Global Payments Problems

The Outlook for 1981

Since late in 1978, oil prices have risen sharply and the major oil-exporting countries have again amassed large financial surpluses. Correspondingly large deficits have been contracted by oil-consuming nations. With political tensions in the world's major oil-producing region at a new high, the questions of how large these deficits and surpluses may become and how long they can persist have taken on renewed urgency This article reviews recent developments and considers the 1981 outlook for international payments of the Organization of Petroleum Exporting Countries (OPEC) members and the non-OPEC developing countries[1] The industrial country members of the Organization for Economic Cooperation and Development (OECD) also face serious problems. But, except for a couple of the least developed OECD members, the central problem is to reduce oil demand with minimum adverse effects on employment and inflation rather than how to finance the oil imports Less developed countries (LDCs), too, must adjust to higher oil prices, but these adjustments at best take time With their often limited capacity to adjust and limited sources of external funds, many LDCs find that their external financing constraint quickly binds The forced adjustment that then results tends to be more costly than necessary.

The combined current account of members of OPEC grew from near balance in 1978 to a surplus of over $110 billion by 1980 (Chart 1). Most of this increase was against the OECD member countries. The OECD accounts for nearly 90 percent of the world's oil imports, and by 1980 its aggregate current account had deteriorated to an estimated deficit of over $75 billion from a surplus of under $10 billion in 1978. Meanwhile, the combined deficit of non-OPEC developing countries widened from about $25 billion to over $50 billion.

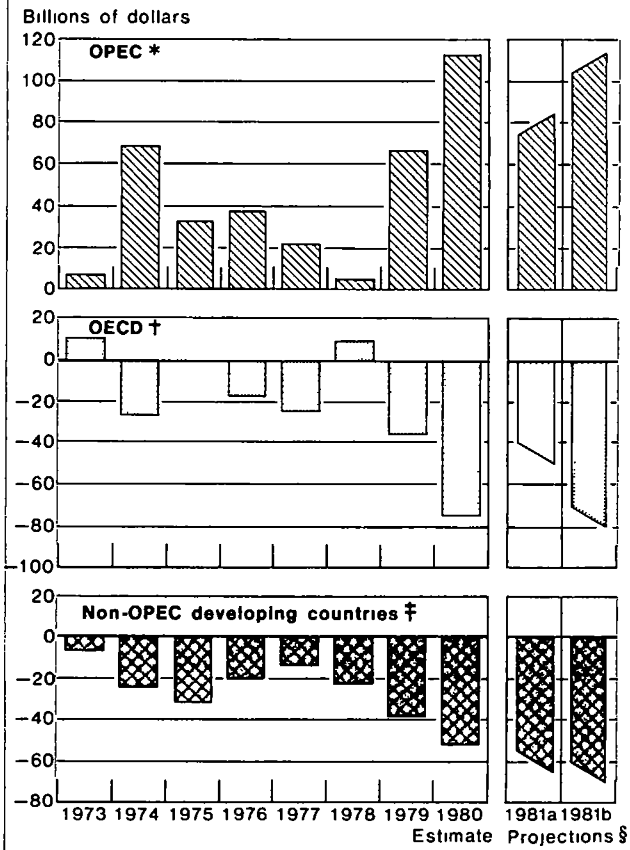
The outlook for 1981 is critically dependent on very uncertain oil prices, so that two different price scenarios are considered If the recent Iran-Iraq supply interruptions are overcome early in 1981, an increase in the oil price at least in line with inflation in industrial countries is likely. A 12 percent OPEC oil price increase on average from 1980, along with a continued rapid rise in their imports would reduce the OPEC current account surplus to about $80 billion. The economic slowdown in major industrial countries is expected to continue, and this would lower the combined OECD deficit some $30 billion to around $45 billion. The deficit of the non-OPEC developing countries, on the other hand, would be expected to rise nearly $10 billion to around $60 billion, as prices of their primary commodity exports stagnate in the face of weaker demand in the industrial world. Even this scenario assumes that developing countries maintain a tight check on real import growth as their deficits are constrained by the availability of finance.

