

EXECUTIVE DINNER FORUM

PRESENTS

Mr. Eugene H. Rotberg

on

**“Petro-Dollar,
OPEC, and the
World Financial
Markets”**

1/30/80

**WHARTON
ENTREPRENEURIAL
CENTER**

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The problems faced by developing countries can perhaps be best defined by example: The poorest one billion people in the world have a Gross National Product per capita of 50 cents a day. In the United States, the Gross National Product is 40 times as great. The poorest 40 percent in those countries with the poorest one billion people earn less than \$50 a year.

Permit me to be more specific: The poorest one billion consume 40 percent fewer calories than do we. Almost 60% of the 2 billion people who live in the 90 developing countries are malnourished. Malnutrition is either the primary or contributory cause of over 50% of all deaths of children at the ages between 1-4 years in developing countries. Child mortality is 10 times greater in the poorest 35 countries than in Western Europe. Almost half of the deaths in Egypt occur before a child is 5 years old. In Pakistan, the 1-4 year old death rate is 40 times the rate in Japan. For 1-2 year olds, it is 100 times that in Sweden.

In industrialized countries, the ratio of physicians to service the needs of the population ranges from 1 in 500 to 1 in 900. In the poorest 35 countries the range is from 1 in 4,000 to 1 in 69,000. By comparison, in France there was one physician for every 680 people in the mid 1970's.

In Ethiopia only 8% of the population has access to safe water; in Indonesia 11%, in Haiti 12%, in Paraguay 13%, in Thailand 25%. Safe water is not available to 75% of the entire developing world's rural population.

The adult literacy rate for the 90 poorest countries is about 50%. It is 7% in Ethiopia, 15% in Zaire, 21% in Pakistan, 23% in Bangladesh, 35% in Algeria. In the mid 1970's only 25% of Latin America's young people

attended a secondary school, 20% in Asia. The proportion is 1 in 10 in Africa. Consider in the context of rising populations what this means when the world has over two billion people who cannot read or write in the year 2000. They will be illiterate, not unwise, not without sense, not without guile or wile or feelings of anger and hostility. Just illiterate.

The population of the world in 1975 was about 4 billion people. In the year 2000 it will be about 6 billion. Half of the increase in population will come from countries whose per capita income is now below \$400 per year. Large cities are doubling in size every decade. Twenty five years ago there were 16 cities in poor countries with populations of 1 million. Now there are 60. In 25 years there will be 200.

In India, the labor force will grow by 48 million people in 10 years from 1970-1980. That incremental growth is approximately equal to the combined labor force of Great Britain and Germany.

Industrialization in many countries is slow and difficult. A reasonable measure of the level of industrialization in a country is its per capita consumption of energy (e.g., measured in kilograms of coal equivalent). The annual energy consumption in industrialized countries ranges from 3,000 to 11,000 kilograms per capita. Annual energy consumption per capita for Zaire is 78 kilograms, for Indonesia 178, for Pakistan 183. It is 4,000 kilograms per capita in France.

These facts are not comfortable. But they are facts. They symbolize the lives of much of the human race. Robert S. McNamara, President of the World Bank, summarized it this way: "Hunger and malnutrition are sapping energy, stunting bodies, and slowing minds. Illiteracy is locking out learning and paralyzing opportunity. Unemployment is not only robbing men of the minimal means to make their way, but leaving their pride broken and their ambition atrophied. Wholly preventable diseases are injuring infants, and aging adults long before their time. It is not a scene that any one of

us here--so favored, fortunate, so surrounded in our personal lives by privilege and advantage can contemplate without compassion and resolve. The blunt truth is that absolute poverty today is a function of neglect --and of our neglect as much as of anyone's".

The cumulative effects of the problems are obvious. As he begins to build a family, the conditions of his lifestyle point only to a repetition of the same cycle for his children. His life becomes one of boredom or despair, or sadness or frustration or violence. Unlike his ancestors he knows--he sees, he hears how others live, though his response is varied and not easily predictable. For some few perhaps, a relaxed resignation characterizes their life--a life slipping into lethargy, basically unproductive and exploitable. For many others, however, events do not change fast enough. And the absence of any perceived change is destructive to the societies in which they live and to their peoples. You may ask why, in view of the rather extraordinary advances in many developing countries, there should remain an underlying pessimism or frustraion. The point is simply that the recent advances have not touched many in a meaningful way. Hundreds of millions have not participated in the growth of the last decade or they have not perceived the growth. They know their lives are short. It may take decades to provide for agricultural extension services, generations to educate, years to build roads and dams. It takes time to accumulate leisure time. Change is almost invisible. It moves by unseen increments, scarcely observed. It is an intangible and often does not touch the lives of the poor. Certainly there may be more cloverleaf overpasses, more dust, more building, but often, for the poor or near poor, there is no access to the rooms within the buildings.

