# KISSINGER-SIMON PROPOSALS FOR FINANCING OIL IMPORTS

## HEARINGS

BEFORE THE

## JOINT ECONOMIC COMMITTEE
## CONGRESS OF THE UNITED STATES

NINETY-THIRD CONGRESS

SECOND SESSION

(Pursuant to S. Con. Res. 93)

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# CONTENTS

## WITNESSES AND STATEMENTS

### Monday, November 25, 1974



### Wednesday, November 27, 1974



### Friday, November 29, 1974



## SUBMISSIONS FOR THE RECORD

### Monday, November 25, 1974



### Wednesday, November 27, 1974



## POINTS OF INTEREST

### Monday, November 25, 1974

WEDNESDAY, NOVEMBER 27, 1974



FRIDAY, NOVEMBER 29, 1974



APPENDIX

# KISSINGER-SIMON PROPOSALS FOR FINANCING OIL IMPORTS

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**MONDAY, NOVEMBER 25, 1974**

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met, pursuant to notice, at 10 a.m., in room 345, Cannon House Office Building, Hon. Henry S. Reuss (member of the committee) presiding.

Present: Representative Reuss.

Also present: John R. Karlik, senior economist; Sarah Jackson, professional staff member; Michael J. Runde, administrative assistant; George D. Krumbhaar, Jr., minority counsel; and Walter B. Laessig, minority counsel.

## OPENING STATEMENT OF REPRESENTATIVE REUSS

Representative REUSS. Good morning. The Joint Economic Committee today begins 3 days of hearings on the Kissinger-Simon proposals for a special oil lending facility to aid industrialized countries seriously crippled by higher oil import costs. These hearings are part of the committee's general study of the causes of inflation.

The new financing mechanism proposed by Secretary of State Kissinger on November 14, and amplified by Treasury Secretary Simon on November 18, makes an important link between energy conservation and financial aid.

Curtailment of oil imports is essential if the huge payments deficits caused by the higher world oil prices are to be managed. Reducing the demand for oil through energy conservation is probably the only way that the United States and other consuming nations can hope to bring down world oil prices in the near future. This initiative for consumer cooperation on energy conservation is highly commendable.

The $25 billion fund under auspices of the Organization for Economic Cooperation and Development (OECD) would finance the oil deficits for industrialized countries no longer able to borrow privately. Borrowers are to be required to make commitments not only to cut oil imports but also to follow appropriate internal and external economic policies. Will these commitments be pursued rigorously enough so that the need for massive foreign assistance will be of limited duration and the United States can look forward to being repaid? Is it sensible to set up this financial safety net outside the International Monetary Fund (IMF), which already has the staff and experience to police such commitments?

While actual participation in the new facility has yet to be negotiated, the U.S. share, by almost any economic criteria, would be one-third, or approximately $8 billion.

If this amount is not raised through taxation or borrowed in domestic capital markets, it will require the creation of additional money. Now struggling with global inflation, the world hardly needs a major boost in total money supply. On the other hand, if the funds are to be borrowed in capital markets, the Kissinger-Simon plan will merely substitute for private lending.

What is the contemplated mechanism? Will the administration seek congressional authorization before it sets up this financial safety net?

This Kissinger-Simon initiative seems to reject the suggestion of French President Giscard d'Estaing—that oil-producing countries be included in negotiations during the period in which consumers are trying to conserve energy and develop new supplies—in favor of obtaining consumer solidarity first. Could President d'Estaing be right and Secretary Kissinger wrong?

Wouldn't keeping the oil-producing countries in the negotiating picture now lessen the likelihood that they will act irresponsibly in the future?

This morning we will hear from Secretary of the Treasury William Simon. Accompanying him is Jack Bennett, Under Secretary for Monetary Affairs, who has just returned from meetings of the OECD Working Party III where the United States formally presented its special lending proposal.

As you can see, Mr. Secretary, from what I have just said, we are very appreciative of the initiative that you are taking. However, as always, we have some fairly tough questions which we will get into this morning.

I would anticipate the timetable on this proposal, if it is going to work, will be rather rapid and that Congress will be confronted on a legislative basis with whatever needs to be ratified within the next couple of months.

Secretary SIMON. There is no doubt about that, Representative Reuss. We intend to have intensive consultation with the Congress as the work party commences work the first week of December on this.

Would you like me to start, Representative Reuss?

Representative REUSS. Yes, would you proceed.

## STATEMENT OF HON. WILLIAM E. SIMON, SECRETARY OF THE TREASURY, ACCOMPANIED BY JACK BENNETT, UNDER SECRETARY FOR MONETARY AFFAIRS

Secretary SIMON. I am delighted that you have scheduled early hearings on the U.S. proposals for international cooperation in energy and finance which were set forth publicly by Secretary Kissinger in his Chicago speech on November 14, and by myself 1 week ago in my speech before the National Foreign Trade Council.

As we indicated in our speeches, the ideas we were expressing were the outgrowth of quiet diplomacy over a period of many months.

The basic elements of our proposals and their rationale were described in my speech, with which I am sure you are all familiar. Today, I would like to make some relatively brief comments which I hope will be responsive to the very important questions posed in your announcement of these hearings and to describe briefly the work program and schedule in prospect for developing further the ideas we have presented.

The increases in oil prices levied by the OPEC producers beginning last October have imposed extensive costs on the world economy.

High oil prices have exacerbated world inflation. Shifts in resources to adapt to the new energy balance will cause serious friction and unavoidable costs of structural adjustment. There is a real possibility that increasing reluctance to borrow to finance oil consumption will, as time goes on, lead some countries to seek lower levels of economic activity in order to preserve their financial positions—and the world will lose heavily through forgone production.

It is also reasonable to expect that OPEC nations will in the future use an increasing portion of their oil export revenues to finance greater transfers of real goods and services from the oil-importing nations.

Such increased OPEC imports could reduce the financial problems resulting from the oil price increases, but the real economic costs imposed would be much greater and the loss of real income associated with these transfers may add significantly to future inflationary pressures. In these circumstances, there is a danger that some countries will feel compelled to take self-protective actions that are disruptive to others and to the world economy, and the risk of possible retaliation and general resort to competitive restrictions cannot be ignored.

The economic problems will not be equal for all countries, but—directly or indirectly—all countries are faced with dimmed prospects for economic growth and prosperity. I can think of no single change that would more improve the outlook for the world economy than a substantial reduction of the price of oil.

The underlying basis of our proposals is that a creative and coordinated response to the oil problem is needed by the world's major oil-consuming nations in which cooperative energy policies and cooperative financial arrangements are linked so as to provide the mutual insurance essential to protect the functioning of the world economic system, to promote greater energy independence, and thus to lay the foundation for an early reduction in oil prices.

Our hope has been that the OPEC nations would themselves recognize that their policies are inconsistent with their own interests and those of the world.

We have taken every opportunity to convey our views to OPEC in this hope. We still believe that a well-prepared consumer/producer meeting can be a major element in reaching a constructive agreement on oil prices and production. But we believe it is crucial to the achievement of such an outcome to develop a concerted view and common policy on the part of the major consuming nations.

At present, OPEC nations do not believe that a reduction in oil prices is in their interest, and they continue to have the ability to support present prices or even further increases if they so choose. Unless major consuming countries act together to establish market conditions which alter this situation, there is little prospect that oil prices will soon come down.

The Energy Coordinating Group established last February at the Washington Energy Conference has reached agreement on a plan of major importance for sharing of energy resources among consuming nations in time of emergency, has provided guidelines for cooperative long-run efforts in energy conservation, production, research and development, and was instrumental in the formation of the new International Energy Agency associated with the OECD to carry out this program.

These steps have established a solid basis for cooperation among the consuming nations. Now we must move forward.

Our analysis of the forces underlying the oil and energy markets, and of the costs and dangers thrust on the world economy by the increase in oil prices, has reinforced our basic belief that it is the price of oil itself, not its financial repercussions, that is the real source of trouble in the world economy. We are not attracted to financing schemes put forward in isolation, for such proposals would simply address the symptoms of the problem and create a false sense of security. This conclusion has determined our basic approach in international discussions on energy and financing, has influenced our response to some of the many financing or "recycling" proposals suggested by others, and has shaped the financial proposals we ourselves have put forward.

Nevertheless, we believe that there must be a greater degree of assurance that financial needs can be met until the goal of reduced oil prices is achieved. A financial safety net which provides standby insurance to countries that are cooperating to reduce their oil imports and to maintain open economies is urgently needed.

The industrial countries must take the lead and assume much of the burden for implementing such a program, for it is these countries that have the greater capacity to conserve and to contribute their resources and technology to the development of alternative supply sources, within their own borders or elsewhere. Moreover, these countries also can be expected to receive, collectively, the bulk of OPEC investments, without any need for special guarantees, above-market rates, or value-indexing schemes.

What is needed are standby arrangements—private and public—to provide insurance that funds will be distributed among the individual oil-importing states so as to avoid unnecessarily severe economic difficulties in particular countries.

Our proposal calls for the establishment of a major new mechanism in association with the OECD to provide standby financial support in case any participating country finds itself in economic trouble after having made reasonable efforts on its own part to resolve its difficulties. We have also proposed that IMF resources be more fully mobilized, and that consideration be given to creation of a trust fund managed by the IMF for concessional assistance to the developing countries most severely affected by the oil price increases.

I will mention the main points of the financial arrangement among the industrial countries first, and then turn to these latter aspects of the U.S. proposal.

Several principles are fundamental to such an arrangement. First, the facility would be designed to support a concerted energy program among the major industrial countries, and participation would be linked with a commitment to cooperate in reducing dependence on oil imports.

The facility is not a "free ride," unrelated to effective policy conditions and without a solid foundation of commitment. Secretary Kissinger and I have both suggested policy objectives and targets that might be adopted as part of this program. Other governments have their own targets in mind and have adopted specific policies with those targets in view.

These obviously must be examined, sorted out, agreed upon and placed in an effective operational framework.

I have no doubt that this will be a difficult task. But I believe it is possible and essential for us to agree on an effective program that will warrant U.S. participation in both its energy and its financial aspects.

Second, participants would also undertake to follow responsible adjustment policies and avoid recourse to restrictive trade measures or other beggar-thy-neighbor policies. I doubt that this principle needs further explanation.

Third, the facility must be large enough to do the job for which it is intended. Countries that agree to act together in energy need to be confident that if a financial emergency arises, credit will be available to them on reasonable terms. We have recommended a facility with total commitments by all members of $25 billion in 1975, large enough to provide reasonable insurance and confidence to participants in a period of great uncertainty about the direction and magnitude of financial flows.

We regard a facility of roughly this magnitude as not excessive in present circumstances if it is to provide nations with basic confidence in the security of their positions in dealing with the energy crisis.

The further amounts which would be provided if necessary after 1975 will depend on the extent, if any, to which the facility is used next year and the situation prevailing a year from now. The facility is not a new "foreign assistance" gimmick. It is an integral part of a comprehensive effort to strengthen the financial security of the world economy. As such, we view the financial arrangements we have proposed very much as an insurance mechanism, not as a regularly used channel of financing.

We hope that the basic confidence in the system that the facility can provide will strengthen the operations of the private markets and make extensive recourse to the facility unnecessary.

Fourth, the facility would supplement and not replace the private markets and other official financing channels and should for this reason do its lending on market-related terms.

The private markets and official facilities already in place have been doing the job of redistribution of oil producers' funds to date, and we have no evidence that they cannot continue to do the job.

The problems of financing higher oil bills can be managed until oil prices come down—not easily or without strain, but they can be managed. Substantial volumes of OPEC funds, probably $45 billion in the first 10 months of this year, have been invested in a variety of ways. A little less than one-quarter of these funds has been invested directly in the U.S. market and about the same amount directly in the domestic assets of other industrial countries.

The OPEC countries have also lent directly to other governments and transferred additional amounts to international institutions.

In addition, substantial amounts have been placed in Eurocurrency markets—but the total, less than 40 percent, is not as large as many have assumed. For borrowers, all these investments represent potential sources of funds and provide a wide range of alternative financing channels.

But while the international finance system has worked well, we must recognize that individual countries could find themselves in economic trouble, with needed credit too scarce or too expensive to permit them to maintain open economies at appropriate levels of activity.

The facility we have proposed would provide the backstopping that is needed to supplement existing channels of financing.

Fifth, decisions on the provision of financial support should be made by a weighted vote of participants and should be based on the overall economic position of the borrower, not on any single criterion such as oil import bills. The question of shares will be an important issue in setting up a facility of this nature.

Various factors have been mentioned that might be taken into account, such as the size of the oil import bills of the member states, the relative value of gross national product, share in international trade, or some combination of these factors. The various possibilities will have to be carefully weighed, but our preliminary view is that the U.S. share should probably be somewhere between 25 and 30 percent.

I should also point out that in our current view, borrowing from the facility should not be related specifically to imports of oil. "Oil deficits" become increasingly indistinguishable from "non-oil" deficits. Access to this facility should be based on an overall judgment of a country's need taken in conjunction with its resources, its basic economic policies, and the actions it is taking to reduce dependence on OPEC oil.

Finally, we believe it important that whatever support the facility provides, all members should share the credit risk on the basis of their share of participation. As we envisage the management of this facility, a board composed of senior finance officials from participating countries would control all decisions on the facility's policies and operations. This board would reach judgments on requests for assistance from the facility on the basis of the factors I just noted—alternative sources of financing, basic economic policies, and actions to reduce dependence on imports of OPEC oil.

There will be risk, but I believe these two factors—the sharing of risk among all participants and the prerequisite of sound, cooperative general economic and energy policies—will do much to create the conditions to make repayment possible and thus to reduce the financial risk.

The much greater risk today is to stand by without acting to reduce our dependence on oil imports.

Apart from these basic principles, many details remain to be worked out. One such question is the manner in which the facility would obtain the funds with which to lend.

We feel there are a number of advantages in having funds provided to the facility through direct lending by member governments rather than guarantees.

The loan route is more efficient, it is cheaper, and it can be activated more quickly in case of emergency. Nevertheless, it may be desirable in establishing the facility to provide some flexibility on this score simply because national practices and legislative requirements vary widely.

We would not want to rule out the possibility that some individual governments might choose to permit the facility to go into the capital markets of the world and borrow funds on the basis of their guarantee in lieu of lending directly.

It should be emphasized that the operation of the facility, whether it takes the form of direct lending or guarantees, would not require inflationary expansion of money and credit and, for example, need not lead to an increase in Federal Government debt held by U.S. citizens.

OPEC revenues which are not spent on imports of goods and services must be invested in the group of oil-importing nations as a whole.

The international financial problem is not one of the overall availability of funds but rather the pattern in which net flows of capital are channeled.

The purpose of the facility is thus not to create new funds, but to rechannel net flows of already existing funds if this proves necessary because the distribution of flows among countries is inadequate.

I would note that we share fully the view that the oil exporters should assume a significant portion of the responsibility in the provision of financing. We would be happy to see the oil exporters invest and lend directly under terms that are appropriate both economically and politically. But they can avoid the risks of lending to particular countries if they wish to do so. We believe such direct placements are more likely if countries are confident that adequate insurance stands behind the system.

For the United States, our present thinking is that participation might best be accomplished through the Exchange Stabilization Fund. This fund has the authority to engage in international lending operations for the purpose of stabilizing the value of the dollar and this would be a basic purpose of our participation in the proposed facility.

However, I assure you that we will consult with the Congress about the most appropriate way to proceed, and we will seek congressional authority for U.S. participation in any facility.

The U.S. proposals are in no way intended to replace the International Monetary Fund as the permanent institution providing the basic financial support for a well-functioning world economy, or to limit its role to the provision of financial assistance to any particular subgroup of its membership.

We will be working closely with the authorities of the IMF and its recently established Interim Committee in translating our proposal into an operating program.

We expect the IMF's lending activity to increase in 1975. With its present resources, the IMF is in a position in 1975 to provide substantial additional support to any of its members on appropriate conditions and without further recourse to borrowings as undertaken by the IMF's oil facility this year.

The Fund has over $10 billion of currencies which are effectively available and usable, quite apart from its holdings of gold. We are prepared to support early measures to insure effective mobilization of the resources that the IMF now has.

And to provide adequate resources in future years we are prepared, in the current review of IMF quotas, to support a substantial increase in fund resources.

We are suggesting an initiative outside the IMF, in part because of the magnitude of the possible transfer requirements among the major industrial countries and in part because the terms and conditions of IMF financial operations are not appropriate to the exceptional circircumstances we now face—I discussed the critical relationships between our energy and financing proposals earlier.

Moreover, it would be inappropriate, even if possible, to introduce into the IMF the full range of policy issues which must be taken into account when decisions and judgments are made with respect to financial support among major industrial countries.

A second major element of the U.S. financial proposal relates to the developing countries and the smaller industrial countries.

For the developing countries it is essential that the major industrial countries maintain healthy, growing economies and open, efficient capital markets in the face of the oil crisis.

A facility which will help to assure the maintenance of economic activity and orderly access to the capital markets in the industrial countries will assist the developing countries as well.

These countries will also be able to make appropriate use of the resources of the IMF.

However, one group of developing countries—those with the lowest per capita incomes and those seriously affected by natural disasters and other problems—will require concessional assistance.

We and others have been redirecting our concessional assistance toward these countries and urging the international financial institutions to do the same.

We look to the oil exporters to provide a major part of the additional concessional funds needed by these countries because of the increase in oil prices.

While the additional amount needed by these poorest countries—perhaps $1.5 billion in 1975—is small in comparison with the oil exporters' surpluses, the sums involved bulk very large for the countries concerned because their needs are desperate.

The new Development Committee will address the problems of these countries on an urgent basis. We shall keep the availabilities of funds, as well as the efforts of developing countries to use available resources effectively, under continual review. As one way to help these countries, we have suggested the establishment of a trust fund managed by the IMF and financed on the basis of contributions from OPEC states and from other sources.

We have requested that this suggestion be given urgent attention by ministers in the IMF Interim Committee and the IMF/IBRD Development Committee.

Under Secretary Bennett has just returned from a series of meetings in Europe where our and other proposals were introduced and discussed.

At these meetings—of the OECD's Working Party III and Deputies of the Group of Ten—other participants expressed interest and requested further elaboration. No commitments were sought or given.

It was agreed, however, that possible new cooperative arrangements should be studied urgently. The Deputies of the Group of Ten agreed to establish a working group to examine in greater detail the technical aspects of both the U.S. proposals and the quite similar proposals developed independently by the Secretary General of the OECD.

This group will meet twice before Christmas and again shortly thereafter, with a view to finishing its report by mid-January.

A reduction in the price of oil is in the best interests of the oil producers and of the world as a whole. The proposals the United States has outlined provide the framework for collective action by the industrial countries to reduce their dependence on imported oil and to promote our mutual economic and finanical solidarity.

Success in this collective effort among the consuming nations will help establish the basis for resolution between consumers and producers of the oil issue.

I urge your support in this effort, and welcome your comments and criticisms.

Representative Reuss, Jack Bennett and I will be delighted to respond to your questions.

As I say, Jack just returned from consultation with our partners abroad. I am sure there are many areas that he can report on that would be of interest to you.

Representative REUSS. Thank you, Mr. Secretary.

Secretary SIMON. Also, Representative Reuss, I would like to submit the responses to your questions for the record of which we have given you a copy.

Representative REUSS. I submitted 10 questions and you have produced a document which has answers to those questions and under the rules and without objection it will be received into the record,[1] but I want to explore that a little more fully.

### KISSINGER-SIMON PROPOSAL VERSUS EXPANDED IMF OIL FACILITY

First of all, as to the amount, $25 billion for the first year alone with $8 billion for the United States, is a tremendous exposure, many times that of the Marshall plan. Why was that very considerable sum of $25 billion, of which $8 billion to be U.S. funds, selected?

Secretary SIMON. Representative Reuss, this is not a firm number. This was our suggestion. Nor is the 25 to 30 percent the exact participation. Both of these figures are going to have to be negotiated in the months ahead.

However, we felt very strongly that this facility should be large enough to provide the confidence that was required for the participating countries to accomplish—everything as far as their domestic economies and financial and economic solidarity and energy policy solidarity among the consuming nations is concerned. So they need to be aware that this safety net exists to take care of their financial problems if an emergency arises, but it includes the very strict criteria of (a) conservation and (b) running their domestic economies properly.

[1] See response of Secretary Simon to written questions posed by Representative Reuss prior to the hearing, beginning on p. 23.

Representative REUSS. I have pointed out that the U.S. exposure in the International Monetary Fund is on the order of 21 percent, yet here it is proposed that we have an exposure of about 30 percent. That is a difference of several billion dollars a year, and I wonder if we wouldn't be better off allying ourselves with the more favorable percentages in the IMF. After all, we have been trying for some years to get our IMF share reduced, as I recall, from 33 percent to 28 percent—now 21 percent. I hate to see us forgo that progress toward a somewhat lessened U.S. participation.

Secretary SIMON. Well, as you know, we have been reducing our size in all of the internatitonal financial mechanisms over the years as the other countries of the world have grown stronger. There again the figure of 25 to 30 percent was just a starting number to be negotiated. While our participation in the IMF is approximately 20.8 percent, we truly believe that, given the magnitude of this problem, if the IMF were to undertake this job, the facility would be large enough for the entire membership and that we would end up somewhere in that area. But again this is just an initial judgment in designing this mechanism.

Representative REUSS. Of course, things would have to be done with the IMF, if that is the vehicle used, but a number of people including Dennis Healey, have suggested that they could be done. I believe Mr. Healey proposed a $30 billion IMF facility. There is no reason why the IMF could not float a fund for the benefit of its beleaguered industrial partners; indeed the IMF-related Group of Ten has been in existence for 10 years or more.

With that kind of approach I hate to see us start our bargaining with a 30-percent rather than a 20.8-percent U.S. exposure.

Secretary SIMON. We believe, as this proposal relates to energy and related financial problems, a facility that is associated with the OECD—I stress the associated part—is consistent with the International Energy Program (IEP) that was recently agreed to.

Representative REUSS. Well, that is all very well. I am a great believer in building up the OECD and I am glad to have the International Energy Agency under the OECD umbrella. However, I must confess I do not like to start out our bargaining on the basis that the United States is going to put in 30 percent rather than on the basis that the United States is going to put in 20.8 percent.

Secretary SIMON. Again I stress we said 25 to 30 percent would be our rough guess, but this is to be negotiated and no one really knows. But as the negotiations proceed and as the criteria are established for a percentage, we will certainly be in close consultation with you, let me assure you of that, on every step of the way.

Representative REUSS. I hope you will make clear to our negotiating partners that the initial reaction of Congress to the 30-percent U.S. input was not one of wild and unbridled enthusiasm and that we would be glad to make our contribution something less.

#### POLICING THE CRITERIA FOR REPAYMENT

On the question of policing the agreements exacted from borrowers from this fund, agreements as to conserving oil and energy, cutting down on oil imports, pursuing anti-inflationary and antirecessionary domestic policies—I, of course, heartily support that those commitments should be obtained and policed, but here again you have in the International Monetary Fund teams of experts who for years have been having annual reviews of each country's economy.

The OECD simply does not have country teams of anywhere near that stature. If in the end it is decided to lodge this task where you propose to lodge it, in the OECD, couldn't there be a little administrative lend-leasing from the IMF so that you would not have to build up two competing bureaucracies, which we would have to pay for in the end, anyway?

Secretary SIMON. I would not envision, Representative Reuss, that this would be the creation of a bureaucracy. On the contrary, I oppose philosophically the creation of additional bureaucracies when indeed one already exists.

We have very marvelous economists in the OECD as far as the OECD member countries are concerned, and so we would imagine, as we envision this facility, that it would be policed by the senior financial officials of the countries that join this facility. And, of course, the staff work could be borrowed from OECD and our own staffs as well. So it would not be the creation of additional staff.

Of course, the OECD does have extremely good energy capability as compared to the International Monetary Fund.

We also think the policy decisions as they relate to lending by this facility really would be better policed by senior finance officials from participating governments, rather than in an OECD mechanism.

Representative REUSS. Well, it is fine to have ministerial level, senior finance officials, being the head policemen, but I was thinking of the long and tortuous annual drill that occurs. The IMF is equipped to do that; the OECD is simply not so equipped.

I am relieved to hear you say you do not propose to set up a big OECD bureaucracy. We would be getting into another situation like putting on price controls and having the Internal Revenue Service administer them, which was not in my judgment one of our finest hours.

Why not work out a little administrative lend-lease arrangement with the IMF?

Secretary SIMON. I am not opposed to that at all, Representative Reuss. I think that that is entirely possible. We should always borrow from the expertise of organizations.

Representative REUSS. Let us talk about the real world, and let's say about Italy, a country for which I have a great deal of love and affection. It is in trouble. It will be one of the first borrowers, I would judge. It has already gotten $2 billion from the Federal Republic of Germany. The setting of tasks and standards for Italy would be a tremendously complex thing.

I would think that you really would need the IMF staff who have been trying to do that for Italy for some years on tap.

Secretary SIMON. We have IMF people at OECD meetings, as you know, and while Italy may or may not be a candidate for the future, they have not yet exercised their rights with our Federal Reserve as far as their borrowings are concerned. They have adopted very stringent domestic financial and economic measures in their country, which have shown some good results in recent months.

Representative REUSS. My impression is that good as the OECD staff is, it is not country-oriented to anywhere near the degree of IMF, but I am pleased by your answer, which suggests you will do a little exploring of that.

Secretary SIMON. Let me assure you I do not have a closed mind. This is all subject to negotiation, as I said. I love to be able to borrow good people to assist us with difficult jobs. We should use all of the expertise that we have in this world.

IMPACT ON DOMESTIC CAPITAL MARKETS

Representative REUSS. Let's look at the question which I posed in my series on how the United States will get hold of the $8 billion.

In your answer you suggest that we get hold of the $8 billion mainly by reaching out and taking hold of some of the Arab credits, OPEC credits in this country and recycling them. But when that happens, when the Treasury, I guess it is the Treasury, goes in and borrows to the extent that it does, it competes in U.S. domestic capital markets, does it not, with other demands, ranging from commercial bank loans to import-stricken countries?

Secretary SIMON. Yes, sir.

Representative REUSS. With domestic housing and capital investment?

Secretary SIMON. We are doing that at a very alarming rate, competing for funds in our domestic capital markets by federally sponsored agencies, if that is the question.

Representative REUSS. What would be your philosophers' stone for distinguishing between when you are going to go into the capital market for your $8 billion at the risk of driving up interest rates and leaving the cupboard bare of domestic and foreign private credits, and when you are going by debt transaction, whatever shuffling of papers is involved, to create new money which, in a world inundated by new money, might simply add to the worldwide inflation? How are you going to work that one out?

Secretary SIMON. I would say that that danger always exists, but we perceive the real danger not as the creation of new funds, because reserves are readily available; the problem is the channeling of the reserves and directing them to the countries that need them, and obviously the Treasury Department must finance a deficit.

It finances a deficit in many ways, as you know, Representative Reuss. Part of the funds that we will receive from the OPEC nations, from the oil producers, will come, as indeed they have come, into government securities. During the year 1974, approximately half the amount of funds that have moved into the United States have come into the U.S. Government securities.

Representative REUSS. In your statement, Mr. Secretary, you said, and I quote:

> The facility need not lead to an increase in Federal Government debt held by U.S. citizens.

Can you assure me that the facility will also not lead to increase in government debt held by the Federal Reserve?

Secretary SIMON. I could not assure you of that, but that is not the way we envision it working. We would not expect that it would be held by the Federal Reserve because obviously it would be most counterproductive in that fear that you very directly raise.

Representative REUSS. That would be inflationary would it not?

Secretary SIMON. Yes, indeed, it would.

Representative REUSS. When you used the word "U.S. citizens," did you mean to include banks as well as individuals?

Secretary SIMON. Yes; any U.S. entity.

Representative REUSS. That could be inflationary, too, could it not, bank holdings of U.S. securities?

Secretary SIMON. Traditionally, banks are large owners today of government securities, and they continually buy these securities for investment and liquidity purposes.

Representative REUSS. I am having a little difficulty with the concept you advance that the operation of this facility will not lead to an increase in Federal Government debts held by U.S. citizens, and you have just defined citizens as including banks.

I should think that when a bank has a deposit credit owing an OPEC country——

Secretary SIMON. That is considered.

Representative REUSS. Then wants to start the recycling process, it is going to, in effect, trade that deposit to buy U.S. securities, and thus U.S. citizens, that is, banks, will end up owning more U.S. securities, maybe by the billions.

Secretary SIMON. I do not follow that transaction, Representative Reuss.

When we say non-U.S. citizens or non-U.S. entities, we expect that the transfer of financial resources that will be flowing to the oil producers will result in at least these amounts being invested in our securities.

As a result, this is not the creation of new reserves, it is a rechanneling.

Representative REUSS. I could agree with that, but it does result in the augmentation of the ownership of U.S. securities by U.S. citizen banks, does it not?

If they start the recycling process by paying for a U.S. Treasury bill with an Arab credit, that, it seems to me, is going to result in a net increase in U.S. securities held by the banks.

Secretary SIMON. I must admit maybe I am a little thick this morning. If we sell a Treasury bill or coupon issue to producing nations outside of the United States, I do not see how it ends up as a U.S.-owned asset.

ASSUMING THE POOR RISKS

Representative REUSS. Let me now pursue the point I made in one of my questions that, by setting up a facility of this nature, which is directed at bailing out the poor credit risks, we in effect tell the OPEC countries, OK, you pick the good credit risk like the Federal Republic of Germany and the United States, and we will take care of the poor ones, and if ultimately the debtor does not repay, of which there is a possibility, it would be the 30 percent at least the United States had lost and the loss of the other Western countries to the remaining extent.

Secretary SIMON. I do not necessarily agree with that basic premise that there are going to be many borrowers and a few lenders, if you will, sir. We would hope that there would be more lenders than there would be borrowers in this facility.

We would also expect that the OPEC nations would lend directly to other countries—as indeed they have been doing this year—countries with financial difficulties.

Representative REUSS. But are they not going to become more leary of lending to the weak debtors because the facility now transfers this obligation to the members of the consortium?

Secretary SIMON. I do not see that in the absence of this facility, Representative Reuss, we can force them to go to the weaker countries anyway.

Representative REUSS. I suspect the truth of the matter is that the criticism I am suggesting is probably valid, but I do not really see any way out of it.

Secretary SIMON. I was about to say, what is the alternative?

Representative REUSS. I do not see any way out of it.

EXCHANGE STABILIZATION FUND AND CONGRESSIONAL CONTROL

Let's now turn to the possible use of the Exchange Stabilization Fund of the Treasury—now on the order of $5 billion—as a total or partial method of funding the U.S. participation in this facility.

This does bother me a good deal because the Exchange Stabilization Fund is, first of all, designed historically to deal with dollar stabilization. Now I know you can argue that, if we save the lira or something else, it will help the dollar, but it does seem to me farfetched and it does have the disadvantage that there really is not any congressional control over it.

I am bound to remind you that Congress is unhappy about some of the things this Ex-Im Bank has been doing, is unhappy about the Russian wheat deals of a couple of years ago. There is a tendency here, and I am sympathetic to it, to want greater congressional control.

Now, I know you are going to say, well, you do not really know how, or to what extent this facility is going to be called on until the event and you do need some flexibility, but I think that we are going to have to work out a way that really gives Congress about as much control as it has over foreign aid.

You say this is not foreign aid, and it is certainly a different form of foreign aid, but it is designed to help other countries, and our interest is simply in the kind of a wholesome world that we hope helping other countries will bring about.

Secretary SIMON. Let me assure you, Representative Reuss, as I did earlier in my testimony, that there is absolutely no intention of circumventing Congress.

We mentioned the exchange stabilization fund as the vehicle because stabilization of the dollar and a more stable international monetary system are major purposes of this facility. Of course, it has other purposes.

We recognize we do not have any plea other than conceived prejudice. This is the route we want to go. We want to work with you to decide whether it should be through authorization and appropriation, the General Agreement to Borrow, a guaranteed approach, or whatever. But it would be through congressional authorization and working it out with you. That I will assure you, sir.

Representative REUSS. What role do you envisage for the Federal Reserve in supplying all or parts of the funds needed to carry out our proposed U.S. commitments?

Secretary SIMON. We had not conceived of any Federal Reserve participation in this whatsoever, Representative Reuss.

Representative REUSS. So there will not be a Franklin National Bank-like use in which the Fed discounted more than a billion dollars of Franklin's paper and then offset this by monetary operations. You do not envisage anything like that?

Secretary SIMON. Absolutely not, sir.

Representative REUSS. Then what role does the Fed have to play in this—not that we have to dream up a role for them—but as a friendly bystander?

Secretary SIMON. Well, when we say friendly bystander, the Fed is a part of the economic policymaking machinery in Government, and they will perform their traditional role of lender of last resort here in the United States. But I cannot envisage any participation in a facility such as this by our Federal Reserve System.

Representative REUSS. In justifying the possible use of the Exchange Stabilization Fund, Mr. Secretary, you say that this fund has the authority to engage in international lending operations for the purpose of stabilizing the value of the dollar. Then this would be a basic purpose of our participation in the proposed facility. What does that mean?

Let's talk about Italy again. Let us suppose that Italy continues to be hurting, the lira is sinking; are we going to support the lira?

Secretary SIMON. It is not only stabilization of our dollar, it is the maintenance of a stable international monetary system. As far as intervening is concerned, we and other governments have agreed—and, indeed, we do have constant consultations with other governments on intervention—to maintain a stable international monetary system.

Representative REUSS. The only use of the currency of the Exchange Stabilization Fund, and indeed of the resources of the Federal Reserve System, are, as I understand it—and you and I have had considerable correspondence on this—to avoid disorderly conditions in the exchange market.

Secretary SIMON. That is generally correct.

Representative REUSS. We are not now going to alter that and suddenly decide that the $x$ foreign currency has to be preserved at any particular level in the absence of disorderly conditions?

Secretary SIMON. I think that from the considerable correspondence that we have had, Representative Reuss, as well as many conversations both privately and in testimony—the last time, I guess, before Senate Finance—my position is well known on that, as is Under Secretary Bennett's position; we do not undertake to rig, if you will, any currency at any particular level.

EXPANDED ROLE FOR OECD

Representative REUSS. Now, I noted that the International Energy Agency under OECD started business in Paris on November 18. I was asked by a European friend when Congress had authorized the International Energy Agency, and so far as I know, we never have. If true, is that not rather an extraordinary way to proceed?

Secretary SIMON. Let me explain what has happened since the Washington Energy Conference in February and the subsequent negotiations on energy sharing and all the other matters discussed over the winter, spring, and summer months. Our State Department and Treasury Department people had intensive consultations with Members of Congress as to the direction we were heading, and Congress was told that when we finally reached some sort of agreement, that this agreement would be reached subject to congressional approval, and we will be up before anything is signed to ask for your approval in several areas: Storage, allocation, et cetera.

Representative REUSS. But with respect to the new Kissinger-Simon financial safety net, will there be advance legislative ratification before any U.S. commitment is made?

Secretary SIMON. Absolutely, Representative Reuss. And I would imagine we would do the same thing we did with the IEA. That is, we will have ongoing consultations with you while we are seeing the direction this facility takes over the next 6 weeks.

Representative REUSS. In my series of written questions, I noted the OECD could well be elevated in general stature in the kind of things that it does. Incidentally, I have thought of the OECD for some time as an agency with great potential and it now has a livewire executive director, Mr. Van Lennep, whom you know. Therefore, I am by no means distressed by adding on to the OECD-related function the International Energy Agency and this new safety net facility.

If OECD is to be elevated, however, to an organization concerned with current economic life and death matters, would it not be worthwhile considering whether OECD would profit by having a parliamentary consultative assembly like the NATO parliamentarians?