A higher price of oil in 1981 would result in a larger OPEC surplus and a larger OECD deficit. For instance, if the average oil price received by OPEC rises 25 percent to $40 per barrel for the year, their surplus would again exceed $100 billion. Most of this increase

[1] The definition of non-OPEC developing countries used here excludes southern Europe, China, and South Africa In discussions of gross bank finance and gross oil trade, data for offshore financial centers and offshore refining centers are excluded as well

Chart 1

Global Current Account Balances



* Members of the Organization of Petroleum Exporting Countries (OPEC)

† Members of the Organization for Economic Cooperation and Development (OECD)

‡ Excludes eastern and southern European countries, China, and South Africa

§ Projection 1981a assumes a $35 per barrel average OPEC contract price for oil, while the 1981b projection assumes a $40 per barrel average price

Sources OECD, International Monetary Fund (IMF), Federal Reserve Bank of New York estimates, projections, and adjustments for consistent country coverage

again would be reflected in the deficit of the OECD area. As a group, these countries would not have a serious financial constraint so long as they continue to attract the bulk of OPEC investments Non-OPEC developing countries, a few of which would gain from an oil price rise, would face a further $5 billion erosion in their current account, bringing it to near $65 billion. The oil-importing countries in this group would have to cover a $10 billion higher oil bill. Because oil imports are concentrated in a few countries, the higher oil price could present serious financing problems for individual countries even though it produces only a small increase in the combined deficit. In this context, it has to be kept in mind that payments interruptions by one or more of the major debtor countries could raise the cost of borrowing for all and compound the adjustment problem for others

OPEC

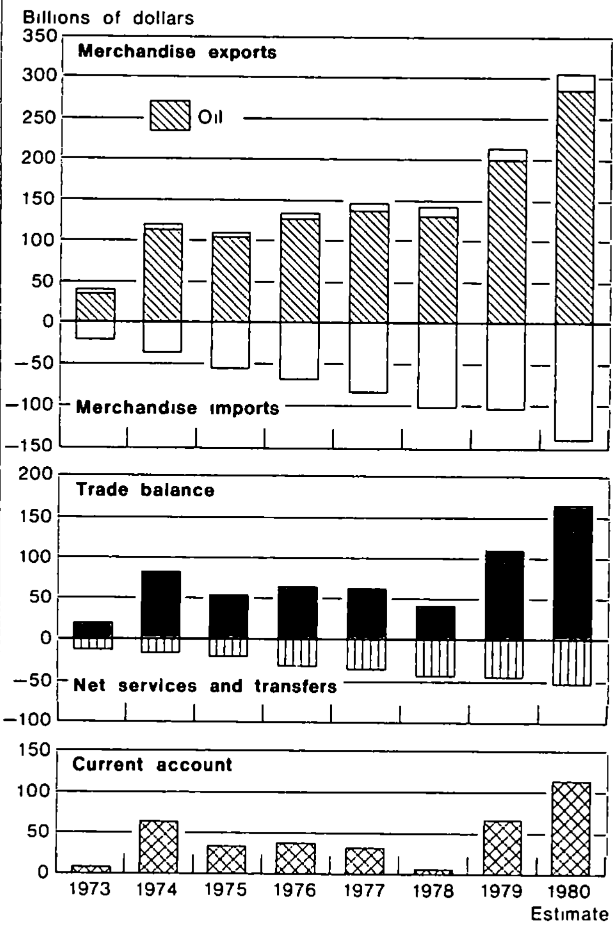
The combined OPEC current account surplus is now estimated at about $110 billion in 1980, up from only about $5 billion two years earlier (Chart 2). The group's annual export receipts more than doubled to over $300 billion during this period, as the 140 percent surge in oil prices dominated a 10 percent decline in oil production and export volume. But, by 1980, more than a third of the $150 billion increase in export revenue was being spent on current import and transfer payments abroad. These payments responded slowly at first to the rising oil receipts Most OPEC members entered 1979 with relatively austere plans for economic development and imports. Their emerging fiscal and balance-of-payments deficits between 1976 and 1978 led most OPEC countries to cut back their import-intensive government spending plans. However, by early 1980, OPEC real import growth once again appears to have been in excess of 20 percent per year As a result, merchandise imports are estimated to have risen to about $140 billion in 1980, nearly $40 billion above their 1978 level Moreover, the OPEC deficit on net services and transfer payments has risen about $10 billion since 1978 to more than $50 billion despite growing earnings on OPEC investments abroad