And, change is often far overshadowed by greater expectations. These expectations often cannot be realized; even when realized they sometimes appear hollow and meaningless. The benefits are often made to seem more alluring and satisfying than they ultimately are or can ever be.

And there are those who are excluded from access to society by language, by speech, by education. They have minimal physical mobility and little access socially. They sense their absence of power--their lack of access to it--and perhaps its absence is the underpinning beneath the patent frustration of the poor. Is it not the lack of access that weakens the sense of conscience, which restrains antithetical behavior?

There is, too, the frustration born simply of the awareness that others are different. There is the sense of frustration over energy and elegance; there is that awareness not only of what they do not have but what you and we have--an ability to run and work hard and play hard without exhaustion.

For those with little hope, the reactions may range from a sort of catatonia, to a holding on to family or children, to a violence born of frustration and anger which accelerates as expectations and education just begin to impinge on their lives. And there develops, inexorably, that hostility between those who work with their hands and those who do not, between those who are born to lead and are comfortable with it and those who have no choice but to compete and be lead, between those who own or are owned and between those who have moved--upwards, toward the class from which they have but recently moved.

Disenchantment has many faces. It shows itself in violence born of hopelessness in depression or sadness or despair, in sickness or in unproductivity, in migration across borders, in days off, in slowdowns.in strikes, in protest, in terrorism, in guilelessness, in war, in insurrection, in coups, in riots and looting, and of course in self-destructiveness.

And in disenchantment, the marginal man's latent propensity to damage himself and others quite overcomes his lethargy. He no longer can wait until someone, something offers hope for a better life. Percy Bysshe Shelley wrote the refrain 170 years ago:

"Rise, like lions after slumber,
In unvanquishable number!
Shake your chains to earth, like dew
Which in sleep had fallen on you!
Ye are many -- they are few."

Rising hostility, we all know, inevitably leads to counter-reaction. In some nation-states, authoritarian control is often achieved for decades --for generations in the name of continuity, orderliness and efficiency. Resources are allocated and mobility is enforced, not achieved; dissent is stifled. In other societies visible and quick palliatives are sometimes designed to dissipate accumulated tension and frustration. You are familiar with the monumental actions or speeches or concepts unveiled to deflect the disenchanted and turn the eyes of the body politic elsewhere. For a while such steps are accommodated or welcomed.

The problem is compounded by the fact that change, modernity, productivity which is sought after, or demanded or needed is a mixed blessing. It is not a welcome visitor by all participants in society. For many, their own security, their ties to where they think they fit are often threatened by chance. Cultural traditions go deep. Change we know is resisted often from those who, on the surface, would appear to benefit the most--at least in material terms. In recent times, we are familiar with governments of the left and right, democratic or demagogic, who have been unable to strike that delicate balance between the demands for change and the resistance to it.

That is the problem in human terms. Let's talk about it for a moment in financial terms, particularly in the context of their most recent problems. In 1978, the developing countries' bill for imported petroleum was \$30 billion. In 1980, it will be \$60 billion. By way of comparison, in 1973 it was \$6.8 billion. In that same year the current account deficit, that is, the deficit that these countries have to finance outside their own borders, was about \$6 billion. In 1980, it will be about \$75 billion. In the early 1970's these resources were primarily financed by commercial banks. The question is whether commercial banking institutions are in the position to massively increase further their lending to those countries as they did in 1974 and 1975. At present, the banks provide almost 2/3 of the net financial requirements of the developing countries as compared to less than 1/3 in the early 1970's. There is no room for complacency. The equity capital of banks to their total assets has declined from 4-1/2% in 1972 to about 3-1/2% currently. The margins of profitability for international lending have narrowed. Their generation of capital internally is limited and their price earning ratios are such that they are unwilling to raise new equity.

