European Communities

EUROPEAN PARLIAMENT

Working Documents

1982-1983

15 February 1983 DOCUMENT 1-1197/82

REPORT

drawn up on behalf of the Committee on Economic and Monetary Affairs

on the recycling of Petrodollars

Rapporteur : Mr. J. PURVIS

PE 80.462/fin

English Edition

On 12 January 1981 a motion for a resolution (Doc. 1-779/80) on the creation of a European financial instrument for recycling petrodollars to increase and diversify world energy supplies was referred to the Committee on Economic and Monetary Affairs as the committee responsible, and to the Committees on Energy and Research, and on Development and Cooperation for their opinions.

On 19 March 1981 the Committee on Economic and Monetary Affairs appointed Mr. J. Purvis as rapporteur. It considered the draft report at its meetings on 23 - 24 November, 30 November - 1 December 1982 and 24 - 25 January 1983, and adopted it on the latter date by a unanimous vote with 5 abstentions.

PARTICIPATED IN THE VOTE

Mr Moreau, chairman; Mr Hopper, vice-chairman; Mr Purvis, rapporteur; Mr Beazley; Mr von Bismarck; Mr Bonaccini; Mr Caborn; Mr Carossino (deputizing for Mr Fernandez); Mr Franz; Mr Leonardi; Mr Nordmann; Mr Nyborg; Mr Papantoniou; Mr Rogalla (deputizing for Mr Walter); Mr Rogers; Mr Seal (deputizing for Mr Schwarzenberg).

The opinions of the Committee on Energy and Research and the Committee on Development and Cooperation are attached.

CONTENTS

Page

The Committee on Economic and Monetary Affairs hereby submits to the European Parliament the following Motion for a Resolution together with Explanatory Statement

MOTION FOR A RESOLUTION

on the recycling of petrodollars

The European Parliament,

- having regard to the Motion for a Resolution tabled by Mr Muller-Herman, and others (Doc. 1-799/80),
- having further regard to the Motion for a Resolution tabled by Mr Sayn-Wittgenstein (Doc. 1-498/82) and to Parliament's previously adopted resolution on trade relations between the EEC and the Gulf States,
- having regard to the report of the Committee on Economic and Monetary Affairs and the opinions of the Committee on Energy and Research and of the Committee on Development and Cooperation (Doc. 1-1197/82),

Considering that -

a) inflation in the industrialised countries and the resulting massive increases in energy costs have dealt a severe blow to growth prospects in both the developed and developing world;

b) a substantial number of the least developed countries are in a critical financial condition with dire effects on the well-being of their peoples and the stability of the world;

c) even though there has been a substantial adjustment to and recycling of financial resources, these have not reached those countries most in need and on terms they can accommodate;

d) there is an obvious need for more rational use of the world's finite energy resources through more efficient use and conservation, and the development of alternative and renewable energy sources, thus necessitating considerable investment in both the industrialised and less developed countries;

(e) a lack of adequately evaluated projects, in the less developed countries, is a major problem, and this is further exacerbated by a shortage of skilled technical and managerial people;

(f) another problem is the reduced investment capacity of the private sector in all the Member States and the excessive public sector borrowing which prevent the European Community from honouring its obligations to the developing countries;

(g) the commercial banking and financial industries world-wide have provided an effective means of recycling oil derived financial surpluses from the oil surplus countries to the industrialised, newly industrialised and the best few of the developing countries but have been unable to support the needs of the less developed countries within the parameters of normal financial prudence;

(h) the supranational organisations (IMF, IBRD, IDA, UN) have made a considerable effort to meet the problem of imbalance in world financial and investment flows but are constrained by

- the sheer scale of the problem especially in the least developed countries

- the concern they must maintain for the interests of their depositors and fund providers

- the inability of many countries to bring forward, manage and administer viable schemes

- the prime concern of the traditional fund providers (the industrialised countries of Europe and North America) to set their own economies and finances to rights, thus restricting their ability to provide adequate funding on appropriate terms

- the unwillingness of the founding controlling countries to admit newly industrialised countries and oil surplus countries to their rightful say and thus discouraging greater contributions from them;

(i) the predominant position of the US dollar in world trade and finance, exposes all development and economic policies to the full effects of American economic and monetary policy, whose prime concern is the domestic American scene and its own political and economic priorities, rather than concern for the world scene;

(j) the interests of the European Community are much more closely aligned and intertwined, than American interests, with the oil producing and developing countries;

Resolves that -

1. The European Community has a responsibility to its own inhabitants and the rest of the world to play its full part in easing the flows of necessary investment resources to mitigating the effects of energy prices on its own economy and that of the developing world.