One does not want to proliferate these agencies, but from my discussions over the years with the Europeans, it seems quite likely that they might be willing to give up a number of their other existing parliamentary agencies such as consultative assembly of the Council of Europe, if somehow OECD could be so endowed.

Secretary SIMON. I think that is an intriguing suggestion which I noted with great interest, Representative Reuss. I think the fact that we have associated the IEA with the OECD, and have now suggested that the oil facility be associated with the OECD, recognizes, as you said in your opening statement, the importance that we place on OECD, the high degree of respect we have for this organization.

Representative REUSS. I would hope in your negotiations that you would keep in touch with the congressional leadership because it might well be reassuring to Congress in the long run to know that it had a continuing parliamentary role which I think would make your task easier.

Secretary SIMON. I agree with you, sir.

### AID TO POOR COUNTRIES

Representative REUSS. You have proposed that the making of concessional loans to the poorest countries be left to the IMF. Why, I have asked, should the IMF get into this aid business directly when the World Bank, the IDA, and several regional development banks are already equipped to handle multilateral assistance?

Secretary SIMON. The World Bank and the other development institutions give primary attention to concessional aid for development programs, while the problem that exists here is one of balance of payments, and IMF has the expertise in the balance-of-payments area. We would expect that the IMF would receive the major portion of these funds from the OPEC producers, recognizing that they have a responsibility—which we believe they do recognize—to assist the most seriously affected countries in the world.

Representative REUSS. I am glad to hear you say that. It would be your intention to do everything you can to get the maximum possible participation in this IMF concessional fund by the OPEC countries?

Secretary SIMON. It most certainly would be.

### CONFRONTATION VERSUS COOPERATION

Representative REUSS. Now, President d'Estaing of France has made a somewhat different suggestion on relations with the OPEC, which seems to me, from what I have been reading in the papers, to have been turned down by the United States. Giscard d'Estaing's suggestion in short was that, while the Western users go about their business of formulating a conservation policy, developing a safety net fund, and the other things that need to be done, negotiations with OPEC countries would continue. There would be a seat at the table for them, whereas our Kissinger-Simon proposal says in effect, first, Western solidarity and a start at least on conservation and safety net measures, and then you do not use the word "confront," and I will not put that into our presentation, but then, only then would the OPEC countries be brought in.

Is there not something to be said for d'Estaing's view? While we prefer it the other way. If, during the course of negotiations, the price of getting France into the conservation effort was to have some OPEC people around—starting at once—would that really be fatal?

Secretary SIMON. No. 1, we correctly, as you said, do not wish to have confrontation with the OPEC nations.

No. 2, we did not turn down Mr. Giscard d'Estaing's proposal; it is a matter of timing. From the time of the Washington Energy Conference last February, we have said that there ultimately must be a meeting between the producers and the consuming nations.

We also believe that international cooperation and the interrelationship between energy, finance, and economic policies in each country have to be closely integrated. Cooperation must exist, and many agreements have to be put in place, such as the development of the International Energy Agency and IEP and research and development and production, et cetera, throughout the world.

This oil facility that we propose is just another proposal in the step on the road to the ultimate meeting between the producers and consumers, but what we have to do rather than just call a meeting is to sit down and very carefully determine what we are going to talk about at this meeting, what the agenda should be, other than the obvious subject of the price of oil and its economic impact on the world.

ENERGY CONSERVATION

Representative REUSS. The energy conservation feature of your program is designed to cut oil imports by 3 billion barrels a day, or $11 billion a year, of which our share would be one-third, 1 billion barrels a day.

How are we going to fulfill our part of that commitment without measures that can generally be described as heroic; that is, sharp increases in gasoline taxes accompanied by some kind of a gas stamp plan or gasoline rationing, or compulsory rules about gas-guzzling automobiles, such as forbidding them and taxing them, or whatever?

Secretary SIMON. No. 1, Representative Reuss, we did not suggest 1 million barrels a day would be our share; nor is the figure 3 million barrels a day. It may turn out when the number of countries that join this proposed facility work on the formula for conservation of energy in their countries, that we may be able to beat that target of 3 million barrels a day.

As far as the United States is concerned, as you know, the President has set a target of a million barrels a day by the end of 1975 for reduction in oil imports.

How can this be accomplished? Look at switching—for which we have submitted legislation—from oil to coal in our industries and public utilities; the national 55-mile-an-hour speed limit, which many believe has somewhat gone by the wayside in most of the United States; and the amendments to the Clean Air Act to allow not only utilities but many industries to burn coal. This will help us reach this goal.

Apart from that, the President said that if the voluntary measures—most of the measures we put in place last year during the embargo were voluntary and we did not have mandatory powers at that time either—do not work, then the President will not hesitate to take stronger measures, whether it is the mandatory allocation program for which we still have the authority, and indeed the mechanism is in place. We could put that in tomorrow morning, Representative Reuss, where we would say that X industry would receive 85 percent of the base period and Y industry 90 percent, and so forth. That could be achieved immediately.

It would be better, especially in an economy that is in a weakened position, if we could achieve this on a voluntary basis, using these measures, rather than exercising the mandatory allocation program which is going to have, albeit, as minimum as possible an impact on our economy.

Representative REUSS. As of today, do you think we can get by with purely voluntary conservation?

Secretary SIMON. Well, it is too early to tell.

As far as the numbers coming in are concerned, it would require, as we said at the outset, the figures over a longer period of time running into January or the end of January and the beginning of February before it will be decided whether or not these measures are taking hold. Certain things cannot be done overnight as far as energy conservation is concerned.

As I say, whether it is allocation or higher tax on gasoline or several other mandatory measures, the President is not going to hesitate to make that decision, and that will be our target by the end of 1975.

PROTECTING THE COMMERCIAL BANKING SYSTEM

Representative REUSS. One of the purposes of our whole facility is not to leave the entire burden of recycling, which has been growing, to the commercial banking system, recognizing it would have to overextend itself in order to carry out the function.

However, even with this facility, what is to prevent the commercial banking system from making improvident foreign loans, wanting to keep at least part of the recycling business to itself?

What needs to be done by the bank regulatory agencies, for example, most of which are under your jurisdiction?

Secretary SIMON. Well, of course, I am sure Arthur Burns will talk to that in some length on Wednesday when he arrives here. We never expected that the massive job of recycling would be handled by any one element of our international financial system. Many mechanisms have been established over the past 10 months that have been rechanneling funds, and these mechanisms include not only commercial banks, the Eurodollar market and special funds of the IMF, but direct aid from the producers to the consumers.

The producers' have their own mechanisms that have been established; for example, a Kuwaiti fund that was increased from $600 million to $3.2 billion, and this is just another supplementary fund as a safety net to add to all of the existing mechanisms that we have today.

NECESSITY OF LOWER WORLD OIL PRICES

Representative REUSS. Would you agree that if the United States enters in a big way on this plan and does make huge loans along the lines suggested, the only way we are ever going to get repayment on those loans is by running equally huge trade deficits with other countries, not necessarily the bilateral debtor country, but with somebody with the same problem we had in the 1930's? I think we have to adjust our trading patterns so that we run trade deficits, we cannot rely on capital flows to make the fundamental adjustment.

Secretary SIMON. As far as repayment is concerned, though I recognize there is a clear danger, I will not accept that because one of the purposes of this special facility is recycling connected with conservation measures to put additional pressures on the price of oil, to bring down the price. That is, the surest way we can guarantee repayment to the members of facilities is to work on the problem itself, not just the results of the problem, as we do so well.

Representative REUSS. A reduction in price would be a happy ending and one devoutly to be hoped.

Secretary SIMON. That is what we really have to work on, the problem itself, which is the price of oil, because if this price of oil were to last for an indefinite period of time, one could conjure up a lot worse scenarios than the one that you have just described.

Representative REUSS. If then the price of oil does not come down, so we have to make the very substantial loans that you are talking about, you would have to be prepared to run trade deficits in order to permit the servicing of those loans. I do not say there is anything wrong with that. Why not let others make some of the things we need?

Secretary SIMON. That would be an option, Representative Reuss, that we would have to look at in that eventuality. But I think in the interim we ought to focus our efforts, as I say, on the problem itself, which is the price of oil. We have shut-in world capacity today, shut-in capacity in the OPEC nations, of slightly over 8 million barrels a day in production.

Simultaneously, in the past year we have had approximately 30 billion barrels of oil discovered in non-OPEC sources, which will result in approximately 13 million barrels a day of production between now and 1980.

This is what we have to focus our efforts on: Measures to conserve and measures to produce—to bring the price down to a realistic level.

### OTHER COMMODITY PRICES

Representative REUSS. I would just have one more question before I thank you, and then I will have a few more for Mr. Bennett after you go.

Switching from oil to another commodity, which is not of equivalent importance but does have a great many Americans worried, sugar.

In the last couple of years you have done valiant service for your country by going around the world and doing your level best to ameliorate our oil import situation. The fact that you were not terribly successful is no reflection on your efforts.

Do we not need some highly placed administration official right now making 3-, 4-, or 5-year mass sugar purchasing deals with some of the cane sugar tropical countries?

The reason they are unable to work world demand, the situation is so bollixed up they are not sure that they will be able to sell. It seems to me to protect the American housewife and that portion of American industry which are important sugar users, we ought to consider what other countries do, which is to have the Government assure an adequate supply.

The little candy manufacturers are not able to go to X tropical country and make a 3-year deal, but the Government can.

Secretary SIMON. Representative Reuss, before I came to this hearing, I, in my capacity as Chairman of the Council on Wage and Price Stability, opened up a 2-day session, which is going to have 35 various people testifying, from consumers to middlemen, the bakers, the small businesses, that are suffering, as you have so correctly described. We have had a situation in the past year where the price of sugar has gone from 18 cents to 64 cents. Something is wrong.

The purpose of these hearings is to determine the exact causes. We know that world production is down, consumption is up, and that is one cause.

Are there other causes? Is there speculation, et cetera? This is what we intend to get to the bottom of.

As far as the overall subject of raw materials is concerned, and even though sugar does not qualify as a raw material per se, it could certainly be considered in this category, and could be considered by the Commission on Supplies and Shortages, recently created by Congress. We are having our first meeting this afternoon to commence that effort.

As you know, this was a very short time frame. I believe it is March 1, 1975, for a final report in this area.

Now whether or not we should have a government entity that would purchase sugar or aluminum or lead or even oil to begin to subsidize and protect, which would have to be subsidized by the consumer in this country, that opens up a much larger subject, as you know.

Representative REUSS. I want to record my view even though sugar is not the most important commodity around, our Government does owe sugar users its best efforts to alleviate the shortages as quickly as possible.

Secretary SIMON. I agree with you.

Representative REUSS. And tropical cane is obviously the place to do it. I would hope that we could get on with that.

Thank you very much, Mr. Secretary. You have acquitted yourself, as always, extremely well; the written questions and answers will be included in the record.[1]

I would like to have Under Secretary Bennett stay for just a minute.

Secretary SIMON. Thank you very much, sir.

REACTIONS OF NEGOTIATING PARTNERS

Representative REUSS. Maybe you could tell us, Mr. Bennett, what the reactions of your negotiating partners were at the Group of Ten meeting in Europe last week, particularly the Federal Republic of Germany, France, and Japan, to the proposal?

Mr. BENNETT. As Secretary Simon said, there was no effort to obtain commitments from the Deputies or their representatives at the Working Party III or the G–10. The effort was to obtain their understanding. There was extreme interest and they voted unanimously to set up a technical working group which will have two meetings before Christmas and report back to the Deputies of the G–10, a meeting which we have scheduled here in Washington on the 10th of January, so that the Deputies in turn can advise their ministers.

As you know, ministers of finance of the world will be convening here in mid-January in Washington.

Representative REUSS. What do you envisage as the timetable? When will a tentative agreement be initialed if all goes as you want it to?

Mr. BENNETT. Our hope will be that the principal ministers of finance might agree in mid-January.

Representative REUSS. By what?

Mr. BENNETT. Mid-January; we would like to see the agreement in principle from the ministers of finance.

Representative REUSS. When would you be coming to Congress?

Mr. BENNETT. Secretary Simon intends consultation meanwhile but, in terms of putting forward a specific proposal to Congress, the decision will be made after we get their more definitive reaction in January.

Representative REUSS. If you do get a definitive reaction from your negotiating, when would you like to come to Congress for the necessary ratifying legislation; right away, late January?

Mr. BENNETT. As soon as possible after mid-January, yes, sir.

Representative REUSS. Mr. Bennett, we have a number of more or less technical questions which I would just as soon not ask because

[1] See response of Secretary Simon to written questions posed by Representative Reuss prior to the hearing, beginning on p. 23.

they are somewhat boring and, also, they require arithmetic. May we present those to you for Secretary Simon to answer them at his convenience? [1]

DETERMINING THE U.S. SHARE

Mr. BENNETT. I would appreciate that, but I would like to make one comment on the arithmetic.

I realize you have been using the number of $8 billion as an illustration. I would remind you that 30 percent of $25 billion is only $7.5 billion and, of course, 25 percent of that is $6.25 billion. So $8 billion, I am sure, is just round, rough arithmetic.

Representative REUSS. Right. But I still stick to my point that 20.8 percent is more merciful to the United States than 30 percent.

Mr. BENNETT. Well, I am not sure of that.

Of the OECD members, we have 32 percent of the quotas in the IMF. We realize that most of the quotas in the IMF these days are not usable, not convertible. Practically speaking, it is the quota of OECD countries which is usable.

So I think there is a reasonable ground not to think that our share would be larger if we attempted this initiative in the IMF.

Representative REUSS. True. But if you are starting at the IMF, a 20.8-percent agency, it seems to me that you have a better chance of sticking to that general area, if you stick with the IMF, who presumably would, if you went the IMF route, presumably the IMF would be the umbrella for this new agency, and would not be just an additional quota.

Mr. BENNETT. Again, a couple of technical points.

Our voting share is 20.8 percent. Our financial share is somewhat higher, almost 23 percent.

Also, the 20.8 is 32 percent, I repeat, of the OECD portion of the IMF.

So, if you follow that route, it could have been larger.

We have for example, as you know, approximately a one-third contribution to the General Agreement to Borrow (GAB), which has some similarity.

Representative REUSS. Yes, of course, the GAB arithmetic was done at a time when, by almost every index, we bought larger—vis-a-vis—the other great industrial countries than we do today.

Mr. BENNETT. It was also done at a time when the possibility that the United States would need to borrow was perhaps greater than it is now.

This is a facility which we wish to approach in recognition that our ability to forecast who will be in need and who will not is not an unblemished record. This is an insurance facility that can work on both sides for each country.

Representative REUSS. Thank you very much, Secretary Bennett. We are very grateful to you; the additional written questions and answers will be made a part of the record.

The hearing will recess until 10 a.m., Wednesday, November 27, 1974, when Mr. Arthur F. Burns will testify.

[Whereupon, at 11:20 a.m., the committee recessed to reconvene at 10 a.m., Wednesday, November 27, 1974.]

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[1] See response of Secretary Simon to additional written questions posed by Representative Reuss subsequent to the hearing, beginning on p. 25.

[The following questions and answers were supplied for the record:]

RESPONSE OF HON. WILLIAM E. SIMON TO WRITTEN QUESTIONS POSTED BY REPRESENTATIVE REUSS PRIOR TO THE HEARING

*Question 1.* The proposed financing facility envisages commitments of $25 billion (with the U.S. providing $8 billion) in 1975 alone, and more later. Why so much?

*Answer.* What we want is a facility of sufficient size to provide reasonable assurance to participants and to the private market that adequate resources will be available to meet emergency needs. There is obviously no "magic number" that can guarantee success in providing such confidence, and the exact size will depend to some extent on the eventual membership in the facility. We believe that $25 billion is not excessive in present circumstances, if the facility is to provide nations with basic confidence in the security of their positions in dealing with the energy crisis.

Participation and shares are by no means decided at this stage. In my speech last week, I mentioned three factors—oil imports, relative GNP, and shares of world trade—that might be given weight in deciding shares of participation in the new facility. These numbers suggest a U.S. share of somewhere between 25 and 30 percent.

*Question 2.* How stiff will be the commitment by recipients to cut down oil imports and to pursue appropriate internal and external economic policies? How will those commitments be policed? What assurances will the United States receive that the massive foreign assistance envisaged will be of limited duration and will be repaid?

*Answer.* No participant will receive a "free ride" from the operation of this facility. Eligibility to join and access to the facility's resources will be conditional upon specific commitments in energy, trade and economic policies which provide adequate assurance that the objectives of the program can be achieved. As we envisage it, supervision of the operations of the facility and surveillance of countries' commitments would be the responsibility of a managing board of senior finance officials, which would operate on the basis of weighted voting.

This is not some kind of foreign assistance scheme. The facility is designed—as an integral part of a comprehensive effort to strengthen the financial security of the world economy—to provide financing in case of emergency need for countries cooperating in energy. It is a standby, insurance mechanism, and the fact that it is in place should buttress the operations of the private markets and, hopefully, make it less likely that countries would have recourse to the facility. Moreover, the facility would operate on market-related terms.

The best assurance of repayment will be the creation of the conditions that will result in a lower price of oil. The fact that each participant will have to share in the credit risk and the prerequisite of a sound energy and general economic policy for obtaining loans will do much to create the conditions necessary for making repayment possible. Certainly the greater risk would be not to act to reduce oil import dependence.

*Question 3.* How will the United States obtain the $8 billion needed to honor its apparent commitment? If this amount is not raised through taxation or borrowed in domestic capital markets, the $8 billion of loans will require the creation of additional money. Now struggling with global inflation, the world hardly needs a major boost in total money supply. On the other hand, if the funds are to be borrowed in capital markets, the Kissinger-Simon plan will merely substitute for private lending. What is the contemplated mechanism?

*Answer.* We have no precise figure for U.S. participation at this stage, although the economic factors we have felt particularly relevant suggest a U.S. share somewhere between 25 and 30 percent.

The operation of the facility, whether it takes the form of direct lending or guarantees, would not require inflationary expansion of money and credit. OPEC revenues which are not spent on imports of goods and services must be invested in the group of oil importing nations as a whole. The international financial problem is not one of the overall availability of funds but rather the pattern in which net flows of capital are channeled. The purpose of the facility is not to create new funds, but to rechannel net flows of already existing funds if this proves necessary.

The facility will not substitute for private lending or other sources of financing. It would be a supplement, for use when needed—under important policy conditions—if funds are not available to participants from other sources on reasonable terms.

*Question 4.* Aren't we letting the OPEC countries off the hook too readily by allowing them to choose the easy way of lending to the good credit risks like the United States and West Germany, while we and a few others assume the risky task of relending these sums to a host of potentially shaky debtors?

*Answer.* I don't think so. I agree that the OPEC countries should assume the normal risk involved in the provision of financing. But they are able to avoid the risk of lending to particular countries if they wish to do so. They do not assume such risk, for example, as a result of the loans they have made to the IMF oil facility, where the major industrial countries in the Fund bear most of the risk.

We believe that our proposal is a preferable approach, for it avoids providing the oil producers with highly attractive guaranteed assets and directs them into the private markets, where they will have to accept normal risks and yields. And we encourage their direct lending to countries in need on reasonable terms and conditions.

*Question 5.* Secretary Simon mentioned the Exchange Stabilization Fund (how $5 billion) as a possible source of U.S. funding. Does this mean that Congress would be denied the authorizing and appropriating function that it now exercises over other forms of foreign assistance? Will the Exchange Stabilization Fund be bolstered financially by the Federal Reserve? If so, will Congress be told?

*Answer.* The Exchange Stabilization Fund was established for the purpose of stabilizing the value of the dollar, which depends on a viable international financial system. Assurance of a viable system would be a basic purpose of the proposed facility.

Legislation will be needed for any U.S. participation in the facility, and we will consult fully with the Congress on the best way to proceed.

*Question 6.* There has been no congressional authorization for U.S. participation in the International Energy Agency, which started business in Paris on November 18, 1974. Does the Administration likewise intend to set up the new Kissinger-Simon "financial safety net" before obtaining congressional authorization?

*Answer.* No. Congressional authority for U.S. participation in the facility will be needed, and we will undertake close consultations with the Congress to determine the most appropriate way to proceed.

*Question 7.* Why was the OECD selected to sponsor the facility, rather than the IMF, as Chancellor of the Exchequer Healy suggested? Is not the U.S. exposure likely to be greater under the OECD alternative—30 percent rather than 21 percent? Isn't there a danger of greatly weakening the IMF by limiting its oil financial function to the most distressed poor nations? Since a high degree of borrower policing will be required, why not use the IMF, which already has the staff and experience in this field, rather than the OECD, which has not?

*Answer.* The organizational details of the facility are not settled. But we have felt an association with the OECD offers the most promising prospects. Our proposal for a facility is intimately linked to our proposals for energy cooperation among the major industrial nations. The principle vehicle for energy cooperation among these countries, the International Energy Agency, has been established in association with the OECD. So it has seemed to us natural and desirable to link the financial aspects of our energy proposals also to the OECD.

The IMF's activities will not be limited to lending to the poorer countries. But we do not believe the IMF is or should be prepared to handle all of the possibly very large transfer requirements among the major industrial countries in the present situation. And we do not feel the terms and conditions of IMF financial operations are appropriate to the exceptional circumstances we now face. We feel the IMF should remain the central institution for handling the financing needs of a well-functioning world economy, and we are prepared to support a substantial increase in the Fund's resources.

On the question of exposure, placing more reliance on the IMF would not mean less exposure or risk for the U.S. First, our share in the new facility has not been determined. Second, to provide financial backstopping for the industrial countries of the magnitude we have in mind, the increase in the Fund's resources for all countries would have to be very large indeed. I would think that our exposure in dollar terms would be substantially the same in either case.

*Question 8.* If it is finally determined that the OECD should have all of these important new functions, should not the OECD be elevated both in importance and in its relationship with legislatures by setting up an OECD consultative assembly, with membership from the U.S. Congress?

*Answer.* I want to stress that while the financing facility would be associated with the OECD, under an OECD "umbrella" so to speak, it would be a creature of the participating governments, not the OECD. Policy and management would be determined by senior finance officials of the participating governments. We certainly intend to consult closely with the Congress, and will keep your suggestions in mind as our discussions of the new facility progress.

*Question 9.* Secretary Simon also proposed that the IMF make concessional funds available to the hardest hit countries. Why should the IMF get into the aid business when the World Bank, the International Development Association, and the regional development banks are already equipped to handle the multilateral assistance needs of the poor countries?

*Answer.* The trust fund we have suggested to assist the most seriously affected developing countries would be managed by the IMF as trustee, and financed principally not out of the Fund's resources but by contributions on concessionary terms from interested countries, especially OPEC countries. The IMF might itself make a contribution to this trust fund from the profits derived by the sale in the private market of some of its gold holdings.

While the trust fund would provide concessional assistance, such financing would be intended to help these countries with their balance-of-payments difficulties arising from the rise in oil and and other commodity prices. In the area of balance-of-payments assistance, the IMF has greater experience and expertise than the World Bank where the principal focus is development project lending, and we have felt the IMF would be the more appropriate agent for this purpose.

*Question 10.* The suggestion of French President Giscard d'Estaing—that the OPEC countries be included in negotiations during the period in which consumers are trying to conserve energy and develop new supplies—has been rejected in favor of obtaining consumer solidarity first. Could President d'Estaing be right and Secretary Kissinger wrong? Wouldn't keeping the OPEC countries in the negotiating picture now lessen the likelihood that they will act irresponsibly in the future?"

*Answer.* We are not seeking a confrontation with the OPEC countries. I believe cooperation between the oil producers and consumers will ultimately provide the best way to reach a durable soltuion to our oil problems. But I think it has become quite clear that consumer cooperation is an essential prerequisite to an effective consumer/producer dialogue toward this end. I don't think the development of effective cooperation among the consuming countries would be aided by bringing the OPEC countries into these discussions among consumers at this stage.

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RESPONSE OF HON. WILLIAM E. SIMON TO ADDITIONAL WRITTEN QUESTIONS POSED BY REPRESENTATIVE REUSS SUBSEQUENT TO THE HEARING

*Question 1.* What kind of criteria will be considered, and does the United States favor, to determine the shares of participation in the proposed oil fund (GNP, expected trade balance, oil deficit, basic balance)? What would be the U.S. share under these criteria if the fund membership were the same as the International Energy Agency? If the fund included in addition France?

If funds borrowed are drawn proportionally from participating members in the financing mechanism, will not the U.S. share effectively be higher than its nominal share of 30 percent (i.e., if several member countries like Italy are in dire straights, their currencies may not be very usable)?

How much of the $25 billion fund will be paid in and instantly available?

*Answer.* As noted in my testimony November 25, we believe a country's participation share should be related to various economic factors relevant to both potential need for financial support and potential ability to provide such support. At the G-10 meetings in mid-January, it was agreed that the distribution of quotas would be based mainly on GNP and foreign trade. The U.S. share based on these factors might be somewhere in the range of 25 to 30 percent. This approximate range for the U.S. share would cover calculations both including and excluding France.

It is agreed that all risk associated with the facility's operations should be borne by participants in proportion to their participation shares, and the risk assumed by the U.S. would therefore not exceed its participation share. It is true that in percentage terms U.S. loans to the facility might exceed its participation share (this is a mathematical necessity for each lender if the borrowing country does not "participate" in a loan to itself). But the absolute amount of U.S. loans would never exceed its share of the overall size of the facility.

Further work is needed to determine financing methods. Under our proposals, none of the contributions would be "paid in," but would be available on call.

*Question 2.* How large an expansion of the IMF oil facility (presently $3.5 billion) will be needed in 1975 if this proposed "financial safety net" is approved; how large would it have to be if this OECD-sponsored fund is not approved?

*Answer.* At the January 15–16 meeting of the Interim Committee it was agreed that the IMF oil facility should be continued in 1975 on an enlarged basis and that loans totaling SDR 5 billion (about $6.0 billion) should be sought for this purpose. While establishment of the solidarity fund could ease pressures on IMF resources, it would not replace the IMF as the first line of official multilateral financing. The "safety net" proposal is, in fact, a supplement to the IMF and other sources of financing, and the availability of this insurance mechanism should improve the operation of the private market, thereby reducing the need to call on all forms of official financing.

*Question 3.* What are the possibilities of getting producers to assume more of the risk in an expanded IMF facility? (For example, the fund would only guarantee 85 percent of resources lent through the facility, with the remainder to be shared proportionally by the producers.)

*Answer.* I would agree that the oil producers should be expected to assume the normal market risks for the major part of their investments. It would seem to me, however, that the better approach is not to try to divide up the risk associated with loans to the IMF in some proportion other than quota shares, but to limit such IMF borrowings to situations in which there is a clear and identifiable need for financing supplemental to the private markets, other official channels, and IMF resources.

*Question 4.* The major energy conservation initiative launched in conjunction with the proposed oil fund facility is designed to cut industrialized nations' oil imports by 3 million barrels a day (or $11 billion a year). How will cutbacks be apportioned (particularly, what will be the U.S. share) and how quickly can they reasonably be made?

How does the U.S. plan to achieve its cutbacks?

*Answer.* President Ford has announced a U.S. program to reduce oil imports by 1 million barrels a day below what they would otherwise have been by the end of 1975 and by 2 million barrels per day by the end of 1977. The President presented his program for achieving these objectives in his State of the Union message. Other major consuming nations have also adopted national programs of energy conservation to reduce oil imports. We believe that effective national programs of energy conservation would by the end of 1975, achieve an aggregate reduction in oil imports by the major industrial countries of the world of at least 3 million barrels a day below what they would otherwise be, without unduly dampening economic activity and performance. If such a reduction in imports were agreed upon and implemented, as we have proposed. it would yield annual imports savings of some $11 billion at present price levels, and add to already strong marketplace pressures to bring down the price of oil.

*Question 5.* The new oil fund appears to be closely linked—in format and intent—to the International Energy Agency. Will eligibility for the fund be linked to participation in the emergency energy sharing agreement (i.e., would France be allowed to join the financing mechanism without adhering to IEA)?

*Answer.* Participation in the financial solidarity agreement would be open to the members of the OECD which accept the principles of the Agreement. which include cooperation in energy. Thus it would be possible for an OECD member to participate in the financial solidarity agreement without being a member of the IEA.

*Question 6.* If it is true that OPEC producers have as much as 8 million barrels a day in shut-in capacity, what is there to lead us to believe that OPEC will not also be able to absorb further cutbacks equivalent to the 3 million barrels a day which the Kissinger-Simon proposal plans to save? (How was the figure 8 million barrels a day derived. and from what source?)

*Answer.* The estimate of OPEC excess capacity of 8 million barrels per day—which, it should be noted, is a higher level than that which prevailed even during the oil embargo—is derived from U.S. Government estimates of OPEC production capacity versus actual production. An additional 3 million barrel per day in unused capacity could place greater pressure on some of the OPEC states to seek to avoid further curtailment of their production by lowering prices.

*Question 7.* OPEC cohesion has benefited its members with four-fold increases in revenue. In your estimation, what equivalent incentive would make it in the oil producers' interest to lower prices or to resist further increases?

What do you think of the proposal to tie oil prices to a world inflation index or commodity basket which OPEC will discuss at its next meeting?

*Answer.* We believe that it is already in the oil producers' interest not only to resist further price increases, but also to lower prices. Sharply increased OPEC prices have spurred both reductions in world oil consumption—which is projected to decline from 48 million barrels per day in 1973 to around 46½ million barrels per day last year—and the development of alternative energy sources. The private sector response to increased oil prices will, moreover, increasingly be supplemented by international as well as national programs to promote energy conservation and production.

Maintenance of present oil price levels will, then, steadily and substantially erode the market and the revenue of the OPEC nations both by decreasing demand for oil and increasing supplies from alternative energy sources. Reduced oil prices would accordingly prove in the interest not only of consumers but also, over the long run, of producers.

We do not believe that indexing provides a satisfactory answer. Indexing is inappropriate in principle for it would establish the price of one commodity in terms of the supply and demand of unrelated goods rather than the products' own supply and demand. There would thus be no incentive for reducing oil prices as a result, for example, of lower consumer demand due to successful conservation programs. Furthermore, indexing would institutionalize current high prices and add to inflationary pressures, since the cost of oil is itself a significant factor in the prices of a wide range of industrial and agricultural goods.

*Question 8.* Since the United States has received a bit less than 25 percent of OPEC investment, as you note, the allocation of OPEC investments hasn't been that unsatisfactory to date. Do you expect the distribution of OPEC investments to change markedly in the future?

*Answer.* To a major degree I would expect the investment pattern to reflect market opportunities with some importance attached to diversification. In recent months OPEC countries appear to have been using a somewhat larger proportion of their surpluses for long-term loans to governments and quasi-governmental agencies in many parts of the world. This trend could well continue. The proportions of the surpluses left on deposit with banks—here and abroad—may diminish as other opportunities expand.

*Question 9.* Project Independence, as it is currently outlined, depends on continued high oil prices to bring forth new domestic production and to curtail demand. However, if the proposed mutual aid fund initiative is successful at bringing down world oil prices, will the U.S. Government not find itself in the position of having to protect its own high-cost production and thus be at a competitive disadvantage with those countries using cheaper imports?

*Answer.* The Project Independence Report identifies several domestic energy production choices with varying levels of production costs. The P.I. analysis indicates a series of investment choices ranging from production of low Btu gas from coal at an oil equivalent cost as low as $3.42 per barrel to oil production from shale at $8.40 to $12.40 per barrel. They include other alternatives at much higher costs. Some of the choices may necessitate downside risk protection and in the event that oil prices drop could result in a competitive cost disadvantage. Other choices would not involve such downside risks. It should be recognized however, that security of supply as well as cost factors must be factored into energy policy decisions. In the choice of a policy to provide such insurance, we should, as your question suggests, retain sufficient flexibility so that we do not eliminate our capacity to take advantage of any future lowering of world oil prices.

*Question 10.* In your statement, you note that the operation of the facility "would not require inflationary expansion of money and credit and, for example, need not lead to an increase in Federal Government debt held by United States citizens". Unless funds are borrowed directly from the producers, which would replace the role of private markets, how can such transactions avoid the increase in Federal debt held by the United States citizens?

*Answer.* The operations of the financial solidarity facility would not require an inflationary expansion of money or of Federal debt obligations held by United States citizens. If, for example, oil producing governments bought United States Government debt obligations from United States citizens in United States private markets, such purchases would offset any debt obligations issued by the Government to finance its contribution to the solidarity fund.

*Question 11.* Is the Exchange Stabilization Fund, the statutory purpose of which is to stabilize the exchange value of the dollar, an appropriate vehicle for U.S. participation in the proposed oil solidarity fund which aims to provide emergency support for other deficit economies? How would the United States define stabilizing the exchange value of the dollar since it ended convertibility in August 1971, in terms of a dollar-SDR rate or a dollar-lira rate?

Does the Administration also plan to use the Exchange Stabilization Fund to contribute to the proposed trust fund for developing countries to be managed by the IMF?

*Answer.* We believe that use of the ESF as a vehicle for U.S. participation in the financial solidarity agreement would be consistent with the purposes of the ESF. The exchange value of the dollar depends upon the maintenance of a viable international financial system and on economic policies both in the U.S. and abroad. By providing assurance of financial assistance on reasonable terms to cooperating countries in case of serious economic difficulties, the proposed facility would strengthen the operations of the private markets and help participants to avoid inappropriate policies—e.g. competitive exchange rate or restrictive trade policies—which could adversely affect the value of the dollar. While we wish to avoid disorderly exchange market conditions and disruptive exchange market practices, the U.S. has no particular exchange rate level as an objective of its policies. We tend to use changes in the dollar rates of the currencies of our significant trading partners, weighted according to the relative value of our trade, as a working guide to movements in the exchange value of the dollar.

We have not, however, reached any decisions on how U.S. participation should be financed and are discussing the best way to proceed with the Congress.

We have no plans to use the ESF to finance a U.S. contribution to the proposed trust fund.

# KISSINGER-SIMON PROPOSALS FOR FINANCING OIL IMPORTS

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WEDNESDAY, NOVEMBER 27, 1974

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met, pursuant to recess, at 10 a.m., in room 345, Cannon House Office Building, Hon. Henry S. Reuss (member of the committee) presiding.

Present: Representatives Reuss, Bolling, Moorhead, and Widnall; and Senator Javits.

Also present: John R. Karlik, senior economist; Sarah Jackson, professional staff member; Michael J. Runde, administrative assistant; George D. Krumbhaar, Jr., minority counsel; and Walter B. Laessig, minority counsel.

## OPENING STATEMENT OF REPRESENTATIVE REUSS

Representative REUSS. Good morning. The committee will be in order for a continuation of its hearings on the Kissinger-Simon proposals for a special oil-lending facility to aid industrialized countries seriously crippled by the higher oil import costs.

Last Monday, Treasury Secretary Simon outlined for us the proposed $25 billion oil fund. It would provide emergency loans to industrialized countries that have exhausted their ability to borrow in capital markets and from the International Monetary Fund. The proposal makes this backup financing contingent upon a borrower's willingness to cut oil imports. This initiative to conserve energy is highly commendable. But is the current proposal really designed to assure the necessary adjustment by deficit economies? Are commitments to be rigorous enough to insure repayment? And are we prepared to permit deficit countries to run trade surpluses with the United States in coming years to be able to repay these obligations?

The U.S. share is likely to be about one-third of the proposed fund, or approximately $8 billion in 1975, with the likelihood of more in 1976. If this amount is not raised through taxation or borrowed in domestic capital markets, it will require the creation of additional money. Now struggling with global inflation, the world hardly needs a major boost in total money supply.

On the other hand, if the funds are to be borrowed in capital markets, the Kissinger-Simon plan will merely substitute for private lending. How will U.S. participation be financed, and what will be its impact on the domestic economy?



