.

assuming that demand-management policy remains neutral. The question that has been raised by many. and to which the paper now turns, is whether the latter assumption is not over-optimistic.

(d) Current Account Targets

It has often been argued that many oil-importing countries will regard prolonged and substantial current-account deficits as intolerable, and will therefore adopt policies designed to eradicate them. Given the low short-run substitutability between oil and other products, these policies could not significantly curtail the collective oil deficit except insofar as output fell, irrespective of whether the actual policies adopted consisted of deflation, depreciation, or import restrictions. Widespread attempts to eliminate individual oil deficits would therefore lead to competitive payments policies, which would threaten to generate international friction, a contraction of trade, and possibly a major slump.

The danger of competitive payments policies was taken very seriously by the international financial community. For example, the Rome communique of the C-20 Ministers in January 1974 included the initial injunction to "accept the oil deficit" in the following terms: [1]

> "They recognised that ... many (non oil-exporting) countries ... would have to have large current account deficits. In these difficult circumstances the committee agreed that, in managing their international payments, countries must not adopt policies which would merely aggravate the problems of other countries. Accordingly, they stressed the importance of avoiding competitive depreciation and the escalation of restrictions on trade and payments".

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(1) IMF Survey, Jan. 21st 1974, pp. 17, 22.

The danger of competitive payments policies has not materialized so far. The French decision to float was initially regarded as a possible example of a predatory policy, but subsequent French action in using reserves to limit depreciation, and in borrowing substantial sums, allayed this fear. The Rome consensus may have contributed to this welcome result, but it is doubtful whether it is principally a tribute to the success of international co-operation. The fact is that the competitive payments policies of the 1930's were not provoked by a desire for current surpluses per se, but for the employment-creating effect of a current-account surplus: the powerful influences on politicians stem from their internal constituencies, who are concerned about jobs and prices, rather than their external obligations. The strength of international co-operation will therefore be put to the test only if a serious recession does develop. If, as suggested in the previous section, an investment boom in the energy industries leads to greater demand pressures and a further acceleration of inflation, most countries would probably welcome current deficits so long as they can finance them. The 1973 problem of preventing countries exporting inflation by competitive appreciation may recur.

Nevertheless, whichever view about future demand pressures - and therefore of internal motives regarding current balances - proves correct, nothing but good can come from the pursuit of a consistent, rather than an incompatible, set of payments objectives. This therefore raises the question as to how such a set of objectives should be determined, which is another way of asking the question as to what the injunction to "accept the oil deficit" is supposed to mean. Should each oil-importing country aim for an increase in the target current deficit equal to the impact effect of the oil price rise on its payments position, less an allowance - presumably distributed pro rata - for increased OPEC imports? Or should the oil importers agree merely to accept the oil deficit collectively, rather than individually? In that event, how should the collective deficit be distributed? By reference to capital flows, i.e. the geographical pattern of investment chosen by the oil exporters?

Doubtless a rule that each country should accept its individual oil deficit provides a useful short-run guide in a situation where some rule is needed and negotiation of a complex rule requires time, but as a long-run guide it makes no economic sense at all. Consider the case in which the additional savings of the oil exporters exceed the autonomous increase in investment of the oil importers, so that the problem is one of persuading each country to expand more, and accept a bigger current deficit, than would be individually optimal. If the level of employment is to be maintained, the oil-importing countries in aggregate have to reduce savings and/or increase investment by a sum equal to the increased OPEC savings. Each oil-importing country can be expected, in the absence of deliberate policy, to reduce its savings by a sum equal to its propensity to save multiplied by the loss in real income occasioned by the oil price increase, i.e. its (initial) individual oil deficit (before making any allowance for increased OPEC imports) The oil importers in aggregate must then increase investment (or other spending) by the difference between the increased saving of the oil exporters and the reduced saving of the oil importers, in order to avoid deflationary pressure. Clearly economic efficiency requires that this increased investment should be geographically distributed with reference to the productivity of investment, rather than disproportionately located in those countries which suffered the largest cuts in real income (as would be required if countries were expected to accept their individual oil deficits).[1] To take a concrete example, the criterion of individual acceptance of oil deficits would require Canada to increase its current surplus, which is self-evidently absurd in view of the opportunities for profitable energy investment within Canada that have been created by the oil price increase.

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(1) This conclusion has been urged by W.M.Corden and P.Oppenheimer, "Basic Implications of the Rise in Oil Prices", Trade Policy Research Centre, London, August 1974.

The preceding argument concerning the determination of appropriate changes in current-account targets may be expressed algebraically. Define:

ΔR	=	increase in payments for oil
ΔM	=	increase in OPEC imports
D	=	$\Delta R - \Delta M$ = oil deficit
Y	=	real income
S	=	savings
I	=	investment
s	=	propensity to save
T	=	target current-account deficit
i	=	ith oil importer.

Then $\Delta S = D - s\Delta R$ (increased OPEC savings minus decreased ROW savings), and the preservation of "full employment" requires that this be matched by increased invesment, ΔI, among the oil importers in aggregate. In principle this investment should be located where the marginal efficiency of investment is highest. If, as has generally been assumed, the induced increase in energy investment is markedly less than D, it would be plausible to suppose that the increase in investment (or other spending) should be distributed roughly in proportion to GNP, or $\Delta I_i = (Y_i/Y)\ \Delta I$. Hence:

$$\Delta T_i = \Delta I_i - \Delta S_i$$

$$= s\Delta R_i + (Y_i/Y)\left[(1-s)\ \Delta R - \Delta M\right] \text{ on substitution}$$

Thus the target current-account deficit should increase by a sum equal to the individual deficit before allowing for increased OPEC imports (ΔR_i), multiplied by the propensity to save; plus a share proportionate to GNP of the collective deficit, after allowing for increased OPEC imports, and also subtracting that part of the oil deficit which is to be absorbed at the point of impact. (1)

(1) I am indebted to J.Marcus Fleming for suggesting this approach.