2. The first concern must be to restore equilibrium in the European economy itself in that this could be the necessary power house in terms of trade, aid and investment to promote growth in the developing world as well.

3. The European Community, and other industrialised countries, have an obligation to continue and reinforce existing policies aimed towards reducing demand for non-renewable energies so as to ease pressure on prices for the less developed countries as well.

4. **The European Community should promote and develop close formalised relationships with (a) the oil surplus countries, and (b) the oil surplus countries and less developed countries together, with the purpose of discussing, defining and monitoring the mechanisms necessary to achieve an improved mobilisation of available resources.**

5. The conditions necessary for the introduction of the ECU as a common currency for the European Community representing the strength of the EEC's economy as a whole must be created as soon as possible.so that it can provide a credible alternative to the US dollar in trade commodity pricing (including oil) and investment flows on a world scale.

6. Such influence can be exercised in particular, in the direction of changing existing voting rights and influence in ways that ensure a better representation of the interests, of less developed countries, newly industrialised countries and the oil surplus States.

7. While welcoming the agreement in principle by the Group of Ten to increase substantially the resources of the IMF in order to help it meet the threat to the World Monetary System caused by the indebtedness of certain developing and Eastern European countries, calls on the Community, the Member States and commercial banks concerned to ensure this is followed up in concrete terms and reinforced by a firm commitment to uphold stability in the Monetary System.

8. The European Community should act as one in the councils of the IMF, IBRD, IDA and other supranational agencies, in line with its perception of the political and economic priorities in the world, and thereby exert much more positive influence than its Member States do at present.

9. Artificial, and probably counter-productive, mechanisms such as a Community oil-purchasing agency, index-linked Community guaranteed bonds to attract oil surplus funds and fixed prices for oil are unsuitable as a means of achieving the desired improvement in movements of capital and in the world financial markets.

10. The Community jointly with a grouping of oil surplus countries should consider establishing with the requisite equity capital, a jointly owned affiliate of the European Investment Bank and Arab equivalent (eg Arab Development Bank) to specialise in the financing of energy-related investments in Europe, the Middle East and the less developed countries, including in particular global loans for the support of small-scale appropriate technology schemes in non-oil-producing developing countries, and that substantial interest rate abatements should be available from the EEC budget and/or OSC country budgets where appropriate.

11. Priority should be given in the Community for -

- an integrated natural gas grid linking all Europe to supplies from the North Sea (Norwegian and British Northern sectors), North Africa, Middle East and USSR with the Southern North Sea fields (UK and Netherlands) incorporated as reservoirs
- nuclear power and uranium supply
- alternative and renewable energies
- coal-field development, infrastructure and technology
- a community electricity grid, cogeneration and CHP schemes
- research into new industrial technologies
- transport infrastructure.

12. Priority should be given in the Less Developed Countries for -

- agriculture, food production and primary crop processing
- administration and management training
- exploiting even small-scale indigenous energy resources.

13. Priority should be given in the Oil Surplus Countries for -

- energy resource maximalisation
- adding value to energy resources
- social and transport infrastructure
- investment management skills.

14. The less developed countries must be able to justify assistance and investment at least to the extent of providing the environment necessary to give a reasonable assurance of success, including -

- adequate administrative machinery at central and local government levels
- assuring reasonable returns to outside investors, lenders patent holders, etc.

- giving top priority to self-sufficiency in food, energy and provision of essential infrastructural services, especially education
- encouraging enterprise by their own inhabitants and avoiding grandiose schemes and projects which are either unnecessary for the country's development or divert available human and financial resources from other more necessary projects.