Real OPEC imports are likely to remain strong as Iraq and Iran reconstruct war damage, or at least rearm. Moreover, the heightened political tensions will likely increase arms purchases elsewhere in the region If oil prices remain about constant in real terms (a 12 percent nominal year-over-year growth), this continued rise in imports would reduce the 1981 OPEC surplus to around $80 billion On the other hand, a 25 percent increase in oil prices to around $40 per barrel for the year average would again produce a surplus in excess of $100 billion

The conditions under which a higher oil price might occur are not implausible The Iraq-Iran war has, as of this writing, driven spot prices to the $40 per barrel range and led OPEC to announce increases in their posted prices to an average of about $35 per barrel However, the OPEC price structure remains split. Under announced plans, Saudi Arabian prices still remain below those of equivalent grade oil from other Middle Eastern producers while prices for higher quality African crude oils remain well above their traditional premia. These price differentials seem unlikely to be sustained, but it is unclear whether market forces will dictate cuts in the premium prices being charged by Algeria, Libya, and Nigeria or induce Saudi Arabia and other price moderates to reconsider their discounts The lower price scenario is consistent with an early return of Iran and Iraq production and exports to near their prewar levels, and no additional supply disruptions elsewhere. With sluggish activity in industrial countries, this would return the world oil market to the oversupply situation that was apparent in the third quarter of 1980. Then, inventories had reached record levels and spot prices were falling, even though OPEC production had declined more than 10 percent from its level a year earlier. This outcome would allow a consolidation of OPEC prices around the $35 per barrel level Production cutbacks by the high surplus Arabian Gulf producers in line with their longer term plans would prevent a further price erosion. On the other hand, a prolongation of hostilities, a spread of the war, or new political disruptions in

Chart 2

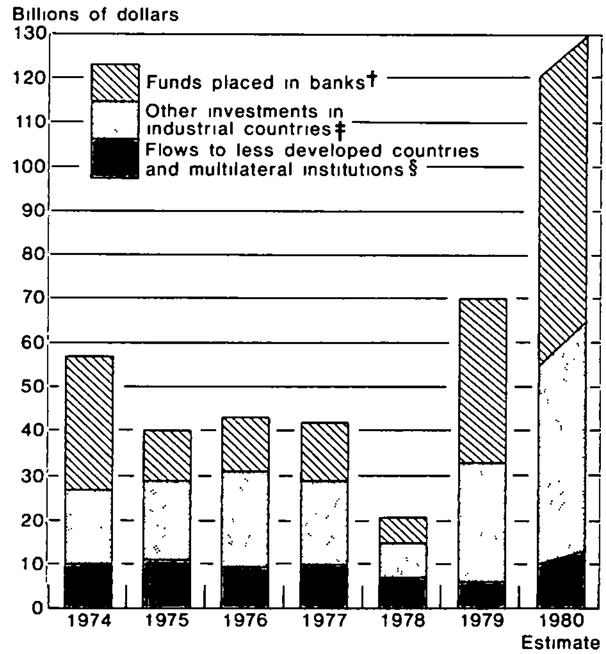
OPEC Current Account



Sources IMF, Federal Reserve Bank of New York estimates and adjustments for country coverage

Chart 3

Disposition of OPEC Surplus*



* The total surplus available for disposition equals the OPEC balance on goods, services, and private transfers plus borrowings by OPEC members plus adjustments for leads and lags of oil-export receipts

† Increase in liabilities of banks in industrial countries as reported to the Bank for International Settlements (BIS)

‡ Includes direct investment, loans, portfolio investment, and unrecorded items

§ Excludes purchases of World Bank bonds in international capital markets

Sources IMF, OECD, BIS, Federal Reserve Bank of New York estimates and adjustments for country coverage other major oil-producing countries could tighten the oil market substantially and produce another run-up in oil prices While one can easily imagine even higher oil price projections based on worsening political scenarios for the Middle East, the $40 per barrel oil price assumption provides the flavor of their impact