The above formula provides a rule by which countries might rationally decide on the extent to which the oil deficit should be absorbed at the point of impact, and the extent to which it should be redistributed. The form of the rule is that which might be appropriate to the case in which OPEC savings rise by more than the autonomous increase in oil-importers' investment. Even in this case, however, the distribution of additional investment in proportion to GNP is somewhat arbitary, and such a rule of thumb is clearly unsatisfactory in the case where investment rises by more than savings. If the induced rise in energy investment proves in fact to be this large - as the study cited in Section 2(c) suggested it will be - it would be empirically easy, as well as conceptually appropriate, to determine the ΔI_i from national plans. (Incidentally, there would seem to be a strong case for charging some group, such as the Energy Co-ordinating Group, with the duty of co-ordinating these national plans. It would essentially be charged with determining the international investment package that would minimize the cost of achieving a given increase in energy output from non-OPEC sources.) The necessary cut in oil-importers' consumption might appropriately be distributed in proportion to GNP. In this case,

$$\Delta T_i = \Delta I_i - (Y_i/Y)(\Delta I - D)$$

The formulae developed in this section might be questioned by some on the grounds that it is inappropriate for countries to develop specific current-account targets: on this view each country should adopt current-account adjustment actions designed to keep the overall balance of payments in equilibrium, i.e. to secure a real transfer to offset any flow of financial capital. This view does not appear very convincing, given the capacity - dramatically illustrated during 1974 - of governments to influence the flow of financial capital. The market - and by this one means in significant measure the portfolio preferences of OPEC members -

cannot be relied on to determine with any great efficiency where additional investment will have the highest real social yield. There is thus no real alternative to governments attempting to determine on rational grounds where additional investment should take place; calculating the current-account implications of this distribution; and then seeking to ensure that capital flows are such as to finance the desirable current-account imbalance.

(e) Disequilibrating Capital Movements

Since the OPEC members are accumulating a large portion of their additional portfolio in highly liquid assets, they will be in a position to switch increasingly massive sums from one currency to another. There are those who see in this ability real dangers - either of the oil exporters making speculative profits, or of them using their financial power to disrupt the economy of the OECD area.

Since the adjustable peg has now been abandoned, the opportunities for unlimited risk-free profits from speculative switching have disappeared. Some economists would argue that, under floating, there is no scope for profitable destablizing speculation.[1] I have elsewhere disputed the proposition that destablizing speculation cannot in principle be profitable,[2] and the model that I constructed would seem more likely to apply where the potential speculators have some monopoly power.[3] Nevertheless, it is difficult to believe

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(1) Cf. M.Friedman, "The Case for Flexible Exchange Rates", in his Essays in Positive Economics, Chicago, 1953.

(2) J.Williamson, "Another Case of Profitable Destabilising Speculation", Journal of International Economics, Feb. 1973

(3) L.D.Price and G.E.Wood, "Another Case of Profitable Destabilisation Speculation: a Note", Journal of International Economics, May 1974

that the danger is very real: if the oil exporters knew enough about the relevant lags and elasticities in the trade flows to exploit the possibilities of making speculative profits, it seems rather unlikely that the central banks of the industrialized countries would be ignorant of such knowledge and thus unable to undertake a highly profitable strategy of stablizing counter-speculation.

The other possibility is that some oil producers might adopt a politically-motivated campaign of economic disruption, even if this was likely to cost them something. The past record of most OPEC members as rather cautious investors does not make this seem particularly probable, and their growing stake in the Western economies - and growing need to avoid provoking thoughts of nationalization - would seem likely to make such disruption increasingly improbable. In addition there remains the residual safeguard provided by the unlimited collective ability of the Western central banks to counter-speculate. There therefore seems little reason for treating the accumulation of liquid assets in OPEC hands as any different to the general growth of mobile liquid assets.

(f) Income Distribution

The preceding sections have considered all those problems raised by the oil price increase which have been asserted to pose major dangers for the functioning of the world economy. With the (important) exception of the difficulty in borrowing faced by those countries whose creditworthiness is in any event somewhat marginal, the discussion suggests a rather complacent conclusion: customary standards of international co-operation, which are not over-demanding, should suffice to prevent anything like a disaster.

If this conclusion is correct, it might suggest that one should puzzle over the question as to why the oil price increase has provoked such apocalyptic expressions of doom. The puzzle is not, however, a very profound one, at least to those who have some sense for political economy, rather than regarding questions of income distribution as extra-scientific and therefore unworthy of recognition. The central fact about the oil price increase is simply that it transferred some $70b. to $75 billions per annum from the consumers to the producers of oil, which transfer is very much a "problem" to the first of these two groups. No one likes to lose income - perhaps especially when it is redistributed to someone else. To some economists it makes matters worse that the redistribution was effected by the exercise of monopolistic power rather than by the play of market forces. However, moral disapproval of the actions responsible for the income transfer scarcely justifies a search for reasons for condemning the transfer as leading to technically unmanageable problems.

Given this diagnosis of the central issue, it may seem surprising that the rich countries, which can relatively easily afford the income loss involved, should have exhibited a far more hostile reaction to the oil price increase than have less-developed countries. An explanation of this paradox might be sought in the markedly differing views in the two groups of countries regarding the legitimacy of the previous income distribution.

Be that as it may, it is clearly relevant to seek to establish some of the basic facts about the impact which the oil price increase has had on the international distribution of income. Table 3 represents an attempt to assemble such information. It will be observed that it is only the Gulf Sheikhdoms that have enjoyed income gains large enough to raise their income markedly above the

TABLE 3

Effects of the Oil Price Increase on the International Distribution of Income

Countries	1971 per capita GNP ($)	Approximate 1974 per capita GNP ($)	Income transfer 1974 ($b)
OPEC			
Kuwait	3860	14,000	+ 6
U.A.E.	3150	40,000	+ 2
Qatar	2370	11,000	+ 1
Libya	1450	5,000	+ 4
Venezuela	1060	2,000	+ 7
Saudi Arabia	540	3,500	+ 14
Iran	450	1,300	+ 11
Iraq	370	1,100	+ 4
Algeria	360	700	+ 2
Nigeria	140	250	+ 4
Indonesia	80	150	+ 3
OECD	3200	4,700	- 53
U.S.A.	5160	6,600	- 13
France	3360	5,200	- 6
Germany	3210	6,400	- 6
U.K.	2430	3,300	- 5
Japan	2130	4,700	- 11
Italy	1860	2,700	- 5
Non OPEC LDCs	60 - 1230	n.a.	- 7

Sources: World Bank Atlas, 1973; OECD, Economic Outlook, July 1974; BP Statistical Review of the World Oil Industry, 1973; E.R.Fried, Energy and U.S.Foreign Policy, Table 14.2; and author's estimates.

general OECD level, and only some 15% of the total income transfer has accrued to them. At the other extreme, some 40% of the increased oil revenue has accrued to countries which are still unambiguously poor by OECD standards. Since close to 90% of the total income loss has been sustained by the OECD countries, it is far from obvious that the overall effect on income distribution can be considered perverse. The worst that can be said is that the effect was capricious; the tragic potential effect on say, the Indian sub-continent, has to be weighed against the benefits accruing to say, Indonesia.