15. The Community, if possible jointly with the Oil Surplus Countries should set up a task force to identify worthwhile large scale and infrastructural projects in (a) the less developed countries (b) the oil surplus countries and (c) the EEC itself, to which resources (both human and financial) should be directed and which will most readily achieve the priority objectives.

16. The Community should promote a preliminary scientific study of potential energy resources in the seas and unexplored land areas of the world, to be followed by more detailed study where justified, the results of which can be sold to commercial exploitation companies or governments as appropriate.

17. Calls on the Commission to implement the recommendations detailed above and to report to the European Parliament and Council of Ministers within 9 months on the steps taken or proposed to be taken pursuant to this resolution.

18. Asks its President to forward this resolution to the President of the EEC Commission, President in Office of the Council of Ministers, the Joint Chairman of the EEC/ACP Parliamentary Assembly, the Council for cooperation of the Gulf States, the Presidents of OPEC, IMF and IBRD.

B

EXPLANATORY STATEMENT

I. ACKNOWLEDGEMENTS

1. The rapporteur would like to express his appreciation to the representatives of OPEC, OPEC Fund, the IMF, IBRD (World Bank), European Investment Bank, the EEC Commission, the Federal Reserve Bank in Washington, commercial international banks and other authorities, for the time and trouble they took to provide information and discuss the various options. This report would have had precious little validity without all this help and advice. If it were not for constraints of time and money, further consultations might well have been beneficial. Although in this report and the attached motion for a resolution, the case is as fully argued as possible, it is to be hoped that it will also prompt further discussion so that the EEC institutions can take what action they deem advisable on the best reasoned basis possible.

2. Opinions were sought and received from the European Parliament's Committees on Energy and Research (1), regarding the energy aspects, and on Development and Cooperation (2), regarding the particular needs and problems of the less developed countries. These opinions are most comprehensive and useful and have been taken into full account in the preparation of this explanatory statement (and the motion for resolution). The rapporteur would like to thank the draftsmen of these opinions (Mr. Muller-Herman and Mr. Fuchs) for their valuable contributions.

---

(1) PE 76.961

(2) PE 77.871

II. THE PROBLEM

3. Recycling of world liquidity is not a new problem. It has existed wherever one economic entity has amassed over any significant period of time an undue proportion of the world's monetary assets. The depression of the 1930's is often ascribed to the USA's positive balance of payments and its sterilisation in the form of increasing gold reserves. The post World War II period was characterised by the Americans 'recycling' their amassed reserves first by the Marshall Plan, followed by many years of deficit financing. In this way the dollar shortage of the 1940s became the dollar glut of the 1960s and 1970s. Nevertheless the availability of these resources in the world financial markets provided the wherewithal for the growth of those decades.

4. With the Vietnam war the extent of these US dollar balances was expanded so enormously, that the convertibility of the US dollar into gold at the fixed price of $35 had to be abandoned and the purchasing power of US dollars held by foreigners was impaired by the resulting inflation.

5. This particularly affected the oil exporting countries who reacted by forming a cartel (OPEC) to safeguard their interests. The method chosen was to force increases in the export price of their oil to compensate for the devaluation of the currency they received in exchange.

6. Although this action was precipitated by the Arab-Israel war of 1973, it is quite probable that some such action would have been taken anyway for reasons of commercial interest.

7. In the era of cheap and cheapening oil supplies, the industrialised countries (ICs) had naturally became more and more

reliant on this cheap source of primary energy to the discounting of other sources of energy and energy conservation.

8. The 'first oil price shock' of 1973 therefore shook the ICs into a greater awareness of their economic and political dependence on oil and OPEC oil in particular. The process towards diversification of sources of supply and towards greater energy efficiency was set in train, though such a process involves an inevitable time lag, which is still working through 10 years later.

9. Another result of this 'shock' was the sudden accrual of financial resources to the oil exporting countries and away from the importers. It was to take time for these resources to find their way back into the world's financial arteries in the form of consumption of industrial products or investment. The time lag in the event was only about 4 years before the 'surpluses' had been redistributed, equilibrium (albeit on an altered plane) regained and the temptation for another 'shock' attempt arose.