47-214—75——3

The proposed facility would provide a financial safety net for major consuming countries that are no longer able to borrow in capital markets. The private markets, however, must still assume the major burden of rechanneling funds from the oil producers back into the consuming economies. Are present safeguards adequate to insure that commercial banks do not overextend themselves under the strain of the enormous capital flows arising from higher oil prices? Is the proposed facility sufficient to prevent the Federal Reserve from having to act as "lender of last resort" to other than domestic U.S. banks?

This morning we will hear from Chairman of the Federal Reserve Board of Governors, Mr. Arthur Burns.

Mr. Burns, we are pleased as always to have you with us. You have a fine statement which I have had the opportunity to look at. Would you now proceed in your own way, please?

## STATEMENT OF HON. ARTHUR F. BURNS, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. Burns. Thank you, Representative Reuss.

No economic event in a long generation, excluding only wartime upheavals, has so seriously disrupted our economy as the manipulation of oil prices and supplies over the past year. The fourfold increase in the international price of oil has compounded the domestic economic problems of other oil-importing nations as well as our own. International financial relationships have been upset. Plans to reform the international monetary system have been partially derailed. And with further interruptions in the flow of oil still a possibility to be reckoned with, a great cloud of uncertainty now surrounds the economic future of nations around the world.

My remarks this morning will concentrate on some of the implications of high oil prices for international finance—as this committee has resquested. But I cannot be silent on the bearing of oil prices on our domestic economy or our international political position.

The manipulation of oil prices and supplies by the oil-exporting countries came at a most inopportune time for the United States. In the middle of 1973, wholesale prices of industrial commodities were already rising at an annual rate of more than 10 percent; our industrial plants were operating at virtually full capacity; and many major industrial materials were in extremely short supply. Inflationary expectations were therefore becoming more deeply ingrained at the very time when inflation was curtailing the purchasing power of worker incomes and creating some weakness for big-ticket items in consumer markets. Thus, the oil embargo, together with the huge increase in oil prices that began in the fall of 1973, contributed to the twin economic problems plaguing us in 1974—namely, high rates of inflation and weakness in production.

Furthermore, the increases in the price of oil have added to the imbalances that have made the current period of economic weakness so unusual by historical standards. Some sectors that depend heavily on a plentiful supply of inexpensive fuel—such as the automobile industry—have had to contend with sharp declines in sales and considerable idle capacity. At the same time, the oil crisis bolstered the demand for energy-saving equipment and stimulated the production of alternative sources of energy. Thus, the energy crisis contributed to the tightness in markets for business capital goods that marked much of this past year.

The adverse effects of rising oil prices have been felt even more acutely in some foreign countries than in the United States. This year, inflation is proceeding at historically high rates throughout the industrial world, while output is growing only slowly or actually declining. In Japan—which has been particularly hard hit because of its heavy dependence on imported oil—consumer prices are 24 percent higher than a year ago, while economic activity is below the level of 1973. This weak performance of the Japanese economy is particularly striking when viewed against the background of the preceding decade, when the output of Japan grew at an average annual rate of over 10 percent.

At the other end of the spectrum, several countries—most notably Canada—have gotten off rather lightly because of their plentiful domestic supplies of oil. Even these countries, however, have been adversely affected by the combination of inflationary pressures and sluggish economic activity of their trading partners.

Economic difficulties are by no means confined to the industrial countries. In particular, because of the heavy reliance on oil in the production of fertilizers, the high price of oil has contributed to the danger of widespread starvation in a number of the less developed countries.

On the other side of the ledger, the increases in the price of oil have resulted in a spectacular jump in the income of members of OPEC—that is, the Organization of Petroleum Exporting Countries. The United States alone will spend about $27.5 billion on fuel imports this year, in contrast to $8.8 billion for substantially the same volume of imports in 1973. The higher price of imported oil has in effect been a heavy tax on American consumers, and it has taken its toll in weaker domestic markets.

Through the first 10 months of 1974, the OPEC nations have received from other countries about $75 billion in oil revenues, nearly three times the amount obtained during the whole of 1973. The imports of OPEC nations have risen rapidly in percentage terms, but they have fallen far short of their increased revenues. As a result, oil producing countries have achieved an estimated $45 billion surplus on goods and services during the first 10 months of this year. Most of this sum has been invested in highly liquid short-term instruments in the Eurocurrency markets and in the British and U.S. money markets.

Of the $45 billion, about $10.5 billion has been placed in the United States. This includes about $5 billion in marketable securities issued by the Federal Government or its agencies, chiefly Treasury bills. Most of the remainder has been placed on deposit in our banks, with scattered amounts invested in real estate, bank acceptances, and other private securities.

Of the total increase in OPEC assets of about $45 billion, by far the largest share—about $16.5 billion or more than one-third of the total—has gone into the Eurocurrency market. Nearly all of this is in the form of Eurodollar deposits, the average maturity of which is quite short. A large proportion consists of 2-day call deposits, and most of the remainder run 6 months or less. Banks located in Britain have been the predominant recipients of these deposits.

Several of the oil-exporting countries—notably Kuwait, the United Arab Emirates, and Nigeria—have traditionally kept part of their reserves in sterling. Those traditional ties are being maintained. During the first 10 months of 1974, OPEC sterling holdings increased by the equivalent of about $6.5 billion. Again, most of this sum has gone into short-term assets, and only relatively small amounts have been invested in government bonds, private securities, and real estate.

The OPEC holdings thus far specified—in the United States, Britain, and the Eurocurrency markets—account for roughly three-quarters of the total increase of $45 billion of OPEC assets. Of the remainder, an estimated $3.5 billion has been loaned to governmental bodies in continental Western Europe and Japan. Bonds issued by international financial institutions, or loans to the International Monetary Fund for use under the oil facility, account for $2 billion. Another $2 billion has been devoted to grants or credits to less-developed countries, either directly or through contributions to regional development banks. Egypt has probably been the largest recipient of such aid. The remaining increases in OPEC assets—estimated at $4 billion—have been scattered among other items, including private securities and real estate in continental Europe and Japan.

To date, the huge financial flows to and from OPEC countries have been handled mainly—and also reasonably well—by private markets, particularly commercial banks. But there is no room for complacency regarding the future. Because of the lag in payments to the oil-producing countries, the peak rates of financial flows to these countries have been experienced only for a few months. Greater strains in financial markets may well develop in the future not only because of new financial flows to the OPEC countries, but also as a result of the growing volume of assets that they will already have acquired.

As a matter of arithmetic, the volume of foreign assets accumulated by the OPEC countries will depend on four factors: First, the flow of oil revenues to the OPEC countries; second, the flow of their other earnings, particularly investment income; third, the expenditures of the OPEC countries on imports of goods and services; and fourth, the financial resources which these countries transfer to others in the form of aid.

Roughly speaking, oil revenues of the OPEC nations will amount to something in excess of $100 billion per year, if their current oil exports and prices are maintained. This is four times as large as the figure for 1973. On the import side, some of the OPEC countries—such as Indonesia, Iran, Nigeria, and Venezuela—have large absorptive capacities. But a substantial proportion of the earnings of other oil exporters—notably Saudi Arabia and the states of the Persian Gulf—will not be spent for additional imports in the near future. The two other key factors in the picture—the flow of investment earnings to the OPEC countries and the transfer of resources from the OPEC nations to the less developed countries—are as yet quite small compared to the flow of oil revenues. While the future volume of aid by the OPEC countries is uncertain, their investment earnings promise to grow at a very rapid rate.

All this suggests very large OPEC surpluses—of perhaps $55 to $60 billion in 1975, something like $50 billion in 1976, and continuing large surpluses for at least another 5 years. The practical counterpart of these surpluses would be the accumulation of a huge mountain of debts by the oil-importing countries—unless the price of oil comes down or unless the consuming nations take major steps to reduce dependence on imported oil.

In view of the enormous debts in prospect for oil-importing countries, it is only natural for governmental leaders and private financiers to concern themselves with recycling. But preoccupation with recycling techniques has had the unfortunate effect of diverting attention from the fundamental need to bring down the price of oil. Unless that is done, it is extremely doubtful whether the financial problems released by the huge increase in the price of oil will prove manageable. As a practical matter, recycling simply means that oil-importing countries will slip more and more deeply into debt. Piling debt on top of debt—or speaking more realistically, piling dubious debt on top of good debt—neither can nor should go on indefinitely.

If the price of oil remains at anything like its present level—and there are repeated stirrings in OPEC countries to move it still higher—there will be a massive redistribution of economic and political power among the countries of the world. This, of itself, carries dangers for our country's future. In addition, the huge and growing financial reserves of OPEC countries may cause very serious problems for some of the countries—both in the industrial and less developed parts of the world—that will simultaneously be piling up, or even just handling, enormous debts.

Clearly, as the financial assets in the hands of the OPEC countries grow, the burden of servicing these assets will grow. The burden of future repayment will grow. Furthermore, as the potential for shifts in deposits from one bank to another increases, financial institutions here and there may become vulnerable. So too may foreign exchange markets, if funds should be moved abruptly and on a large scale from one currency into another. These dangers can be easily exaggerated, but they cannot be dismissed. Nor can we ignore the possibility that this or that foreign industrial country, already finding itself in a weakened position, may be unable to adjust sufficiently to the burdensome price of oil and as a result suffer economic and political collapse.

As I have already noted, commercial banks—particularly banks in the Eurocurrency markets—have been playing a major role as intermediaries in the oil-related financial flows, taking the deposits of the OPEC nations and relending them. Thus far, they have been able to cope with the strains brought on by the oil financing. But OPEC money cannot continue to be directed to the banks on anything like the recent scale.

Financial prudence sets limits to the willingness of banks to rely on large, interest-bearing, potentially volatile deposits from relatively few sources. Banks must be concerned that the maturity structure of their assets and liabilities does not endanger their liquidity. They must be concerned that their exposure in any one country does not become excessive. They must be concerned about the decline in the ratio of their capital to their liabilities. The well-publicized difficulties of several banks heavily engaged in international finance have served as a warning that bankers have not overlooked. Nor have their regulators been entirely silent.

It is clear, therefore, that banks cannot prudently continue to play the role of intermediary for flows of oil money to the extent that they have in the recent past. Indeed, as banks have moved toward the limits of sound intermediation, they have begun to shave the interest rates at which they will accept large new deposits on a short-term basis. In recent months, OPEC countries have not put so large a share of their assets in the Eurocurrency markets as they did in the first half of 1974. And there have been some indications of larger diversification of OPEC holdings among countries.

As yet, however, there has been no large shift by OPEC nations into longer term assets; as noted earlier, most of their holdings continue to be short-term assets. This may simply reflect a lag in the adjustment of the OPEC countries to their newly won affluence. As large and growing creditors, they have an increasing stake in international financial stability, and they should contribute to it by moving more rapidly to acquire longer term assets. Further reductions in the interest rates paid on large short-term deposits would hasten such movement.

Even so, the plight of countries whose weak financial position makes them unable to borrow in international financial markets will remain very worrisome. To be sure, it is desirable that they, along with other oil-consuming nations, look sternly to measures of oil conservation and the development of alternative sources of power as a means of controlling their deficits. But as long as oil prices remain at their present level, a huge overall deficit will remain for the oil importers as a group; and some countries will have disproportionately large deficits. If help is not provided to those in a weak financial situation, they may be driven toward beggar-thy-neighbor trade policies, thus disrupting international trading relationships. They may be driven toward excessively tight domestic policies, threatening a prolonged recession and political disorder. And in their desolate need, they may be tempted to bend to the political will of oil-exporting countries in order to obtain loans.

It is therefore to the interest of the United States and the entire community of industrial nations that we develop institutions to ease the financial strains to which any one of them may be subjected. If the weaker countries are left unprotected to face their oil bills, they may be forced into special arrangements with oil-producing countries. Such arrangements would undercut the bargaining power of the oil-consuming nations, and delay the day when the present exorbitant oil prices are reduced.

It is toward the goal of unity and mutual aid among the industrial countries that a new initiative has recently been announced by Secretary Kissinger and elaborated by Secretary Simon. The American proposal for a new financial mechanism, to be developed in association with the Organization for Economic Cooperation and Development, would provide standby financial assistance to participating countries that find themselves in difficulty after reasonable efforts on their part to deal with their oil import and balance-of-payments problems. The proposal is intended to promote cooperation among oil-importing countries and to facilitate rational dialog with the oil-exporting countries. It is not intended to replace the private market and other official channels such as the International Monetary Fund, but rather to supplement them.

The details of the American proposal remain to be worked out, and the proposal itself must still be negotiated with other countries. It is nevertheless clear that any new financing facility must have sufficient resources at its disposal to meet the needs of countries in difficulty. Unless that is assured, the new facility will not serve the purpose of providing mutual security to its participants. In consideration of this security, participating countries should undertake cooperative efforts to reduce dependence on oil imports. They should also undertake to follow responsible adjustment policies, avoiding the use of trade restrictions. The facility might be financed through direct contributions by the participating governments or through loan guarantees, with the credit risks being shared. In either case, congressional authority will be needed for U.S. participation.

The program proposed by the administration thus has the objective of bringing the major oil-consuming countries together in a common effort. It has two major aspects: Cooperation to reduce dependence on imported oil and financial cooperation. Financial cooperation is important; it can contribute to international economic and political stability in the face of large oil deficits. But financial cooperation alone is not enough. Even with an orderly financing of deficits, the immense burden of carrying and ultimately repaying the debts will still remain. Financial cooperation may ease the transition, but it does not answer the most troublesome question: A transition to what?

The fundamental problem is the huge oil bill of the importing countries, and a fundamental solution requires that the price of oil be reduced. The OPEC cartel will not last forever, and the most promising way of breaking or weakening it is to bring about changes in the demand and supply relationship of the oil market. Already some change in this relationship is taking place. Excess capacity of oil producers is now much larger than it was last year. New oil discoveries have occurred in Bolivia, China, Malaysia, and Mexico, to name a few. The proven oil resources of the North Sea have doubled in the past year. In the United States, the potential of offshore oilfields is enormous. The high price of oil is thus stimulating the search for new oil fields, and also the development of coal, nuclear power, and other alternative sources of energy.

While the effects of these adjustments on the supply side will not become quickly visible, immediate adjustments are already taking place on the demand side. Oil consumption of the importing countries will be about 3 percent less this year than last. A number of countries have recently stepped up their efforts to save oil. France has set a limit on expenditures for oil imports. The recent British budget again hiked the gasoline tax, and as a consequence the British motorist will now pay about $1.20 per gallon.

The United States consumes about 30 percent of world oil production. Partly for that reason, partly also because of our strategic role in the world, other nations look to us for leadership. The administration has invited other industrial countries to join us in a vigorous cooperative effort to deal with the grave oil problem. We should now do our part by moving more decisely to conserve energy, by moving more resolutely to develop domestic alternatives to imported oil, and by reducing our vulnerability to the threat of embargo by increasing our storage capacity.

This October, the President outlined a number of proposals to conserve energy and develop alternative domestic sources. The President's program included legislation to require the use of coal or nuclear power in new electric generating plants and the conversion of existing plants to coal. It included proposals for gasoline savings on new automobiles, for fuel savings by industry, and for further conservation within the Government. The immediate objective of the program was to achieve a reduction of 1 million barrels a day in oil consumption by the end of 1975. These proposals by the President deserve strong support from the Congress and the general public.

While the President's program emphasizes voluntary actions, it is well to keep in mind that he has indicated that more stringent measures to reduce dependence on imported oil may become necessary in the future. In view of the gravity of the international energy situation, I believe that some preliminary planning on stronger measures to reduce domestic consumption should be undertaken at once. These might include a sizable tax on gasoline, or on imported oil, or on automobiles according to their weight or horsepower.

The recent report of the Federal Energy Administration on Project Independence also deserves prompt attention by the Congress. While this report does not offer specific recommendations for the reduction of oil imports, it does provide a wealth of information and analysis regarding the steps that might be taken to increase domestic sources of energy, to conserve fuel, and to establish standby emergency programs, including stockpiling. It is high time that we moved from the rhetoric to the reality of Project Independence, and the FEA study can help to speed and guide our path to this objective.

In conclusion, I can only say to this committee that the problems caused by the recent manipulation of oil prices and supplies are among the gravest with which this Nation has had to contend under peacetime conditions. Unless we take stronger measures than we have yet done to conserve oil, to develop alternative sources of energy, and to lead other industrial nations in a common policy to lighten the burden that OPEC oil actions have imposed on the world, we may endanger our Nation's future. The policy that I have advocated this morning is a policy of austerity. I recognize that it must be carried out prudently—if possible, without intensifying the recessionary tendencies that are already developing in our economy. The alternative of drift, I fear, may lead to a permanent decline of our Nation's economic and political power in a very troubled world.

Thank you; that concludes my statement, Representative Reuss.

Representative REUSS. Thank you very much, Mr. Burns. When you are talking about the rather flip use of the word "recycling" to describe the means of financial transfers, you say that—

> As a practical matter, "recycling" simply means that oil-importing countries will slip more and more deeply into debt. Piling debt on top of debt—or, speaking more realistically, piling dubious debt on top of good debt—neither can nor should go on indefinitely.

Isn't this $25 billion a year for the indefinite future program precisely such a plan to pile debt on top of debt, and the mere fact that it is done by Government rather than by the commercial banking system doesn't alter that?

Mr. BURNS. No; I don't think of this as a program for the indefinite future. I would see no hope or use for the program if it lasted more than a year or two. Beyond that it could come to no good end, and we might just as well face it right now. I think of it as a program that would last a year or two.

I realize there are uncertainties here, Mr. Reuss. It might last longer and I would very much hope that it would not. I would not be in favor of it if I thought that it would last for a significantly longer period.

NECESSITY OF LOWER OIL PRICES

Representative REUSS. Throughout your presentation there runs the major theme, as I read it, that the whole point of the exercise is to reduce the price of oil.

Mr. BURNS. Correct.

Representative REUSS. There are those, you know, at least some of whom seem to know what they are talking about, who point out that it could be that the OPEC suppliers would stand fast and that they simply would not respond to what in other circumstances would be regarded as normal economic pressures and hence they would not reduce the price of their oil.

You and I hope, of course, that the price will be reduced, but if the contrary is what happens, if our hopes are dashed, then this program is likely to prove a very expensive venture, will it not?

Mr. BURNS. That is true. But if that happens I see very little hope for the world we are living in and, therefore, I don't think it is going to happen.

Representative REUSS. While you certainly say all the right things about conserving energy, the fact is, and you recognize this, that action in this country and most every other place has not yet caught up with the rhetoric. We aren't really doing very much about conserving energy. In fact, the best way to make a great effort to reduce the price of oil and to have the best kind of a safety net is, namely, a vastly lessened dependence on oil. Wouldn't that really be a program of greater sense than the relatively mild conservation program envisaged here plus elaborate bailout authorization for an indefinite interim period?

You say it here but certainly there is nothing that the administration told us, or nothing that has been reported, to suggest that it is going to be limited to a year. In fact, just the opposite. They say $25 billion the first year and more thereafter.

I am thinking about countries that are admittedly hard hit—Italy, a member of the European Economic Community. You know we have been patting the European Economic Community on the back for the last 15 years saying what a great thing it is and submitting to their trade discrimination against us, all inherent in allowing a customs union to come into being. But now we propose to bail out individually, and perhaps collectively, many of its members. After all, outside of us and Canada, which isn't hurting on oil, almost all of the beneficiary countries are Common Market countries. Add Japan and you have really got the list of supplicants.

So I think you have raised the important questions and laid it out here. If this exercise in peaceful psychological warfare, or whatever it is, to get the price of oil down doesn't work, we will simply have postponed the inevitable. We will have greatly bled the United

States in the interim, and whoever else contributed the other 70 percent of the proposed loan fund, and maybe have caused ourselves to be less prepared for the waning of the age of oil in a few years than we would have been if we got ready for it now.

Wouldn't that really be a better policy? If you want to accompany that policy by a transition fund of large proportions, even as large as this, I certainly would not object; but this program seems to me to be based on rather a dubious assumption that all this is going to bring the price of oil down.

I would like your general reaction to that.

Mr. BURNS. If your essential point is that our efforts in this country have been insufficient to deal with the crisis, that the measures that we have taken to conserve oil are inadequate, if that is your essential point, I agree with that. I think our efforts have been inadequate.

I think we should pursue much sterner measures. Actually, we have been lecturing the rest of the world. But our own practice leaves a great deal to be desired.

Take the tax on gasoline. We have done absolutely nothing about it. In the meantime, during the past year the tax on gasoline was raised substantially in Great Britain, in Italy, and in Japan. There have been smaller increases in France and Germany, and increases of some kind in other countries around the world. We haven't touched the tax on gasoline. The President has announced a program that relies heavily on voluntary methods. This program may work reasonably well. I hope it does. But I also hope we will not waste precious time, if the voluntary program proves inadequate, as many people including myself believe it will.

Representative REUSS. In other words, our attitude has been that of the Army sergeant who says "do like I say, not like I do," and I have the feeling, too, that it isn't leadership.

## SWAP ARRANGEMENTS

Let me turn to a source of Federal Reserve international monetary power, the swap arrangements.

Refresh my recollection again, what do those arrangements which, of course, aren't activated at the moment, what do they amount to, what was the total amount of our swaps—$10 or $12 billion, I think?

Mr. BURNS. No; the permissible amount, or the outstanding lines of credit, so to speak, comes to $20 billion.

Representative REUSS. Testifying before this committee a couple of years ago, on September 15, 1972, you said that "swap drawings will not be made for the purpose of providing medium or longer term financing for U.S. payments deficits nor will they be used as a substitute for needed adjustments in basic economic policies."

In your judgment, are swaps a permissible device for the Fed to use to bail out industrialized countries on their oil problems?

Mr. BURNS. No, they definitely are not. Furthermore, they will not be so used.

Representative REUSS. I am glad to hear that because I agree that is not a proper use.

Mr. BURNS. You know the purpose of the swap line is to assist in financial adjustments for very short periods, a few months. These are lines of credit for a period of 3 months. They may be renewed. But it is a matter of policy with us not to go beyond 1 year. As far as the oil problem is concerned, the deficits that are involved, are unfortunately matters of much longer duration. So the Federal Reserve swap networks will not be used to deal with the oil deficit problem, except possibly at the margins to help out in financing for a few weeks or a few months.

Representative REUSS. Thank you.

Congressman Widnall.

ADEQUACY OF OFFICIAL FINANCING

Representative WIDNALL. Thank you, Representative Reuss.

Mr. Burns, we always welcome you before this committee because we value highly your opinion on these very important subjects. We know it will be sound, it will be true, and it will be pointed. It will not be coated with sugar and plums like some testimony that comes before the committee.

If the Kissinger-Simon proposal is merely an arrangement for standby financing, will it provide the kind of intervention which commercial bankers feel is necessary to facilitate the channeling of funds, and can it be implemented soon enough, given required congressional approval?

Mr. BURNS. Well, it will take time to work out the details of this plan within our own shop and in other governmental shops, to carry out negotiations with other countries, and then for Congress to act.

I would hope that these several necessary steps—our own further work on details of financing arrangements, negotiations with other countries, and congressional action—could be completed within a few months. I feel we have enough time, that is, we can get by for a few months, but I would urge the Congress to look into this proposal very promptly and consider it from all sides, as you must, but reach a decision without undue delay.

Representative WIDNALL. This is important enough so that Congress should act as quickly as possible. We again are going to be handicapped by a reorganization of Congress, by the inevitable postponement of action from week to week, maybe from month to month, while the entire American economy faces the danger of going down the drain. I think this is important enough so the Congress has to get on the job and stay on the job without the usual interruptions of vacations and recesses and other things that have taken place in years past.

OPEC INVESTMENT IN THE UNITED STATES

You refer to the large trade surpluses projected for the OPEC countries in the years ahead, as well as referring to the present investment practices of the OPEC countries in connection with these surpluses.

If the OPEC countries do shift to longer term investment over the next few years, what are some of the implications of such a shift for the American economy?

For example, how do you view the possibility of very large foreign investments in equity securities of the 500 to 1,000 largest American corporations which control the major part of American business assets and production?

Mr. BURNS. I think this is a very good question, it is an important question, a difficult question.

We may need some new legislation in this area. In general, my own feeling would be that investments in equity securities by OPEC countries in certain types of enterprises, for example, Quaker Oats, would be fine. I have no prejudice against that company. It just comes to my mind—or Coca-Cola. I have no prejudice against that company either. Investment in such enterprises wouldn't bother me. Maybe it should but it wouldn't.

On the other hand, investments by OPEC countries, or, for that matter, foreign investments of any sort, in some of our strategic industries or enterprises would concern me. This is a problem to which my own shop is giving some attention now, and I think all of us in Government must give much more attention to it in the coming weeks. This I think is an urgent question. We ought to clarify our thinking.

I have given you my preliminary thinking, but I know it will have to be sharpened up.

Representative WIDNALL. Of course the very nature of our democracy provides for a slow consideration of the various important matters in the economy that come before the congressional committees. We haven't as yet shown the sense of urgency that the condition of the world and the United States demands at the present time. We still are celebrating all holidays and lengthening all recesses, shortening each legislative day, at a time when we have very critical problems facing the American economy and the American people. I think all of us have to get used to a different manner of doing business. It might be well for Congress to be up all night bargaining on these things the way labor and management are in trying to settle their problems.

### THE NEED FOR STRINGENT ENERGY CONSERVATION

How can the American people believe that there is an urgent, critical problem that the Government is facing, that they themselves are facing, if Government is still lethargic in action and leadership fails to exert the pressures that they can exert in order to have immediate attention to problems?

The proposed oil solidarity fund would require all participants to decrease their dependence on oil imports, thus lowering their own deficits and making possible a world surplus necessary for a decline in world prices.

However, how successful would such a fund be at getting borrowers to make stringent cutbacks if the United States, the prolific energy user, does not itself make a more serious commitment to energy conservation?

Shouldn't the administration seek mandatory conservation measures, a gas tax, rationing, a Btu tax on all energy uses, in order to assure that agreement on this financial safety net is obtained?

Mr. BURNS. I would say that we ought to be doing two things.

First, working energetically on laying plans, which means the Congress, in my judgment, ought to be considering a gasoline tax, or a tax on imported oil, or possibly a tax on automobiles according to their size and weight or horsepower, or possibly some combination of taxes designed to conserve energy.

I think Congress ought to be working on that legislation.

At the same time we ought to be observing closely what is happening in the sphere of oil consumption. It is just possible that the voluntary program will work. I have expressed my skepticism about that. I wouldn't wait. I think Congress ought to get busy immediately.

But it will take Congress some time to pass complicated and controversial legislation of this character. If after a couple of months we find that the voluntary program is working better than any of us believed, we will be all quite happy about that.

I don't think that events will work out in that fashion. Therefore, I would like to see the Congress work actively on legislation, but watch progress on the civilian front. If things are working out well, the Congress can take its time and not act finally on the legislation. But I do think you ought to be ready in the Congress.

Representative WIDNALL. Thank you, Mr. Burns. I regret my time is up.

Representative REUSS. Congressman Bolling.

### GASOLINE TAX VERSUS RATIONING

Representative BOLLING. Mr. Burns, pursuing that line of questioning, you in your statement and also in your reply to Mr. Widnall cited words that you used in your statement, "these might include a sizable tax on gasoline, or on imported oil, or on automobiles according to their weight or horsepower."

Congressman Widnall did mention possible rationing and you did not mention that either in your statement or in your reply.

Why?

Mr. BURNS. Oh, I didn't mention rationing partly because the thought of rationing makes me a little unhappy. I was working hard on this paper and I didn't want to spoil my mood. However, I don't take an ideological position on rationing. I would much prefer to go the market route, but if Congress is unwilling to take that route, if that should be the case, then I for one would consider rationing a second best plan. So I would rule that out.

Representative BOLLING. Mr. Burns, I wouldn't rule out the idea of a sizable tax on gasoline either. I have the same kind of approach that you do. But I would like to hear you in the remaining time I have, which I suppose is 7 or 8 minutes, discuss the relevant advantages of the tax on gasoline, or on imported oil, or on automobiles according to their weight or horsepower, or a sophisticated kind of rationing that would somehow or other make the black market legal. I understand that there have been rather ingenious suggestions that would eliminate the probability of illegal black market—that would eliminate a black market.

I would be interested in having your best opinion on the relevant virtues or the vices, if I may put it in moral terms, of these different approaches.

Mr. BURNS. Rationing, no matter how it is devised, would require an additional bureaucracy. I think that rationing, no matter how it is devised, will also lead to the embarrassment of shortages.

The long gasoline lines we had last winter are not a pleasant thing to contemplate. Having people get up very early in the morning to be at the head of the line is not a pleasant thought for citizens, for any of us. I would prefer to let the market work.

Now, I would be concerned, as I know you would be, by the burden that a sizable gasoline tax would impose on poor people, working people who need an automobile to get to their jobs, to do their shopping.

I would try to work out a tax program such that the financial burden on these people was relieved. My opinion is—I may be mistaken—that a tax system can be devised that would be equitable, that would not impose undue hardship on poor working people, and that would avoid the inconvenience and the bureaucracy that would inevitably go with rationing.

Representative BOLLING. Mr. Burns, has such a proposal been devised?

Mr. BURNS. Such proposals, yes, have been discussed within the Government. The Treasury has silently, quietly been working on proposals along these lines.

Representative BOLLING. If I understand your sense of urgency, it is somewhat equivalent of mine, it seems to me that we are long past the time to be preliminary or to be thinking about planning, and if there are techniques and methods that might work in either fashion, either the market way or the rationing way, it would seem to me that there should be some sort of attempt to communicate them so that they can be discussed.

Mr. BURNS. If Congress started hearings on the subject, they would have to be discussed.

Representative BOLLING. Of course, you recognize my embarrassment in that area. It is a little difficult to decide where Congress would start doing that because the jurisdiction is somewhat diverse but the emergency somewhat diffused. The emergency is such it would seem to me it would be wise for the administration, on which a part of the responsibility lies, and for the Fed, on which a part of the responsibility lies, and for the Congress to make a major effort to forget some of their political differences, and, of course, the Fed has no politics, some of their political differences in the interest of speeding up the process of at least getting the preliminary planning, and I am the last person I guess in the Congress who could be accused of not being critical of Congress. But my feeling is that everybody is not, not you in particular, but that everybody tends to say that the fair way is this way, and it is up to the other side to start coming up with their proposal. I am certainly not including you in this, I am merely using your very excellent testimony to state what I believe to be a fact and the end result is that the American people, if I sense their mood at all, are tired of all of us. They sense very deeply that we have a critically serious problem which may be fatal, and they want us to begin to function.

It would seem to me it would be a part of that functioning for all of us to, if we have any ideas, pitch them in.

Mr. BURNS. Well, I very much appreciate your very eloquent and effective pronouncement. I would endorse it heartily.

Representative BOLLING. I am completely disarmed, Mr. Burns.

Representative REUSS. Senator Javits.

### AVOIDING ECONOMIC BLACKMAIL

Senator JAVITS. Mr. Burns, it is always a great privilege to welcome you to a hearing and to join with you in trying to think through these monumental problems.

I am very interested in the very last statement you make in which you say, "the policy that I have advocated this morning is a policy of austerity."

I thoroughly agree with you that we should start hearings on some kind of legislation to protect us against an Arab buy-out of critical production facilities in this country. I shall do everything I can to forward that idea.

It is one thing to make investments, it is another thing for the Nation to assure itself as to the administration of those investments in a way which is compatible with the national interest of the United States. We certainly don't want Arab States in here pursuing the same make-or-break policies that they are pursuing with the oil weapon politically to force a settlement on their terms of the Arab-Israeli struggle and indeed this is what it is all about. Indeed it is to the credit of Americans as individuals that they are not falling for it or having their resolution broken by it.

Now, as I say, and I quote from your statement, your prescription:

> We should now do our part by moving more decisively to conserve energy, by moving more resolutely to develop domestic alternatives to imported oil, and by reducing our vulnerability to the threat of embargo by increasing our storage capacity.

Was that the total of the program of a policy of austerity which you recommended this morning, or is there more to it than that?

ENERGY AUSTERITY

Mr. BURNS. Well, an active conservation policy is by its very nature a policy of austerity. We might just as well recognize that. No matter how we do it, whether we do it by tax on gasoline or by rationing, if we are going to use much less gasoline in this country, import much less oil in this country, then there will be certain economic consequences that we might just as well recognize. We won't be able to drive our cars, take pleasure trips on a scale to which we are accustomed. The automobile industry, which is already a depressed industry, will sell fewer automobiles. Business in recreational vehicles will suffer, and there will be an impact even on the homebuilding industry, which is in great trouble, as you well know. Its recovery would be retarded somewhat by measures of that kind.

These effects can be offset. They cannot be offset completely in other directions. What I am talking about, very literally, is a policy of austerity. Those of us who talk about an active conservation program, by raising gasoline taxes or by rationing, are advocating, whether we recognize it explicitly or not, an austerity program.

Senator JAVITS. Mr. Burns, do I take it then, at least by implication, which seems to me clear, that, in your judgment, if we are to have any chance of bringing down the oil price, it is only going to be if the United States as the leading consumer of 30 percent of the oil in the world, will reduce its own demand factor so that it is in effect no longer unduly dependent upon these imports?

Your figures would indicate that it means we would have to cut our import bill by something like two-thirds or three-quarters to bring it down to what was normal, or roughly $9 billion a year.

Is it your belief that if the United States cut its oil consumption by 15 to 30 percent that we could break the OPEC front?

Mr. BURNS. It is my belief that unless we do our part on conservation, we will be unable to persuade other nations to do their part. Our leadership will be a leadership of rhetoric that will be ridiculed around the world rather than observed around the world.

Second, if we make our leadership effective by setting an example, by being true to our own words, and getting other countries to cooperate, then I think we have a good chance, along with working on increasing supply, to break the oil cartel.

Senator JAVITS. So the key to the world's financial salvation is a major cut in American oil consumption?

Mr. BURNS. I believe that to be the case, yes.

Senator JAVITS. I think it is critical, I thoroughly agree with you, and that is why I am trying to pinpoint it very sharply.

ACCELERATED PROJECT INDEPENDENCE

Second, it is also an element of that total plan, which necessarily is a global plan, that the United States should greatly accelerate Project Independence in whatever its permeations may be. In short, right now, by the passage of the ERDA bill we figure on a 10-percent swing, roughly about $2 billion a year.

Now, would it be a relevant move in your view as to really how to bring this whole situation back to rationality to pack that 10 years back into 3 or, as we did with the Manhattan project with the American bomb in World War II, on the theory this is worse than war, that we will be casualties while we stand up and breathe?

Mr. BURNS. I agree with every word you have expressed, Senator. That is certainly my own thought too.

Senator JAVITS. The last point. If it is kind of a three-point operation, do you believe also that the United States as an element of that policy, of which we have now identified two parts, should add a third part, in its own enlightened self-interest of being willing, if it does the first two, to share, even if it means more austerity, some of what it has with nations that would be even more bereft? The example being, of course, that of the fantastic courage of the Dutch in standing against the last oil embargo.

Mr. BURNS. I think that is essential. This has been a part of the plan from the beginning and steps in that direction have already been taken, as you know.

Senator JAVITS. So we now have a three-part program. One, conserve 15 to 20 percent in our own demand factor; two, accelerate unbelievable Project Independence, just giving it a trade name; and, three, some evidence that we will profit greatly from world discipline that we are willing to make some further sacrifice in order to encourage it?

Mr. BURNS. Yes; I think these three parts are essential, and there is a fourth part.

Senator JAVITS. That is what I was going to ask you—is there anything else?

Mr. BURNS. Yes; the financing; the broad plan for financial solidarity that Mr. Kissinger has put forward in a recent address and that Secretary Simon has elaborated on.