3. The Responses of International Policy

The preceding section was devoted to an analysis of the problems posed to the international economy by the oil price increase. The conclusion reached was that the fundamental issues concerned the "real"problems of resource waste and income distribution, rather than the financial questions on which so much attention has been lavished. This is not to say that the financial issues are unimportant, but rather that - given the maintenance of reasonable standards of international co-operation - they should, with one exception, be capable of satisfactory resolution. Thus the problems confronting demand management policy no doubt require special alertness, and the case for agreement on current account targets is unusually strong; but a perpetuation of the traditional marginal disagreements on these issues does not seem likely to threaten disaster. The one financial problem that was identified as posing a critical danger was the decreased creditworthiness of those countries whose credit is in any event suspect. The situation is really critical where this financial problem reinforces the "real" problems of a loss of real income - whether caused by the inefficiency induced by turning to more expensive energy sources or by income transfer - in countries that are in the weakest position to sustain such a loss, i.e. the poorer of the less-developed countries.

The present section is intended to provide a brief survey of the ways in which these problems have already influenced international economic policies, and some suggestions as to the additional responses that might be looked for in the future.

(a) Financial Intermediation

There were three major policy initiatives addressed to this problem during the first half of 1974. The first was the United States action in abolishing controls over capital outflows. This action had the effect of greatly reducing the importance of OPEC decisions as to where to place their funds, since it meant that a failure by some oil-importing country to attract OPEC investments directly, or through the Euro markets, could be compensated by increased borrowing from the United States. The second initiative was the creation of the IMF "oil facility" following the final meeting of the Committee of Twenty in June. This facility is intended to borrow funds directly from the oil exporters and lend them to those oil importers with a balance of payments need, up to a maximum determined by a formula that takes account of the increased cost of oil imports, the strength of the country's reserve position, ahd the country's Fund quota.[1] This facility is of particular usefulness to those countries faced with problems of creditworthiness. The third initiative was the active solicitation of OPEC investments by the IBRD. This can be expected to benefit principally the more developed LDC's.

The severity of the problems of countries with diminished creditworthiness suggests that there will be a need for additional mechanisms to supplement, and eventually follow, the IMF's oil facility.

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(1) IMF Survey, Sep.16,1974, pp.299 - 301.

There would seem to be two general patterns which such new mechanisms might follow. One would involve the oil exporters taking equity-type investments in the countries involved; this would give the investors protection against unforeseeable changes in the rate of inflation, and an expectation of good returns in the long run, but without adding correspondingly to the host country's medium-term indebtedness and thereby its problems of creditworthiness. Individual investments - whether in the form of direct investments or the purchase of existing equities - would of course be quite risky, but the oil exporters' portfolios are sufficiently large to enable them to cope efficiently with problems of risk by diversification. The second pattern would involve further use of the international financial institutions as financial intermediaries. This serves to reduce the risk of default so far as the OPEC lender is concerned, and perhaps also - given the reluctance of countries to incur the disapproval of the whole international community - the risk of default by the borrower. There are a wide variety of organizational forms which could be utilized: the sale of additional IBRD bonds, the issue of additional SDRs - if these were given a sufficiently high interest rate to make them an appealing investment medium to the oil exporters, the expansion of the oil facility or the creation of some new facility within the Fund.

An important question that would be raised by extensive use of the international institutions as intermediaries concerns the unit in which their liabilities should be denominated. The IBRD still uses national currencies for this purpose, and frequently uses the national currency of the lending country. Given the absence of any balance of payments constraint on the part of many OPEC members, this amounts to giving the lending country the right to write up the value of its assets - and other countries' debts - unilaterally. Irrespective of the confidence one may have that any particular country will not abuse this ability, it seems highly dubious whether the creation

of such temptations is either wise or morally justifiable. The Fund's definition of the SDR in terms of a basket of currencies has the effect of freeing the value of the SDR from the unilateral control of any country, and therefore gives the SDR one important feature of a satisfactory international, inter-temporal unit of account. However, the SDR still suffers from the disadvantage that its purchasing power is eroded by inflation in the countries whose currencies compose the basket. A known rate of inflation could be (though the present rate of inflation has not been) offset by an appropriate rate of interest, but no fixed interest rate can eliminate the risk - to both lenders and borrowers - stemming from unanticipated changes in the rate of inflation. Insofar as both lenders and borrowers are risk averse, both could benefit by the adoption of a unit of account defined in real terms, i.e. by indexation. Apart from objections to indexation on the grounds of its supposed inflationary effects, however, the rapid implementation of any proposal on these lines would not be feasible, for the simple statistical reason that no general index of the price of internationally traded goods is at present in existence.

(b) Adjustment Policy

As noted in Section 2(d), the danger that the oil price increase would stimulate competitive adjustment policies has been taken very seriously by the international community. The C-20's injunction in January 1974 to countries to "accept the oil deficit" was followed in May by the pledge by the members of the OECD that they would refrain from introducing or intensifying import restrictions for a one-year period, and in June by the C-20 agreement that the IMF would sponsor a voluntary "trade pledge", which would bind subscribing members to an obligation to seek Fund approval before intensifying current-account restrictions.

Despite these international agreements, the year 1974 was not entirely free of restrictive policies. The two most important cases were the imposition of a 50% import deposit by Italy, and the raising of indirect taxes on a large number of items with a high import content by Denmark, in May. There are many smaller countries which have also taken restrictive actions. Nevertheless, the central fact is that all the countries involved have had large non-oil deficits which clearly required remedial measures of one kind or another. One may be critical of the particular measures adopted, but not because they were part of a competitive scramble to offload the oil deficit on to other countries.

Nevertheless, the fact that the danger has not yet materialized is no reason for not trying to further strengthen the defences against its realization, especially if one accepts the suggestion in 2(d) that the incentive for competitive policies would be greatly intensified by recession, but not the suggestion in 2(c) that a serious recession is improbable. The obvious measure to secure this strengthening is explicit agreement on a set of consistent current-account targets. The principles which should underlie such an agreement were discussed in 2(d).