10. The 'second oil price shock' duly occurred in 1979 and the IC economies, just having adjusted to the first, were again squeezed. The cumulative result is best evidenced in the growth of unemployment and much reduced rate of economic growth. And this in spite of significant shifts in the relationship between economic growth and the increase in energy consumption.

11. If the effect was serious for the ICs, it was all the more so for the LDCs and in particular the oil-importing LDCs. They were hit by the reduction in demand for their raw material exports by the depressed ICs and by the financial drain resulting from the massive increase in their oil import costs, which was all the more serious in that any economic growth in such basic economics required a relatively high extra demand for energy.

12. A particularly grievous effect for the LDCs arose from the world monetary situation brought on by the shift of liquid resources from the ICs to the oil surplus countries (OSCs). The ICs (and especially the USA in that the dollar is the main vehicle for international trade and investment) were forced to bid up for money in the hands of the OSCs. Interest rates paid, and therefore charged, on deposits and loans had to match the rate of inflation plus enough to provide an attractive real rate of return to investors. As the inflation rate was itself induced by large energy cost increases, the heavily indebted LDCs were hit both ways - higher energy costs and escalating costs of servicing their debt. And all this impacted them inevitably as the demand and price for their exports were reduced by recession in the ICs - a recession induced by the same forces.

13. So while the ICs could, to some degree, protect themselves from the direct consequences because of their diversified economic bases and ability to impose rectifying economic policies, the LDCs were not so able - even if politically and administratively they had been willing.

14. Even so, the OPEC countries were again net borrowers, taken as a whole, by the third quarter of 1981. The lag was less than 3 years, but within this overall picture there are certain countries (notably Saudi Arabia and Kuwait) who are still running in surplus and who have, in the meantime, amassed foreign assets amounting to about $250 billion as well as undertaking massive domestic investment programmes.

15. The weakness in early 1982 of the oil market and the current (July 1982) disarray in OPEC, if this continues for any appreciable length of time, will no doubt help to rectify the imbalances from the oil producing to the oil consuming economies. Perhaps the fundamental adjustments that have been made to energy consumption propensities in the ICs will hasten and even exaggerate such a shift. But the question remains as to whether

we will not remain exposed to volatility in the factors of production of which energy costs are now an important element, and whether the available mechanisms are sufficient to deal with such movements without burdening both the ICs and LDCs with very difficult problems of managing their economies and the resulting effects on employment, indebtedness, standards of living and development.

16. The critical problems facing the ICs are -

a) dependence on imported energy, especially oil and the need to diversify energy resources
b) restoring dynamic growth so as to satisfy aspirations regarding standard of living and employment
c) resisting tendencies to protectionism and a breakdown in the open world trading environment
d) preserving stable political and economic conditions at home and in the LDCs.

17. The critical problems facing the LDCs are -

a) dependence on imported energy and the need to develop appropriate indigenous resources
b) promoting self-sufficiency in food supplies at least
c) securing remunerative markets for basic raw material exports
d) indebtedness and its cost
e) internal political and economic stability
f) balance of payments difficulties and the resulting problem of paying for essential imports (eg spare parts, consumer goods)
g) improving administrative efficiency and effectiveness.

18. The critical problems facing OSCs are -

a) preserving cohesion of OPEC and value of oil resources
b) preserving value of financial resources
c) avoiding unwelcome political implications of international monetary system
d) no substantial alternative to US dollar for investment and trade
e) avoiding political and social complications of their citizens' sudden massive wealth.

III. SOLUTIONS

(i) Existing Mechanisms

19. The commercial banking and financial system has taken up most of the strain in recycling world liquidity. The growth in the euro-currency (and related asian-currency) markets is an indication of the scale. From beginnings in the 1950s, and increasing growth in the 1960s and 1970s, the estimated amounts involved now are about $700 billion net. This growth is closely related to the extent of the ICs (and particularly USA's) growing deficits in that they represent US dollars and other convertible currencies in the ownership of foreigners and the depreciation in real terms of those currencies.

20. This market is very flexible in that it can deal with anything from money at very short notice to long term loans.

21. It can also achieve a certain transformation of such resources from shorter to longer term and from lower to higher risk situations.