They are concerned about a concentration of portfolio risk. Right now, for most money center Banks, claims on only 7 countries account for almost half of their lending to developing countries. And these are in countries who will require even more financing. Thus, if banks were to finance the same share that they have in recent years, it is estimated their exposure to

developing countries would have to grow by approximately 20% a year. This is highly unlikely as the annual rate of bank lending has declined from 31% to foreigners in the early 1970's to only 13% since 1976. Developing countries therefore need either direct access to markets, access to the World Bank or International Monetary Fund, or OPEC directly for increasing amounts of resources or bilateral concessional resources, or they will be faced with slower growth, increased economic problems and further deterioration in their standard of living and increased political vulnerability.

Who are these people who we can talk about with such detachment in financial terms? Are they simply nations who have little to do with our daily lives? Let's talk a moment about what they are like. The great numbers I have referred to earlier know little about international finance or the narrowing spreads in the Eurodollar market or the shrinking size of their access to that market. Nor are most cognizant, for the most part, of the difficulty that they will face in the future when they will face the twin horns of the dilemma of on one hand not being able to pay for the imported oil and the energy which they need for growth or taking on the other hand the dangerous political route of restructuring their society to reduce growth and lower their standard of living.

You may ask what concern all this is to us. For centuries, we must admit, these countries' raw materials and primary products were controlled

outside the borders where they were physically located. This was no longer true after the Second World War. Leaders of emerging nations recognized that growth in the industrialized world in large part was attributed to cheap energy, inexpensive raw materials, and captive markets. And after the Second World War, developing nations increased their exports to satisfy the almost insatiable demand for consumer goods. Many resources were not and are not in abundant supply even in great industrial powers. What are the facts? In the middle 1970's the United States imported 90% of its bauxite, 35% of its iron ore, 85% of its tin, 60% of its zinc, all of its natural rubber. It imported almost 100% of its coffee, cocoa, banana and palm oil. It imported 30% of its tobacco and over 40% of its sugar. It now imports almost 45% of its oil. Jamaica, Guinea, Surinam and Guyana exported 70% of the world's bauxite; Chile, Zambia and Zaire 40% of its copper; Malaysia, Bolivia, Indonesia and Thailand over 70% of its tin. Over 80% of the world's natural rubber is exported from Malaysia, Indonesia and Thailand, and 25% of its sugar is from Brazil, the Philippines, the Dominican Republic and India. Rhodesia has the chromium.

The United States will pay about \$90 billion for imported oil in 1980. In 1970, it paid less than \$3.0 billion. The cost of oil has risen tenfold over the price levels of 1972. OPEC net external assets, that is, their holdings of foreign assets, mainly government debt and bank deposits, in 1972 was on the order of \$25 billion. It is now \$200 billion and will increase by \$100 billion this year alone. Most projections put those assets at between \$500-600 billion by 1985. The reciprocal of that \$500-600 billion is the measure of the world's reliance on a commodity held basically by some poor countries, some rich countries but, for the most part, undeveloped countries, many of whom are politically vulnerable and who have, for the most part, few

ties, in the historic, social, ethnic, or cultural sense, with those in this room. And they know what you think of them.

Industrialized societies are also confronted with higher raw material and primary commodity prices, increased competition in finished goods and products, sophisticated product design and development, entry into basic industry such as steel production--usually the prerogative only of the richest countries. And new political, economic and financial relationships have pressed what we label "Western" societies to cope, in a very short time, with a bewildering array of new and emerging arrangements.

And the fact is you are not comfortable with them. We mix them all up. They are neither elegant enough for us or effective enough or productive enough or too pushy. They are raising prices. They are getting into wars. They have coups, assassinations, oil, copper, bauxite. They vote in the United Nations. You don't like the way they vote. They get themselves invaded. They are sovereign. They talk too much and you think they are not faithful allies. They are weak and undemocratic. They are of a different religion. They have few cultural ties to us. They threaten our sense of superiority. But they are much poorer than us and can't quite figure it out. They come across the borders illegally. They dump their products in our markets. They threaten, therefore, our economic structure we think. They are illiterate. (But, alas, "they" take all the first place prizes in our schools.) They protest when they are here and can't go back home. And if they haven't left home, they make speeches against something called colonialism and imperialism and multi-nationalism and stuff that you and I used to read about in history books as something that other countries did