In investing its surplus, OPEC continues to favor low-risk investments, particularly government securities of major countries and deposits in large international banks (Chart 3) The effect has been to shift the job of lending to most oil-importing countries—including developing countries—over to banks and other participants in the world capital markets. At least three quarters of the available OPEC surplus in 1979 and 1980 was invested in industrial countries or in Eurocurrency deposits of banks from these countries, and the banks alone have taken about half the surplus The remaining quarter includes direct credits to developing countries, indirect funding through multinational organizations, and unrecorded items. Direct and indirect assistance to other developing countries has not grown in real terms since 1974 and has fallen far short of the growth of the OPEC surplus in the last two years.

Under the lower oil price scenario for 1981, the level of OPEC lending to LDCs would increase little from the $10-12 billion estimated for 1980 In the past during periods of declining surplus, such lending has fallen back although with a lag. Also, as in the past, much of this lending would be in the form of concessional loans and would follow the political ties of the high surplus OPEC members with Middle Eastern and North African countries Increased OPEC investments at market-related terms may be anticipated. However, these investments probably would compete with bank lending in those few more advanced developing countries that are adjusting well to the oil shock, rather than complement bank lending in countries where adjustment proves more difficult.

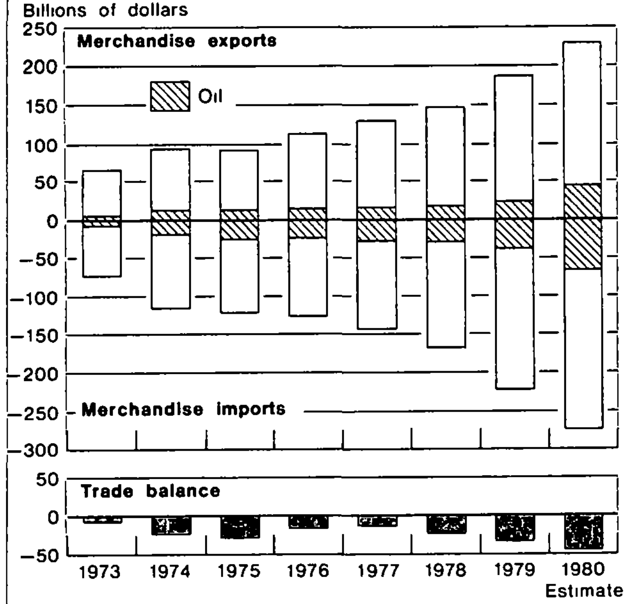
The main difference under the alternative higher surplus scenario would be increased bank placements Some increase in direct LDC assistance and the funding of multilateral institutions might also be possible, but the past growth and direction of these flows suggest they would not compensate for the additional oil cost to many LDCs without a serious effort to augment official recycling

Non-OPEC developing countries

The non-OPEC developing country current account deficit mounted to over $50 billion in 1980, more than double its level two years earlier. This deterioration was nearly equal to the $35 billion growth of the annual oil-import bill of the group over the period (Chart 4).

Chart 4

Non-OPEC Developing Countries' Trade Account



Sources IMF, OECD, Federal Reserve Bank of New York estimates and adjustments for country coverage

But the direct impact of higher oil prices on the developing countries is very uneven. Four countries—Brazil, India, Korea, and Taiwan—account for nearly half of the group's oil-import bill. These four also accounted for about half of the deterioration of the deficit Many smaller countries with less export or borrowing potential have been even more seriously affected in proportion to their own income and output. At the other extreme, those developing country oil exporters that are not members of OPEC showed about a $15 billion increase in net oil receipts over the 1978-80 period[2] These countries have expanded their oil production nearly 25 percent since 1978, but their domestic oil consumption and nonoil imports have also grown As a result, they showed only a modest $2 billion improvement in their current account deficit by 1980.