INDUSTRIALIZED COUNTRIES ASSUME RISKS

Senator JAVITS. One point on that. One of the things that worries me about the so-called Kissinger-Simon plan is that we exchange their debts to us for good debts to the Arabs. In short, that we underwrite what is put into this fund which the developing countries suffer because they can't buy this oil, and we have their IOU's, and they are not going to be worth much.

What do you think about that?

Mr. BURNS. No; there is some misunderstanding here, Senator.

Senator JAVITS. It is very important to clear it up.

Mr. BURNS. Yes; the central feature of the Kissinger plan is that the fund would be used to assist industrial countries that find themselves in a condition of dire need. The money needed would come from other industrial countries. In other words, the industrial countries join together in a mutual insurance society to help one another. The essence of the plan is that we, the industrial countries, are not going to turn to the OPEC nations for the funds. We will ourselves provide the funds to assist any one of us, any one of the industrial countries that is in need.

This, I would say, thinking politically, is the most important feature of the Kissinger plan in contrast to other plans that have been put forward, such as the one by Mr. Healy, the British Chancellor of the Exchequer. He would establish a facility in the IMF. IMF would sell securities to the OPEC nations. Funds would be raised in that fashion. The OPEC nations, which have brought all of these miseries on the rest of the world, would then ostensibly come to the rescue of the world. Kissinger has put all that aside. The American plan requires that we, the industrial countries, help ourselves.

Senator JAVITS. So you prefer Kissinger's plan?

Mr. BURNS. Oh, definitely.

Senator JAVITS. Of those four points, the blueprint for what America ought to do?

Mr. BURNS. That in my judgment is a very sound approach politically. It is also an acceptable economic and financial approach to the energy problem, the very grave energy crisis, that we and the rest of the world now face.

Senator JAVITS. Thank you very much.

Representative REUSS. Congressman Moorhead.

Representative MOORHEAD. Thank you, Representative Reuss, and thank you for your statement, Mr. Burns.

First, to follow up on Senator Javits' point, you state that recycling means piling debts on top of debts, or more realistically, piling dubious debt on top of good debt.

Isn't that the essence of this consortium, even though they are all industrialized countries, some are weaker than others? As you said, we will make good the debts of the Arab nations but will some of our partners be able to make good their own debts to us?

ADEQUACY OF BANKING SYSTEM

Mr. BURNS. Yes; there are risks here. There are risks in any course of action that one can conceive of in this whole area.

47-214—75——4

We need, therefore, to focus on what I think is the main problem, namely, getting the price of oil down, and we must work energetically to keep the risks that you have described, and they are there, down to a reasonable minimum. There is no escape from this.

Representative MOORHEAD. Mr. Burns, I would like to focus on the problem as I see it, the very short-term problem, the middle range, and long run. The short-term problem, as you mentioned, is the highly liquid short-term instruments that the OPEC countries have been investing in.

You mentioned the 2-day call deposits and the fact that there has been no large shift by the OPEC nations into longer term assets.

It seems to me that this short-term problem has to be faced immediately. I notice that you state that further reductions in the interest rates paid on large short-term deposits would hasten a movement toward longer term deposits.

Can you do something to further reduce the interest rates paid on short-term securities in U.S. banks?

I realize that won't solve the world's problem but do you have the power to reduce the interest rate in U.S. banks?

Mr. BURNS. Let me make two observations.

First, the market itself is moving in this direction and it is the opinion of this country's leading bankers that the market will continue strongly moving further in that direction.

That is also my own view.

Now, as to the legal problem, I would have to check this, but I doubt whether we at the Federal Reserve have the legal power at the present time to accomplish this. However, we can exert moral power. We are not entirely without influence in the banking community, and the number of banks that are involved in this activity is very limited.

Therefore, if I am right in thinking that we do not have the legal power, I am still not sure that I would need to come to the Congress and ask for it. Conversations with the country's bankers may be able to accomplish what we need without the use of any legal power.

Representative MOORHEAD. I was interested in the 2-day call deposits. Do our banks pay interest on these 2-day call deposits?

Mr. BURNS. They don't do that here in the United States.

But my answer to that question for the Eurodollar banks, subject to further check which I must do, is definitely yes.

Representative MOORHEAD. It seems to me that in the very short term we should do everything within our legal power to curb our own banks and by leadership over others to make the short-term, highly liquid, highly volatile investments as unattractive as possible because they are the ones that give the greatest political leverage.

Mr. BURNS. You know, in our own country we have done something recently at the Federal Reserve. We restructured reserve requirements so as to encourage the banks around the country to move into longer term certificates of deposit in contrast to short-term funds raised in this fashion. We have done that by lowering the reserve requirements on certificates of deposit having a maturity of 6 months or longer. That was accomplished a week or two ago. So we have given, through this regulatory change, an incentive to our own banks to move in this direction. All this is a part of the general problem we are discussing.

RECESSIONARY EFFECTS OF CONSERVATION TAXES

Representative MOORHEAD. In the middle term I agree that conservation of energy is the answer. We should be an example to the rest of the world. However, I am concerned that the recessionary tendencies—you call it a recession—may be aggravated. The suggestions you make—a tax on gasoline, on imported oil, or on automobiles according to the weight or horsepower—which of those suggestions would have the least effect on our recessionary problems?

Mr. BURNS. It is difficult to answer that question in the abstract. One would have to examine specific taxes of these types to be able to give confidently an answer to your question.

But I would say that the last of the three types of taxes that you mentioned, the horsepower tax, let us say, would have less effect on recessionary tendencies than the other two.

On the other hand, it would also be less effective in cutting down gasoline consumption in the near future.

If Congress. let us say, were to pass a tax of this type you probably couldn't make it effective until 1976 or 1977. It takes time for the automobile companies to adjust their production plans, and so forth, in line with legislation of this sort.

So I would think that from the viewpoint of getting a shortrun effect, either a gasoline tax or a tax on imported oil, getting shortrun effects on conservation, would be more effective than a horsepower tax. A horsepower tax would be more effective over the long run.

Representative MOORHEAD. Do you know of any inhibition under GATT agreements, or otherwise, that would prohibit the imposition of a tax on imported oil?

The French have already put an absolute quota on imported oil. Do you see any obstacles there?

Mr. BURNS. Not that I am aware of.

Representative MOORHEAD. And on the gasoline tax, I think it is important to consider the impact on the consumer, particularly the low-income worker.

Do you have in any method or technique by which the revenues raised could be recycled into the economy so that it would not have the recessionary effect which you discuss in your statement?

Mr. BURNS. That is very difficult to achieve. For example, you could raise, say, $10 billion through a 10-cent gasoline tax, then you could distribute the $10 billion to the owners of automobiles. Every owner of an automobile would get his proportionate share.

So that the net taxation on the American public—I am not recommending this as the ideal way of handling this problem, I am just thinking out loud with you—would not be affected, in the aggregate, one way or the other. But, in spite of that, there would still be a negative effect on the automobile industry. There would still be a negative effect on producers of recreational vehicles, also on owners of hotels and motels around the country. Moreover, if you have to go 30–40 miles from your place of work to buy a home, it will cost you much more to commute to your job, and this would tend to retard, to slow down the purchase of new homes.

To deal with that problem, you would have to go beyond the kind of redistribution that I have just talked about. You would have to try to devise some stimulative measures to offset these special recessionary tendencies.

To be sure, the redistribution of the tax revenue that I spoke of would of itself tend to release stimulating influences in other directions, in other trades, but that will not offset the restrictive effects in the short run.

In doing all of this, if your thinking begins moving along these lines, you cannot lose sight of the very grave inflationary problem that this country faces. I had these thoughts in mind when I spoke, at the end of my statement, of a policy of austerity, I don't know how we can escape it at this time.

Representative MOORHEAD. Thank you, Mr. Burns. Thank you, Representative Reuss.

REGULATORY REFORM

Representative REUSS. Mr. Burns, one of the financial sources of worry about the international oil situation has been the enormous amount of short-term highly volatile deposits that were entering the American commercial banking system, and it was thought this might put them into imprudent overlending and into a later financial liquidity bind, which could have very critical effects.

The Kissinger-Simon plan in and of itself doesn't deal with this particular worry, does it?

Mr. BURNS. No, it does not.

Representative REUSS. So you and the other bank regulators will have the continuing problem of riding herd over the American banking system to see that it does not depart from sound banking principles?

Mr. BURNS. Yes; that is entirely right.

Representative REUSS. To the extent that banks get large-scale OPEC deposits, that is good for the country, isn't it?

Mr. BURNS. Well, if these deposits are very short-term deposits, that could weaken our banking system. Anything that weakens our banking systm cannot be good for our economy, and that is something we have to guard against.

I don't know if you have had the opportunity to read the address I gave in Honolulu to the bankers. I wish you would take a look at that because it deals with the need for banking reforms in this country, reform of banking practices, to be brought about in part by the bankers themselves, and in part through new legislation and new regulatory measures.

But I should say that private bankers are very much aware of the difficulties that they will face as bankers if they continue to accept short-term OPEC deposits on anything like the scale that they have in earlier months of this year.

Representative REUSS. Earlier, when you were being questioned by Mr. Moorhead, you said that because the number of American banks which accept large-scale OPEC deposits is rather limited, it might well be that the Fed in an informal way, in a sort of way often exercised by European central banks, might have a role to play in cutting down on very volatile short-term deposits.

What Germany and Switzerland, of course, have done for some time is when they don't want deposits they impose a tax on them or a negative interest or zero interest.

Could you do that?

Mr. BURNS. Our position is very different from the position of other countries around the world because our money market is so much larger, so much more influential than that of other countries. We would have to think very carefully before we moved in any such direction.

I assure you that some thoughts on this subject are running through our minds. We have not done anything overtly in this direction though we certainly have talked this problem over with private bankers.

Representative REUSS. Thank you very much, Mr. Burns, for your testimony, which has always been most clear and helpful.

I have a number of technical questions which I would like to submit to you so that you or your staff can answer them for the record, if that is agreeable?

Mr. BURNS. I will be very pleased to address myself to the questions.[1]

Representative REUSS. The committee will recess until Friday, November 29, 1974, at 10 a.m., at which time Assistant Secretary of State for Economic Affairs Thomas Enders will testify.

[Whereupon, at 11:45 a.m., the committee recessed, to reconvene at 10 a.m., Friday, November 29, 1974.]

[The following questions and answers were subsequently supplied for the record:]

RESPONSE OF HON. ARTHUR F. BURNS TO ADDITIONAL WRITTEN QUESTIONS POSED BY REPRESENTATIVE REUSS

*Question 1.* If the lenders participating in this facility expect their loans to be repaid, then the borrowers must be permitted to run the payments surpluses sufficient to enable them to make these repayments. Trade surpluses with either the lenders—the United States and Germany—or the oil producers are likely to be essential. What are we prepared to do to help the borrowers repay their loans? Are we prepared to run trade deficits with the borrowers?

*Answer.* The provisions of the OECD "safety net" scheme should be seen in the context of the overall financial flows associated with oil payments. The safety net itself involves loans or guarantees by some of the participating oil-consuming countries to other consuming countries. Thus, it involves changes in the debtor-creditor relationships among OECD countries. But, at the same time, a much larger change in debtor-creditor relationships is taking place; the OECD countries (and other oil-importers) are accumulating large debts to the OPEC nations.

When OPEC countries eventually begin to draw down their claims on oil-consuming countries (importing goods and services at a faster rate than their exports), the oil-importing countries as a group will run current account surpluses with the oil exporters. At present, it is impossible to foresee the detailed trade relationships which will develop in this situation. It is possible, for example, that the other oil-importing countries as a group will run current account surpluses with the United States, while the United States runs large surpluses with OPEC nations. Alternatively, it is possible that the United States will have a balance or a surplus in its current account with the other oil-importing countries, while these countries in turn run surpluses with the OPEC countries.

Prior to the time when oil-consuming countries as a group can run a current account surplus with oil-exporting countries, individual consuming countries can repay their borrowings (from a safety net or other sources) only if other consuming countries are willing to accept larger current account deficits or

[1] See response of Mr. Burns, beginning on this page.

smaller surpluses. The United States may well have, in the circumstances, a current account deficit of some magnitude. But the U.S. deficit should not be a disproportionately large part of the total deficit of the consuming countries.

*Question 2.* Is the proposed "standby" financial system sufficiently large to prevent the Federal Reserve from having to act as the "lender of last resort" to other than domestic U.S. banks? Under what circumstances would the Federal Reserve act as a lender of last resort for foreign branches of U.S. banks or for foreign subsidiaries of U.S. banks?

*Answer.* The safety net is designed to help countries, not individual banks. It is not intended to serve as a substitute for assistance that might be needed by an individual bank from a central bank acting as a lender of last resort.

While there is a connection between the general international financial situation and the possibility that U.S. banks will come to the Federal Reserve for liquidity assistance, there is no way through general monetary policies or through general "financial safety net" provisions to guarantee that banks will not suffer liquidity difficulties. Thus, to respond to the question of whether the facility is "sufficiently large" to rule out liquidity problems for individual banks altogether, the answer must be no. Indeed, there is no fund which would be large enough to rule out completely such problems.

Regarding the responsibilities of the Federal Reserve as lender of last resort, I should like to draw to your attention a passage from the testimony of Governor Wallich before the Permanent Subcommittee on Investigations, Committee on Government Operations, U.S. Senate, October 16, 1974: "There are dangers in trying to define and publicize specific rules for emergency assistance to troubled banks, notably the possibility of causing undue reliance on such facilities and possible relaxation of needed caution on the part of all market participants. Therefore, the Federal Reserve has always avoided comprehensive statements of conditions for its assistance to member banks. Emergency assistance is inherently a process of negotiation and judgment, with a range of possible actions varying with circumstances and need. Therefore, a predetermined set of conditions for emergency lending would be inappropriate." For similar reasons, it seems prudent not to try to spell out in advance a set of circumstances in which the Federal Reserve would or would not lend to foreign subsidiaries of U.S. banks. Foreign branches of U.S. banks can look to their head offices for liquidity assistance, if needed; and the Federal Reserve could, if appropriate, lend to the head offices.

*Question 3.* The proposed "financial safety net" insures that industrialized nations no longer able to borrow in private capital markets will not go bankrupt, but are present safeguards adequate to insure that U.S. banks will not overextend themselves in the hustle to capture their share of the enormous accumulation of producer revenues?

*Answer.* Banks have repeatedly asserted that they will not accept OPEC funds beyond amounts consistent with prudent management. In recent months, there have been some indications that banks have not been especially eager to attract additional OPEC funds, while some banks may have taken measures to discourage further deposits (e.g., by quoting an interest rate below the market rate). Moreover, banks are aware that the Federal Reserve has for some time been concerned with the adequacy of their capital positions; we intend to continue our emphasis on the need of banks for adequate capital. These factors suggest that an "overextension" by U.S. banks is not a likely development in the months ahead.

*Question 4.* Is the Exchange Stabilization Fund, whose statutory purpose is to stabilize the exchange value of the dollar, an appropriate vehicle for U.S. participation in the proposed oil solidarity fund which aims to provide emergency support for other deficit economies? How would the United States define stabilizing the exchange value of the dollar since it ended convertibility in August 1971 (in terms of the dollar-SDR rate, or the dollar-Lira rate)?

*Answer.* It would be more appropriate for the Treasury Department to comment on questions regarding the Exchange Stabilization Fund.

Stabilization of the exchange values of the dollar in an operation market sense involves sales or purchases by the Treasury or the Federal Reserve of a particular foreign currency, or currencies, against the dollar in exchange markets. Selection of the currencies for a particular intervention operation depends, among other things, on which foreign currency or currencies are particularly weak or strong on the day of the operation. When appraising the over-all movement of the dollar against foreign currencies in general, we would typically employ one or more of the weighted-average measures commonly in use.

A basic purpose of intervention operations is to help maintain orderly and efficient exchange markets for transactions in U.S. dollars. No effort is made to peg exchange rates at any particular level.

*Question 5.* In your statement, you suggest the potential for shifting deposits from one bank to another increases as the amount of OPEC assets grows. How? Where can producers move such enormous amounts of money, particularly under a regime of floating exchange rates? What evidence is there that OPEC governments have acted disruptively in currency markets?

*Answer.* The larger the stock of assets under one management, the larger the potential for movement from one bank to another, or from one curency to another. Under a system of exchange rate flexibility, a shift from one currency to another will result in a movement of the exchange rate; such a movement can feed on itself for a time, although it cannot prevail over fundamental trends. Moreover, as the exchange rate moves, it becomes more costly for the depositor to continue to shift his funds. Nevertheless, the possibility of significant shifts cannot be ruled out, and they could have a disrupting effect on trade and other international economic relationships.

The OPEC countries could disturb exchange rate relationships in the normal pursuit of income-maximizing objectives, as the result of inadvertence or oversight or, conceivably, as a means of exercising political or economic power. For example, the recent request, in November 1974, of Sauid Arabia not to be paid in sterling, just prior to a scheduled oil payment, caused temporary unsettlement in exchange markets. So far, however, there seem to have been only a few instances of significant market disruption traceable to movements of funds by OPEC countries.

*Question 6.* In your statement you note that producers have not really begun to shift thir funds from short-term to longer term assets although Euro-currency interest rates have begun to drop. Is it because banks have not yet reached their limits in being able to find ways to place short-term funds? Or are banks themselves taking unnecessary risks in hopes that they can gain a share of the market of producer funds?

*Answer.* Several factors seem to be at work in the build-up of short-term balances. A number of the oil countries are developing ambitious projects for the use of their funds, and it is natural in such circumstances that they accumulate large holdings of liquid funds during the period of planning. Even for those countries with relatively low absorptive capacities, a build-up of liquid funds may be considered a natural response in the short run. A number of these countries are short of financial expertise, and they naturally approach the problem of investing their huge funds with a degree of uncertainty and hesitation. International political uncertainties may also have contributed to the desire for short-term assets, in the effort to maintain flexibility.

*Question 7.* How will the United States obtain the $8 billion needed to honor its apparent commitment? If this amount is not raised through taxation or borrowed in domestic capital markets, the $8 billion of loans will require the creation of additional money. On the other hand, if the funds are to be borrowed in capital markets, the Kissinger-Simon plan will merely substitute for private lending. What is the contemplated mechanism? What will be its domestic economic impact? How much of the proposed $8 billion will actually be paid in and instantly available? Will the same amount be paid in by other countries?

*Answer.* The exact mechanics of the financial arrangements are yet to be worked out. Direct government financing or guarantees or both might be involved. The recent communiqué of the Ministerial Meetings of the Group of Ten, sets out the present degree of agreement on the details of the arrangements.[1]

Insofar as funds are raised in this country to be loaned through the facility, financial conditions in the United States will be affected, but to a minor degree. Even if as much as $6 to $8 billion were provided by the United States, this would still represent only a small fraction of the roughly $180 billion of total financing in U.S. credit markets in 1974. Moreover, such lending by the United States, if it did take place, would be occurring at a time when large amounts of foreign capital—notably that of the OPEC countries—would be coming into the United States.

The "safety net" aspects of the U.S. financial proposals should be stressed. This is financing which is to be available only if other sources prove inadequate.

*Question 8.* The Project Independence Blueprint as currently outlined uses relatively high oil prices to bring forth new domestic production and curtail

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[1] ee communiqué, beginning on p. 107 of the appendix.

demand. If the Kissinger-Simon proposal is successful in bringing down world oil prices, will the U.S. Government not find itself in the position of having to protect its high-cost production and be at a disadvantage competing with those countries using cheaper oil?

*Answer.* The problem of providing incentives for domestic fuel production, while at the same time working for a reduction in the international price of oil, is one of the difficult aspects of the energy crisis. As far as I can see, there is not a simple solution to this problem. This problem underlines the importance of taking a balanced approach—both domestically and internationally.

The recent report on Project Independence considered a number of principal strategies for dealing with the energy problem—the development of domestic sources, steps to reduce domestic consumption, and stockpiling of oil. Because each of these strategies involves problems and costs, no single strategy should be looked upon a an exclusive means of solving the energy crisis. It is essential that we move on a number of fronts, stressing not only the development of alternative domestic sources, but also the conservation of energy, and the stockpiling of oil.

# KISSINGER-SIMON PROPOSALS FOR FINANCING OIL IMPORTS

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**FRIDAY, NOVEMBER 29, 1974**

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met, pursuant to recess, at 10 a.m., in room 345, Cannon House Office Building, Hon. Henry S. Reuss (member of the committee) presiding.

Present: Representative Reuss.

Also present: John R. Karlik, senior economist; and Sarah Jackson, professional staff member.

## OPENING STATEMENT OF REPRESENTATIVE REUSS

Representative REUSS. Good morning. The Joint Economic Committee will be in session for the third of its hearings on the Kissinger-Simon proposals for a special oil lending facility to aid industrialized countries seriously crippled by the higher oil import costs.

Treasury Secretary Simon outlined for us on Monday Mr. Kissinger's proposed $25 billion fund. It would make emergency loans to industrialized countries that have exhausted their ability to borrow in capital markets and from the International Monetary Fund. The proposal makes backup financing contingent upon a borrower's willingness to cut oil imports. This initiative to conserve energy is highly commendable.

However, is the current standby proposal really designed to assure the necessary adjustment by deficit economies? Are commitments to be rigorous enough to insure repayment? And are we prepared to permit deficit countries to run trade surpluses with the United States in the coming years so that they will be able to repay these obligations?

On Wednesday, Federal Reserve Board Chairman Arthur F. Burns stressed to us the need for lower oil prices if a major redistribution of economic power in the world is not to take place. However, the U.S. hopes for greater independence from OPEC now seem to be based on the present high oil prices which will stimulate new supplies from domestic and non-OPEC sources, as well as cut consumption. Are not these objectives paradoxically opposed? If world oil prices drop, would not the United States then have to be prepared to guarantee its own high-cost domestic production and thus be placed in a relatively uncompetitive position?

The new Kissinger-Simon proposals seek to shore up consumer unity by providing financial security in addition to protection against supply interruptions agreed to in the International Energy Agency. This initiative seems to reject the suggestion of French President Giscard d'Estaing—that the OPEC nations be included in negotiations during the period in which consumers are trying to conserve energy and develop new supplies—in favor of obtaining this solidarity first. Could President d'Estaing be right? Would not keeping the OPEC countries in the negotiating picture now lessen the likelihood that they will act irresponsibly in the future?

Would it not improve the chances of joint action by the importing countries to control their sales of military hardware to some of the OPEC countries?

This morning we will hear Thomas Enders, Assistant Secretary of State for Economic and Business Affairs. I understand he has recently returned from Europe, where he met with several of our industrialized partners to discuss the proposal.

We welcome you before the Joint Economic Committee for what I believe is your first formal appearance here. Would you now proceed in any way you choose. Perhaps since this is your first official appearance here you would be good enough to give us a few sentences about what you have done before you came here this morning.

## STATEMENT OF HON. THOMAS O. ENDERS, ASSISTANT SECRETARY OF STATE FOR ECONOMIC AND BUSINESS AFFAIRS

Mr. ENDERS. Thank you very much, Representative Reuss. It is a pleasure to be here for my first appearance. You were kind enough to suggest I might give an idea of my biography. It is simple.

I was educated at Yale and Harvard and the University of Paris primarily in history and economics. I have done most of my service in the State Department in Washington, but have been assigned to Sweden, Yugoslavia, and most recently to Cambodia where I served until April of this year.

Most of my service in the State Department has been in the economic area.

Representative REUSS. Thank you. Would you now proceed with your statement?

Mr. ENDERS. Representative Reuss, the proposals that were made by Secretaries Kissinger and Simon for a $25 billion facility to back up capital markets over the next 2 years is part of a larger strategy as you have indicated to resolve the oil crisis. In this statement I propose to review the main elements of that strategy, situating the proposed financing facility in relation to them.

The starting point for our analysis is the belief that unless the consumers take action to limit their dependence on oil imports, OPEC probably has the will and the capability to maintain the real price of the oil they export, and the financial surplus they are earning, at roughly constant levels over the next several years, and possibly indefinitely.

OPEC is earning a total income of perhaps $110 billion at the current annual rate, of which it spends for imports a little less than one-half. OPEC's import expenditures will, of course, rise in the future, in part because of inflation in the cost of manufactured goods it buys—but note that the current rate is only about 7 percent—in part because the new affluence and the new ambition of the producing countries will increase their spending.

But OPEC's total income will also rise. To oil will be added a rapidly growing investment income. The volume of oil imports into the OECD will increase as industrial growth resumes, perhaps at a rate of 4 or 5 percent a year.

We think new oil may well be found at a more rapid rate, in Mexico, Peru, Malaysia, and China. But with even the poor countries such as Indonesia and Nigeria disposing of unprecedented liquid assets, the cartel may retain for years the capacity to cut back production to sustain and increase prices.

Since total OPEC income has only to grow at a little more than one-half the annual rate of total OPEC spending to protect the financial surplus at the $60 billion level, we must expect that in the absence of new action by the consumers, the surplus will be sustained indefinitely. OECD estimates that if real prices for oil are constant, only in 1980 will the net surplus fall to $50 billion a year, by which time OPEC will have accumulated assets of $425 billion. Any increase in the real price of oil would be additional.

Hopeful arguments have been advanced to convince us that this will not happen.

Some say that OPEC members will see the damage an annual accumulation of this magnitude will cause to the industrial economies, and let the real price of oil erode through inflation. There is no question that this would be a prudent course of the producers to adopt in their own interest. But we cannot count on them to do so.

Because of ideology—monopoly action to raise commodity prices is a main plank of the "New Economic Order"—because of real or imagined scores to settle for past exploitation, because of the power and authority the new money gives, OPEC members are unlikely to let real prices erode if they can help it. Even if individual countries may wish to move prices downward, they are unlikely to be able to do so alone.

For as a matter of practical politics, no country will be able to explain to its public why it gets less for its oil than do other OPEC members. Nor would it be a full solution simply to let prices erode by inflation, for sinking real prices would stimulate consumption again, thus slowing the absorption of the surplus. Thus, if the real price of oil were allowed to erode by one-third by the end of 1980, the cumulative OPEC surplus might fall only from $425 billion to about $375 billion.

Others say that OPEC will tire of accumulating surpluses, and will cut back production, keeping oil in the ground as an investment rather than claims on the industrial economies. It is possible that this will happen, but if it does, the surplus will, if anything, grow, for as oil becomes scarcer, the price it commands will go up.

The important point is not to be able to make a precise forecast. There are too many variables for that. What matters is that there is a wide range of probable situations in which the OPEC financial surplus continues essentially intact for an indefinite period, or falls only slowly.

What does that mean? It means that unless they act, the industrial democracies face an inexorably rising danger of financial collapse, or depression, or both, over the next decade. As oil debts pile up in the industrial countries, first the weaker, then the stronger will find their credit unacceptable, and will try to balance their external accounts by restrictions on trade and on the level of economic activity. But one country's success in balancing its external accounts will only make the problem more urgent for others.

For whether the industrial world runs its economies at a high level of activity, or at a low level, the deficit to the oil producers will remain massive. Unless we are all willing to take 20 percent unemployment, there is no way that deflation or restrictions can solve the problem.

But there is more. It is impossible that Europe, Japan and America could undergo a decade of threatening financial collapse and low or no economic growth without the most shattering social and political upheavals. Already this year we have seen how inflation and no growth is embittering the political life of all the great democracies, undercutting the authority of leaders, setting class against class. And this is only the first year. It is no accident that the Soviet Union and China, securely self-sufficient in energy, with a sustained growth rate, have begun to analyze and exploit a great new crisis in capitalism.

Apart from the United States and Britain, none of the major oil importers have the possibility of becoming self-sufficient within a decade, and self-sufficiency in energy cannot be the goal of the industrial economy as a whole for the foreseeable future.

But invulnerability to cartel action to raise prices is both a possible and a necessary goal.

At present, the consuming countries import approximately 30 million barrels of oil a day, mostly from OPEC sources. But current prices of about $10 a barrel f.o.b. Persian Gulf are very attractive, and a worldwide oil boom is underway. Subsequently finds of oil have been reported from Mexico, Peru, China, Malaysia; and the wave of exploration is just beginning. The owners of this new oil will understandably want to sell it at the going price; but they will also want to develop it sufficiently so that they can receive a substantial income. Together they may already represent the possibility of new production several years from now of 10 million barrels a day. And more will follow.

The impact of this prospective new production on price depends on the development of the market as a whole. OPEC members have shown that they are willing to cut back output to sustain price. Arab producers are currently working at less than three-quarters capacity. With the enormous assets all producers are receiving, there is no doubt a margin for further cuts, even in the poorest countries will be considered. Thus, if the overall market were to increase from 30 to 40 million barrels a day over the decade, it might be possible for OPEC to accommodate the new producers and still sustain the price.

But if the market did not grow at all, the burden of adjustment on existing OPEC members would be more than they could adjust to. States now launching ambitious development programs would find that by the end of the decade they were receiving only about half the expected revenues. Negotiation of the required cutbacks in production would become more and more difficult. First clandestine, then open violations of product quotas would occur. Ultimately all efforts to sustain the artificial price would be abandoned.

There is no way we can know now the precise size of market at which OPEC efforts to rig prices become inviable in the face of new production. But it would clearly be wrong to start down this road with a goal that might turn out to be inadequate. To be sure they make this and any future oil cartel inviable, the goal of the consumers must be to hold their collective imports steady over the next 10 years.

This is a demanding goal, but we now believe from the analysis in our own Project Independence Blueprint, and from the OECD's long-term energy assessment, that it can be attained.

Project Independence Blueprint shows that we have many options for achieving substantial self-sufficiency by 1985.

On the supply side, policies to lease the Atlantic Outer Continental Shelf, reopen the Pacific Outer Continental Shelf and tap the naval petroleum reserves can significantly increase domestic oil production. The Federal Energy Administration estimates potential increases at from 4 to 8 million barrels a day, depending on the level of price.

On the demand side, energy conservation actions can significantly reduce the rate of growth of energy utilization by 1985. Standards for more efficient new autos, incentives to reduce miles traveled, incentives for improved thermal efficiency in existing homes and offices and minimal thermal standards for new homes and offices could all contribute. Petroleum demand could be decreased by up to 2 million barrels a day, and electricity consumption would also fall.

Also on the demand side, further savings of limited oil and gas supplies can be achieved by policies that require switching from oil and natural gas to coal or coal-fired electric power. Up to 2.5 million barrels a day of oil and 2.5 trillion cubic feet of natural gas might be saved by this method, although environmental restrictions and capital costs are significant contraints.

On November 14, Secretary Kissinger announced the goal of reducing U.S. oil imports from over 6 million barrels a day to 1 million barrels a day in 1985. The administration is now working to develop Project Independence policy options for decision by the President. The President expects to submit his proposals to Congress in January.

The options open to Europe and Japan to limit their dependence on imported oil are less far-reaching, but they are by no means negligible.

In this regard, Representative Reuss, the European Commission announced today a plan to reduce its dependence on imported oil from close to two-thirds to a little over 40 percent. Studies made in the OECD suggest that this is an entirely feasible goal.

In Japan, a program of long-term conservation combined with the expected development of nuclear power could reduce dependence from 90 to about 80 percent.

If the United States goes to substantial self-sufficiency and Europe and Japan reduce their dependence in the manner indicated above, the level of oil imports by industrial countries will be no greater in 1985 than now.

Many policy instruments are available to achieve these goals. On the demand side, this choice ranges from voluntary programs of restraint, mandatory fuel switching, price decontrol, taxation, and various kinds of allocation. On the supply side, energy investments will come in at various levels of return and risk, and countries will have to be sure that there are adequate incentives to yield the level of output desired.

Policy instruments available for this purpose include tax incentives, long-term contracts, deficiency payments, or subsidies for given projects, tariffs or other import protection.

All of our studies show that both demand and output are quite responsive to effective internal prices. Project Independence Blueprint indicates that the United States has many options for achieving substantial self-sufficiency at lower than world prices today, but higher than internal prices in the past, with both demand restraint and new supplies playing an important role.

We must, however, distinguish effective price levels insofar as they affect consumers and investors, and the means by which they are achieved. Such instruments as price decontrols, taxes, and tariffs all have different income and policy impacts, but they can be used to achieve the same effective price to the consumer. On the investment side some instruments such as purchase agreements and project subsidies would affect only new investment. Others, such as tariffs and tax incentives, could affect all investment. Each has different income and policy implications.

Each country will adopt the policy instruments best suited to its own energy and fiscal structure.

However there are three potentially important areas for common action:

One is to adopt clear targets for the level of dependence each country wishes to achieve over the decade and national conservation and supply policies to achieve them. These targets and policies should then be examined and monitored together.

Second, it may be useful for the consuming countries to agree on the minimum level—although not the policy instruments—at which they will support new investment. This would back up the dependence targets by creating stable investment expectations throughout the consuming countries; it would work to insure an equivalence of effort.

Third, the consumers can magnify their several investment efforts by entering joint R. & D. projects in energy, and by creating a common fund to guarantee or finance energy projects in consuming countries.

But these fundamental actions on supply and demand will take years to give results. We think that four things are needed to bring our present jeopardy to manageable proportions between now and then:

One is an oil safety net, to make sure that we can act in concert, on the basis of equitable sharing, to counter any new embargo directed against all or any of the consuming countries. This protection is alreay in place.

In Paris last week, 16 countries formally adhered to the International Energy Program, committing themselves to a far-reaching program of preparedness for and solidarity against a new embargo. The IEP creates a situation in which a restrictive act directed against any member becomes an act against all. It is the indispensable basis for all future cooperation among the consumers. Implementing legislation for this program will be submitted to Congress shortly for its consideration.

The second is an immediate effort by consuming countries to conserve oil, the only way open to them to lessen the financial drain in the short term. Even now, after the embargo and price increases, our studies show that there remains a significant margin for further savings of oil in both industry and personal consumption that can be realized without jeopardizing output or jobs.

Worldwide, that margin is probably at least 3 million barrels a day. President Ford announced a savings program of 1 million barrels a day in October. We are monitoring its execution carefully in order to reinforce it if needed; and we are prepared to consider increasing the program to match others in attaining the collective target of 3 million barrels.

The third action within the IMF framework is to make sure the financing needs of the developing countries can be met, while waiting for the price of oil to come down. It would be very wrong to force the developing countries to adandon their growth programs and goals.

We estimate at $1.5 to $2 billion the gap in 1974 for which no financing has yet been found. Concessional terms will be needed. Secretaries Kissinger and Simon proposed that a new fund be established for this purpose, managed by the IMF and financed by oil producers, other contributions, and perhaps by profits from sales of IMF gold.

As we see it, Representative Reuss, the final requirement is for a financial "safety net." This is needed to make sure that no country is forced to take unwarranted restrictive trade or economic policy measures as a result of the maldistribution or instability of reflows of oil dollars and of the growing burden of oil debts.

Representative Reuss. Could I interrupt? I have been taking notes, and I thought the first point was that "safety net," and here we are at the fourth and it is "safety net" again. This is a different one?

Mr. Enders. I beg your pardon. The first point was an oil "safety net" which is a collective effort to insure our invulnerability—or to have less vulnerability—to a new oil embargo, whether a selective or a general one.

This oil safety net, the so-called International Energy Program, is an undertaking among the major industrial countries, acting in concert, to build up oil stocks so as to be prepared for an emergency and to cut demand by a given amount in a crisis in order to make sure that no country need suffer more than any other from an embargo. That is the task of the IEA.

Now, as has been remarked here several times, so far private capital markets have performed well in receiving and redistributing the enormous flow of oil dollars. We believe there is substantial further room for expansion of the flows handled by private markets, but we cannot be sure of how great that expansive capacity is. Already there are some indications of approaching constraints.

In banking, for example, there have been no significant additions to capital since the start of the oil crisis. Yet the total assets and liabilities built upon a given capital structure have increased greatly. At some point it will not be prudent for the banks to expand further without substantial new additions to capital, which will be difficult and costly to raise in current market conditions.