22. However, there are obviously limits in that the institutions concerned have to give their own solvency the highest priority. While seeking the extra profit available from such transformation, this has to be consistent with the principles of financial prudence.

23. Throughout the history of the euro-currency markets, there has been concern whether the whole pyramidical edifice was stable. These concerns have been accentuated more recently by the doubts over whether the ultimate debtors, often heavily borrowed LDCs are in a position to service the accumulated debt. The effect of default by any such borrower or group of borrowers and the possible 'domino' sequence that might follow are certainly worrying. But as yet no such irremedial event has occurred.

24. Being by definition extra-territorial, the euro-currency markets are not readily susceptible to effective government supervision, control or rescue. This is in fact the reason they have been so effective as they have been in the recycling process and could continue to be so. It may also be the reason that no irreversible disasters have so far taken place.

25. But it is also arguable that -

a) the situation is potentially explosive given the necessary conjuncture of circumstances and that therefore some form of international 'fire fighting force' should be in readiness

b) the recycling benefits have necessarily been restricted and, in particular, have accrued to the ICs, the newly industrialised countries (NICs) and only the strongest of the LDCs

c) that therefore the weaker LDCs are falling further and further behind with the resulting implications, not only for themselves and their inhabitants, but also for world political and economic stability.

26. In ther aftermath of World War II, certain world-wide institutions were established. Preeminent amongst these are the International Bank for Reconstruction and Development (IBRD or World Bank) and the International Monetary Fund (IMF) both based in Washington, D:C: The IBRD has now turned its attention from the highly successful 'reconstruction' of a devastated Europe to the 'development' of the third world. Directly and through specialised offshoots such as the International Development Agency (IDA), it provides grants, loans, project advice and management to LDCs. The IMF is concerned primarily with balance of payments problems. Often its financial support is accompanied by conditions on economic and monetary management which supports the political will of the country concerned to take unpalatable steps.

27. Although these bodies have undoubtedly played a major role in mitigating effects of the oil price shocks in both the ICs and LDs, criticism is levelled against them on various counts -

a) Domination of their policies by the USA by its rights as principal financial supporter.

b) Unwillingness of USA and European participants to acknowledge changed and changing facts of world financial power by permitting greater role for OSCs, especially Saudi Arabia and Kuwait.

c) Conditionality attached to financial assistance. Such conditionality may consist of economic, administrative and/or management requirements being attached to loans or grants. They may involve secondment of "experts" to monitor, supervise or even control certain aspects of the recipient country's affairs. This can therefore arouse sensitivities connected with concepts of national political and economic sovereignty.

d) The donor countries, especially the USA, are restricting the resources available to these organisations and demanding stiffer conditions as part of their own harder economic policies borne of a conservative reaction to the difficulties of their own economies. They do not seem to appreciate how much worse off are the LDCs and that such an approach can only worsen the situation and prospects of the whole world economy.

28. The responses to these criticisms are as follows -

a) The USA is by far the biggest provider of resources (75% - 80%) and can therefore expect to have the dominant say. Otherwise it would not be prepared to continue such support and her withdrawal would be disastrous for the recipient countries. The IMF and IBRD have therefore to give major consideration to their providers of resources. However, power is related to long term capital rather than shorter term deposits. The result is a lack of short term deposits which could be a way of encouraging OSCs to start using IMF as an intermediary.

b) Quotas, and the concomitant voting powers, were established in the very different circumstances of 1946. It is often countries like the UK and France who are most insistent on the status quo in order to maintain their perogatives. A qualified majority of 85% is required for critical votes, so the USA can dominate. But 4 other main quota holders (UK, Germany, France, Japan) do not let USA get isolated and these 5 countries effectively run IMF. They elect the managing director, who appoints his deputies, who in turn appoint senior staff. The IBRD also needs capital restructuring, especially to give Japan a role commensurate with its current status. The EEC countries could be determinant in improving attractiveness of both organisations to other potential creditor countries. This applies to their own attitudes and the pressure they could exert on the USA for a change (or evolution) of their capital and voting structures. Subject to <u>basic</u> safeguards for the