(c) International Monetary Reform

When the C-20 decided, in January 1974, to abandon the attempt to write a new monetary constitution for the world, the principal justification given was the uncertainties created by the oil developments. In fact, however, the oil situation was an alibi for, and not a cause of, the abandonment of international monetary reform. The reform effort had failed before the October war set in motion the events that revolutionized the oil market. Why it failed is an interesting question that cannot be pursued here. The extent of failure can be gauged from the facts that the

only agreed aspects of reform, notably the exchange-rate regime envisaged, were patently unworkable, while a wide range of issues of secondary importance, such as the use of objective indicators of the need for adjustment, had provoked doctrinal conflicts that showed no signs of being bridged in the First Outline of Reform published in September 1973.

It is difficult to identify any analytical reason for supposing that the organization of the international monetary system should depend on the price of a particular commodity, even of the most important single commodity entering international trade. Any satisfactory system would need to make provision for the orderly adjustment of current-account positions in response to disturbances; for the channelling of flows of financial capital to areas where investment opportunities exceed local savings; for the elimination of the incentives to disequilibrating capital movements; and for the investment of substantial sums by countries that run prolonged current-account surpluses. These needs were emphasized, but not created, by the oil developments. If some of the C-20 negotiatio s from the industrialized countries failed to appreciate these needs prior to the oil developments, it is they, and not OPEC, who should bear the onus for the failure of the C-20.

(d) Aid

As previously stated, the really critical problem posed by the oil price increase is the loss of real income sustained by the poorer LDCs. The income loss sustained by all LDCs amounts to some $7 b. per annum. It is particularly critical to their prospects because it takes the form of a balance-of-payments deterioration; insofar as the shadow price of foreign exchange exceeds the official exchange rate, the loss is more damaging than is suggested by the figure of $7 b. Furthermore, payments deterioration must undermine

these countries creditworthiness, which will in turn aggravate their payments problem, raise the shadow price of foreign exchange, and further curtail real income. The IBRD has estimated that these effects are likely to prevent any significant growth in per capita income for 800 million people for a decade. (1)

These consequences would be entirely avoided by an increase in grant aid of $7 b. per annum. (If increased aid took the form of loans, rather than grants, but the present value of the grant element amounted to $7 b. per annum, the position of the LDCs would be improved as compared to the status quo ante, on account of the excess of the shadow price of foreign exchange over the official exchange rate. It may be reasonable, however,to ignore this second order effect.)

Experience to date provides little ground for expecting an increase in aid flows of this magnitude. It is true that certain OPEC members - notably Kuwait - have pursued rather generous aid policies in the past; that the bonds of sympathy between OPEC members and LDCs are likely to induce a number of other OPEC members to follow Kuwait's example; and that many of the OPEC members have been earmarking for aid sums which are substantial when measured by the standards used to evaluate Western aid efforts - commitments to LDCs are reported to have reached $15 b. already. (2) But it is also true that most of this aid is being given as project aid through the medium of special Funds, and that disbursements are therefore likely to be subject to long lags. Far more fundamental, however, is the sheer arithmetic involved. Since OPEC is getting over about 10% of its additional revenue from the LDCs, and increased

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(1) World Bank Annual Report, 1974, p.5

(2) Estimates of the US Treasury reported to the US Senate, quoted in IMF Survey, Sept.20, 1974

oil revenue amounts to well over 50% of current GNP on average for the countries that are sufficiently wealthy to be potential aid donors, the complete offsetting of the additional burden on LDCs through increased aid by the OPEC members alone would require aid levels many times higher than those officially proclaimed, let alone achieved, by the West.

Several policy initiatives designed to increase the aid flow have been taken by the international community during 1974. The IBRD has launched a drive to borrow some $2.5 b. per annum from the oil exporters, and had raised some $1.15b. by September 1974. The IMF has launched its oil facility and secured commitments by the oil exporters to lend some $3 b.: although this money is not necessarily earmarked for the developing countries and is not described as aid, the facts are that a substantial proportion of the early loans made were to developing countries, and that the interest rate is concessional. The United Nations launched its Special Fund, designed to relieve the hardest-hit of the LDCs by giving grant aid, following the special session of UNCTAD in April, with a target of $3 b.: to date the sums promised have been only $500m. from the EEC and $150m. from Venezuela.

After adding the project aid from the several development Funds that were set up, or expanded, by the oil exporters, and the credit for oil imports given by certain OPEC members to certain LDCs,(1) these additional resources may well in aggregate come within striking distance of the balance-of-payments cost of the oil price increase. Since most of the additional funds are loans rather than grants, however, this would not offset the LDCs' loss in real income, but merely prevent the effects of that loss being compounded by a worsened balance-of-payments problem. Even that may be unduly

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(1) The source cited in the previous footnote estimated that actual OPEC disbursements up to Sept. 1974, totalled some $3 b., including $0.5 b. in IBRD bonds.

optimistic: increasing indebtedness will still tend to erode creditworthiness, and thereby curtail the scope for foreign borrowing. Moreoever, it seems likely that some of the least-developed countries will fail to attract substantial additional aid from OPEC, so that severe problems would arise from maldistribution of aid even if the aggregate level were adequate.

I have elsewhere[1] suggested that the prospect of securing agreement on how the provision of aid should be shared between the members of OECD's Development Assistance Committee (DAC) on the one hand, and the members of OPEC on the other hand, would be promoted by explicit recognition that it is the "aid burden" - the present value of income sacrificed by the provision of aid - which should be divided between countries on the basis of some indicator of wealth, such as GNP. Such an approach would allow - and indeed encourage - aid donors with strong payments positions but limited income levels, such as most of the OPEC members, to provide a large volume of aid with a limited concessional element. Aid donors with weak payments positions but high income levels, such as most of the traditional DAC donors at the present time, would concentrate on providing a smaller gross aid flow, but with a very high concessional element, to the least-developed countries. Specification of aid obligations along these lines might do something to ensure that the problems caused to the LDCs by the loss of real income are not reinforced by a payments deterioration.