Thus, rather than test the limits of our present system, Secretaries Kissinger and Simon proposed creation of a new large-scale intergovernmental financing facility. This facility would be—

Designed to back up, not substitute for, the workings of private capital markets.

Temporary; intended to enable the consuming countries to pursue sound economic and trade policies while waiting for basic energy policy decisions to take effect.

Not an aid fund, but rather a facility lending at commercial terms on the basis of established criteria for appropriate economic and energy policies pursued by the borrower.

Structured so as to distribute risk equitably among the consuming countries.

It would of course be subject to approval by Congress.

Each of the four proposed interim actions is important, we think, in itself; equally significant, both analytically and politically, is their linkage to each other and to the energy dependence targets and program. No country, certainly not the United States, will want to help another financially unless that other country is helping itself by conserving oil and joining a long-term effort to lessen dependence. And we must adopt a clear strategy to bring the price of oil down, and back up that strategy with the appropriate policy decisions, in order to be sure that the loans under the proposed facility or, indeed, the present structure of oil debts as a whole can be repaid.

It has often been suggested that we can talk or pressure the oil producers into accepting a reduction in price.

Neither approach, in our judgment, is likely to lead to more than tardy or partial results. And there would be significant costs, we think, for relying on that—the false security our people would gain from the impression that we were solving the energy crisis when in reality we were only temporizing—or the damage to the structure of international security that might result.

Instead, what Secretary Kissinger has proposed is a program of action designed to change conditions within the consuming countries themselves. Its purpose is not to create a position of force which can then be imposed upon the producers, but rather to create conditions in which a new long-term equilibrium between oil producers and consumers can be achieved. That equilibrium must be such that the producers receive an appropriate price for their products, while the consumers can be free of the threat of embargo and of artificial action to raise prices.

Achievement of this result depends critically on the solidarity of the consuming countries. I think every country since the start of the energy crisis has been tempted to go it alone to try to work out some special deal with the producers, or hope that the actions of others will end the crisis. And I think each of us has been uncomfortable with having his future depend so totally on other countries. But our analysis of each country's position shows that going it alone is not a superior option for any consumer. Over the decade only the United States and Britain can go to self-sufficiency; all others will remain dependent on imported oil. All industrial countries, especially those heavily involved in trade, will be vulnerable to financial crisis. And if the United States and Britain can eventually solve the price and financial transfer problems by going self-sufficient, the only way Europe and Japan can is by cooperating with each other and with us. And in between no country, including the United States, can solve the price problem alone.

We think in the end that the prices give us no alternative except consumer action, and we think the financial solidarity aspect, enabling us to live in an orderly manner for the several years required to have energy policies take their effect, is an essential part of this program.

Thank you very much for letting me come before you here.

PROTECTING DOMESTIC ENERGY PRODUCTION

Representative REUSS. Thank you. I am not quite clear but I thought most of your statement was directed to the probability that the price of foreign oil would come down and to the desirability of maintaining some guaranteed price system for the U.S. producers, whether by import quotas or tariffs or whatever device, so that investments in the United States for new energy facilities would be made and would not be eroded if the world price of oil dropped. Where does that come from? Do you have a name for that proposal? Whose is it, where does it come from and how does it fit in with the four proposals that you mentioned at the end of your remarks?

Mr. ENDERS. As analyzed by the Federal Energy Administration, Representative Reuss, the basic situation is that at historic levels of oil prices, the $2 or $3 per barrel that have prevailed in the past, it would be impossible for the United States to achieve substantial independence of oil supply. The rate of consumption would be too low at this level and the rate of investment would be too high at that level, no matter what the policy instruments were, to permit over the next 10 years a significant reduction in the gap between our oil consumption and our oil supplies domestically produced.

An effort at lessening our dependence through Project Independence no doubt will require market arrangements or tax or other arrangements which would bring somewhat higher prices than we have had in the past, but probably lower prices than we now have in the international market. You must balance, then, our desire for lower prices on the one hand and our desire for independence on the other; and the two lines cross somewhere in between.

The proposal that is being referred to here is in fact the proposal of Project Independence that we substantially reduce our reliance on imported oil. We think that not only this country but every other country in the industrialized world should have a Project Independence or equivalent and we would hope that they could be put side by side and give some relationship between each other.

Representative REUSS. Well, Project Independence is not the name of an agency. It has no doors so far as I know in which I can walk. Who is it that is suggesting that the U.S. Government guarantee the future price of U.S. oil and perhaps related forms of energy from falling? Is this the State Department or the Treasury Department?

Mr. ENDERS. Oh, I see. I misunderstood your question. No one is suggesting any individual method for obtaining Project Independence's goals. Secretary Kissinger has stated, on behalf of the administration, that the Project Independence goal is to reduce our present oil imports from a little over 6 million barrels a day to 1 million barrels a day. To achieve that goal, Mr. Chairman, a number of policy actions would be required. There is a very wide range of options, depending upon whether you put the weight mostly on the side of conservation or you put the weight mostly on the side of resupply—or new supplies—or you have a balance between them.

47-214—75——5

The purpose of my statement is only to indicate some of the policy instruments that might be adopted for that.

Representative REUSS. Well are those suggestions made on behalf of the State Department or the administration or who?

Mr. ENDERS. On behalf of the administration we are proposing to the other industrialized countries that they join with us in adopting firm targets for limiting import dependence over the net decade. We are suggesting that they then explore with us ways and means by which those policies and targets can be made effective. There are many such ways and means and in the end there will be national policy decisions in each case, but we think it important to try to coordinate those ways and means and achieve a policy balance.

Thus, there is no firm policy by the State Department or by the administration as to the best ways and means for doing this, sir, but rather a discussion of how it can be accomplished. But we think that the hard thing which should be accomplished first is the establishment of the targets themselves.

NEW SUBSIDIES FOR MAJOR OIL COMPANIES

Representative REUSS. To the extent that this administration's proposal envisages guaranteeing the giants of the American oil industry. who also control a lot of our coal, uranium, oil shale and other sources of energy, that they can enjoy a price which is deliberately rigged and maintained high by their government, I just wonder what shall it profit the American consumer of oil if he is freed from the tyranny of the OPEC countries only to be ripped off by the U.S. oil companies? I see no net gain there.

Mr. ENDERS. There is no such proposal, Representative Reuss. The point is simply this: If you seek less dependence on oil imports, then you must also commit yourself to a substantial effort of conservation and a substantial effort at new investment and supplies or both. How that new supply, if that is to be an element of the policy—and it is very hard to achieve a policy that substantially reduces your dependence on imported oil without having a significant contribution from new supply—how that is to be achieved is a matter for which there is no precise proposal at this time. This does not necessarily imply that the existing companies would have a guaranteed market.

One alternative, for example, would be to consider the kinds of individual project subsidies that would be required to develop energy from new relatively high cost sources. So in other words the problem is how do you get the investment you want?

It does not mean necessarily that you do this by providing a guaranteed market to existing oil companies.

Representative REUSS. If you go the individual subsidy route such as writing a check to one or the other of the Standard Oil Cos. to undertake exploration that would result in lower prices for the oil produced and it would also result in it being unnecessary to keep out lower priced foreign oil by a quota, is that not correct?

Mr. ENDERS. That is also correct. That would be an alternative way of doing it.

Representative REUSS. That seems to me a much better alternative. Wouldn't a better alternative be rather than to write checks to what is essentially a monopolistic industry, wouldn't the TVA approach be worth exploring; that is, setting up a government corporation?

Mr. Enders. That is yet a further alternative. Our purpose here, Representative Reuss, is simply to state the problem and not to state the proposed policy instrument.

Let me add, in this regard, that yet another alternative which has been suggested is a device for a long-term contract, perhaps by a government agency, for the purchase of the energy to be produced by a given investment at a price that can be predicted or negotiated in advance. This is a sort of analog to various kinds of support devices which are used in agriculture, for example.

I think there is a very wide range of possible ways of doing this, each one of which has a different kind of social and economic effect.

Representative Reuss. Well I am just wondering. I just want to record my own thoughts. About the worst combination for the average American would be the heads-you-win-and-tails-I-lose deal inherent in having the Kissinger-Simon plan whereby in order apparently to try to get the international price of oil down, we are going to hazard $8 billion a year of American taxpayers' money in loans to oil-threatened countries and then accompany that with a plan to maintain the domestic price for the indefinite future by keeping out foreign oil with a quota if it ever gets cheap. I can't imagine a method more fiendishly devised to absolutely clobber the American taxpayer and consumer than that combination, can you?

Mr. Enders. May I comment?

Representative Reuss. I just can't see those two things occurring really without a taxpayer and consumer revolt in this country.

Mr. Enders. I think. Representative Reuss, that the Kissinger-Simon plan would be misunderstood if it were portrayed in those terms. Clearly the point, as we see it, is that if we do want less dependence—and we think that all Americans do—then we will have to do something on the supply side. But that doesn't say what we will have to do on the supply side. There is no specific policy prescription, and there are a large number of possible devices for doing that.

One of the most effective may be one which has been advocated in Europe, a deficiency payment system whereby the return to investors would be set at a given level for given projects, but the actual price at which the energy was sold could be left to the market where it might be substantially lower. A device of this kind might be consistent with the kind of conceptions that you have just expressed.

Representative Reuss. Who would pay the subsidy on this device?

Mr. Enders. Well, clearly there would have to be a national determination of the degree to which we wish to be free from foreign oil and there would then have to be a decision as to how much American taxpayers' money should be devoted to obtaining that degree of independence.

One way. Representative Reuss. to achieve independence is a maximum effort in the direction of conservation. But in terms of resupply, we would obviously have to have some incentives or some form of protection.

Sir. I do not wish to characterize the Kissinger-Simon proposals as containg any specific element or recommendations as to how to obtain new supply. That is a Project Independence decision and these choices will, be made on the basis of that study. We hope other countries will make smaller Project Independence decisions also.

Representative REUSS. Well I just hope that before this program of providing enormous subsidies at the taxpayers' expense to the same large oil companies who lobbied so successfully for import quotas in recent years is enacted, that studies will be made of the companies' profit picture and of why it is that they seem to want to put capital that could be used for investment in oil exploration in all sorts of extraneous ventures, chains, dry goods stores, circuses, so that we don't get more energy. Has FEA made that kind of study?

Mr. ENDERS. I can't speak for FEA, of course, in detail. I think that the only distance that we have gotten so far, Representative Reuss, is that we think there is no way to obtain substantial self-sufficiency—a goal the administration and others have set—without a major effort on both the conservation and resupply side. Now what is required to get the additional new supplies is a question we are now grappling with.

Representative REUSS. Thank you.

In his testimony before this committee this Monday the Secretary of the Treasury, Mr. Simon, said that OPEC producers had as much as 8 million barrels a day capacity which was shut in; that is, they simply were not using it. If this is true, why should there be all this confidence that cutbacks by reason of the Kissinger-Simon proposal on the order of 3 million barrels a day globally is going to induce them to cut the price? If they are willing to let 8 million barrels a day go untapped, why should raising that figure to 11 million cause them to panic?

Mr. ENDERS. I think I have three things to say about that. The basic purpose of the conservation proposal of 3 million barrels a day for industrialized countries is to provide an immediate means for lessening the financial drain upon us to the greatest extent possible. We think that is about as much as could be achieved in the short run and it would also indicate to the producers that we are really serious about attempting to end the crisis which we are manifestly in. We hope that this would provide some pressure on prices, but we cannot be sure that it will.

That 8 million barrels a day that Secretary Simon referred to is almost exclusively—well not quite exclusively because Venezuela is there—but is almost exclusively in Arab oil producers' hands. Libya, for example, is producing at only about 40 percent of its rated capacity and Kuwait is at a little more than half. If in fact 3 million barrels a day had to be levied largely upon the producers that are now cut back, then some of them would be close to going out of business. It depends very much on whether it is spread over the whole group or only on individuals.

We can't tell for certain, Representative Reuss, where the cuts would be taken within the OPEC countries if the 3 million barrels a day were realized. It would add to the pressure, but we can't be sure that it would result in the lower prices we desire.

Finally, we think that in every country the public will want to get going as quickly as possible on a strong program that can contribute to the ultimate end of the energy crisis. That was the purpose of President Ford's proposal and it is a proposal that we think other countries will follow.

### WITHHOLDING ARMS EXPORTS

Representative REUSS. One hears from time to time out of the Pentagon and sometimes in higher places, talk about armed invasions of various Middle Eastern places to secure the wellheads and end this thing once and for all; these conversations which I do not find at all edifying but which do exist. When one inquires about it, one is usually told, "Well this isn't serious but you want to keep before the eyes of the OPEC countries the range of options available and so on."

I wonder how credible that really is? After all, at a time when we are pouring arms into Saudi Arabia and into Kuawit and into Iran, it wouldn't seem to me that the effect of such talk would be taken very seriously. Do we really want them to tremble in their boots and, if so, why don't we perhaps adopt Giscard d'Estaing's suggestion and start conversations right now between all the major importers, as he suggested, and all the oil producing countries out of which might conceivably emerge some sort of unified position by the principal suppliers, namely, France and the United Kingdom and ourselves; I mean the principal arms suppliers?

It may well be that we have a counterweapon that we haven't used against the more arms-hungry OPEC powers. Wouldn't that be a useful string to our bow?

Mr. ENDERS. As we understand Mr. d'Estaing's proposal, Representative Reuss, it is for so-called trilateral talks with the producers, with the consumers, and with the major developing countries. We had not understood that he had proposed the question of armaments be included——

Representative REUSS. No, he hadn't, but why don't we accept his kind offer and then, after we get together, we can say: "Incidentally, Mr. d'Estaing, we want to talk about arms sales, too."

Mr. ENDERS. Those countries of Iran and Saudi Arabia in particular, and others as well, have, we think, important security needs which our programs of arms sales are of course designed to assist.

Representative REUSS. Like what?

Mr. ENDERS. Well the position of Iran next to the Soviet Union is clearly one which requires a significant military effort on their part. I think no independent neighbor of the Soviet Union would wish to be without a major defense program.

Representative REUSS. How about Saudi Arabia?

Mr. ENDERS. Well somewhat the same concerns apply there, although at a lesser level, and their armaments are, of course, less impressive than Iran's. Each of these countries is relatively moderate and has been, in varying degrees, relatively helpful in trying to unravel the Middle Eastern crisis. Each of these countries has to some degree the uncertainty of living in a world which is potentially threatened from outside. In other words, Representative Reuss, it is not immediately obvious to me that by attempting to take away their instruments of security, one could force them into economic concessions, which is the question which I think was the thrust of your remarks.

### INTERNATIONAL CONSERVATION EFFORTS

Representative REUSS. Let me now turn to the Kissinger-Simon proposal itself, namely for a $25 billion annual oil rescue fund. Arthur Burns when he was here on Wednesday made a very strong plea for the very prompt adoption of a meaningful U.S. oil conservation program and one that could be used as the basis for an equally prompt related oil conservation program by the countries of Europe. I think there is general agreement on the part of this committee that Mr. Burns was right.

Mr. Simon said, and I think you said too this morning, that the hope is that the Kissinger-Simon oil rescue negotiating agreement will be up before Congress in January. Did you not say that?

Mr. ENDERS. No, but if we are successful in negotiations then we should have a clear idea in January as to the degree of agreement by other countries to this proposal. At that time it should be possible to come back to Congress and lay before it where we stand. That is optimistic, but it is possible, Representative Reuss.

STRINGENT CONSERVATION METHODS NEEDED

Representative REUSS. Yes, I would just like to lay before you my own ideas on timing. I don't think Congress will or indeed should be very anxious to have a program like this with a financial exposure potentially greater than the Marshall plan, which was the greatest in history, unless it really sees, not just hears about, heroic efforts at oil conservation by all the principal countries involved, and of course those who might be its beneficiaries. For example, if in January, as today, the Italians continue to whiz up and down their roadways at 75 miles an hour and if in January, as today, the French go on building in Paris, American-type glass enclosed skyscrapers, which are enormous heat and energy wasters, and if for example, leading countries of Western Europe are continuing to convert utility companies to the use of oil, I can't imagine Congress will feel justified in imposing such an exposure on the American taxpayers.

If on the other hand we see conservation being taken seriously and, as Mr. Burns pointed out, we take the lead—and I see no indication at the moment that we are taking any kind of a lead. It is pretty much business as usual with pleasure driving, industrial waste, architectural folly. The thought I want to leave you with is that the Kissinger-Simon $25 billion a year program is going to be viewed by Congress as the third in a series of actions and those actions are:

Step 1, heroic methods by the United States in conservation in place and operating;

Step 2, heroic efforts in place and operating by other participating countries;

And step 3, then I, speaking for myself, would then be a very strong supporter of a program to give a financial rescuing hand to that kind of an operation. But I cannot imagine Congress voting for, or the American people standing for it if we did, a system in which we would bail out country *x* indefinitely while it continues to squander oil in its utility boilers, gasoline on its highways, and heat energy in its buildings. I don't think that Congress is likely to do it and I don't think that Congress would survive long with the folks back home if it did.

So since I am as interested in a speedy timetable as you are, let me now ask you what is being done internationally today about seeing what kind of conservation programs can be put in place in every country? Obviously they need to be different. Japan for instance uses about 80 percent of its energy on industry and therefore, the cuts have to be different, but each must do the best they can. Who is in charge of that today? That is a big one.

Mr. ENDERS. It is a big one, Representative Reuss. We agree, I think, essentially—without getting into the fine points—but clearly we agree on the basic linkage between these two sides of the proposal. The approach that we have is to attempt now to obtain adherence to the 3 million barrels a day saving by basically the countries grouped in the so-called IEA, International Energy Agency.

The way in which we propose to do this is as follows: We have had an initial meeting on the 18th of November at which it was agreed to put together existing or proposed national programs of conservation in what we called a first collation of programs. This is to be done by mid-December. We are going to have another meeting of the International Energy Agency in mid-December to examine all existing programs and all proposed programs, to see how they compare with each other and what the reality of the programs is.

In between times, we expect the European Community to have made some decisions on energy conservation which will probably be reflected, at least by those members that are also members of the IEA, in the discussions in mid-December. Following that, if those programs are not adequate—and there is some likelihood that they might not be adequate—then we would make recommendations for each country to return to its capital in an effort to put together somewhat larger, somewhat different, somewhat more forceful programs and again come together in mid-January to examine those. It is possible that if this is not sufficient to obtain the kind of serious programs we all have an interest in, then a further, possibly higher level and possibly even ministerial, meeting might be required at the end of January or early February in an effort to obtain these results.

Representative REUSS. Can you tell me anything about the discussions going on in this country among our own leadership concerning conservation, which I find presently nonexistent? There is no tax, no rationing, no allocations, and horsepower taxes haven't been used in many years.

Mr. ENDERS. The present U.S. program essentially is a voluntary program and will be monitored by a weekly digest to be put out by the Federal Energy Administration. It will show the target for the total of all fuels, as well as a breakdown by each fuel, projected over the course of the next four quarters.

Representative REUSS. When will they have the results of that? When will they have the results of this monitoring?

Mr. ENDERS. I beg your pardon?

Representative REUSS. When will the result of this monitoring be disclosed?

Mr. ENDERS. It will be disclosed weekly so that each week we could see how well we are doing, whether the present approach is working or whether it needs to have some reinforcement.

Representative REUSS. I can tell you now it isn't working. We are wasting oil and energy like mad.

Mr. ENDERS. I think that we have to get into this voluntary program with an accompanying program of publicity in order to see whether it is working, whether it can work or whether it requires reinforcing. I don't know exactly when that decision can be made, but in the view of the administration it certainly cannot be made until we have at least some experience with the existing program and with the monitoring of it. This is just starting.

### CONGRESSIONAL PREREQUISITES

Representative REUSS. You have tried very faithfully to answer a series of questions I have asked you about a lot of matters not immediately related to the State Department, but I do want to make my point that they are all going to be related in the congressional mind. The Kissinger-Simon proposal will not fly if it comes up here as a $25 billion annual plan with just talk about commitments by other countries that they will conserve. We want to know what they are doing and what we are doing. I do want to warn you now and I do see very little possibility of getting something out on your timetable.

You, or at least the Treasury, said that the administration would like to bring the authorizing bill up here, perhaps in January. Well the way things are going, international conservation is not really going to be launched actually until considerably after that and even our own required conservation effort, is unlikely to be ready until afterward. So I do want to let it be known that Congress really will require a completed package unless there is an additional imperative here with all the other imperatives, and I think this job of coming up with a completed package has to be done mainly by the President.

Congress will cooperate but Congress I don't think should be asked to recommend various taxing proposals and gas stamp proposals and industrial requirement proposals by itself and send them off to the administration. That isn't the way programs are accomplished. I think it must come from the administration and then the Congress will speedily get to work on it.

Mr. ENDERS. Let me say, Representative Reuss, that this set of proposals is founded on exactly the same concept of linkage. They have to be linked. We think that every country should have a Project Independence. There should be a sharing of the burden in that regard. There must be a sharing of the burden of conservation and there must finally, be a sharing of the burden of monetary security. All of those things are linked in our view, as I see they are in yours.

Representative REUSS. Yes, the one caveat I was posing is that before Congress writes the check, it wouldn't want simply a commitment from the proposed beneficiaries as to what they intend to do in the future, because I think they are all able to make great commitments, but it will want evidence that heroic self-denying ordinances are in place and functioning.

Those are good anyway. They have to be good or all the dire consequences, which you and others have rightly been pointing out to us, will come to pass.

### FUTURE TRADE ADJUSTMENT

I will finally ask a question that I have asked of other witnesses. If the lenders participating in the Kissinger-Simon facility expect their loans to be repaid, the borrowers must be permitted to run the payment surpluses sufficient to enable them to make these repayments. Trade surpluses with either the lenders, which is likely to be the United States and Germany, or the oil producers are likely to be essential.

What are we prepared to do to help the borrowers repay their loans? Are we prepared to run trade deficits with the borrowers?

Mr. ENDERS. This poses, Representative Reuss, the problem of eventual adjustment to a zero rate of accumulation by the OPEC countries. Sooner or later we must reach that point so that we can achieve the repayment or stabilization of the existing debt structure and a new equilibrium not only with the OPEC countries but among the Western countries. Clearly if there are, at that time, large outstanding debts from one member of the consuming group to another, they can be repaid over time only by the device that you indicate unless they are of course offset by other flows in the balance of payments, such as other capital flows; private capital flows in the balance of payments. How long that kind of adjustment would take and exactly how it would be accomplished is difficult to say now but clearly some adjustment of the type you indicate would be required.

Representative REUSS. Did I understand you right that repayment of these oil facility loans couldn't be expected until the OPEC countries ceased adding to their reserves? Well, I should think there are additions to the reserves that might go on and on indefinitely. They are adding it at a rate of $50 billion or $60 billion additional a year now. All of that money will earn returns and I should think their favorable reserves will go on indefinitely. I would hate to think that the repayment of the United States $8 billion a year exposure couldn't start until the OPEC countries ceased to run surpluses.

Mr. ENDERS. It could of course start beforehand. We had envisioned medium term loans in the order of 5 to 7 years, possibly. Our view though, Representative Reuss, is that it is absolutely essential that some time in that time frame that we get the international price for oil down sufficiently so that a new equilibrium can be created between the consumers and the producers and essentially no accumulation. If it goes on much beyond that, we think the dangers of financial collapse becomes almost total so that we need, we think, to have the strategy that gets the price down in a reasonable period of time in order to make sure that a device of the kind that we are discussing here can be repaid. The two are linked.

That does not mean, in our mind, that repayment could not be achieved on the terms of the loan already beginning in advance and there may be amortization procedures.

Representative REUSS. Thank you very much, Secretary Enders, for your excellent statement and your willingness to take this on.

Mr. ENDERS. Thank you.

Representative REUSS. The committee now stands adjourned.

[Whereupon at 11:25 a.m., the committee adjourned, subject to the call of the Chair.]

# APPENDIX

ADDRESS BY HON. HENRY A. KISSINGER, SECRETARY OF STATE ON THE "ENERGY CRISIS: STRATEGY FOR COOPERATIVE ACTION," CHICAGO, ILL., NOVEMBER 14, 1974

THE PROBLEM

A generation ago the Western world faced an historic crisis—the breakdown of international order in the wake of world war. Threatened by economic chaos and political upheaval, the nations of the West built a system of security relations and cooperative institutions that have nourished our safety, our prosperity, and our freedom ever since. A moment of grave crisis was transformed into an act of lasting creativity.

We face another such moment today. The stakes are as high as they were 25 years ago. The challenge to our courage, our vision, and our will is as profound. And our opportunity is as great.

What will be *our* response?

I speak, of course, of the energy crisis. Tonight I want to discuss how the administration views this problem, what we have been doing about it, and where we must now go. I will stress two themes that this government has emphasized for a year and a half:

*First*, the problem is grave but it is soluble.

*Second*, international collaboration, particularly among the industrial nations of North America, Western Europe, and Japan is an inescapable necessity.

The economic facts are stark. By 1973, worldwide industrial expansion was outstripping energy supply; the threat of shortages was already real. Then, without warning, we were faced first with a political embargo, followed quickly by massive increases in the price of oil. In the course of a single year the price of the world's most strategic commodity was raised 400 percent. The impact has been drastic and global.

The industrial nations now face a collective payments deficit of $40 billion, the largest in history, and beyond the experience or capacity of our financial institutions. We suffer simultaneously a slowdown of production and a speedup of an inflation that was already straining the ability of governments to control.

The nations of the developing world face a collective yearly deficit of $20 billion, over half of which is due to increases in oil prices. The rise in energy costs in fact roughly equals the total flow of external aid. In other words, the new oil bill threatens hopes for progress and advancement and renders problematical the ability to finance even basic human needs such as food.

The oil producers now enjoy a surplus of $60 billion, far beyond their payments or development needs and manifestly more than they can invest. Enormous unabsorbed surplus revenues now jeopardize the very functioning of the international monetary system.

Yet this is only the first year of inflated oil prices. The full brunt of the petrodollar flood is yet to come. If current economic trends continue, we face further and mounting worldwide shortages, unemployment, poverty, and hunger. No nation, East or West, North or South, consumer or producer, will be spared the consequences.

An economic crisis of such magnitude would inevitably produce dangerous political consequences. Mounting inflation and recession—brought on by remote decisions over which consumers have no influence—will fuel the frustration of all whose hopes for economic progress are suddenly and cruelly rebuffed. This is fertile ground for social conflict and political turmoil. Moderate governments and moderate solutions will be under severe attack. Democratic societies could become vulnerable to extremist pressures from right or left to a degree not experienced since the twenties and thirties. The great achievements of this generation in preserving our institutions and constructing an international order will be imperiled.

The destinies of consumers and producers are joined in the same global economic system, on which the progress of both depends. If either attempts to wield economic power aggressively, both run grave risks. Political cooperation, the prerequisite of a thriving international economy, is shattered. New tensions will engulf the world just when the antagonisms of two decades of the cold war have begun to diminish.

The potentially most serious international consequences could occur in relations between North America, Europe, and Japan. If the energy crisis is permitted to continue unchecked, some countries will be tempted to secure unilateral benefit through separate arrangements with producers at the expense of the collaboration that offers the only hope for survival over the long term. Such unilateral arrangements are guaranteed to enshrine inflated prices, dilute the bargaining power of the consumers, and perpetuate the economic burden for all. The political consequences of disarray would be pervasive. Traditional patterns of policy may be abandoned because of dependence on a strategic commodity. Even the hopeful process of easing tensions with our adversaries could suffer because it has always presupposed the political unity of the Atlantic nations and Japan.

### THE NEED FOR CONSUMER COOPERATION

This need not be our fate. On the contrary, the energy crisis should summon once again the cooperative effort which sustained the policies of North America, Western Europe, and Japan for a quarter century. The Atlantic nations and Japan have the ability, if we have the will, not only to master the energy crisis but to shape from it a new era of creativity and common progress.

In fact we have no other alternative.

The energy crisis is not a problem of transitional adjustment. Our financial institutions and mechanisms of cooperation were never designed to handle so abrupt and artificially sustained a price rise of so essential a commodity with such massive economic and political ramifications. We face a long-term drain which challenges us to common action or dooms us to perpetual crisis.

The problem will not go away by permitting inflation to proceed to redress the balance between oil producers and producers of other goods. Inflation is the most grotesque kind of adjustment, in which all elements in the domestic structure are upset in an attempt to balance one—the oil bill. In any event, the producers could and would respond by raising prices, thereby accelerating all the political and social dangers I have described.

Nor can consumers finance their oil bill by going into debt to the producers without making their domestic structure hostage to the decisions of others. Already, producers have the power to cause major financial unheavals simply by shifting investment funds from one country to another or even from one institution to another. The political implications are ominous and unpredictable. Those who wield financial power would sooner or later seek to dictate the political terms of the new relationships.

Finally, price reductions will not be brought about by consumer/producer dialogue alone. The price of oil will come down only when objective conditions for a reduction are created and not before. Today the producers are able to manipulate prices at will and with apparent impunity. They are not persuaded by our protestations of damage to our societies and economies, because we have taken scant action to defend them ourselves. They are not moved by our alarms about the health of the Western world which never included and sometimes exploited them. And, even if the producers learn eventually that their long-term interest requires a cooperative adjustment of the price structure, it would be foolhardy to count on it or passively wait for it.

We agree that a consumer/producer dialogue is essential. But it must be accompanied by the elaboration of greater consumer solidarity. The heart of our approach must be collaboration among the consuming nations. No one else will do the job for us.

### A STRATEGY FOR CONSUMER COOPERATION

Consumer cooperation has been the central element of U.S. policy for the past year and a half.

In April 1973 the United States warned that energy was becoming a problem of unprecedented proportions and that collaboration among the nations of the West and Japan was essential. In December of the same year, we proposed a program of collective action. This led to the Washington Energy Conference in February 1974, at which the major consumers established new machinery for consultation, with a mandate to create, as soon as possible, institutions for the pooling of effort, risk, and technology.

In April 1974 and then again this fall before the U.N. General Assembly, President Ford and I reiterated the American philosophy that global cooperation offered the only long-term solution and that our efforts with fellow consumers were designed to pave the way for constructive dialogue with the producers. In September 1974 we convened a meeting of the Foreign and Finance Ministers of the United Kingdom, Japan, the Federal Republic of Germany, France, and the United States to consider further measures of consumer cooperation. And last month President Ford announced a long-term national policy of conservation and development to reinforce our international efforts to meet the energy challenge.

In our view, a concerted consumer strategy has two basic elements:

*First*, we must create the objective conditions necessary to bring about lower oil prices. Since the industrialized nations are the principal consumers, their actions can have a decisive impact. Determined national action, reinforced by collective efforts, can transform the market by reducing our consumption of oil and accelerating development of new sources of energy. Over time this will create a powerful pressure on prices.

*Second*, in the interim we must protect the vitality of our economies. Effective action on conservation will require months; development of alternative sources will take years. In the meantime, we will face two great dangers. One is the threat of a new embargo. The other is that our financial system may be unable to manage chronic deficits and to recycle the huge flows of oil dollars that producers will invest each year in our economies. A financial collapse—or the threat of it—somewhere in the system could result in restrictive monetary, fiscal, and trade measures and a downward spiral of income and jobs.

The consumers have taken two major steps to safeguard themselves against these dangers by collaborative action.

One of the results of the Washington Energy Conference was a new permanent institution for consumer energy cooperation—the International Energy Agency [IEA]. This agency will oversee a comprehensive common effort—in conservation, cooperative research and development, broad new action in nuclear enrichment, investment in new energy supplies, and the elaboration of consumer positions for the consumer/producer dialogue.

Equally significant is the unprecedented agreement to share oil supplies among principal consumers in the event of another crisis. The International Energy Program that grew out of the Washington Energy Conference and that we shall formally adopt next week is an historic step toward consumer solidarity. It provides a detailed blueprint for common action should either a general or selective embargo occur. It is a defensive arrangement not a challenge to producers. But producing countries must know that it expresses the determination of the consumers to shape their own future and not to remain vulnerable to outside pressures.

The International Energy Agency and the International Energy Program are the first fruits of our efforts. But they are only foundations. We must now bring our blueprint to life.

### THE FIVE "ACTION" AREAS

To carry through the overall design, the consuming countries must act in five interrelated areas.

*First*, we must accelerate our national programs of energy conservation, and we must coordinate them to insure their effectiveness.

*Second*, we must press on with the development of new supplies of oil and alternative sources of energy.

*Third*, we must strengthen economic security—to protect against oil emergencies and to safeguard the international financial system.

*Fourth*, we must assist the poor nations whose hopes and efforts for progress have been cruelly blunted by the oil price rises of the past year.

*Fifth*, on the basis of consumer solidarity we should enter a dialogue with the producers to establish a fair and durable long-term relationship.

Let me deal with each of these points in turn.

### CONSERVATION

Conservation and the development of new sources of energy are basic to the solution: The industrialized countries as a whole now import nearly two-thirds of their oil and over one-third of their total energy. Over the next decade we must conserve enough oil and develop sufficient alternative supplies to reduce these imports to no more than one-fifth of the total energy consumption. This requires that the industrialized countries manage the growth of their economies without increasing the volume of their oil imports.

The effect of this reduced dependence will be crucial. If it succeeds, the demand of the industrialized countries for imported oil will remain static, while new sources of energy will become available both inside and outside of OPEC [Organization of Petroleum Exporting Countries]. OPEC may attempt to offset efforts to strengthen conservation and develop alternative sources by deeper and deeper cuts in production, reducing the income of producers who seek greater revenues for their development. The majority of producers will then see their interest in expanding supply and seeking a new equilibrium between supply and demand at a fair price.

Limiting oil imports into industrial countries to a roughly constant figure is an extremely demanding goal requiring discipline for conservation and investment for the development of new energy sources. The United States, which now imports a third of its oil and a sixth of its total energy, will have to become largely self-sufficient. Specifically we shall set as a target that we reduce our imports over the next decade from 7 million barrels a day to no more than 3 million barrels or less than 2 percent of our total energy consumption.

Conservation is, of course, the most immediate road to relief. President Ford has stated that the United States will reduce oil imports by 1 million barrels per day by the end of 1975—a 15 percent reduction.

But one country's reduction in consumption can be negated if other major consumers do not follow suit. Fortunately, other nations have begun conservation programs of their own. What is needed now is to relate these programs to common goals and an overall design. Therefore, the United States proposes an international agreement to set consumption goals. The United States is prepared to join an international conservation agreement that would lead to systematic and long-term savings on an equitable basis.

As part of such a program, we propose that by the end of 1975 the industrialized countries reduce their consumption of oil by 3 million barrels a day over what it would be otherwise—a reduction of approximately 10 percent of the total imports of the group. This reduction can be carried out without prejudice to economic growth and jobs by cutting back on wasteful and inefficient uses of energy both in personal consumption and in industry. The United States is prepared to assume a fair share of the total reduction.

The principal consumer nations should meet each year to determine appropriate annual targets.

### ALTERNATIVE ENERGY SOURCES

Conservation measures will be effective to the extent that they are part of a dynamic program for the development of alternative energy sources. All countries must make a major shift toward nuclear power, coal, gas, and other sources. If we are to assure substantial amounts of new energy in the 1980's we must start now. If the industrialized nations take the steps which are within their power, they will be able to transform energy shortages into energy surpluses by the 1980's.

Project Independence is the American contribution to this effort. It represents the investment of hundreds of billions of dollars, public and private—dwarfing our moon-landing program and the Manhattan Project, two previous examples of American technology mobilized for a great goal. Project Independence demonstrates that the United States will never permit itself to be held hostage to a strategic commodity.

Project Independence will be complemented by an active policy of supporting cooperative projects with other consumers. The International Energy Agency to be established next week is well designed to launch and coordinate such programs. Plans are already drawn up for joint programs in coal technology and solar energy. The United States is prepared to expand these collective activities substantially to include such fields as uranium enrichment.