[2] The major non-OPEC developing country oil exporters are Mexico, Oman, Trinidad and Tobago, Egypt, Malaysia, Angola, Bahrain, Peru, Syria, and Tunisia

On top of their higher oil-import bill, developing country exports have suffered from weakening demand in their markets in industrial countries The slowdown in real gross national product (GNP) growth of the industrial countries during 1979-80 cut 1980 developing country exports $10 billion to $15 billion below what they would have been Moreover, the full impact of this slowdown has not yet been felt Primary commodities prices were relatively strong for LDC exporters until just recently and rose about 35 percent over the past two years But the increases were concentrated in a few products—sugar, copper, tin, and rubber—and benefited only some countries Many developing countries also import primary commodities, particularly foods, and have been hurt by the nearly 40 percent rise in grain prices

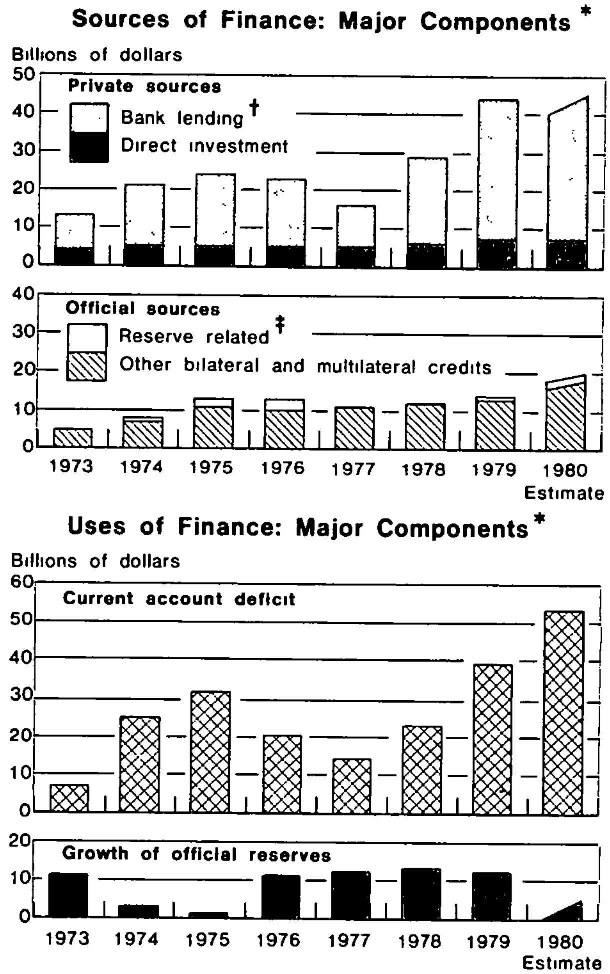
For 1981, the non-OPEC developing country current account deficit is projected to widen to about $60 billion, if oil prices remain constant in real terms. The further slowing in industrial country growth and the weaker commodities prices will further reduce the growth of export receipts. Thus, most of the deterioration will be reflected in the trade account, even if real import growth is again held to about 3 percent The outlook for commodities prices is mixed Most prices have been falling since the third quarter of 1980, and only grains appear to have much potential for a strong 1981 performance As a result, the terms of trade for developing countries is projected to deteriorate about 2 percent Moreover, the relatively strong grain prices will help only a few and hurt the low income food-importing countries who may least be able to finance larger deficits

A run-up in oil prices to $40 per barrel would add another $5 billion to the combined developing country deficit in 1981, widening it to around $65 billion But the $10 billion addition to the oil bill that this price brings would again be concentrated in a few oil-dependent, newly industrialized countries Moreover, those least developed countries where oil import payments already consume a heavy share of export receipts would be forced to cut real imports and their economic growth further Some may not have the option of running a larger deficit Most of these countries will not be helped by the $7 billion increase in receipts that would accrue to the few LDC oil exporters that are not OPEC members as the real oil price rises The indirect effects of the price hike could add perhaps $1-2 billion to the 1981 deficit, after allowing for a pickup in LDC exports to OPEC members On the basis of past experience, however, these indirect effects work slowly Thus, the further slowing of activity in industrial countries brought by higher oil prices would depress developing country exports well into 1982 when even larger LDC deficits would be expected