However, the worsening in the already grim prospects for the 800 millions who are the centre of attention in the 1974 IBRD Annual Report will not be reversed without additional aid with a grant element comparable to the initial $7 b. per annum loss in real income. The all too probable failure to achieve this result is not explicable by the absence of possible mutually-advantageous bargains which might be conceived by economic statesmen with sufficient

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(1) "Aid and the Adjustment Process", IMF Survey, forthcoming.

imagination. It is true that the strength of OPEC's short-run position is such that there are no obvious concessions which its members particularly need, and for that reason any bargain with OPEC will be possible only if OPEC leaders feel some interest in objectives beyond material national self-interest. There is, however, reason to suppose that they are already interested in at least two such objectives: international recognition of the legitimacy of their new position, and opportunities for progress by their fellow developing countries who do not have the advantage of possessing oil. If OPEC were prepared to lend its bargaining strength to wresting concessions from the West for the benefit of the non-oil LDCs-in areas of access to export markets, particularly for industrial products; access to capital markets; and an honouring of aid targets - and the West were prepared to bargain, rather than bully, an oil price reduction, there might be scope for agreement. After all, the evidence suggests that the current oil price is too high, not merely from the standpoints of the interests of the oil importers and of global efficiency, but also from the standpoint of maximizing the long-run returns of the oil exporters, even if these maintain an effective cartel.[1] If they are reluctant to admit the truth of this fact, they might nonetheless be willing to agree to pursue their enlightened self-interest as part of a bargain which substantially benefited countries with which they empathize, recognized their changed status in the international economic community, and perhaps called on them to participate in collective enforcement of the obligation to achieve aid targets, e.g. by the imposition of surcharges on the price of oil sold to defaulters.

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(1) This conclusion seems clearly implied by, e.g. the analysis of W.Nordhans, "The Allocation of Energy Resources", Boorkings Papers on Economic Activity, 1973, (3)

To return from the normative to the positive, it seems more likely that the West will continue to believe that it is suffering under a grave injustice which curtails its obligations to the LDCs, that the OPEC members will show no great imagination in their economic diplomacy, and that the least-developed countries will adjust by Malthusian means.

819/7/5

Files November 20, 1974

Ernest Stern, Director, Development Policy CONFIDENTIAL

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WBG ARCHIVES

IMF Board Discussion on the Special Oil Facility

1. The IMF Board started its preliminary discussion of the proposed 1975 oil facility on Monday morning and continued throughout the afternoon. The morning speakers focussed on the staff papers submitted, but after lunch the U.S. Executive Director expanded on Mr. Simon's speech of that morning, and the rest of the speakers were much influenced by this new development. At the end of the meeting, the Managing Director concluded that there was adequate support for pushing ahead. The staff would prepare a revised proposal in light of the comments made, and a number of the issues raised would have to be explored in further detail.

2. There was general support for the oil facility, including its size, the interest subsidy proposal, the open-endedness of the facility for 1975 and the diversification of the source of the funds, including IMF market borrowing. All of the speakers from the developing countries supported the facility and all stressed that the revised formula, which puts greater emphasis on the adjustments countries have made rather than the absolute amount of the oil import bill, was unfair to the developing countries since it left them with less resources out of an expanded facility than they had obtained in 1974. They also stressed the desirability of diversifying the source of funds, particularly through borrowing from developed countries which might be in balance of payments surplus. A number of them pointed out that while the subsidy scheme was desirable for the lower income countries, it was more important to be able to obtain large volumes of capital even if that meant paying market rates of interest.

3. The statements of the Part I countries were more mixed. Although in general they supported the Fund facility, they noted that the Fund should not have a monopoly on the recycling and that other mechanisms might well have to be established. The U.K.'s statement was perhaps the most representative of this approach. Mr. Rawlinson stressed the central role of the IMF, noted that there continued to be a need for inter-governmental arrangements for recycling, and noted that his Government was rather more optomistic on the capacity of the private sector since there was now the evidence that the number of banks participating in the

recycling was expanding. While the IMF should continue to play a central role in the recycling process, the Fund facility should not be seen as a monopoly. The Kissinger proposals were a useful supplement which the U.K. was considering sympathetically.

4. The U.S. statement was an expansion on the Simon speech which had been delivered earlier in the day. The U.S. Executive Director noted that recycling did not address the real problem, which was the high price of oil. A real solution required a reduction of the OPEC surpluses, and this could only be brought about by concerted consumer action on conservation. The U.S. had announced its program to save one million barrels a day. If others joined and the total were to reach three million barrels a day, this would save $17 billion in 1975. Because of the prospect of such substantial changes, the U.S. disagreed with the staff estimates of 1975 requirements. Mr. Simon had said at the Annual Meeting that the U.S. would support new facilities to recycle funds when these were needed. The present decision implied no change from that.

5. The proposal to establish a $25 billion oil facility in the OECD should be seen as a safety net in case the other elements of the international system failed. The center of the international system was the IMF which had global responsibility for managing balance of payments adjustments, but IMF lending should be related to total balance of payments requirements and not just the oil deficit. Calculations of requirements which are based on oil imports only, take no account of adjustments in other parts of the balance of payments, such as a country's capacity to increase exports to OPEC. If the regular IMF facilities are unduly constrained by the quota system, it would be possible to suspend, temporarily, the quota limitations. In order to obtain the resources which might be necessary, the IMF could utilize the general resources now available more effectively; and increase the quotas. The U.S. would support a 25% increase in quotas. It might then be possible to avoid any need for borrowing. Obviously, the MSAs were a special problem and a trust fund should be established for them which "hopefully" would receive contributions which might enable it to lend at moderately long maturities and at an interest rate of 2-4%, perhaps subsidized by some of the profits of IMF gold sales.

6. The loan facility for major industrialized countries associated with the OECD would supplement the IMF system. Lending would be on market-related terms. The new facility was not intended to replace the IMF, but because of its magnitude and because of the terms and conditions which would be appropriate for the use of its resources, it might not be desirable to have it as part of the IMF.

7. France strongly supported the proposed 1975 oil facility. It complained that the staff papers do not provide an analysis of the overall capital flows, likely prospects for the different financial channels and longer term estimates of the size of the problem. The Fund should not be seen as a residual financier of requirements. The British Chancellor of the Exchequer had suggested that the Fund facility should be expanded considerably so that it could play a central role in the recycling. The present proposal fell short of this.

cc: Messrs. McNamara
Knapp o/r
Cargill
Chenery
Fowler

EStern/ls

CONSEJO NACIONAL DE PLANIFICACION
Y COORDINACION ECONOMICA

C.I.

SAN SALVADOR, 18 DE NOVIEMBRE DE 1974.

SEÑOR ROBERT S. MCNAMARA,
PRESIDENTE DEL BANCO MUNDIAL
1818 H. STREET, N. W.
WASHINGTON D. C., 20433
U. S. A.