The area of controlled thermonuclear fusion is particularly promising for joint ventures for it would make available abundant energy from virtually inexhaustible resources. The United States is prepared to join with other IEA members in a broad program of joint planning, exchange of scientific personnel, shared use of national facilities, and the development of joint facilities to accelerate the advent of fusion power.

Finally, we shall recommend to the IEA that it create a common fund to finance or guarantee investment in promising energy projects, in participating countries and in those ready to cooperate with the IEA on a long-term basis.

FINANCIAL SOLIDARITY

The most serious immediate problem facing the consuming countries is the economic and financial strain resulting from high oil prices. Producer revenues will inevitably be reinvested in the industrialized world, there is no other outlet. But they will not necessarily flow back to the countries whose balance-of-payments problems are most acute. Thus many countries will remain unable to finance their deficits and all will be vulnerable to massive sudden withdrawals.

The industrialized nations, acting together, can correct this imbalance and reduce their vulnerability. Just as producers are free to choose where they place their funds, so the consumers must be free to redistribute these funds to meet their own needs and those of the developing countries.

Private financial institutions are already deeply involved in this process. To buttress their efforts, central banks are assuring that necessary support is available to the private institutions—particularly since so much of the oil money has been invested in relatively short-term obligations. Private institutions should not bear all the risks indefinitely, however. We cannot afford to test the limits of their capacity.

Therefore, the governments of Western Europe, North America, and Japan should move now to put in place a system of mutual support that will augment and buttress private channels whenever necessary. The United States proposes that a common loan and guarantee facility be created to provide for redistributing up to $25 billion in 1975, and as much again the next year if necessary. The facility will not be a new aid institution to be funded by additional taxes. It will be a mechanism for recycling, at commercial interest rates, funds flowing back to the industrial world from the oil producers. Support from the facility would not be automatic, but contingent on full resort to private financing and on reasonable self-help measures. No country should expect financial assistance that is not moving effectively to lessen its dependence on imported oil.

Such a facility will help assure the stability of the entire financial system and the creditworthiness of participating governments: in the long run it would reduce the need for official financing. If implemented rapidly it would:

Protect financial institutions from the excessive risks posed by an enormous volume of funds beyond their control or capacity:

Insure that no nation is forced to pursue disruptive and restrictive policies for lack of adequate financing;

Assure that no consuming country will be compelled to accept financing on intolerable political or economic terms; and

Enable each participating country to demonstrate to people that efforts and sacrifices are being shared equitably—that the national survival is buttressed by consumer solidarity.

We have already begun discussion of this proposal: it was a principal focus of the meeting of the Finance and Foreign Ministers of the Federal Republic of Germany, the United States, Japan, the United Kingdom, and France in September in Washington.

THE DEVELOPING WORLD

The strategy I have outlined here is also essential to ease the serious plight of many developing countries. All consuming nations are in need of relief from excessive oil prices, but the developing world cannot wait for the process to unfold. For them, the oil crisis has already produced an emergency. The oil bill has wiped out the external assistance of the poorer developing countries, halted agricultural and industrial development, and inflated the prices for their most fundamental needs, including food. Unlike the industrial nations, developing countries do not have many options of self-help: their margin for reducing energy consumption is limited; they have little capacity to develop alternative sources.

For both moral and practical reasons, we cannot permit hopes for development to die, or cut ourselves off from the political and economic needs of so great a part of mankind. At the very least, the industrial nations must maintain the present level of their aid to the developing world and take special account of its needs in the multilateral trade negotiations.

We must also look for ways to help in the critical area of food. At the World Food Conference I outlined a strategy for meeting the food and agricultural needs of the least developed countries. The United States is uniquely equipped to make a contribution in this field and will make a contribution worthy of its special strength.

A major responsibility must rest with those oil producers whose actions aggravated the problems of the developing countries and who because of their newfound wealth now have greatly increased resources for assistance.

But even after all presently available resources have been drawn upon, an unfinanced payment of deficit of between $1 and $2 billion will remain for the 25 or 30 countries most seriously affected by high oil prices. It could grow in 1976.

We need new international mechanisms to meet this deficit. One possibility would be to supplement regular International Monetary Fund (IMF) facilities by the creation of a separate trust fund managed by the IMF to lend at interest rates recipient countries could afford. Funds would be provided by national contributions from interested countries, including especially oil producers. The IMF itself could contribute the profits from IMF gold sales undertaken for this purpose. We urge the Interim Committee of the IMF and the joint IMF/IBRD Development Committee to examine this proposal on an urgent basis.

## RELATIONS WITH PRODUCERS

When the consumers have taken some collective steps toward a durable solution—that is, measures to further conservation and the development of new supplies—and for our interim protection through emergency planning and financial solidarity, the conditions for a constructive dialogue with producers will have been created.

We do not see consumer cooperation as antagonistic to consumer/producer cooperation. Rather, we view it as a necessary prerequisite to a constructive dialogue as do many of the producers themselves who have urged the consumers to curb inflation, conserve energy, and preserve international financial stability.

A dialogue that is not carefully prepared will compound the problems which it is supposed to solve. Until the consumers develop a coherent approach to their own problems, discussions with the producers will only repeat in a multilateral forum the many bilateral exchanges which are already taking place. When consumer solidarity has been developed and there are realistic prospects for significant progress, the United States is prepared to participate in a consumer/producer meeting.

The main subject of such a dialogue must inevitably be price. Clearly the stability of the system on which the economic health of even the producers depends requires a price reduction. But an equitable solution must also take account of the producers' need for long-term income security and economic growth. This we are prepared to discuss sympathetically.

In the meantime the producers must recognize that further increases in the prices while this dialogue is being prepared, and when the system has not even absorbed the previous price rises, would be disruptive and dangerous.

On this basis—consumer solidarity in conservation, the development of alternative supplies and financial security, producer policies of restraint and responsibility, and a mutual recognition of interdependence and a long-term common interest—there can be justifiable hope that a consumer/producer dialogue will bring an end to the crisis that has shaken the world to its economic foundations.

## THE NEXT STEP

It is now a year and a month since the oil crisis began. We have made a good beginning, but the major test is still ahead.

The United States in the immediate future intends to make further proposals to implement the program I have outlined.

Next week, we will propose to the new IEA a specific program for cooperative action in conservation, the development of new supplies, nuclear enrichment, and the preparation of consumer positions for the eventual producer/consumer dialogue.

Simultaneously, Secretary Simon will spell out our ideas for financial solidarity in detail, and our representative at the Group of Ten will present them to his colleagues.

We will, as well, ask the Chairman of the Interim Committee of the IMF as well as the new joint IMF/IBRD Development Committee to consider an urgent program for concessional assistance to the poorest countries.

Yesterday, Secretary Morton announced an accelerated program for domestic oil exploration and exploitation.

President Ford will submit a detailed and comprehensive energy program to the new Congress.

CONCLUSION

Let there be no dobut, the energy problem *is* soluble. It will overwhelm us only if we retreat from its reality. But there can be no solution without the collective efforts of the nations of North America, Western Europe, and Japan—the very nations whose cooperation over the course of more than two decades has brought prosperity and peace to the postwar world. Nor in the last analysis can there be a solution without a dialogue with the producers carried on in a spirit of reconciliation and compromise.

A great responsibility rests upon America, for without our dedication and leadership no progress is possible. This Nation, for many years, has carried the major responsibility for maintaining the peace, feeding the hungry, sustaining international economic growth, and inspiring those who would be free. We did not seek this heavy burden, and we have often been tempted to put it down. But we have never done so, and we cannot afford to do so now—or the generations that follow us will pay the price for our self-indulgence.

For more than a decade America has been torn by war, social and generational turbulence, and constitutional crisis. Yet the most striking lesson from these events is our fundamental stability and strength. During our upheavals. we still managed to ease tensions around the globe. Our people and our institutions have come through our domestic travails with an extraordinary resiliency. And now, once again, our leadership in technology, agriculture, industry, and communications has become vital to the world's recovery.

Woodrow Wilson once remarked that "wrapped up with the liberty of the world is the continuous perfection of that liberty by the concerted powers of all civilized peoples." That, in the last analysis, is what the energy crisis is all about. For it is our liberty that in the end is at stake and it is only through the concerted action of the industrial democracies that it will be maintained.

The dangers that Woodrow Wilson and his generation faced were, by today's standards, relatively simple and straightforward. The dangers we face now are more subtle and more profound. The context in which we act is more complex than even the period following the Second World War. Then we drew inspiration from stewardship, now we must find it in partnership. Then we and our allies were brought together by an external threat, now we must find it in our devotion to the political and economic institutions of free peoples working together for a common goal. Our challenge is to maintain the cooperative spirit among like-minded nations that has served us so well for a generation and to prove, as Woodrow Wilson said in another time and place, that "the highest and best form of efficiency is the spontaneous cooperation of a free people."

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ADDRESS OF HON. WILLIAM E. SIMON, SECRETARY OF THE TREASURY, BEFORE THE 61ST NATIONAL FOREIGN TRADE CONVENTION, SPONSORED BY THE NATIONAL FOREIGN TRADE COUNCIL, INC., AT THE WALDORF-ASTORIA HOTEL, NEW YORK, N.Y., MONDAY, NOVEMBER 18, 1974, AT 10:30 A.M.

We meet today in serious times—times that demand plain speaking—and I intend to speak plainly and bluntly.

As all of you know, the policies of the oil cartel now pose a fundamental challenge to the economic and political structure which has served the international community for a quarter of a century. Some believe the world confronts the greatest economic crisis since the early postwar years. Yet, as President Eisenhower once observed, a crisis need not stampede men into headlong panic. "A crisis," he said, "is also the sharpest goad to the creative energies of men, particularly when they recognize it as a challenge to their every resource, and move to meet it in faith, in thought. and in courage."

That was a lesson the leaders of the early postwar years had already learned. and they applied it well. Their vision and their work laid the foundations for a period of unprecedented growth and progress. not only among the industrialized nations but among the newly developing nations as well.

Today. the vision and creative energies—and indeed. the principles—of those earlier years are needed once again. With consumers. we must seek a new unity of purpose and strength of common effort. With producers. we must seek to resolve our differences through mutual understanding and cooperation. And with developing nations, we must continue to provide help and assistance so that they may fulfill their dreams of advancement. This is the basis upon which the United States is moving forward today in both its trade and energy policies.

NEED FOR SWIFT ACTION ON THE TRADE BILL

With trade deficits mounting in almost every nation outside the Oil Producing and Exporting Countries bloc, governments in many countries are increasingly tempted to restrict trade in the name of shortage, surplus, inflation or unemployment. As we have learned once before in this century, however, beggar-thy-neighbor policies by one party are ultimately destructive for all. This is not a time for unconstrained bilateralism, for monopolistic restriction on supply, or for other administrative arrangements which distort normal patterns of trade and investment. The solutions to the problems of an interdependent world lie in more interdependence, not less. An expanding world economy with reasonably stable prices is essential to the political, social and economic interests of all nations. This can only be achieved if conditions are established which permit foreign trade and investment to play their historical role as engines of economic progress.

Negotiations on trade and trade relations were never more appropriate or timely. In this regard, we place great importance upon enactment of the Trade Reform Bill before the end of this year. A clean act, unencumbered by extraneous amendments, is a matter of urgent priority to the President. Only with this legislative mandate can our negotiators be effective in seeking an open and flexible world trading system, and only with the full participation of the United States can we solve common economic problems.

Previous international trade negotiations have focused on the problem of opening national markets to the exports of other countries. It is essential that the Multilateral Trade Negotiations in Tokyo now turn to the other side of the question, finding means to ensure international access to food and raw material supplies.

THE CHALLENGE OF THE OPEC BLOC

This problem of gaining access to supplies has been pointedly raised, of course, by actions of the oil exporting nations belonging to the OPEC bloc—first by the embargo last fall, then by a quadrupling of prices, and finally by their production cutbacks designed to maintain prices.

Before the price increase in October of last year, the average payment to producing countries for a barrel of oil—using Saudi Arabian light crude as a benchmark—was less than $2; today it is approximately $10. Payments to OPEC nations for oil, amounting to $22 billion in 1973, are expected to exceed $85 billion this year and as of this fall are running at an annual rate of about $100 billion. This year alone the OPEC nations will have $60 billion in earnings which they do not spend on imports of goods and services. A receipt for the OPEC group is obviously a payment for the oil importers, and a surplus for OPEC is a deficit for the rest of the world. Only by piling up debt to the OPEC nations can the importers, as a group, pay for the oil.

The costs imposed on the world economy by exorbitant oil prices are both severe and extensive. They make our battle against inflation more difficult and the inflation itself more virulent. As the world shifts resources to adapt to a new energy balance, there will also be serious frictions and unavoidable costs of structural adjustment. Reluctance to borrow year after year to finance oil purchases will cause nations to maintain lower levels of economic activity and there will be slower economic growth. There is a clear danger that some countries might take inappropriate or disruptive actions, with the risk of retaliation and resort to competitive restrictions. At some time, furthermore, real resources will have to be transferred to OPEC countries to pay for accumulated debt. The direct impact will not be equal for all countries—but directly or indirectly, all countries will find their hopes for prosperity dimmed. I can think of no single change that would more improve the outlook for the world economy than a substantial decrease in the price of oil. And I can conceive of no development more essential to the preservation of our international trading system.

### WHY OIL PRICES MUST EVENTUALLY FALL

The producing nations are aware that oil is not immune to the forces of supply and demand. The sharp jump in prices has already resulted in reduced oil consumption around the world—and as the passage of time permits further adjustments, such reductions will be far greater. In the oil importing countries of the non-Communist world, consumption is projected to decline from the 1973 level of 48 million barrels per day to about 46-½ million barrels per day this year. When it became evident that consumption was declining, a number of OPEC countries cut their output, not their price. Prior to the embargo last year, OPEC spare capacity was on the order of 1-½ million barrels per day. Now they have unutilized capacity of nearly 8 million barrels a day. Even during their oil embargo, excess capacity did not reach this level. Inevitably, if that excess capacity grows, there will be increasing pressures for lower prices.

In the face of high prices, consumers are also accelerating development of their own sources of energy which, in time, will cost them significantly less than the current price of OPEC oil. If the OPEC nations persist in cutting back output in order to maintain price, they will find that both their market and their income have been drastically eroded. To me, the question is not *whether* oil prices will fall but *when* they will fall.

I know there are energy doomsayers in the world who believe that the world is about to run out of oil. Those people are dead wrong. First of all, many experts believe that in the Middle East itself, proven reserves of nearly 400 billion barrels of oil are matched by additional reserves at least equal in amount. Nor are the world's energy consumers locked in an OPEC vise. The world's oil and energy resources outside the OPEC nations are even larger than inside. Here in the United States, our oil production potential is enormous from new sources off our shores and in the Arctic and from older sources through improved and more intensive methods of recovery. And other traditional energy sources—natural gas, coal and nuclear power—will become increasingly important as market incentives move our potential into production. Waiting in the wings, new sources of energy will be brought forth by technological progress and economic incentives—the same process by which our energy resources have always been developed.

Realistically, some potential sources of energy will require passage of time before they result in substantial production. But the oil market itself is already in the process of being transformed. In the past year alone, 26 significant, new oil discoveries have been reported. At least 30 billion barrels of oil have been added to proven reserves outside the OPEC countries—an increase of 25%. Proven North Sea reserves have doubled since last fall; Mexico has discovered enormous new fields; even China has announced finds that allow it to become a signifcant oil exporter. Oil has also been found in commercial quantities in Guatemala, the Peru-Amazon Basin, the Tierra Del Fuego region of Chile and Argentina, Gabon, Zaire, Cabinda, Angola, Tunisia, India, Bangladesh, Burma, Malaysia, Brunei, Thailand, South Vietnam, Taiwan, and Egypt. And all these discoveries have taken place in just one year.

Altogether these finds outside OPEC have an estimated production potential of 13 million barrels per day by 1980—all of which reduce OPEC's potential market. And this doesn't even include the oil which will be flowing from Alaska and our outer continental shelf.

We do have an energy crisis, but it's clearly solvable. The OPEC nations, by stringently limiting the rate at which their oil is flowing, are inevitably creating the conditions under which floods of energy from other sources will be forthcoming—and forthcoming at prices well below current levels.

There is no justification today for the present price of oil. It bears no relationship to the costs of production. The contention by some OPEC members that the increase was required in order to keep pace with the rise in price of other commodities is just not true. A barrel of oil today buys in imports some five times what it did two decades ago and four times what it bought as recently as last September.

Let us also be clear that we are not faced with a case of producing companies rigging the markets. Profits of the oil companies have increased, but this is largely a short-run phenomenon resulting from revaluation of inventories, profits in collateral activities such as chemicals and transportation, and other factors. Certainly the oil companies would not conspire to escalate the revenues of the OPEC countries so that the host countries would then take over their industry.

Oil is now over-priced for one reason and one reason only: because a small group of countries have joined together to manipulate the price.

SECURING COOPERATION AMONG CONSUMER NATIONS

It has been our hope that these nations would recognize that their policies are in neither their own interests nor in the interests of the world. Their hopes as well as ours lie in the resumption of international trade on reasonable terms. Until now, however, our arguments have fallen on seemingly deaf ears. The United States has long recognized that logic and moderation might not prevail, and for that reason, over the past year and a half, we have been quietly but firmly laying the groundwork for a more effective response to this challenge by the major consumer nations.

A central thrust of our policy has been to achieve greater cooperation among consumer nations. In pursuit of that goal, literally hundreds of hours have been devoted to private and public diplomacy by the highest-ranking officials of our government. Our record is clear:

In April of 1973, President Nixon warned that energy was becoming a major problem and that close cooperation was needed between the United States, Western Europe and Japan.

In February of 1974, at our invitation, a dozen major consuming nations gathered here for the Washington Energy Conference. I submitted a detailed paper at that time on the financial and economic aspects of international oil prices and on the need for conservation and expanded production. At that conference, the international Energy Coordinating Group was established, providing essential machinery for consultation and negotiations among consuming nations.

After extended discussions by members of that coordinating group, an agreement was reached in Brussels this September for an unprecedented plan to share energy resources among consumer nations during times of emergency. The Brussels agreement represents a major breakthrough, for it will provide mutual protection in time of need and it was reached after previous attempts had failed. The Brussels meeting also produced guidelines for cooperative long-run efforts in energy conservation, production, and research and development, and led to the formation of a new organization associated with the OECD to carry out this program, the International Energy Agency. The Governing Board of this new agency is holding its first meeting today. These are all solid achievements, but now we must go further.

THE NEW PROPOSALS BY THE UNITED STATES

In many meetings with senior officials of other nations over the course of the past ten months, Secretary Kissinger and I and our senior deputies have discussed our views of the current world economic situation and listened to theirs. We have continually stressed that energy, economic and financial problems cannot be separated and that new initiatives in one area must be linked to new initiatives in the other areas. In the past several weeks, we have presented a comprehensive set of proposals in private talks with a limited number of major industrial countries, and the discussions that followed have been very intensive and constructive. Recently, feeling that the agreements reached in Brussels gave us solid foundations upon which to build, President Ford directed that the United States should finally make a public presentation of its proposals. That was the basis of Dr. Kissinger's speech in Chicago last Thursday night, when he outlined the global aspects of our position, and my talk here today, in which I will present the financial aspects of our proposals in greater detail.

The essence of the United States position can be succinctly described:

The price of oil itself, not its financial repercussions, is the real source of trouble in the world economy.

To help bring about lower oil prices, and to reduce the economic burden of oil imports, major consuming nations should work together to achieve significant reductions in their imports of OPEC oil.

They should also coordinate policies and pool their technical resources to increase energy production within their own nations.

IMF resources should be more fully mobilized for all its member nations.

A major, new financial mechanism should be set up in association with the OECD to provide stand-by financial support in case any of the participating countries find themselves in economic trouble after having made reasonable efforts on their own part.

Consideration should also be given to setting up a special trust fund managed by the IMF to help developing nations that are suffering the most and require financing on concessional terms.

Finally, serious preparations should be made for an eventual dialogue between a united consumer group and the producer nations.

Our ideas call for a forthright, earnest effort by the world's major industrial countries to resolve the international energy crisis. To implement such a far-reaching initiative will require further weeks of diplomacy with our allies and friends. We will need the cooperation of the Congress. And we will need your support and the support of all other Americans.

### REDUCING OIL IMPORTS

Let us look more closely now at these proposals. All major oil consuming countries have adopted national programs of energy conservation to reduce oil imports. President Ford has announced a U.S. Program to reduce oil imports by one million barrels a day below what they otherwise would have been by the end of 1975. The President has made it clear that we will meet this target and that whatever steps are necessary will be taken. The French Government announced some weeks ago that it would take actions to limit 1975 oil imports in France to a quantity costing no more than imports in 1974. Just last week, the British Government announced new taxes on gasoline in order to reduce oil imports. Other governments have adopted targets, goals and policies differing according to national circumstances, but all directed towards reducing oil imports.

These first steps toward conservation could be strengthened if the major industrial nations as a group were to place on the table their proposed conservation programs and their proposed programs for expanding energy production so that both could be internationally reviewed and discussed to determine their overall adequacy and the equity with which the effort is being shared among nations.

We believe that effective national programs of conservation could achieve a reduction in imports of the major industrial countries of the world by the end of 1975 of at least 3 million barrels a day—without unduly dampening economic activity and performance. Such a reduction in imports, were it to be agreed upon and implemented, would result in import savings at an annual rate of some $11 billion at present price levels, and would provide strong marketplace pressures to bring down the price of oil. The impact of the efforts of each of us can be multiplied many times by the efforts of all of us. I would be less than candid if I were to leave the impression that achieving this goal will be easy. But I would be less than honest if I were to pretend that what is easy will be effective.

Immediate efforts to reduce oil imports are essential. But equally essential are the efforts needed to promote energy conservation and production in the longer run. Fortunately, we now have, in the new International Energy Agency, a forum for developing and coordinating new national and international policies to achieve these ends. It is no secret that administrative and policy barriers to conservation and to increased production still exist in almost all countries—including the United States. It is also no secret that international efforts to achieve these same objectives face many difficulties. But it is essential that we push ahead.

A basic requirement is to develop in the IEA a common longer-term target for reducing the rate of growth of energy consumption and oil imports. Such a longer-run objective will be helpful to governments as national policy decisions are made, and will also serve to demonstrate to OPEC nations where their present course is leading.

We should also establish a review process within the International Energy Agency of the policies of the participating countries for developing new energy sources. Out of this process should evolve not only useful, guiding principles for energy development, but an increased awareness among all members of the requirements of successful policies in this field.

Another complex problem with which we must come to grips in the IEA is the so-called "downside risk" problem. Which energy resources will be developed in the future and at what rates will depend on investor estimates of the prospective price of oil. Prospective investors in energy projects can be expected to be cautious in a situation in which the price of oil could plunge as easily as it has soared. Thus, we must begin to consider methods of international cooperation to provide investors an appropriate degree of protection against such risks.

47-214—75——7

Finally, there remain unexploited opportunities for cooperation in energy R&D—in nuclear fusion, coal technology, the use of hydrogen, and enriched uranium—and the new International Energy Agency can usefully serve to expedite and facilitate such cooperation in these and other areas.

In all of these areas, a collective determination to move forward quickly and effectively will not only serve to reduce our dependence on oil from OPEC nations, but also to accelerate the process by which the price of OPEC oil is brought down to acceptable levels.

## PROVIDING FINANCIAL SECURITY

At the same time, countries which agree to act together in energy need to be confident that if a financial emergency arises, credit will be available to them on reasonable terms. They could be given such confidence through a new supplementary financial mechanism which the major industrial nations could themselves establish. Among them they will receive the capital represented by the OPEC surpluses. The OPEC countries do not have to be offered special guarantees, above market rates of return, or value indexing schemes. They can place their money where they choose. All that is needed are adequate arrangements—private and public—to insure that funds are distributed among the individual oil importing states so as to avoid unnecessarily stringent economic difficulties in particular countries.

Existing private and public facilities have been doing this job of redistribution in the past, and there is no evidence that they cannot continue to do the job. The problems of financing higher oil bills can be managed until oil prices come down—not easily, not without strains, and not without effort, but they can be managed. Substantial volumes of OPEC funds, probably $45 billion in the first ten months of this year, have been invested in a variety of ways. Nearly one quarter of these funds have been invested directly in the U.S. market and nearly another quarter in the domestic assets of other industrial countries. The OPEC countries have also lent directly to other governments and transferred additional amounts to international institutions—for example, the International Monetary Fund's special oil facility. In addition, substantial amounts have been placed in Eurocurrency markets—but the total, less than 40 percent, is not as large as many have assumed. For borrowers, all these investments represent potential sources of funds and provide a wide range of alternative financing channels.

While the international financial system has worked well, we must recognize, however, that individual countries could find themselves in economic trouble, with needed credit too scarce or too expensive to permit them to maintain open economies at appropriate levels of activity. A supplementary loan facility, established by the major industrial countries associated with the OECD, would provide the backstopping that is needed to supplement existing channels of financing. This is the financial safety net that the United States is recommending.

Certain principles would be fundamental to such a mechanism:

1. Participation should be linked with a commitment to cooperate in reducing dependence on oil imports.
2. Participants would also undertake to follow responsible adjustment policies and avoid resorting to the use of trade restrictive measures or other beggar-thy-neighbor policies.
3. Like any insurance policy, the facility should be large enough to do the job. It must be clear that the potential for borrowing is adequate to meet the need. We recommend a facility with total commitments by all members of $25 billion in 1975. Additional financial resources would be provided in subsequent years in case of need.
4. The facility should supplement private market channels and other channels, including the IMF and other official institutions. It should not replace them. For this reason it should do its lending on market related terms.
5. Decisions on the provision of financial support should be made by a weighted vote of participants and should be based on the overall economic position of the borrower, not on any single criterion such as oil import bills.
6. Whenever support is provided by the facility, all members should share the credit risk on the basis of their share of participation.

Beyond these general principles there are many details to be worked out and on which we are open-minded. One question that must be answered is the manner in which the facility would obtain the funds with which to lend. An individual government could lend directly to the new facility or could permit the facility to go into the capital markets of the world and borrow funds on the basis of its guarantee.

There would appear to be a number of advantages in having funds provided to the facility through direct lending by member governments rather than guarantees. Traditionally, the loan route is more efficient and it is cheaper. Nevertheless, it may be desirable in establishing the facility to provide some flexibility on this score simply because national practices and legislative requirements vary widely. Whatever means is chosen, the United States will need to obtain additional authority from the Congress in order to proceed.

For the United States, participation might best be accomplished through the Exchange Stabilization Fund. This Fund has the authority to engage in international lending operations for the purpose of stabilizing the value of the dollar and this would be a basic purpose of our participation in the proposed facility.

Arrangements for administration of the facility will also have to be negotiated. Our initial feeling is that it should be associated with the OECD in a manner similar to that of the new International Energy Agency, and administered by its own governing board, whose members might be drawn from among the senior finance officials of the member countries.

The question of shares will be an important issue in setting up a facility of this nature. Various factors have been mentioned that might be taken into account, such as the size of the oil import bills of the member states, the relative value of gross national product, share in international trade, or some combination of these factors. The various possibilities will have to be carefully weighed.

It may also be important to state that in our current thinking, borrowing from the facility should not be related specifically to imports of oil. "Oil Deficits" become increasingly indistinguishable from "non-oil" deficits is of limited utility in the world we face today. In our view, access to this facility should be based on an overall judgment of a country's needs taken in conjunction with its resources, its basic economic policies and the actions it is taking to reduce dependence on OPEC oil.

We have been discussing the broad outlines of how such a facility might work with a number of other governments for several months. Both my personal conversations with other finance ministers and our official-level contacts give me confidence that there will be support for this general line of thinking. We now intend to urge consideration of this idea more formally in official level discussions in Paris this week. I should note that the Secretary General of the OECD has independently developed suggestions for a supplementary funding mechanism similar in many respects to the one I have just described. His ideas, which are very welcome, will also be on the table at the meetings this week in Paris of the OECD Working Party Three and of the Group of Ten deputies.

We will be prepared to devote many hours and many days of hard work over the next few weeks to translate these broad outlines into an operating program. We will need to work very closely with the authorities of the IMF and the newly established interim committee of that body. Intensive consultations with out Congress will also be undertaken, and I am sure that our partners in this venture will be consulting intensively with their legislatures.

What we are suggesting is in no way intended to replace the International Monetary Fund as the permanent institution providing the basic financial support for a well-functioning world economy. The IMF is in a position to provide substantial additional support to any of its members. It has over $10 billion of currencies which are effectively available and useable, quite apart from its holdings of gold. We are prepared, in the current review of IMF quotas, to support a substantial increase in that figure. Furthermore, we are prepared to support early measures to insure effective mobilization of the resources that the IMF now has.

At the same time we are suggesting an initiative outside the IMF, in part because of the magnitude of the possible transfer requirements among the major industrial countries and in part because the terms and conditions of IMF financial operations are not appropriate to the exceptional circumstances we now face. Moreover, it would be inappropriate—even if possible—to introduce into the IMF the full range of policy issues which must be taken into account when decisions and judgments are made with respect to financial support among major industrial countries.

MEETING THE NEEDS OF THE DEVELOPING NATIONS

Of equal importance is our concern for the developing countries and the smaller industrial countries. Of course, it is true that for the developing countries it is essential that the major industrial countries maintain healthy, growing economies in the face of the oil crisis. The developing countries depend on the industrial nations to take a growing volume of their exports and to continue essential concessional aid levels. If we establish a facility which will help assure the maintenance of economic activity in the industrial countries, we are assisting the developing countries as well. Many of the developing countries have come to depend on continued large capital flows to support their rapid economic growth. By helping to assure orderly access to the major capital markets and thereby reducing the danger of undue competition for the surplus investment funds of the oil exporters, the establishment of a new financial mechanism for industrial countries would enhance the ability of many developing countries to attract the large amounts of capital they need and can productively employ. These countries will also be able to make appropriate use of the resources of the IMF.

One group of developing countries—those with the lowest per capita incomes and those seriously affected by natural disasters and other problems—will, however, still require concessional assistance. We and other developed countries have been redirecting our concessional assistance toward these countries and urging the international financial institutions to do the same. We also look to the oil exporters to provide a major part of the additional concessional funds needed by these countries because of the increase in oil prices. The additional amounts needed by these poorest countries—perhaps $1.5 billion in 1975—is small in comparison with the oil exporters' surpluses. But although relatively modest in global terms, the sums involved bulk very large for the countries concerned because needs are this desperate.

We shall be addressing the problems of these countries on an urgent basis in the new Development Committee where we shall keep the availabilities of funds under continual review as well as the efforts of developing countries to make maximum efforts to use available resources effectively. One way to help these countries would be to establish a trust fund managed by the IMF and receiving contributions from OPEC states and from other sources. Perhaps the IMF itself could contribute to such a fund profits derived by the sale in the private market of some portion of its gold holdings. A trust fund of this nature which would offer credit at relatively low cost—perhaps 2 to 4 percent and on moderately long maturities—would provide funds to those most seriously affected on terms which are not appropriate for other borrowers. We hope this suggestion will receive the urgent attention of ministers in IMF Interim Committee and IMF/IBRD Development Committee.

COOPERATION WITH THE OPEC NATIONS

U.S. proposals for greater solidarity among major industrial countries in no sense stem from any desire for confrontation with the OPEC nations. We recognize and support the legitimate aspirations of these nations to accelerate their own development, establish their industrial and agricultural bases, and to improve the living standards of their peoples today and in the years to come.

We have established Joint Cooperation Commissions with the key oil producers in the Middle East to help them achieve these objectives. We have undertaken a major effort within our government to provide them the expertise we have achieved in developing the economy of our own country and to help make it adaptable to their development programs. I personally visited a number of countries in the Middle East last July to launch this effort and intend to return soon to ensure its momentum. My visit last summer was followed by meetings both here and in the Middle East of other U.S. officials, technicians and experts, with their counterparts, which have put flesh on the Commission structures that have been established. We are prepared to continue to do what we can to accelerate the economic development of OPEC nations and to encourage the private sector of our country and other industrial countries to take an active role in this process. In the meantime, we will continue to permit these countries to invest in our markets and I am confident they will be allowed to invest in the markets of other nations as well.

For their part the OPEC countries must recognize that their position in the world economy has already changed dramatically. These countries will continue to have greater influence in the world even with a substantial fall in oil prices.

These countries are now the major surplus countries of the world, with a surplus of a magnitude unprecedented in history. It is vital to the maintenance of a sound and equitable world economy that they accept, without delay, the responsibilities which have historically fallen upon major creditor countries.

I have spoken already of their responsibilities for assisting the needy of the world. They must also understand that their foreign investments can be treated no differently from the investments of others. They cannot realistically expect the rest of the world to devise a special system of guarantees for them alone. It is also encumbent upon them to shed the outmoded habits acquired when they were developing countries with limited resources. The resources of this group of countries are adequate to finance their legitimate development aspirations, even though the situation of individual OPEC countries may differ. Their excess revenues this year alone approximate six times the flow of development assistance to all developing countries last year. This new reality must be reflected in the policies of our international financial institutions.

In my conversations with officials of OPEC nations, and on my travels to the Middle East, I have found that there is widespread understanding in OPEC countries of the responsibilities inherent in their new international role. Certainly leaders of OPEC nations are well aware of the important stake they have in a healthy world economic system. I remain confident that a basis can be found for the industrial nations of the world to continue to work constructively with OPEC nations.

Of course, they must recognize that we continue to be strongly opposed to the actions they have taken to compel a massive temporary transfer of resources—real and financial to them from the rest of the world. We believe they can achieve their development objectives on a more secure basis at a substantially lower level of oil prices.

They must recognize, too, that each passing day takes us a step further away from an optimal utilization of the world's resources, as other nations revise their policies toward reliance on oil imports. Certainly, there is even now no possibility that oil consuming countries can return to the energy practices of two years ago. But the full scope of consuming country reaction is not yet defined, and the hope remains that reasonable men can find rational solutions.

We remain persuaded that extreme policies will, in time, prove very harmful to the basic economic and social aspirations of these nations, and that there is a solid foundation for reaching agreement on a constructive resolution of this issue. Greater cooperation among the world's industrial countries along the lines that Secretary Kissinger and I have set forth last week and today will help establish the basis for such agreement.

## CONCLUSION

In their own interest, and in the interest of the world as a whole, the time has now come when the major industrial nations must grasp the nettle. The evidence before us—of rapid inflation and economic stagnation—offers bleak encouragement for the future unless we now take decisive collective action to break the present train of events. We must act together to limit our dependence on imported oil and to promote our mutual economic and financial solidarity. Such action will inevitably be carried out through decisions and actions often appearing to be technical in nature and limited in scope. But underlying all of what we do must be a solid foundation of commitment—a political consensus that we will act together to determine our own destiny—and a mutual faith that we can do so. We must maintain our commitment to expanding trade and foreign investment. We are too far down the road to interdependence to look back. We have it in our power to choose whether we are prisoners of a history yet to be written or the architects of a future yet to be seen. I have no doubt what our choice will be. We know what the required international response must be.

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[From the Wall Street Journal, Nov. 22, 1974]

## Kissinger's Petroleum-Crisis Strategy Faces Skepticism at Home and Abroad

(By James Gannon and Richard Janssen)

After months of delay and indecision, the U.S. finally has developed a grand strategy for coping with the world oil crisis. But it is far from certain that American strategists can win the support of those needed to make it work: European allies, the U.S. Congress, the American consumer and Arthur Burns.

The U.S. strategy, outlined last week in a major policy declaration by Secretary of State Henry Kissinger, faces a multiplicity of diplomatic, political and financial hurdles. Its ambitious design calls for a bold new international lending scheme, stern energy-conservation efforts, exceptional cooperation and unity among oil-using nations and acceptance by Congress and Mr. Burns' Federal Reserve Board. None will be easy to achieve, U.S. officials concede.