The above projections for developing country deficits assume they can be financed. Past and emerging financing trends provide a guide as to how this might

Chart 5

Financing Non-OPEC Developing Countries



* Sources exclude suppliers' credits and bonds which are more than offset by growth of nonreserve assets on the uses side and by errors and omissions

† Growth of claims of banks in industrial countries as reported to the BIS

‡ Includes allocations of special drawing rights

Sources IMF, OECD, and BIS, Federal Reserve Bank of New York estimates and adjustments for country coverage be accomplished (Chart 5). In the past, bank lending[3] has been the major source of finance as well as the source most responsive to changes in LDC deficits. But this bank lending has been concentrated in a few of the more advanced non-OPEC developing countries. Just ten countries[4] account for nearly 75 percent of outstanding international bank credits, and since 1978 four of these countries—Brazil, Mexico, Argentina, and South Korea—have received two thirds of the net new bank lending to the group of more than 100 individual countries The remaining developing countries have relied heavily on official source credits to finance their deficits. Except for reserve-related lending, mostly from the International Monetary Fund (IMF), these credits grew only slowly during the 1974-75 and 1978-79 periods of rising LDC deficits. Bilateral (government-to-government) lending usually requires legislative approval in industrial democracies, and developing country finance often takes low priority in times of economic contraction at home. Multilateral loans and credits (from the World Bank and regional development banks) are linked mostly to project finance and are disbursed only as these projects progress.

Financing the $60 billion 1981 deficit anticipated for non-OPEC developing countries, if real oil prices remain constant, does not appear unsurmountable. Problems for individual countries doubtlessly would remain, and there would be little room for reserve asset accumulation for the group as a whole. However, a relatively modest growth of official finance and direct investment, along with continued bank lending at its recent rate, would cover the overall deficit. Official source credits should continue to grow, principally because of stepped-up IMF and World Bank lending. Official financing is estimated to have grown from $14 billion in 1979 to near $20 billion in 1980. An increase to around $25 billion in 1981 appears reasonable. Recent increases in IMF quotas and guidelines on maximum lending to individual countries, as well as stepped-up disbursements on World Bank project and structural adjustment loans, should make up a good part of this increase. Private source credits would still have to provide nearly $40 billion of the financing under this scenario, mostly in the form of bank lending. The growth of bank claims could be somewhat less than the $36 billion reported in 1979 and about in line with the increase now estimated for 1980. This would represent about a 20 percent growth of bank claims on non-OPEC developing countries, somewhat below the average growth rate since 1975.

The $40 per barrel oil price scenario calls for only a $5 billion larger combined deficit, but little additional official lending can confidently be expected. An additional $5 billion in bank loans might not be out of the question, particularly if the lending spreads were to widen. However, some of the countries that would be hardest hit by the $10 billion rise in the LDC oil bill may already have stretched their borrowing capacity to the limit. Domestic political constraints may make it impossible for them to reduce real imports enough to avoid payments interruptions. Interruptions in trade credit or debt service payments would not entail a broad or permanent default on existing loans. Interruptions, however, would lead to difficult and possibly prolonged periods of negotiation to restructure the debt and reestablish credit. During these periods, new credit to the country concerned would be sharply curtailed. Forced import cuts would then reduce the current account deficit to meet available finance. If these interruptions arise in a couple of the countries that account for most bank credits, a drop in the overall rate of bank lending and in the overall deficit is possible. In any event, the increasing incidence of problems in individual developing countries could cause a retrenchment of bank lending in general and aggravate the adjustment problems in otherwise sound countries.

William J. Gasser

[3] Bank lending is defined here to comprise the total increase in claims on non-OPEC developing countries of banks in industrial countries, as reported to the Bank for International Settlements This is a lending-net-of-repayments concept which includes short-term credits and loans to the private sectors of developing countries which may not carry government guarantees

[4] The ten major non-OPEC developing country debtors to commercial banks are Argentina, Brazil, Chile, Colombia, Korea, Mexico, Peru, Philippines, Taiwan, and Thailand