100 years ago. They blame us for their conditions and they have oil, bauxite, the tin, and the chromium that we need to maintain our standard of living and they know the way we feel about them, and vice versa. And, the fact remains that the death rate for children in Pakistan is 40 times as great for children as in Sweden. They know that, too. And our feelings become even more ambivalent as we recognize that the world's greatest producers of oil in the Middle East has a population of only 5 or 6 million people, about twice that of the Philadelphia metropolitan area, in an area that is the size of the entire US up to the Mississippi. And even if we had our feelings straightened out and we knew what we wanted to do, other powerful nation states, Russia, China, western democracies, have an awful lot to say about what they would like and they have the military and economic wherewithal to make their views known and stick.

The question remains what do we industrialized countries do, faced with the bewildering array of feelings, needs, priorities. I suspect that the first and most important thing is to admit what is bugging us and why we feel the way we do and then do what is simply right. Second, "assistance" must be provided for many reasons and in many different forms.

I certainly do not mean to suggest that major geo-political problems, the relationships of the United States with the Third World, or with the world powers, can be resolved or substantially changed by a more forthcoming posture of assistance to developing countries. But certainly it doesn't take any great brilliance to recognize that poor countries are vulnerable--that they are easy targets and that many are unstable. The United States is a great and giving nation. It has always permitted social and financial access for both those within this country and without. The

obvious latent trends toward protectionism and isolationism have always hurt us. I assume that countries know what is in their best interests, and programs in which the United States can support healthy economic development of countries in Asia, Latin America and Africa are not only morally justified, but also provide extraordinarily practical and beneficial results. Societies do what is in their own best interest, just like you and I do, and if they perceive that they have some hope for the future, that they are obtaining resources which permit them to grow, then leaders and citizens will encourage the maintenance of close ties and relationships. The reciprocal of denying wheat or a trade embargo as punishment is to make available resources, project finance capital. The Western world either must assist countries in developing their markets by providing, for the very poor, concessional aid and, for those better situated, access to our markets--or lose any hope of retaining influence.

We must first, therefore, offer markets for developing countries to sell their products. Only by selling their products to us can they earn the foreign exchange needed to buy what we produce and to service their debt. In short, we should encourage Mexico to develop their products by providing the necessary capital either directly or indirectly through such institutions as the World Bank or the International Monetary Fund or through commercial bank lending so that incentives are created to work in Mexico, to produce and to sell their goods around the world. Better to take the goods and products of developing countries than to implicitly encourage unplanned and random immigration across national borders of countries who are not prepared to absorb the influx. It is rather simple--

countries can only buy our goods and products, and thereby help their standard of living, if they can ship their goods and products to earn the dollars necessary for such purchases.

The United States and other industrialized countries should recognize what is in their own best interest when textiles from Thailand or the Philippines or Korea or India are brought to the United States. Certainly it poses temporary employment problems and certainly it threatens the labor, but to a far less extent than technological unemployment or the unemployment caused by recession or economic dislocation. It is counter-inflationary. It is in our self-interest. When I was in high school in Philadelphia, I used to debate for Central on behalf of the position there should be "one world." I think I probably lost most of those debates simply because interdependence was a label which nobody believed in. It was, in fact, not true then. That is not the case today. It is now a fact of life and I suspect that many policies of industrialized countries reflect the lag in our perception that interdependence is a fact.

Second, only by providing investment opportunities in a strong dollar will those countries in financial surplus be prepared to maintain their investments with United States. That is precisely what you should want. And so should other countries.

The fact that the United States dollar on a trade-weighted basis has, in fact, not deteriorated in recent years with the countries with whom it trades may be one of the reasons why drastic measures were not quickly perceived as necessary to strengthen the U.S. dollar. After all, if you do substantial trading with, say, Canada or Mexico, the fact that

the German mark or Swiss franc substantially appreciates may be of no great concern except to Mercedes buyers or skiers. I would suggest that this is a rather short-sighted view since the world financial community has the option of choosing the Deutsche mark, Swiss franc or yen. While it is true that, for a variety of reasons, OPEC states have not and cannot shift out of dollars in substantial amounts, even marginal shifts can have extraordinarily unsettling effects on foreign exchange markets. Further, such instability makes it quite difficult for people who deal in real things to predict how they should price their goods and services. It is, therefore, most important that the U.S. take those steps necessary to control inflation so as to maintain the confidence of those who have financial surpluses that we are an appropriate vehicle for their investments.