ESTIMADO SEÑOR MCNAMARA:

TENGO EL AGRADO DE DIRIGIR A USTED LA PRESENTE PARA SALUDARLO Y AL MISMO TIEMPO COMUNICARLE LOS NOMBRAMIENTOS, TANTO DEL DOCTOR VICENTE AMADO GAVIDIA HIDALGO, EN CONCEPTO DE ASOCIADO ANTE EL COMITÉ CONJUNTO MINISTERIAL DE LOS GOBERNADORES DEL BANCO Y EL FONDO MONETARIO SOBRE TRANSFERENCIA DE RECURSOS REALES A LOS PAÍSES EN DESARROLLO (COMITÉ DE DESARROLLO) (JOINT MINISTERIAL COMMITTEE OF THE BOARD OF GOVERNORS OF THE BANK AND THE MONETARY FUND ON THE TRANSFER OF REAL RESOURCES TO DEVELOPING COUNTRIES (DEVELOPMENT COMMITTEE)), COMO EL SUSCRITO EN CARÁCTER DE ASOCIADO SUPLENTE.

AL HACER DEL CONOCIMIENTO DE USTED LO ANTERIOR, ME COMPLACE APROVECHAR LA OPORTUNIDAD PARA EXPRESARLE LOS SENTIMIENTOS DE MI MAYOR CONSIDERACIÓN Y APRECIO.

ATILIO VIÉYTEZ,
SECRETARIO EJECUTIVO.-

Note: Original sent to IBRD Secretary's Dept. for filing on 12/4/74.

IBRD LANGUAGE SERVICES DIVISION	
CONTROL NO. E-677/75	DATE: December 3, 1974
ORIGINAL LANGUAGE: Spanish (El Salvador)	
DEPT. Office of V.P. Dev. Policy	TRANSLATOR: JHH:jmcl

PRESIDENCY OF THE REPUBLIC OF EL SALVADOR

November 18, 1974

National Council for Planning and
Economic Coordination

Mr. Robert S. McNamara
President, World Bank
1818 H Street, N.W.
Washington, D.C. 20433
USA

Dear Mr. McNamara:

I have the honor to present my compliments and to inform you of the appointments of Dr. Vicente Amado Gavidia Hidalgo as member and of myself as alternate member of the Joint Ministerial Committee of the Board of Governors of the Bank and the Monetary Fund on the Transfer of Real Resources to Developing Countries (Development Committee).

I remain,

Yours very truly,

(signed)

Atilio Viéytez,
Executive Secretary

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

819/7/4

TO: Mr. Robert S. McNamara, President DATE: November 18, 1974

FROM: Ernest Stern, Director, Development Policy

SUBJECT: Commitments Under the UN Emergency Operation

1. The status of officially reported commitments under the UN Emergency Operation (Table I) is little changed from the last report on October 15, 1974. Some minor corrections to earlier reported amounts and the addition of the IDA credit of $50 million to Bangladesh have raised the total of reported commitments by $54 million to $2,774 million as of November 15, 1974.

11/19

2. There has been no change in the amount of commitments to be channelled through the Secretary-General's Special Account (Table II) since October 15, 1974. However, the receipts of the Special Account rose by $57 million to $87 million. Of this sum, about $12 million has already been disbursed and $22 million committed.

3. Since commitments to the UN Emergency Operation appear to have reached a plateau, I propose to send you the next status report two months hence, unless there are significant changes in the interim.

Attachments

cc: President's Council

SChernick:ls

Table I

C[illegible]cially Reported Commitments Un[illegible]r the
UN Emergency Operation
As of November 15, 1974

Donor	Commitment Amount	Commitment Of Which in Grants	Assistance Direct	Assistance Through UNEO	Comments
	(in mlns. of US$)				
Algeria	51	43	31	20	Additional to $107m. contributed to Arab Regional Funds and Af. D.B.
Australia	49	49	49	-	Excludes contribution tc Papua New Guinea.
Canada	101	85	101	-	Excludes contribution to Jamaica.
Denmark	1	1	1	-	Additional to EEC contribution.
EEC	150	150	120	30	First tranche of the qualified commitment of up to $500 million.
Finland	11	0	11	-	
Iceland	.04	-	-	.04	
Iran	1,577	not reported	1,577	20	Our monitoring shows total commitments of $867 million with a grant element of $367 million. Possible untied credit of $400 million to India, but terms not known.
Japan	100	not reported	100	-	Possible additional commitment of up to $100 million.
Kuwait	...	not reported	-	-	Contributed $65 million to Arab Regional Funds and over $500 million bilaterally.
Netherlands	16.35	16.35	-	16.35	Additional to EEC contribution.
New Zealand	9	9	9	-	To FAO fertilizer pool and conditional on others contributing.
Norway	17	17	14.2	2.8	
Saudi Arabia	30	30	-	30	Also contributed $90 million to Arab Regional Funds
Sweden	37	34	26	11	
United Arab Emirates	127	not reported	117	10	Bilateral assistance, largely grants to Sahel countries, Yemen A.R., Tunisia, Syria and Somalia.
United Kingdom	48	19	48	-	Additional to EEC contribution.
Venezuela	100	80	20	80	
Yugoslavia	7	3	3.8	3.2	In local currency.
Arab Funds for Eco. and Social Dev.	72	not reported	72	-	
IDA	150	129 1/	150		Board approved IDA program credits to India, Sri Lanka and Bangladesh
League of Arab States	121	not reported	121	-	
	2,774.39		2,551	223.39	

1/ Grant equivalent
Source: UNEO Secretariat

PRD/11/15/74

Table II

Secretary-General's Special Account as of November 15, 1974

(in US$ millions)

A.	Contributors	Commitments in 1974	Receipts to date	Observations
1.	Algeria	20	-	Of which $10 million is earmarked for specified countries.
2.	European Community	30	-	
3.	Iceland	.04	.04	
4.	Iran	20		
5.	Netherlands	16.35	6	
6.	Norway	2.8		
7.	Saudi Arabia	30	30	
8.	Sweden	11.41	11.41	
9.	United Arab Emirates	10	10	$0.5 million earmarked for Honduras.
10.	Venezuela	80	30.5	$50 million promised for early 1975.
11.	Yugoslavia	3.2		In local currency.
	TOTAL	223.80	87.45	