Still, the mere fact that the U.S. has finally developed some sort of overall plan to deal with the staggering economic and financial impliciations of high-priced oil is being greeted here and abroad as a major event. Some European observers are grandly comparing the Kissinger energy strategy to the Marshall Plan for rebuilding Europe after World War II. While that may exaggerate its importance, others agree it is a major initiative. "It shows we aren't sitting around like so many hypnotized rabbits," comments a senior European central banker, relieved that the U.S. finally has moved.

In the year since the Arab oil-cartel nations imposed their embargo and began a series of price hikes that has quadrupled the cost of imported oil, U.S. policy had been largely passive. It rested mainly on a hope that somehow oil prices eventually would fall in response to lagging demand, and that the private banking system meantime could handle the "recycling" of billions of surplus oil dollars from the suddenly wealthy oil states to the suddenly needy petroleum-importing countries. This posture was championed by Treasury Secretary William Simon, who was skeptical of widespread fears that the oil-price problem could trigger national bankruptcies and an international financial panic.

FROM PASSIVE TO ACTIVIST

Now the U.S. is switching to a more activist policy, designed both to provide new safeguards against a financial crisis and to force down oil prices by concerted action of the major oil-using nations. Mr. Kissinger is the champion of the activist posture. He views the danger of an oil-caused financial crisis as much more likely than Mr. Simon. More important, he fears that the economic woes caused by the energy crisis could lead to political turmoil or even to the rise of left-wing or right-wing extremist governments in Europe.

The switch to a more activist U.S. policy reflects the growing influence of Mr. Kissinger over international economic policy, traditionally a Treasury preserve. "Henry has taken the ball and run with it," one senior White House official says. "I feel like we've just lost our pants," a chagrined Treasury aide comments. Mr. Simon has denied that the Kissenger initiative reflects a major change of policy or any difference of view between himself and the Secretary of State. Treasury officials are portraying the new policy as a joint Kissinger-Simon plan that they had kept under wraps for weeks while the Treasury Secretary publicly held to his more passive posture.

The key to the new U.S. strategy is a link between energy conservation and financial aid. The plan has two essential ingredients: first, a proposed $25 billion mutual-aid loan fund, financed by the industrial nations themselves, to provide emergency loans to any participating country in financial distress; second, *a major oil-conserving push by the industrial natiions designed to cut their imports by three million barrels a day or about $11 billion a year*—which U.S. strategists figure might be enough to break the oil cartel and cause prices to fall.

Only those industrial nations that pledge to cut oil imports would be eligible for loans from the $25 billion aid fund, which U.S. officials view as a "financial safety net" to aid nations unable to borrow in the private market or from such institutions as the International Monetary Fund. The loan fund would be run by a new agency affiliated with the Paris-based Organization for Economic Cooperation and Development, which includes 24 industrial countries. It wouldn't aid the poor nations of Asia, Africa and Latin America; they would have to rely on the IMF.

The industrial nations would make commitments to the $25 billion fund based on the size of their economies and other factors. The U.S. share likely would be about 30% of the total, or $8 billion, American officials suggest. When a loan is made, the participating nations would share the risk in like proportions; in event of a default, the U.S. would absorb 30% of the loss.

### 'A LOT OF ROUGH WATER'

This ambitious plan is far from a reality at present. U.S. officials and their counterparts from Europe and Japan have been holding a series of meetings in Paris this week to begin discussing it. Hard negotiating lies ahead on many points, such as how much money each nation would put into the $25 billion loan pool and how deeply each would cut oil imports. "It's the detail that counts," one European monetary expert says; he predicts that there "is a lot of rough water to go through yet."

Even before negotiators get to such detail, however U.S. strategists must sell the allies on the overall strategy which won't be easy. Fear that the Kissinger approach could anger the Arabs into new oil-production cuts is a major hurdle in winning over some nations that are more dependent on the Arabs than the U.S. is.

"I don't like the political gloss Kissinger has put on this," says a European economist, contending that the Secretary of State has depicted his oil-loan plan as "a sort of fighting fund" to help Western consumer nations stand up against the Arabs.

France, which has taken a go-it-alone approach to the oil crisis, views the new U.S. initiative with mistrust, officials say, largely on grounds that oil-producing nations would view it as unfriendly. To Paris officials, the Kissinger scheme appears to be an American attempt to frustrate French hopes for a three-sided summit of industrial, developing and oil-producing nations.

Other European nations are likely to be more receptive. West Germany's attitude is basically "friendly," says a government spokesman, though he adds that the Germans have some unspecified reservations. Britain is likely to give the Kissinger plan "a fairly unqualified welcome," one insider says. But he adds that Chancellor of the Exchequer Denis Healey still may push for a major expansion of the IMF's oil-loan facility as well. The IMF facility, financed largely by funds from the oil nations, totals about $3.5 billion and IFM officials would like to double or triple that for 1975.

### DECISIONS IN JANUARY?

In Paris, deputies of the group of ten key industrial countries agreed unanimously yesterday that study of the Kissinger-Simon proposals should start urgently with a view towards decisions in January. One aspect that appears settled is that the Basel-based Bank for International Settlements will have a technical operational role, while policy would be coordinated by a small staff linked with the Paris-based Organization for Economic Cooperation and Development.

French officials agreed to the study and to the principle of multilateral standby assistance, but they still appeared reluctant to commit themselves to participation. "We Frenchmen first taste a meal before we eat it," one negotiator said. The French want to remain flexible prior to the forthcoming Maritinique meeting between President Ford and President Valery Giscard d'Estaing, sources said, and have some reservations about whether a large U.S. role in the lending operation would also enhance the political influence of the U.S.

There's apparently some skittishness on the U.S. side, too, about whether France would be eligible to tap the proposed lending agency's credits and guarantees because France is staying out of the OECD-linked emergency oil-sharing plan. Asked what treatment a nonmember of that international energy agency would receive. Jack Bennett, Treasury under secretary for monetary affairs, replied, "we will make sure the energy policy" of any would-be beneficiary nation "is compatible with Western solidarity."

Study of the many issues and details involved started immediately yesterday. Some officials were assigned to a "working group" that is to remain in Paris for several days.

### HOW IT WOULD WORK

The new lending agency proposed by the U.S. differs importantly from the IMF recycling facility and similar schemes. It wouldn't borrow surplus money from the Arabs and other oil states and relend it to oil-importing nations, as the IMF fund does. Instead, it would be a mutual-aid fund, built on commitments of members to help each other if necessary.

Even U.S. officials can't say exactly how the fund would work. Treasury chief Simon has said that either individual countries, such as the U.S., could lend money to the OECD agency, which would relend it to the nation in need, such as Italy, or that the agency itself could borrow on the capital markets backed by a guarantee from some financially strong nation. In practice, the scheme raises the prospect of direct government-to-government loans—such as from the U.S. or West Germany to Italy—with a provision for sharing the risk of default.

In addition to negotiating the mechanics of the lending plan, the industrial nations also will have to thrash out agreement on how to cut oil imports, if the U.S. plan is to work. American officials agree that achieving a cut as large as three million barrels a day by the end of 1975 will be very difficult. European nations and Japan, which rely more on imports and consume less oil in nonessential or "wasteful" uses than does the U.S. can't painlessly cut foreign oil purchases.

Cutting U.S. oil imports won't be easy either, American officials stress. Though President Ford has proclaimed a target cut of one million barrels a day by the end of next year, the Kissinger strategy probably will require an even larger cut than that, administration officials believe, because they doubt that Europe and Japan can reduce imports by as much as two million barrels.

### INVITING STIFFER MEASURES?

The Kissinger plan thus raises the odds that the Ford administration will have to switch to mandatory energy-saving measures from the voluntary approach it is trying now. Treasury officials talk of such possible steps as a dollar-volume limit on imports, a sizable tariff on foreign oil, a tax on domestic crude oil and rationing of gasoline. Whether any of these stiffer measures will be imposed depends on the success of voluntary conservation over the next few months, officials say.

Congress also could be a stumbling block for the new U.S. oil strategy. Mr. Simon says that congressional authority will be needed for U.S. participation in the $25 billion loan program. Many Europeans, acutely aware of Congress' sour attitude toward anything that smacks of "foreign aid," are worried that the Ford administration won't be able to convince lawmakers to go along. "Kissinger is a great guy in the world, but does he have clout back home?" one Briton wonders.

So far, congressional reaction to Mr. Kissinger's plan has been negligible, partly because Congress was out of session when it was unveiled. But Congress is likely to examine the plan skeptically.

"We will have to take a very long, hard look at it to make sure it isn't just papering over a problem that would get worse," says Sen. William Proxmire (D., Wis.). "I want to be sure we're not just engaging in a giveaway," he adds. The oil-loan plan "might be used as a kind of concealed foreign-aid program," he fears. Sen. Proxmire is expected to become chairman of the Senate Banking Committee next year, and he figures the committee likely will hold hearings on the oil-lending plan.

Finally, there is the uncertain posture of Mr. Burns, chairman of the Federal Reserve Board. He has publicly attacked the idea of setting up big "recycling" schemes to lend money to oil-importing nations as "an escape from reality." Such schemes would merely build a pyramid of bad debt, Mr. Burns has said, indicating his fear that some of the loans might never be repaid and the U.S. could be left holding worthless IOUs.

Mr. Burns hasn't commented publicly on the Kissinger plan. The plan's strategy of linking loans to petroleum-import cuts probably appeals to him, however, because he has been an ardent advocate of efforts to cut oil demand and thus put downward pressure on the price.

In Europe, financial experts wonder if the Fed stands fully behind the lending plan. "We'd like to know something about the lender of last resort in this—about who, in fact, is going to carry the can in the event of a problem," says the top economist of a major London bank.

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[From the New York Times, Nov. 27, 1974]

## U.S. OIL PLAN TIED TO HIGH PRICE

(By Leonard Silk)

United States strategy for dealing with the international oil crisis continues to unfold, layer by layer. Last week's major development was the disclosure by Secretary of State Kissinger of American plans to negotiate a new $25-billion special oil fund for relending petrodollars to Western nations in deep balance-of-payments deficit.

Now comes the unveiling of the American plan for narrowing the gap between Western energy needs and dependency on imported oil from producers of the Organization of Petroleum Exporting Countries.

It is basically a high-price, high domestic production strategy.

The new plan was disclosed this week in a forum at Yale University, by Thomas O. Enders, Assistant Secretary of State for Economic and Business Affairs. Mr. Enders is regarded by insiders as the chief architect of Secretary of State Kissinger's energy policy including the International Energy Agency, the oil-sharing program for industrial nations, and the $25 billion petrodollar revolving fund.

The rationale for the new United States strategy for closing the energy gap stems from the massive Project Independence report, released two weeks ago by the Federal Energy Administration.

That report set forth two basic patterns that would result from either (a) acceptance of an $11 price per barrel of crude oil in the world market or (b) early reduction of the world oil price to $7 a barrel.

As the F.E.A. data indicate, the rate of growth of domestic production would be much faster at $11 than $7, and there would be a far greater drag on the growth of oil consumption. By 1985, at the $11 price, according to the F.E.A.'s study, the expanded supply of oil—plus expanded output of coal and nuclear energy—could eliminate the need for imported oil.

But at the $7 price per barrel of oil, the gap could widen to about 13 million barrels a day, or more than half of all the United State's petroleum needs. The American dependency—and probably foreign dependency as well—on OPEC oil would increase rather than narrow, according to the F.E.A. projections.

REPEATED DECLARATIONS

The startling news broken by Mr. Enders at Yale—startling against the background of repeated declarations of high American officials that OPEC nations must reduce their exorbitantly high prices—is that the United States is now founding its strategy on the $11 price. This assumes, incidentally, a "real" price of that magnitude, one that would rise step by step with other goods, if world inflation continues.

Without following the Project Independence blueprint slavishly, nor limiting his analysis to the United States alone, Mr. Enders stated that the present high world prices—starting at about $10 a barrel F.O.B. for Persian Gulf crude—had started a worldwide oil boom.

"Substantial finds of oil have been reported from Mexico, Peru, China, Indonesia," he said, "and the wave of exploration is just beginning."

'AND MORE WILL FOLLOW'

He estimated that the finds already made represent the possibility of new production a few years from now of 10 million barrels a day—"and more will follow."

OPEC members will try to sustain the high price by cutting production. They are now working at less than three-quarters of capacity, according to Mr. Enders. How long they can sustain the existing price will depend on how fast the world market develops for oil. Thus cuts in consumption—resulting primarily from the high price of oil—in the United States and by other major industrial users is crucial to breaking the cartel, if it is to be broken.

Mr. Enders implied that the United States thinks the cartel could fall apart. If demand is restrained, and new supply from non-OPEC producers comes to market, negotiation of the required cutbacks in production by OPEC would become more and more difficult: "First clandestine, then open violation of production quotas would occur. Ultimately all efforts to sustain the artificial price would collapse," he said.

DEVASTATING TO INVESTMENT

Paradoxically, however, the United States is worried that such a downward break in world oil prices could come too soon, and be devastating for heavy American and other Western investment in the development of alternative energy sources, based on the assumption of a continued "real" oil price of $11 a barrel.

What is important, Mr. Enders argues, is that all the major oil companies adopt policies, having the effect of creating stable investment expectations at a level of return roughly equivalent to current oil prices, protected for price increases; he wants "an international agreement to embody this fundamental decision."

This is what, in informal discussion, he called the Catch-22 of the United States position: It is designed to reduce Western dependency on foreign oil and ultimately break the OPEC oil price, but when the oil prices comes down the United States and its partners will hold up their own oil prices to protect high-cost domestic production.

### $11 WOULD BE CONTINUED

In other words—for the sake of illustration—if the world oil price dropped to $5 a barrel before the Western oil coalition—which might be called antiOPEC—was ready, the United States and its partners would continue to pay $11 to their domestic producers.

Foreign oil would then enter this country only at about the $11 price, with the United States Government collecting the $6 difference, whether via a tariff, through a Governmental oil-importing agency, or some other device. The foreign oil would be sold to domestic distributors at a price that would not shake current domestic production or jeopardize domestic investment in future energy development.

Thus as the price for foreign oil came down before 1985—and Mr. Enders made clear that he expected it to come down substantially—the United States and its partners would move toward a two-tier cost structure for energy: "One that assures the consuming countries their desired degree of independence; the other balances a constant demand and growing supply for imported oil at prices that diminished, or even reversed, the accumulation of assets by producers," he said.

### NO LONGER VIABLE

If this country and others do not follow such a strategy, he said, new investment stimulated by current high prices would proceed anyway, if less rapidly. But when the world price fell—later and less markedly—much of the investment now undertaken would no longer be viable. It would either have to be protected after the fact, or the United States and others would have to "succumb again to the comforts and vulnerabilities of reliance on cheap imported oil."

Does this plan make sense? Is it in accord with the facts and reasonable expectations about the way nations—not only the European nations and Japan but even the United States itself, with Congress and the voters generally exerting their influence on Government—can be expected to react to what is clearly an extremely costly, long-term program for stimulating and protecting domestic oil and other energy producers?

### 'OVER-OPTIMISTIC' PLAN

J. K. Jamieson, chairman and chief executive officer of the Exxon Corporation, who was on the program with Mr. Enders at Yale, found the United States plan "over-optimistic." Mr. Jamieson said the F.E.A. had overestimated future oil production in this country on several accounts.

For instance, he maintained that the F.E.A. was expecting far too much from secondary and tertiary oil recovery. "All fields are already under secondary recovery," he said, "and there is no current technology for tertiary recovery that would not require energy inputs in excess of the energy output."

Mr. Jamieson also believes that the United States Government has been over-optimistic on nuclear power and other energy sources. However, the Project Independence report was relatively cautious about the rate of growth of other energy supplies, even including coal.

Prof. James Tobin of Yale, a former member of the President's Council of Economic Advisers, raised questions about the cost of the program and whether it was the most economic way either to protect United States oil supplies or to deal with the problem of the transfer of wealth to the OPEC countries.

Mr. Tobin argued that there might be cheaper ways "to buy insurance"—as through increased storage or stand-by production capacity.

The political feasibility of the Kissinger-Enders plan is also questionable. Other nations, such as France, might refuse to go along—and, if the United States and its partners did succeed in driving down the world oil price, the outsiders would have a clear cost advantage in production and competition in world trade—in effect, a free ride resulting from the sacrifices of "anti-OPEC."

Questions can also be raised about the very heavy emphasis on expanding production at high cost and the relatively light stress on conservation. President Ford has thus far backed an essentially "voluntary" program of restraining consumption, resisting proposals even for moderate increases in gasoline taxes.

But the new program could send gasoline taxes far higher—unless, as is possible, the United States still had, in addition to two tiers for world and domestic prices, two or more additional tiers for "old" and "new" oil produced in the United States, as now.

88 CENTS A GALLON

Mr. Jamieson of Exxon estimated that, at an average price of $11 a barrel for crude oil, the price of a gallon of gasoline in the United States would be 88 cents—far higher than the price at the pump that would result from even a 20 cent rise in the gasoline tax.

In response to criticism that the Administration had understressed conservation and in fact had no real conservation plan, Mr. Enders disclosed that a new daily and weekly monitoring program would begin by which the F.E.A. would measure the shortfall, if any, between oil consumption and a target for restrained fuel consumption.

If the United States did fall behind the President's goal of a reduction of 1 million barrels a day in consumption—that is, below what it otherwise would have been, not an actual reduction—he might propose a stiffer plan for cutting consumption.

Mr. Enders said the President "will make final his Project Independence proposals for submission to Congress in January"—and at the same time, the new International Energy Agency would consider joint decisions on conservation and energy investment policy.

'VULNERABLE TO NEW EMBARGO'

He suggested that going it alone was not a viable energy policy for any oil-consuming nation today, and that over the coming decade, only the United States and Britain can go to self-sufficiency—all the others would "remain vulnerable to a new embargo."

Meanwhile, all the nations would be vulnerable, he said, "to financial crisis, and if the United States and Britain can solve the price and financial transfer problem by going self-sufficient the only way Europe and Japan can is by co-operating with each other and with us."

Behind the United States position on energy, as developed by Mr. Enders, is the belief that the only way the United States can get a handle on the crisis is via its international dangers—and that is also the only way Americans can be brought to see the urgency of the crisis.

The steady and vastly mounting flow of arms to the Middle East, from France, the United States and others, to pay for oil imports, is one dimension of the problem to which Mr. Enders did not address himself. But that may be the most critical dimension of all.

And the most paradoxical aspect is that the United States, in fighting to bring down the OPEC price, means to keep its own price high.

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[From World Financial Markets, Morgan Guaranty Trust Company of New York, Sept. 23, 1974]

## The Build-up of OPEC Funds*

The build-up of funds by the oil-exporting nations—particularly those of the Middle East—continues to be a major subject of discussion in financial circles around the world. The attitudes taken toward the likely financial and economic impact of these "petro-dollars" cover a wide spectrum. Some observers have expressed a deepening anxiety over the very large magnitude of the newly created trade and financial imbalances, and over their probable duration. Fears have been voiced that the resulting flows of funds will be so huge as to seriously impair the functioning of international financial markets, thereby contributing to a significant worldwide economic slowdown. Many other observers however, have adopted a much more sanguine attitude toward the imbalance, believing that

*Speech delivered by Rimmer de Vries, Vice President, Morgan Guaranty Trust Company, on September 23, 1974 at a conference on The Middle East in World Finance organized by the London Financial Times and held in Beirut, Lebanon.

with the appropriate international cooperation, it will "finance itself" more or less automatically, and that the resultant economic and financial dislocations should be relatively small.

While economists and others undoubtedly will go on arguing about the likely consequences of the oil imbalances and the appropriate responses to them, enough time has passed to permit an assessment of what actually has been happening as a result of last year's oil price increases. Hard facts are now emerging as to the size of the imbalance between oil-exporting and oil-importing nations, as well as to the financing of that imbalance.

For the present year, certain patterns are becoming apparent that allow the guesstimates made earlier to be revised into firmer estimates. Even 1975 is becoming a bit more visible. The prospect beyond 1975 is still very unclear, however. The latitude for widely differing medium- and long-run projections is evident from the markedly dissimilar analyses recently produced by the staffs of the World Bank and the OECD. The World Bank puts the cumulative build-up of funds by the OPEC member countries at $650 billion by the end of 1980, thereafter projecting additions to those countries' external financial assets at an annual rate of over $100 billion, with the result that total OPEC external assets are projected to rise to $1.2 trillion by end-1985. The OECD, however, anticipates an accumulation of OPEC country funds on the order of $300 billion by the end of 1980, with the annual increase by that time being only some $15 billion. True, both organizations project a very large build-up of funds; but a $350-billion difference is not to be sneezed at, even in these days of rapid inflation.

The wide variations in these projections are due of course to the differing underlying assumptions. It is well to bear in mind that the pace of the build-up of OPEC funds in the next decade or so will depend largely on trends in five factors: first, the volume of OPEC oil exports—that is, world demand and supply for imports of OPEC oil; second, the price of this oil, defined as per barrel OPEC government earnings; third, the volume and price of OPEC imports of goods and services from non-OPEC countries, as well as of OPEC non-oil exports; fourth, the magnitude of OPEC grant aid flows; and fifth, the average financial rate of return on OPEC external investments.

## THE BUILD-UP OF FUNDS IN 1974 AND 1975

A key fact that is now beginning to emerge is that world demand for OPEC oil in 1974 is likely to be little changed from last year. Indeed, oil consumption in some of the major industrial countries may well fall somewhat. In the first half of this year, the volume of oil products consumption is reported to be down 14% in Germany by comparison with the same period last year; in the United Kingdom, the decline is reported at 10%; in France, 6%; in Italy, 4%; and in Japan, 1%. In the United States, the Federal Energy Administration estimates that there was a 5% drop in oil demand in January-August 1974 by comparison with the first eight months of last year.

During the remainder of this year, of course, oil consumption may show some increase; but the prospects for slow economic growth throughout the OECD area, as well as the energy-saving response of consumers, businesses and governments to the much higher price of petroleum products, will result in very moderately increased oil demand. Given the marginally brighter economic outlook for 1975, oil consumption next year may show a somewhat larger rise—perhaps 1½% in the United States and Western Europe and 4% in Japan by comparison with this year; but continuing, energetic conservation efforts might narrow even these small projected increases. In the rest of the world, growth in oil consumption also is likely to be substantially below past trends.

The foregoing assumptions would imply a slight decline in 1974 in the volume of world demand for OPEC oil imports, and perhaps a 3%–4% increase next year. This contrasts sharply with the annual rate of growth of about 10% in actual OPEC oil exports during the past five years. Part of the slowdown in oil demand growth is due, of course, to the sluggishness of the world economy: the impression is inescapable, however, that the price elasticity of demand for oil and energy may be considerably higher than many have estimated or assumed. Moreover, it is logical to anticipate that the long-run elasticities will prove greater than the short-run elasticities.

Another key determinant of the build-up of OPEC funds is the average government take per barrel—now more than five times as high as it was early last year. In the case of Saudi Arabian light crude, *average* per barrel government take amounted to about $1.70 on January 1, 1973. By January 1 of this year, it had risen to $8.00 per barrel. With the increase to 60% of the Saudi government's share in the Aramco concession, and the 3½% rise in government take recently agreed to by the OPEC countries, average revenues apparently have reached $9.75 per barrel. Therefore, while there has been some reduction in prices paid for marginal quantities of oil since early this year, on balance the average government take has risen, and in fact quite significantly.

Perhaps no single question is of greater importance in the international financial scene today than the future trend of oil prices. The OPEC nations have quintupled their purchasing power in a little over a year. To what extent will they attempt to maintain this improvement in their terms of trade? They are not fully unified in their perceptions of the appropriate future level for oil prices. Furthermore, it is not clear that the present price of OPEC oil relative to other energy sources is one that will maximize OPEC purchasing power in the long run. In the absence of a more certain sense of the future for oil price movements, I assume in what follows that after last week's announced increase in government take, next year's increase will be on the order of about 5%.

On this basis—and even taking into account the crude oil production cuts recently announced in some countries—the OPEC countries are likely to earn some $105 billion this year from oil exports. Including non-oil exports of goods and services, total OPEC exchange earnings in 1974 will be in excess of $110 billion, up from about $30 billion last year. The Middle East members of OPEC will earn some $75 billion this year, a $60 billion increase from 1973. For 1975, assuming a 3% to 4% increase in demand for OPEC oil exports and a 5% increase in OPEC oil export prices, total OPEC oil revenues would be on the order of $117 billion, and total foreign-exchange earnings perhaps $125 billion. Of this 1975 total, the Middle East members of OPEC would likely earn some $80 billion—assuming that oil export volume increases are proportionately distributed.

TABLE 1.—EXPORT TRENDS FOR SELECTED INDUSTRIAL COUNTRIES (JANUARY-JUNE; PERCENT CHANGES)

| | Exports to OPEC, 1973 | Exports to OPEC, 1974 | Total exports, 1974 |
|---|---|---|---|
| Japan | 57 | 74 | 48 |
| United States | 22 | 62 | 45 |
| Germany | [3] 18 | 47 | 31 |
| United Kingdom [1] | −1 | 37 | 15 |
| France [2] | 62 | 25 | 25 |
| Total, five countries | 25 | 52 | 33 |

[1] January-April.
[2] January-March.
[3] Estimated.

A source of income of growing importance to OPEC countries, of course, will be investment income receipts. Based on assumptions adduced further below as to the likely size of their financial assets, and assuming a 10% average rate of return on them, such income could amount to $5 billion in this year, and over $10 billion in 1975.

An additional key determinant of the OPEC build-up of funds will be the extent to which these countries will spend their foreign exchange earnings for current imports of goods and services. Most commentators have tended to underestimate—and some have virtually ignored—the rapidly growing import capacity of the oil-exporting countries. In many OPEC nations, per capita income remains very low by the standards of the developed world. In the attempt to improve living standards and transform their economies, most OPEC countries have already mapped out very ambitious development programs. In addition, military equipment purchases by some of these nations have been and are likely to remain very large.

In 1973, in fact, OPEC goods and services imports were about $28 billion, up a solid 50% from 1972. In volume terms, OPEC imports probably registered close to a one-third gain last year.

This year, OPEC goods and services imports may well rise to $45–$50 billion, a two-thirds increase from 1973—in part a result of higher world export prices for manufactures and food. Already during January–June 1974, exports to OPEC members from the five major industrial countries were up over 50% from the same period last year. Not only is this twice the rate of increase experienced during the same period a year earlier, but it is also half again as fast as the expansion of these countries' total exports. Exports to OPEC countries from Japan in the first six months of 1974 were up 74%, from the United States 62%, from Germany 47%. For 1975, OPEC goods and services imports may realistically be expected to grow by at least another 40%, reaching a level of $65–$70 billion.

Another form of disbursement is OPEC grant aid; this has been little discussed because of the paucity of data, but nevertheless it may well amount to three to five billion dollars annually during this year and next.

Putting the above estimates together, it seems likely that the OPEC countries as a group will experience a current-account surplus on the order of $65 billion this year. About three-quarters of this surplus will accrue to the Middle Eastern members of OPEC, and perhaps one-third to Saudi Arabia alone. OPEC external financial assets could amount to over $80 billion by the end of this year, a remarkable increase from the $16 billion figure of a year earlier. On the assumptions noted above, the current surplus would be of similar magnitude next year, and OPEC external assets would rise to over $140 billion.

TABLE 2.—FOREIGN-CURRENCY RESERVES OF MAJOR OPEC COUNTRIES

[In millions of dollars]

| | End-December 1973 | End-July 1974 | Change |
|---|---|---|---|
| Venezuela | 1,671 | 3,605 | 1,934 |
| Ecuador | 211 | 367 | 156 |
| Indonesia | 753 | 1,745 | 992 |
| Nigeria | 473 | 2,940 | 2,467 |
| Algeria | 813 | [1] 1,556 | 743 |
| Saudi Arabia | 3,707 | [1] 6,917 | 3,210 |
| Kuwait [2] | 357 | 786 | 429 |
| Iran | 976 | 5,822 | 4,846 |
| Iraq | 1,323 | 2,800 | 1,477 |
| Libya | 2,017 | 3,242 | 1,225 |
| Totals | 12,301 | 29,780 | 17,479 |

[1] June.
[2] Central bank only.

## FINANCING THE IMBALANCE

If the OPEC countries are unable to expand their imports as rapidly as their exports—thus preventing the rest of the world from paying for its oil imports with current exports—then they must accept an increasing level of financial claims on the rest of the world. In this sense it may be said that the surplus funds of the oil-exporting countries, by definition, will find their way back to the oil-importing nations.

Much more important than this definitional relationship, however, is the pattern that this reflow of funds will take: in which currencies and countries will the OPEC nations wish to hold their external assets; how will the banking system recycle these funds to the countries with current-account deficits; and what is the capability of the banking system to perform this intermediation function in a fashion consistent with the best interests of international economic and financial stability? Let us examine first what the available data reveal.

TABLE 3.—U.S. LIABILITIES TO FOREIGN BANKS AND OFFICIAL INSTITUTIONS IN OPEC COUNTRIES[1]

[In millions of dollars]

| | End-December 1973 | End-June 1974 | Change |
|---|---|---|---|
| Venezuela | 1,156 | 2,346 | 1,190 |
| Indonesia | 117 | 238 | 121 |
| Other OPEC/Asia[2] | 1,134 | 1,929 | 795 |
| OPEC/Africa[3] | 1,115 | 2,493 | 1,378 |
| Totals | 3,522 | 7,006 | 3,484 |

[1] Liabilities include bank deposits, U.S. Government securities, other money-market instruments, U.S. Government agency bonds and corporate bonds; but exclude equities, direct investment, and real estate investment; change in liabilities to non-official entities believed to be small.

[2] Includes Iran, Iraq, Kuwait, Saudi Arabia, United Arab Emirates, and Qatar; also includes other, non-OPEC, countries whose reserve changes have been small.

[3] Includes Algeria, Libya, and Nigeria; also includes other, non-OPEC, countries whose reserve changes have been small.

In the first half of this year, the combined *reported* (and undoubtedly understated) increase in the foreign currency reserves of the OPEC countries as a group totalled $15½ billion. During June and July, these reserves grew at a monthly rate of more than $3½ billion.

About 80 percent of this reserve buildup is reflected in U.S. and U.K. banking statistics. During the first half of this year, OPEC countries' Euro-currency deposits (almost all Euro-dollars) in banks in the United Kingdom rose about $6½ billion; their dollar assets in the United States increased about $3½ billion; and their sterling assets rose almost $2¼ billion. These bank-reported assets, of course, include deposits, certificates of deposit, government securities, and all types of other marketable money-market instruments, but no equities, real estate or direct investments. Thus, the available statistics indicate that during the first half of this year about 40% of the OPEC country reserve accumulation was in the form of Euro-dollar deposits in U.K. banks; about 25% went to the United States; and about 15% went into sterling assets. Some of the remaining 20% probably found its way into Euro-currency deposits in banks in Germany, Switzerland, and elsewhere, but part of it may also have represented placements and loans made directly to consuming nations and some equity investments.

TABLE 4.—CHANGES IN OPEC FOREIGN-CURRENCY RESERVES AND INDICATIONS OF THEIR DISPOSITION

[In millions of dollars]

| 1974 period | (a) Changes in OPEC foreign currency reserves | (b) Estimated changes in OPEC dollar holdings in the United States[1] | (c) Changes in OPEC sterling holdings in the U.K. | (d) Changes in OPEC European currency holdings in the U.K.[2] | (e) Estimated changes in other OPEC reserve assets[3] |
|---|---|---|---|---|---|
| January–March | 4,549 | 858 | 840 | 2,271 | 580 |
| April–June | 10,885 | 2,626 | 1,337 | 4,247 | 2,675 |
| June | 4,118 | 1,476 | 212 | 1,323 | 1,107 |

[1] as defined in note to Table 3.

[2] includes some private funds.

[3] residual = a—(b+c+d).

By the middle of this year, the pattern of the OPEC reserve accumulation began to change quite significantly. In June, the share of the OPEC reserve increases put in sterling and the Euro-currency market dropped considerably, but the proportion placed in domestic U.S. assets rose to 35%. It is also interesting to note that about 80% of the OPEC funds entering the United States in the first half of this year originated in Venezuela, Indonesia, and African oil-exporting countries; through June, in other words, only a very small portion of the Middle East petro-dollar build-up had reached the United States. Preliminary data for July and August indicate that OPEC countries continued placing about $1½ billion per month in the United States. With Middle East investments in the United States still small relative to the total reserve increases of the Middle Eastern OPEC countries, it would appear that the U.S. share of future increases of OPEC surplus funds may grow further to perhaps 50% over the next year or so, probably at the expense of the Euro-market's share.

Thus far, most of the fund flows from the OPEC countries to the oil importers have been handled through the banking system with impressive skill, in the words of Chancellor Healey, and with great courage. Faced with enormous uncertainties, banks did not react by pulling in their horns, but instead responded quickly to the newly created financial requirements of the oil-importing nations. Banks in the United States, aided by the well-timed U.S. Treasury decision in the latter part of January to remove all U.S. capital controls, increased their claims on foreigners by not less than $14 billion in the first seven months of this year. In addition, publicly-announced Euro-currency loans reached nearly $24 billion by mid-September, about twice as much as in the corresponding period of 1973.

TABLE 5.—CLAIMS ON SELECTED FOREIGN COUNTRIES OF BANKS IN THE UNITED STATES

[In millions of dollars]

| | End-December 1973 | End-June 1974 | Change |
|---|---|---|---|
| Developed countries, total | 14,879 | 22,559 | 7,680 |
| Japan | 6,647 | 11,034 | 4,387 |
| United Kingdom | 1,596 | 2,552 | 956 |
| France | 793 | 1,074 | 281 |
| Switzerland | 179 | 673 | 494 |
| Italy | 376 | 667 | 291 |
| Spain | 335 | 547 | 212 |
| Non-oil exporting developing countries, total | 8,296 | 11,338 | 3,042 |
| Mexico | 1,814 | 2,300 | 486 |
| Brazil | 1,549 | 2,254 | 705 |
| Argentina | 635 | 813 | 178 |
| Peru | 237 | 377 | 140 |
| Chile | 287 | 341 | 54 |
| Korea | 506 | 705 | 199 |
| Taiwan | 230 | 474 | 244 |
| Philippines | 341 | 456 | 115 |
| Israel | 378 | 432 | 54 |
| Thailand | 291 | 429 | 138 |
| Other countries [1] | 3,406 | 5,138 | 1,732 |
| World total | 26,581 | 39,035 | 12,454 |

[1] Includes some non-oil exporting countries not identified separately.

Several additional emerging trends are apparent from the figures now available. First, loans made from the United States to foreigners have increased sharply as a proportion of total international lending. In fact, after the middle of this year, international loans made from the United States were about equal in amount to the loans arranged in the Euro markets. Second, there are signs that in the last month or two the pace of new international lending from the United States and the Euro markets has begun to slacken. Though the numbers continue to be impressive, new publicly-announced Euro credits in July and August were about half the monthly average amount made in the first half of this year. U.S. bank loans to foreigners also dropped off in July. It is quite possible that much of this slowing is being offset by increased direct lending from OPEC countries. Third, projecting the current slowdown in bank lending through the remainder of this year, it seems likely that total lending may amount to about $45 billion, of which about $28 billion will have been arranged through the Euro market, and $18 billion through banks in the United States.

The remainder, or about one-third of the current-account surplus of OPEC countries, totalling about $20 billion, is likely to be financed by them, and will bypass the world financial markets. Apart from the grant aid referred to above, substantial sums will be loaned to international financial institutions, made available to national and regional development banks, provided on a concessionary basis to developing countries, and lent directly to governments and official agencies of oil-importing countries. This direct lending of course, is a logical outgrowth of the OPEC countries' having developed a structural balance-of-payments surplus, and it is bound to expand.