In short, I would assume that it is in your best interests that the U.S. should encourage OPEC to invest your savings which were and will be spent for energy in the United States rather than anywhere else. That in turn demands control of inflation so that a real return is possible.

Third, the industrialized world should stop looking for scapegoats. We must create the incentives for new forms of energy. And scapegoats inhibit that process.

It is not useful to label as monopoly or cartel pricing that price which results from 15 or 20 countries as disparate as Iraq, Iran, Saudi Arabia, Indonesia and Mexico. The price of oil is where it is because you want it and a very diverse category of suppliers have it. I assure you that that if you had raised the price of your products 10 times, you could not sell them. Nor could you arrange with your competitors to raise their price tenfold. If you did, new competitors would spring up and/or the public would not buy your product. OPEC has been successful in selling oil

at \$30 a barrel simply because the marginal cost of the form of energy we need, whether it be in the form of gasahol, nuclear fusion, solar energy, coal, far exceeds the current cost per barrel to us--otherwise we would substitute. We set the price, they haven't. Nor is it a monopoly price like electricity where there is only one supplier. There are lots of diverse suppliers with tremendous differences or costs and needs but there is not that much oil. It is finite and it is going to run out and you and I need it. And its theirs and not ours. And as long as we think "they" raised the price and "they" are making unconscionable profit and it is all one conspiracy with multinational oil companies, then will we not conserve oil or seek alternative sources. We will instead create scapegoats. The market sets the price. Before 1972 despite an increasing use of oil, a finite and shrinking resource, the price remained the same. That was price fixing over which industrialized countries had control. That power was lost. I assure you Canada, the United Kingdom and Alaska are not members of OPEC and have no difficulty in getting the new price. Why not? Because that's what the market will bear.

There are many ways to encourage the production of alternative sources of energy. They relate to internal tax incentives and constraints on what can be imported into the country. Time obviously cannot permit even a reference to the diverse ways that this might be done, but the end product is that the cost of energy in the United States, in your best interests, should be higher than it is now and substantially so to encourage the development of alternative sources.

Fourth, it is simply in all of our political best-interests to offer

economic support to developing countries. Korea, the Philippines, Mexico, Brazil, and many, many others are important for political reasons not appropriate to be spelled out here. It is in the political interests of most of the world that these countries obtain support. The World Bank and the International Monetary Fund, the commercial banks and concessional aid provide a crucial intermediary function to permit the process of development to continue and to create subtle but strong ties with the industrialized world. Ties which ultimately provide a far greater identity of interests than ad hoc, one-shot gifts or palliatives. Their viability as independent nation states depends on their economic growth. In short, you should learn to carefully define what is in your interests.

And it is also in our interest as rational human beings. John Stuart Mill said that one of the beauties of free speech is that you have to defend your position against anybody, no matter how outrageous the position. We are forced to think clearly and logically as to the underlying logical and empirical basis for what you do. I am sure he said it more elegantly than that. So, too, there is a certain advantage to taking advantage, once in a while at least, of the gifts of what rational human beings can do.

Robert Kennedy wrote about the beauty of what rational man can do.

I quote him:

"Think how our world would look to a visitor from another planet as he crossed the continents. He would find great cities and knowledge able to create enormous abundance from the materials of nature. He would witness exploration into understanding of the entire physical universe, from the particles of the atom to the secrets of life. He would see billions of people, separated by only a few hours of flight, communicating with the speed of light, sharing a common dependence on a thin layer of soil and a covering of air. He would also observe that most of mankind was living in misery and hunger, that some of the inhabitants of this tiny, crowded globe were killing others, that a few patches of land were pointing huge instruments of death and war at others. Since what he was seeing proved our intelligence, he would only wonder at our sanity. It is this monstrous absurdity that must be the target of the modern revolution."

But there is another perhaps more fundamental basis for our concern for our fellow man. The poet John Donne put it simply:

"No man is an Iland, intire of it selfe; every man is a peece of the Continent, a part of the maine; it a Clod bee washed away by the Sea, Europe is the lesse, as well as if a Promonterie were, as well as if a Mannor of they friends or of thine owne were; any man's death diminishes me, because I am involved in Mankinde; And therefore never send to know for whom the bell tolls; it tolls for thee."