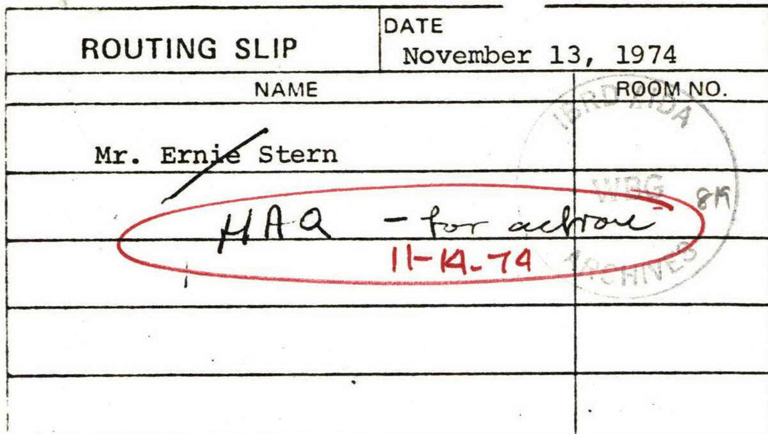
B.	Recipients	Actual Disburse-ments	Committed	Observations
1.	Bangladesh	7.4		Covers shipping of cereals granted by EEC.
		5.0		For purchases of rice imports.
2.	India		7	Maintaining essential imports - largely food and fertilizer. (items 2–9)
3.	Mali		2.5	
4.	Central African Rep.		1.0	
5.	Sierra Leone		0.75	
6.	Chad		0.5	
7.	Kenya		1.75	
8.	Malagasy Republic		1.00	
9.	Sri Lanka		2.0	
10.	Tanzania		4.5	For purchase of feed stock for fertilizer plant.
11.	Honduras		1.5	Hurricane relief.
	TOTAL	12.40	22.50	

Note: Unexpended Balance $87.45 - $12.4 = $75.05
Uncommitted Balance $75.05 - $22.5 = $53.55

Source: UNEO Secretariat.

FORM NO. 75
(7-73)

WORLD BANK GROUP



ROUTING SLIP	DATE November 13, 1974

NAME	ROOM NO.
Mr. Ernie Stern	
HAQ - for action 11-14-74	

x	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	COMMENT		PER OUR CONVERSATION
	FOR ACTION		PER YOUR REQUEST
	INFORMATION		PREPARE REPLY
	INITIAL		RECOMMENDATION
	NOTE AND FILE		SIGNATURE

REMARKS

Would you, or someone in your shop, please write an appropriate reply on behalf of Mr. McNamara ("Mr. McNamara has asked me to thank you for your letter and to say...").

Kindly forward a copy of the reply for my RMcN Correspondence Files.

Thank you.

FROM	ROOM NO.	EXTENSION
John L. Maddux	E843	2449

819/7/3

24, RUE ROTHSCHILD CH 1202 GENÈVE
TÉLÉPHONE (022) 31 59 40 C.C.P. 12-593
BIBLIOTHÈQUE 32 13 98

Institut d'études du développement

IDA WBG 819 ARCHIVES

November 4, 1974

Mr. Robert McNamara
President
International Bank for Reconstruction and Development
1818 H Street, N.W.
Washington, D.C. 20433

Dear Sir,

I am writing to you personally since you are now so closely identified with the tremendous reappraisal of international development strategies which is now shaking the world of "developers". At present, I am involved in an effort to propagate the ideas as you have outlined them mainly in your speeches in Santiago de Chili, Washington and Nairobi. The paper which is attached is a summary of those speeches which I am presenting at three different Congresses this month. The most important one of these will bring together members of our Institute of Development Studies in Geneva and the responsible heads of the European Development Fund in Brussels.

I consider it to be of vital interest to work towards a new strategy along the lines outlined in your speeches. These ideas should be more widely known and lead to serious debate in various circles, with the aim of getting research started on various aspects of implementation

Of course you must be aware that there is a lot of scepticism about the feasibility of the proposed strategy, notably with regard to its political aspects. The main argument is that no significant change can occur as long as the present elites remain in power in the Third World (some of these points are mentioned on p. 12 of the paper). Therefore, the question of practical implementation takes priority in thepresent discussion.

We have set up a small working group at the Institute to propagate new ideas on development strategy and to study problems of implementation. Unfortunately, our means are very limited and we had to restrict our action to Switzerland so far. Two very precise questions now arise:

1) Is there any possibility for us to have access to detailed information on ways and means envisaged for the implementation of the new objectives ?

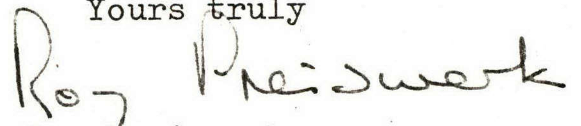
educ & health & RD papers will be published

2) Would it be in any way possible for the World Bank Group to give limited financial support to our working group in order to enable it to devote more time to this endeavor and to extend the scope of the project, while at the same time giving it a wider audience in Europe ? (Our working languages are French, German and English) This is only a preliminary enquiry to find out whether the principle of such a project is acceptable according to your rules.

I am enclosing a brochure of the Institute which gives an idea of the teaching programme. It should be added that the working group I have mentioned does not so far include an economist ! Of course, there are some economists on the staff, but our group was formed with anthropologists, sociologists, political scientists and psychologists preoccupied with the implications, for the Third World, of predominant theories on development among economists. It is clear to us, however, that in the event of external financia assistance and a consequent expansion of our programme, we would have to include at least one economist with a potential to accept new ideas.

I seriously hope that some kind of cooperation between our two institutions along the lines indicated above will materialize.

Yours truly



Roy Preiswerk
Professor at the Institute of Development Studies
Professor at the Graduate Institute of of International Studies
Geneva, Switzerland

McN
819/7/2

November 8, 1974

Dear Jerry:

Thank you for your letter of October 2 on the MIT Industrial Liaison Program. As you point out, our staff has had many contacts with MIT. Moreover, since these have been valuable to us, I am sure that they will continue and, hopefully, will be of mutual benefit. We have seriously considered whether there would be advantage in formalizing these contacts through the establishment of an ILP liaison officer, but, in view of their varied nature, have come to the conclusion that it would be better to continue the relationship as it is. Nevertheless, I wish you every success with the program.

Sincerely,

(Signed) Robert S. McNamara

Robert S. McNamara

Mr. Jerome B. Wiesner
President
Massachusetts Institute of Technology
Cambridge, Mass. 02139

cc: for Mr. McNamara's Office (2)
Mr. Stern ✓
Mr. van der Tak
Mr. Weiss
Mrs. Hughes

BBKing:gm

November 7, 1974

HBC

Seems to me McN would be interested in this.

(8)

OCT 29 1974

Already sent? No, original attached.

IBRD/IDA WBG ARCHIVES

INTERNATIONAL DEVELOPMENT ASSOCIATION INTERNATIONAL FINANCE CORPORATION INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT
ASSOCIATION

INTERNATIONAL FINANCE
CORPORATION

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McN
819/7/1

OFFICE MEMORANDUM

IBRD / IDA
819
ARCHIVES

TO: Mr. Robert S. McNamara, President

DATE: November 5, 1974

FROM: Hollis B. Chenery, VP, Development Policy

SUBJECT: Mankind at the Turning Point--The Second Report to the Club of Rome

As you requested, I attach a summary and evaluation of the Pestel-Mesarovic volume. It suffers from sloppy analysis, a gross error in the calcuations, and a naive presentation of the results. In summary, the final product is not much of an improvement over the seminar that we attended.

cc: Messrs. W. Clark
E. Stern

HBchenery:gss

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

Mr. Stern

OFFICE MEMORANDUM

TO: Mr. Hollis B. Chenery

DATE: October 23, 1974

FROM: John H. Duloy

SUBJECT: Mankind at the Turning Point -- The Second Report to the Club of Rome

1. The first report to the Club of Rome, Limits to Growth, was based on the simple proposition that exponential growth rates collide with finite resources. It lead to the simple and unacceptable conclusion that it is necessary to reduce growth rates across the board. The study was mechanistic, simplistic and pessimistic. Although it cannot be taken seriously as a piece of analysis, Limits to Growth had an impact on opinion, particularly in the industrialized countries. It contained a simple idea simply presented.

2. The second report, Mankind at the Turning Point by Mesarovic and Pestel, is more ambitious. The world is disaggregated into 10 regions, and the book examines a number of issues and related policy options -- aid flows, population, energy and food. The basic viewpoint of the authors is supportive of the cause of developing countries. While the book will doubtless be widely publicized, I believe that it will not have much impact -- there is not much new in the book, the presentation is not always clear, and the analysis underlying it is seriously deficient.

(i) Population

3. The population component of the study, although detailed and disaggregated, in some respects reaches extremely pessimistic conclusions largely due to model misspecification. It repeats the basic error of Limits to Growth (and many other population projections) of taking birth rates as purely policy variables unaffected by economic development, while allowing undernourishment to increase death rates. This formulation guarantees catastrophe. Given the misspecification of food production conditions discussed below, the only escape is through "deliberate population policy." Mesarovic and Pestel completely ignore the possibility that fertility might decline with development, thus exaggerating the need for direct control through unspecified government action. Nor would modelling the "demographic transition" make much difference in their model given the misspecification of food production which makes development almost impossible.

(ii) Food

4. The analysis of prospects for food production concentrates on South Asia. The results in the text are alarming: by 2025 South Asia will require annual grain imports of 500 million tons or there will occur massive deaths among children (500 million up to 2025) or massive aid to South Asia (600 billion 1973 dollars up to 2020) will be required. It is

also stated that a policy of diverting investment from industry to agriculture within South Asia will give only short-run relief: this policy leads to disaster by 2025, with the regional gross product being about one half of what it would otherwise have been.

5. I have examined in some detail the characteristics of the model which lead to these results, as a partial test of the model's specification and estimation. To do this, it was necessary to go to the background documentation; information needed to evaluate the study is not contained in the book itself. The manner in which increases in food production is modelled is both unrealistic and pessimistic. For example, the level of investment for the development of land in agriculture (irrigation, clearing and the like) is a policy variable. The cost per hectare of land developed is computed within the model. This cost increases from 1975 to 1979 by a factor in excess of one billion! 1/ The effect of this is that land development virtually ceases by 1979, food production expands slowly due to additional fertilizer, but vast resources are absorbed by the land development sink. It is because of this peculiarity of the model that the diversion of investment funds towards agriculture actually worsens the food situation, as well as halving gross regional product. In summary, the model contains a gross error in its specification of agricultural production relations. This means that the results on food production, population (death rates are linked to food availability), the impact of aid flows, and regional product growth rates are without foundation.

6. This should not be taken to suggest that the prospects for food production in the face of rapid population increases in South Asia are otherwise than deeply disturbing. On the contrary, my own view is that this is perhaps the major emerging problem area. But the treatment of the problem in Mesarovic and Pestel illuminates neither the dimensions of the problem nor likely solutions to it.

1/ Land is either "developed" or "undeveloped," with land development being a once-and-for-all process (over a 50 year time horizon!). In the case of South Asia, it is assumed that, in 1975, 94% of land is already "developed." The next step in the chain is a relationship between the capital costs of land development per hectare and the fraction of land remaining for development. The relationship included in the model specifies very steeply increasing costs for low fractions remaining, and it bears little or no resemblance to empirical observations. The combined effect of these various errors is that the cost per hectare of developing land increases by 1979 to 1.39 billion times its 1975 level; and about 250 billion 1963 dollars are spent over 50 years to produce about a two percent increase in the area of land which is "developed"!

(iii) Energy and Oil

7. The other major issue addressed by Mesarovic and Pestel is energy and oil. I have not yet examined the technical background papers on this component of the study, relying only on the material presented in the text. The major conclusion drawn is the need for a cooperative strategy among oil-producing and oil-consuming regions and that this strategy offers all parties better conditions than conflict strategies. Once again, however, the analysis is mechanistic and deficient. The major weakness is in the treatment of substitution possibilities -- both in terms of growth paths using less energy in total and direct substitution among energy sources. Equally important is the fact that the grouping of countries is not such as to permit an analysis of the effects upon the most severely affected developing countries -- the Middle East only exports oil, while Nigeria is included with the rest of Africa, Indonesia with the rest of Asia, and Venezuela with the rest of Latin America.

8. The most preferred strategy is defined in terms of the benefits (or costs) accruing to the Middle East and the industrialized countries. Mesarovic and Pestel are naive in considering that this strategy is acceptable in any real sense: it leads to the accumulation by the oil producers of between about 7 and 14 percent of the industrialized countries' total capital stock by 2025! Further, they do not appear to have taken into account the disposition of the earning streams from this stock and their impact upon the relevant regional products and external balances. The mechanism appears to be some variety of costless accumulative recycling!

9. Overall, the model system is not suitable for its intended purpose -- the analysis of policy changes. For such an analysis, it is necessary to include within the system the changes which come about by the usual mechanisms of adaptation, including changes in prices and in technologies. If the objectives call for more radical changes than can be accommodated in the above way then deliberate policy intervention may be needed. Putting all the burden upon the latter and none upon the normal capacity to adjust grossly overstates the realm of international policy intervention. Finally, the study concentrates on global or international policy choices. But if we are concerned with food availabilities, poverty, and fertility rates, intra national and redistributive policies are of crucial importance.

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