Largely as a result of the effective intermediation of the commercial banking system, thus far this year almost all oil-importing countries have been able to finance their deficits without undue difficulty. Some countries, such as the United States, Britain, and France have been able to attract substantial capital inflows directly from the OPEC countries—inflows that have covered a very large part of their deficits. In the case of the *United States*, in fact, *OPEC capital inflows have by far exceeded the current-account deficit, enabling U.S. banks to recycle large amounts of dollars to Japan and other deficit countries.* The only industrial country that appears to have had major difficulty in financing its balance-of-payments deficit thus far is Italy. And, it is generally recognized that Italy's financial problems stem only partly from its increased oil bill; more fundamentally, they are related to domestic economic policies, and also to the large intra-European trade imbalance.

TABLE 6.—PUBLICLY ANNOUNCED EURO CREDITS TO SELECTED COUNTRIES [1]

[In millions of dollars]

| | Year 1973 | January–mid-September 1974 |
|---|---|---|
| Developed countries, total | 12,251 | 16,188 |
| United Kingdom | 2,782 | 4,954 |
| France | 50 | 3,041 |
| Italy | 4,732 | 2,307 |
| Spain | 385 | 1,008 |
| Netherlands | 250 | 765 |
| Denmark | 192 | 340 |
| Ireland | | 267 |
| South Africa | 498 | 276 |
| Non-oil exporting developing countries, total | 5,550 | 5,118 |
| Philippines | 132 | 808 |
| Brazil | 702 | 845 |
| Greece | 606 | 443 |
| Peru | 571 | 432 |
| Argentina | 187 | 415 |
| Mexico | 1,738 | 450 |
| Sudan | | 225 |
| Communist countries, total | 834 | 1,504 |
| Yugoslavia | 243 | 579 |
| Poland | 270 | 390 |
| World total | 21,460 | 23,441 |

[1] Credits arranged but not necessarily drawn down.

Nor has the smooth financing of oil-related deficits been confined to industrial countries. Many of the non-oil-exporting less developed countries have also been able to tap the U.S. and international financial markets on a very large scale. So far this year, they have been able to obtain loans of more than $5 billion in the Euro markets. This sum represents about 22% of all publicly-announced Euro credits, roughly the same proportion of total Euro loans made to developing countries during last year. In addition, the developing countries obtained over $3 billion in credits from banks in the United States during the first half of this year. In part for these reasons, the foreign-exchange reserves of these countries have not in the aggregate been under particular pressure. Indeed, their international reserves rose from $25 billion at the end of 1973 to more than $27 billion at the end of June 1974. These global figures, of course, hide reserve and balance-of-payments pressures on a number of individual countries. Not surprisingly, therefore, some 20 of the non-oil exporting less-developed countries by mid-September had applied for full utilization of their allotted portion of the new IMF oil facility.

In short, a number of factors can be cited that so far this year have significantly relieved the strain on the world economy caused by the sharp increases in oil prices. Among these factors have been some cutback in oil usage, the stepped-up aid and sharply increased purchases of goods and services by OPEC countries, the willingness of OPEC countries to extend loans directly to certain deficit countries, thus assuming direct credit risks themselves, and, above all, the vigor and resiliency of the international banking system.

LOOKING AHEAD

However, the favorable developments to which I have just alluded have had the unfortunate effect of contributing to a sense of complacency among governments with respect to the future problems that will be created by the build-up of funds. As a result, governments are giving total inadequate attention to the potential dangers that lie ahead.

Looking ahead, it should be made very clear that the international commercial banking system cannot be counted on to continue to increase its international intermediary role at the pace experienced so far this year. Some of the factors that will increasingly constrain the banks are well known. Growing concentration of short-term deposits has in some cases already reduced the willingness of banks to accept further funds. On the lending side, the international credit risks involved could become too large for private institutions to accept prudently. Another restraining force on the banks is the fact that their capital resources are not growing as rapidly as their total balance sheets. Even in the United States, where both custom and regulation have required the maintenance of stronger capital positions than those of banks in other countries, there is a great deal of soul searching as to capital adequacy.

This is not to say that international lending will suddenly end with a bang, but only that borrowers will increasingly find that there are limits to the amounts that they can obtain from private banks. No private financial institution is willing and able to assume unlimited credit risks. Lending on commercial terms requires the expectation that borrowings will be repaid within a reasonable time span, even though some loans may be rolled over for extended periods. But, if the prospects are dim for a reduction, and eventually a reversal, in national current-account deficits, then the less creditworthy borrowers will have growing difficulty in obtaining funds to finance their deficits. Such financing as they can obtain will become increasingly costly, and may be available only upon the pledge of collateral. At some point, and for some countries, commercial credit may become virtually unavailable. As these difficulties develop, and in the absence of adequate alternatives to commercial financing, there will be no choice for such countries but to wipe out the current-account deficit by curbing domestic economic growth, reducing imports directly, and depreciating their currencies, with whatever domestic economic and political adjustments that may entail.

The probability of a significant reduction in the pace of international commercial bank lending requires that no time be lost in the search for a workable solution to the problems created by higher oil prices. I agree with recent suggestions made by several observers from oil-exporting and oil-importing nations that the time is getting ripe for leaders of both groups to sit down together in an attempt to evolve a coordinated set of policies that will respond to their most important mutual interests. Only in this way can potentially very serious economic and financial repercussions be avoided.

An integral part of such a coordinated set of polices must be a program for narrowing the huge imbalance between the oil-exporters and the oil-importers. As I have mentioned, there is a school of thought which subscribes to the view that such a narrowing is neither necessary nor urgent, and that the financial aspects of the imbalance can be managed in such a way as to avoid disruptive economic consequences. As I have attempted to show, however, trends in world financial markets increasingly suggest that the limits to the ability of existing mechanisms to cope with the problem are being approached. A build-up of OPEC external assets to $1.2 trillion in ten years is simply not imaginable in the context of a stable economic, financial, or indeed political world. The imbalances of payments of the United States and other major industrial countries that have shaken the Breton Woods system in the past decade were relatively small in comparison with those projected by the World Bank staff. The consequences if these projections are fulfilled would go far beyond what we have seen. The shift in ownership and international distribution of wealth would be so large and so rapid as to be inconceivable from a social and political point of view.

What are some of the preconditions necessary for avoiding movement toward the World Bank projection? A reasonable approach might consist of the following elements. The consuming nations—aided by energetic government efforts to promote effective energy conservation and to develop alternative energy resources in their own countries—could keep the annual rate of increase in the demand for OPEC oil exports to less than 3%. OPEC countries, by stepping up rapidly their industrial and economic development, could maintain the increase of their import volume at around 20%–25% per annum. Also very importantly, for the next few years at least the oil-exporting countries should accept some deterioration in their sharply improved terms of trade—perhaps by raising oil prices by no more than half of the increase in the price of their imports.

Under these circumstances, the collective current-account surplus of the OPEC countries would begin to decline within two years. Toward the end of this decade the surplus would disappear, even after making allowances for increasing annual earnings on external investments; the build-up of funds would peak about four or five years from now at around $300 billion. While only illustrative, this exercise in numbers does demonstrate that, with appropriate policies and actions in both oil-exporting and oil-importing countries, it would be possible to correct the newly created oil imbalance within a fairly reasonable period of time.

It is not enough, however, to deal only with the collective imbalance between the OPEC countries and the rest of the world, while neglecting the large trade and payments imbalances among the industrial countries, particularly those in Europe. The OECD countries must make progress in developing a coherent set of balance-of-payments aims. The oil imbalance could be apportioned among the individual industrial countries according to criteria which might take into account a country's net oil imports in relation to total world oil imports. Thus, an industrial country with relatively small net oil imports should accept a weakening of its non-oil trade balance by letting its currency strengthen; or it should be prepared to be a capital exporter. If a country has a large current-account surplus, in spite of substantial net oil imports, it clearly has a significant adjustment problem which must be corrected by stepping up domestic economic growth, revaluing its currency or exporting capital to oil-deficit countries. A better intra-OECD balance would relieve trade and payments pressures on countries such as Italy.

With these prospects, the financing problems created by the oil imbalance would be lessened. Commercial banks would then be more inclined to continue to lend at a healthy pace and to more countries, there being reasonable expectations for a substantial reduction and eventual elimination of the imbalances. The same would apply to the lending and investing activities of the OPEC countries themselves. They will be more willing to assume direct credit risks if they have the expectation of being repaid. In fact, borrowing countries can only repay if their imbalances are wiped out and reversed, and unless this happens many of their obligations will assume the nature of Consols—securities with perpetual maturity on which only interest is paid. Also, of course, OPEC countries' willingness to spread equity investments over a great number of countries will increase if the latter's payments problems are progressively reduced.

Let me wind up by saying a good word for the Community Chest. During the period ahead, commercial bank and direct OPEC financing must be supplemented by increased international agency financing. The IMF has a role to play here, but the scope for its role is clearly larger and perhaps different than is permitted by its new oil facility. The terms of this temporary facility resemble too closely those of a commercial banking operation and are ill-suited for countries with severe balance-of-payments difficulties. IMF members should liberalize the borrowing and lending terms of this facility.

Some thought should also be given to the question of whether there is emerging a serious shortage of international liquidity. The level of existing reserves has declined relative to the value of international trade and is likely to decline further. Gold has become a highly immobile reserve asset and the growth of usable foreign-exchange reserves has slowed with the improvement in the U.S. balance-of-payments position. Indeed, the present U.S. deficit on official settlements is largely the counterpart of OPEC countries' investments in the United States, rather than a source of additional reserves in the hands of oil importing countries. Finally, reserve creation through the Euro-currency market has greatly diminished.

Thus, aggregate international liquidity available to the non-oil-producing countries is being progressively squeezed. It may well become necessary in the foreseeable future to boost this liquidity, whether by measures to mobilize gold reserves, by large-scale creation of SDRs, or by other means. Furthermore, while balance-of-payments deficits currently are being financed primarily through extension of credits, they could also be financed through the run-down of existing reserve assets. However, there is a general unwillingness at present to make use of reserve assets, reflecting in part a desire to avoid the unfavorable impact on a country's credit standing thought to be conveyed by a declining level of reported reserves. Therefore, given growing concern for the accumulating indebtedness of certain countries, relief could appropriately be provided through the resumed creation of reseve assets under international management. The resulting liquidity creation, needed for the financing of OPEC surpluses, would not necessarily be inflationary, given that such surpluses would not in themselves represent increased real demand for goods and services.

In closing, it should be emphasized once again that none of these suggestions of a purely financial nature can provide a satisfactory long-term solution to the serious problems created by the large oil-related international imbalances. Such a solution can only come from a concerted action program, arrived at through statesmanlike cooperation between the governments of the major industrial and oil-exporting nations, and designed to assure significant progress toward scaling down these new imbalances.

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[From World Financial Markets, Morgan Guaranty Trust Company of New York, Jan. 21, 1975]

## Oil: Looking Back and Looking Ahead

Throughout the past year, opinions have differed widely about the financial consequences of the large buildup of funds by the oil-exporting nations, the role the commercial banks would play in financing the large balance-of-payments deficits swollen by the higher oil payments, and the size and duration of these huge deficits. From the available evidence presented in the analysis below, it is possible to draw several conclusions.

First, the domestic and international money-markets do not appear to have been strained excessively by the heavy influx of petro-dollars. Only about 50% of the $55-billion current-account surplus of the OPEC countries was placed in banks in 1974, and this percentage appears to have been declining slowly. Although initially the bulk of the funds came in a relatively small number of large banks, the number of banks receiving OPEC deposits has been increasing.

Second, OPEC funds do not appear to have been concentrated excessively in any particular country. The United States received the largest amount, but it remained well below this country's increased oil payments. The dollar, against the expectations of many observers, remained rather weak. Britain received the second largest amount of funds from OPEC countries, more than enough to finance its increased current-account deficit with them, and the pound remained relatively firm against the dollar, although it weakened on an effective basis. Several other deficit countries also received funds directly from OPEC countries in the form of loans and grants. Altogether, more than one-third of the deficit between the oil-exporting and the oil-importing nations was financed directly by the former, a natural and sound development.

Third, in 1974 international bank loans financed, directly or indirectly, more than one-half of the oil deficit. In fact, these loans exceeded the deposits banks received from OPEC countries. However, since last August international bank lending has slowed down considerably, although this decline has been offset in part by increased new issue volume in the international capital market.

Fourth, the current-account imbalance between the oil-exporting and oil-importing nations in 1975 again will be on the order of $55–$60 billion, but the financing pattern will be quite different from that of 1974. Commercial banks are likely to finance only one-quarter to one-third of this year's imbalance, but more funds may be available from the international capital market than last year. Furthermore, official recycling facilities now in place—the IMF oil facility and the EEC Community loan—will make available about $10 billion. Thus, there could be a financing gap of about $25 billion which probably will not be met by private financial markets together with present official recycling arrangements. Hopefully, a substantial portion of the remaining financing will be forthcoming again directly from OPEC countries in various forms including direct loans and grants, sterling balances, portfolio investments, and possibly deferred payments arrangements. Nevertheless, direct OPEC financing probably will not cover the entire projected financing gap. Therefore, in order to prevent further economic contraction and to avoid trade and payments restrictions, it is necessary to bring into operation as soon as possible Secretary Kissinger's Solidarity Fund under the OECD, or to expand further the IMF oil facility.

**TABLE 1.**—*Estimated OPEC revenues and their use in 1974*

| | *Billions* |
|---|---|
| Foreign-exchange receipts | $105 |
| Imports of goods and services | −50 |
| Current-account surplus | 55 |
| Liquid investments | 37 |
| Dollar bank deposits and government securities in the United States | 10½ |
| Sterling bank deposits and government securities in the United Kingdom | 6 |
| Euro-currency deposits | 20½ |
| IMF oil facility | 2 |
| Loans to World Bank and other international institutions | 2¼ |
| Grants and loans to developing countries | 2½ |
| Direct loans to Europe, Japan, and Canada | 6½ |
| Direct investments, real estate, other | 4¾ |

Fifth, in view of the downward shift in demand for OPEC oil and the sharp actual and projected rise in imports of goods and services by OPEC countries, the current-account surplus of the oil-producing countries may well have reached a plateau. The surplus probably will decline next year and disappear before the end of this decade. Significantly, the curbing of oil consumption, the expansion of energy production outside the OPEC area, and the increase in OPEC countries' imports of goods and services, all will contribute to eliminating the present large surplus. The total accumulation of funds by OPEC countries may not exceed $250 billion, with the peak to be reached well before 1980. The financing of the oil deficit, therefore, appears to be a serious problem for only a few more years.

## DISPOSITION OF OPEC FUNDS IN 1974

Oil revenues received by OPEC countries probably reached $95 billion in 1974. Revenue receipts were somewhat smaller than revenues accrued because revenue payments lagged oil shipments. In addition, OPEC nations earned an estimated $7 billion from non-oil exports and roughly $3 billion in investment income. Out of the estimated $105 billion in gross foreign-exchange receipts, OPEC countries spent close to $50 billion for imports of goods and services—up from nearly $30 billion in 1973. As a result, OPEC's combined current-account surplus amounted to about $55 billion last year.

As shown in Table 1, approximately $37 billion, or about two-thirds of the OPEC current-account surplus, was invested in liquid assets in the United States, United Kingdom, and Euro-currency markets. About $6 billion went into U.S. Government securities, and approximately $3½ billion was invested in British Government securities. An estimated $27½ billion, or one-half of the total OPEC surplus, was placed on deposit in banks, including about $4½ billion in dollars in banks in the United States, close to $2½ billion in sterling in banks in the United Kingdom, and approximately $20½ billion in Euro-currency deposits. The bulk of the Euro-currency deposits—about two-thirds of which were lodged in London—was in dollars, but included also were some German marks, Swiss francs, and sterling.

In Table 2 these estimates of OPEC investments in liquid assets are broken down into quarterly flows. Placements of OPEC funds in liquid assets peaked at just over $11 billion in the third quarter of $1974, and lessened to an estimated $9½ billion in the fourth quarter of last year. Since OPEC's current-account surplus probably increased during each quarter of 1974—from perhaps $6–$6½ billion in the first quarter to roughly $18–$19 billion in the fourth quarter—it is evident that the portion of OPEC's surplus invested in liquid assets declined steadily during the year from an estimated 90% in January-March to only about half in October–December 1974.

TABLE 2.—ESTIMATED GROWTH IN OPEC LIQUID INVESTMENTS IN 1974

[In billions of dollars]

| | Year | I | II | III | IV |
|---|---|---|---|---|---|
| Dollar bank deposits and government securities in the United States | 10.5 | 1.1 | 2.6 | 4.3 | 2.5 |
| Sterling bank deposits and government securities in the United Kingdom | 6.0 | 0.8 | 1.4 | 1.8 | 2.0 |
| Euro-currency deposits | 20.5 | 3.8 | 6.7 | 5.0 | 5.0 |
| Total | 37.0 | 5.7 | 10.7 | 11.1 | 9.5 |
| Of which: | | | | | |
| Bank deposits | 27.5 | 4.4 | 8.5 | 8.0 | 6.6 |
| Dollars in the United States | 4.5 | 0.6 | 1.2 | 2.1 | 0.6 |
| Sterling in the United Kingdom | 2.5 | 0.0 | 0.6 | 0.9 | 1.0 |
| Euro-currencies | 20.5 | 3.8 | 6.7 | 5.0 | 5.0 |

Similarly, the amount of OPEC funds placed in the banking system—estimated at $27½ billion during 1974—probably peaked in the second quarter at about $8½ billion, with flows into bank deposits declining to slightly more than an estimated $6½ billion in the fourth quarter of last year.

Only about one-fifth of OPEC's surplus was invested directly in the United States last year. This included approximately $10½ billion in U.S. Government securities and bank deposits, in addition to which there were relatively small amounts invested in corporate securities and real estate. The total of about $11 billion directly invested by OPEC countries in the United States was considerably less than the $17½ billion increase in U.S. oil imports last year.

As shown in Table 2, OPEC flows directly into U.S. Government securities and bank deposits in the United States slowed to only an estimated $2½ billion in the fourth quarter of 1974 from about $4.3 billion in the third quarter. In part, this slowing probably reflected the decline in interest rates in the United States relative to those in other markets.

OPEC flows directly into Britain in the form of sterling deposits and U.K. Government securities amounted to an estimated $6 billion in 1974. In addition, between $1½ billion and $2 billion came into Britain in the form of direct loans to U.K. public-sector entities and purchases of equities and real estate by OPEC countries. Although close to $2 billion may have been invested in sterling deposits and government securities in the United Kingdom in the fourth quarter of 1974—about the same as in the previous quarter—most of this investment occurred in October. Only a small amount is believed to have gone into such sterling instruments in the last two months of 1974. However, some OPEC countries appear to have accumulated sterling during these two months in the Euro-currency market instead of in the U.K. domestic market. U.K. money-market rates declined substantially in the closing months of 1974, and a sizable differential developed in favor of Euro-sterling deposits.

TABLE 3.—INTERNATIONAL BANK LENDING

[In billions of dollars]

| | Changes in claims on foreigners held for own account by banks in the United States | Publicly announced Euro-currency bank credits |
|---|---|---|
| 1973 | 4.02 | 21.44 |
| 1974 | [1] 15.10 | [3] 27.99 |
| 1st half | 11.46 | 19.91 |
| 2nd half | [2] 3.64 | [3] 8.08 |
| July | 1.57 | 1.95 |
| August | 1.92 | 1.57 |
| September | —1.28 | .84 |
| October | —.24 | 1.58 |
| November | 1.66 | .75 |
| December | na | [3] 1.39 |

[1] January-November.
[2] July-November.
[3] preliminary and subject to revision.

Other OPEC financial flows in 1974 included $2 billion to the IMF oil facility out of a total commitment of $3.5 billion. OPEC countries also purchased obligations of the World Bank, Inter-American Development Bank, and the Asian Development Bank amounting to nearly $2.2 billion during 1974. Grants and loans made directly by OPEC countries to developing countries may have totaled around $2½ billion. The latter represents estimated disbursements. Commitments by OPEC nations for bilateral assistance to developing countries exceeded $9 billion in 1974, in addition to which OPEC countries announced plans for capitalizing various national and regional development funds.

Direct loans by OPEC countries to developed countries—mostly to governments and state enterprises in Europe, Japan, and Canada—amounted to an estimated $6½ billion last year, of which about $5 billion went to Europe. This direct lending accounted for an increasing share of OPEC investments in the second half of the year. Publicly-announced direct investments and purchases of equities and real estate in developed countries totaled approximately $800 million.

The remaining $4 billion included among other items OPEC purchases of corporate bonds and shares, other investments in real estate and joint ventures, repayments of outstanding external debt, payments connected with OPEC governments' increased ownership of the oil-producing entities in their respective countries, and military assistance grants to other Arab nations.

### FINANCING THE DEFICIT IN 1974

More than one-third of the $55-billion collective current-account deficit of the oil-importing countries with the OPEC countries in 1974 was financed by funds received in various forms directly from the latter. As noted earlier, grants and loans received directly from OPEC countries totaled an estimated $9 billion in 1974—$2½ billion for developing countries, and $6½ billion for industrial countries. Investments from OPEC countries in corporate securities and real estate also provided some, albeit relatively limited, financing of oil-importing countries' deficits. The $6 billion placed by OPEC countries in sterling deposits and government securities in the United Kingdom completely financed the $6 billion increase in Britain's net oil imports. The $10½ billion that flowed directly into the United States from OPEC countries in the form of bank deposits and purchases of government securities financed roughly two-thirds of the increase in the U.S. current-account deficit with OPEC. However, this inflow was substantially in excess of the overall U.S. current-account deficit, estimated at about $4 billion.

In addition to the funds obtained directly from OPEC countries, oil-importing nations financed part of their deficits by borrowing from the IMF oil facility (more than $2 billion) and by drawing on regular IMF credit tranche facilities (close to $1.2 billion). And, of course, loans from international development institutions, such as the World Bank, contributed to meeting the financing needs of the developing countries.

More than half of the financing for oil-importing countries' combined current-account deficit with OPEC was obtained through borrowing in the private financial markets, especially the banking system. Publicly-announced new Euro-currency bank credit facilities arranged in 1974 totaled $28 billion, up from about $23½ billion in 1973. The estimated net size of the Euro-currency market—a measure of outstanding Euro bank credit, which includes actual utilization of such facilities—increased by more than $30 billion last year. Banks in the United States increased their claims on foreigners by $15 billion in the first eleven months of 1974. In addition, more than $6.3 billion of new bond issues, including publicly announced private placements, were offered in the international bond market last year, compared with nearly $7.8 billion in 1973.

After July, however, the pace of bank lending slowed considerably. As shown in Table 3, whereas nearly $22 billion of new Euro-currency bank credits were publicly announced in the first seven months of 1974, the amount disclosed in the August-December 1974 period was just over $6 billion. Moreover, claims on foreigners held by banks in the United States for their own account increased by only $2 billion between the end of July 1974 and end-November 1974, following an increase of about $13 billion in the first seven months of last year. It is evident from these figures that in the latter part of 1974, banks were no longer willing or able to provide anywhere near the portion of the financing required by oil-importing countries than they did earlier in the year.

TABLE 4.—NEW INTERNATIONAL BOND ISSUES

[In billions of dollars]

| | In the United States | Outside the United States |
|---|---|---|
| 1973 | 0.96 | 6.82 |
| 1974 | 3.20 | 3.19 |
| 1st half | 1.42 | 1.48 |
| 2nd half | 1.78 | 1.71 |
| July | .41 | .13 |
| August | .03 | .21 |
| September | .18 | .27 |
| October | .27 | .16 |
| November | .29 | .46 |
| December | .60 | .48 |

The pronounced slowdown in bank lending was partially offset by a pickup in new issue activity in the international bond market in the second half of 1974. During this period, approximately $3.5 billion was raised through new issues—public offerings and private placements—compared with $2.9 billion in the first half (see Table 4). The increase in new issue activity was most pronounced in the U.S. market, where foreign borrowers raised $3.2 billion in 1974, including about $1.8 billion in the second half of the year, compared with less than $1 billion in 1973. New issue activity also recovered in the international bond market outside the United States, particularly in the final two months of the year when about $940 million was raised by various borrowers.

It is interesting to note that there was virtually no transfer of primary reserve assets—gold, SDR's, and IMF reserve positions—from oil-importing countries to OPEC nations. Moreover, oil-importing countries as a group actually registered a small increase in their foreign-currency reserves last year.

## FINANCING THE IMBALANCE IN 1975

In 1975 oil-importing countries are likely to be faced with a combining current-account deficit with OPEC nations on the order of $55–$60 billion. The pattern of financing of this deficit will be quite different from that of last year.

More of the deficit, probably about $10 billion, will be financed through various official recycling arrangements. The IMF oil facility could provide about $7½ billion—about $1½ billion remaining under last year's arrangement plus the $6 billion agreed upon last week by the IMF for this year. The EEC may float its Community Loan around mid-year; the amount may be little more than $2 billion since the authorized $3 billion includes interest payments. The Group of Ten has agreed in principle on Secretary Kissinger's proposed $25-billion Solidarity Fund, which would serve as a safety net and supplement the IMF oil facility. However, this Fund is not likely to be operational until much later this year, and will also be spread over two years instead of one year as originally proposed.

The portion of the deficit financed through the banking system will be considerably smaller than last year—perhaps only one-quarter to one-third of the total, compared with over half in 1974. The slowdown in the pace of banks' international lending which occurred in the latter part of 1974 is likely to continue this year. Banks' lending will be constrained partly by the credit risks entailed in financing large and persistent current-account deficits of some countries. An equally important constraint may be the efforts of banks to limit the growth of their total assets and liabilities, which in recent years has outpaced the increase in their capital. Many bank managements have expressed the view that bank capital ratios have fallen as low as is prudent.

More financing may well be obtained via the international bond market in 1975. Recent declines in short-term interest rates and the prospects for a lessening of inflation in some countries may well give a boost to the international bond market. The recovery of the market outside the United States, which began in the closing months of 1974, has continued this month with about $500 million of new public offerings and private placements. More foreign borrowers may come to the U.S. bond market this year as well, although domestic borrowers—both government and corporate—will also be placing heavy demands on the U.S. market.

Thus, the official recycling facilities now in place, plus credits provided by the banking system and the international capital markets, may be sufficient to provide as much as $30–$35 billion of the funds required to finance oil-importing countries' deficits with OPEC nations this year, leaving a gap of about $25 billion.

One way that this remaining gap could be covered is through increased direct lending and investing by OPEC nations. Grants and loans to developing countries by OPEC nations are likely to increase, particularly in view of the sizable commitments made by OPEC countries during the past year. Moreover, developed countries are likely to seek more direct loans from OPEC countries, and there will be disbursements under previous arrangements, such as those concluded last year by the United Kingdom and France with Iran. A further buildup of sterling balances in the United Kingdom will help finance Britain's deficit.

Another possibility, and one which would be very constructive, is that OPEC countries could sell their oil on a deferred payment basis. Such arrangements have already been made on a very limited basis between a few OPEC countries and several developing nations. Sheikh Ahmed Zaki Yamani in a speech made last December hinted that it might be possible for producing countries to accept deferred payment for a considerable portion, perhaps 25%, of their crude oil. Such arrangements could serve to distribute part of OPEC's surplus to countries whose balances of payments have been most affected by the increase in oil prices.

To the extent this direct OPEC lending and investing either is inadequate to finance the remaining gap or is distributed in ways that do not match the financing requirements of individual oil-importing countries, there will be strong pressure to increase official arrangements through the IMF, to speed implementation of the OECD safety net, or to employ central bank swap facilities for bridge financing.

NARROWING THE IMBALANCE

There are many reasons to believe that the views expressed on the outlook for the current-account imbalance between oil-exporting and oil-importing countries have been too pessimistic. Market forces appear to have been quite effective, both in reducing world demand for OPEC oil, and in stimulating OPEC purchases of goods and services from the rest of the world.

TABLE 5.—OPEC IMPORTS FROM SELECTED INDUSTRIAL COUNTRIES IN 1974

[Percent increase over same period in 1973]

| | Imports from | | |
|---|---|---|---|
| | United States | Japan | Germany |
| January–October | 79 | 100 | 66 |
| First quarter | 41 | 55 | 51 |
| Second quarter | 80 | 89 | 72 |
| July–October | 105 | 126 | 71 |

Particularly impressive has been the decline in demand for petroleum and petroleum products in the industrial countries, due of course to generally sluggish economic activity, as well as higher prices. In the United States, consumption was down 3% in 1974 by comparison with 1973. In Western Europe, the decline was around 6% for the first ten months of last year. In Japan, consumption through September 1974 was little changed from 1973. By contrast, in the five years through 1973, oil consumption in these areas had grown at an average annual rate of 7.4%. Additional demand constraints will stem from government measures already implemented or proposed in a number of industrial countries.

As a result, imports of oil by the United States, Japan, and Western Europe as a group have ceased to grow, and in 1975 may even decline somewhat from their 1973 level. Largely for this reason, oil production in a number of OPEC countries has had to be cut back significantly; in others, plans for production increases have been put off. Toward the end of 1974, oil production in OPEC countries was running close to 10% below the production rate for the third quarter of 1973.

In addition, higher oil prices have stimulated greatly increased oil exploration in non-OPEC countries around the world. Production increases of some importance were already expected in the North Sea, Alaska, the countries of the upper Amazon Basin in South America, and Malaysia. Substantial new finds have been recently announced in Mexico and Brazil. The search is accelerating in many other countries, including Guatemala, Egypt, India, the Philippines, and Thailand, to mention but a few. Even China may become a substantial oil exporter in the not too distant future. As a result of reduced growth in world oil consumption as well as increasing oil production in non-OPEC areas, it seems likely that, for the rest of the decade, demand for OPEC oil by the rest of the world will be little changed.

In addition, the OPEC countries have been increasing their purchases of goods and services from the rest of the world at a much more rapid pace than many had thought possible. As discussed further below, this is true both of the so-called "high-absorbers," but also of the less heavily populated OPEC countries. Indeed, as shown in Table 5, the rate of increase in OPEC imports seems to be accelerating. OPEC countries are spending more, and not only for development projects and military equipment; they are also in some cases subsidizing the domestic consumption of imported products. The value of aggregate OPEC imports may have increased by as much as $20 billion in 1974, or some 70%–75%.

Indeed, Algeria probably will return to a current-account deficit this year. Venezuela and Iran will probably be experiencing small current deficits by 1977 and 1978, respectively. Even Kuwait might approach a current-account deficit in the early 1980s.

In short, it seems likely that the annual current-account imbalance between oil importers and oil exporters collectively has plateaued. The imbalance will begin to decline significantly after 1976. OPEC holdings of external financial assets may peak in 1978 at around $250 billion, declining thereafter. At that point, only three or four of the OPEC members will still be experiencing sizable current surpluses.

Table 6 presents a scenario that is based on the following assumptions: little change for the remainder of the decade in demand for OPEC oil by the rest of the world; a 5% per annum average increase in the OPEC governments' "take" per barrel; an average 15% per annum increase in OPEC non-oil exports; a 20% average annual increase in the volume of OPEC imports; in 1975 a 12% increase in the price of OPEC imports, and 7% on an average annual basis thereafter; and an 8% per annum financial return on OPEC external investments.

Actual developments, of course, may deviate from these assumptions. The slight annual reduction implied in OPEC's terms of trade with the rest of the world is based on what appears to be the likelihood of continuing excess oil producing capacity in the OPEC countries for some time to come. However, OPEC countries may be able to maintain present terms of trade for a few years, and the assumed deterioration may not occur until later in the decade, as market factors put increasing pressure on oil prices. It is also possible that some OPEC countries may reduce the rate of growth of their imports as the decade proceeds, to avoid the emergence of current deficits of the magnitude implicit in the table. In addition, the pace of non-OPEC oil exports may increase more rapidly than is assumed. Nevertheless, the basic thrust of the scenario shown in Table 6 is not likely to be changed by modifying somewhat the stated assumptions.

TABLE 6.—THE BUILDUP OF OPEC FUNDS: A SCENARIO [1]

[In billions of dollars]

| | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 |
|---|---|---|---|---|---|---|---|
| Exports of goods and services | 112 | 117 | 127 | 135 | 139 | 148 | 158 |
| Oil revenues | [2] 105 | 110 | 119 | 125 | 128 | 135 | 143 |
| Non-oil exports | 7 | 7 | 8 | 10 | 11 | 13 | 15 |
| Imports of goods and services | 50 | 65 | 83 | 108 | 138 | 117 | 227 |
| Trade balance | 62 | 52 | 44 | 27 | 1 | —29 | —69 |
| Investment income | 3 | 8 | 13 | 16 | 19 | 19 | 16 |
| Current account | 65 | 60 | 57 | 43 | 20 | —10 | —53 |
| Grant aid | 2 | 3 | 3 | 3 | 3 | 3 | 3 |
| Surplus to be invested | 63 | 57 | 54 | 40 | 17 | —13 | —56 |
| External financial assets [3] | 80 | 137 | 191 | 231 | 248 | 235 | 179 |

[1] See text for assumptions underlying this table.
[2] Value of oil exported. Exceeded actual revenue receipts by an estimated $10 billion.
[3] Cumulative amount outstanding at year-end.

*January 16, 1975.*

COMMUNIQUÉ OF THE MINISTERIAL MEETINGS OF THE GROUP OF TEN IN WASHINGTON ON THE 14TH AND 16TH OF JANUARY 1975

1. The Ministers and Central Bank Governors of the ten countries participating in the General Arrangements to Borrow met in Washington on the 14th and 16th of January 1975, under the Chairmanship of Mr. Masayoshi Ohira, Minister of Finance of Japan.

The Managing Director of the International Monetary Fund, Mr. H. J. Witteveen, took part in the meetings, which were also attended by the President of the Swiss National Bank, Mr. F. Leutwiler, the Secretary-General of the OECD, Mr. E. van Lennep, the General Manager of the Bank for International Settlements, Mr. R. Larre, and the Vice-President of the Commission of the E.E.C., Mr. W. Haferkamp.

2. After hearing a report from the Chairman of their Deputies, Mr. Rinaldo Ossola, the Ministers and Governors agreed that a solidarity fund, a new financial support arrangement, open to all members of the OECD, should be established at the earliest possible date, to be available for a period of two years. Each participant will have a quota which will serve to determine its obligations and borrowing rights and its relative weight for voting purposes. The distribution of quotas will be based mainly on GNP and foreign trade. The total of all participants' quotas will be approximately $25 billion.

3. The aim of this arrangement is to support the determination of participating countries to pursue appropriate domestic and international economic policies, including cooperative policies to encourage the increased production and conservation of energy. It was agreed that this arrangement will be a safety net, to be used as a last resort. Participants requesting loans under the new arrangement will be required to show that they are encountering serious balance-of-payments difficulties and are making the fullest appropriate use of their own reserves and of resources available to them through other channels. All loans made through this arrangement will be subject to appropriate economic policy conditions. It was also agreed that all participants will jointly share the default risks on loans under the arrangement in proportion to, and up to the limits of, their quotas.

4. In response to a request by a participant for a loan, the other participants will take a decision, by a two-thirds majority, on the granting of the loan and its terms and conditions, in the case of loans up to the quota, and as to whether, for balance-of-payments reasons, any country should not be required to make a direct contribution in the case of any loan. The granting of a loan in excess of the quota and up to 200 percent of the quota will require a very strong majority and beyond that will require a unanimous decision. If one or more participants are not required to contribute to the financing of a loan, the requirements for approval of the loan must also be met with respect to the contributing participants.

5. Further work is needed to determine financing methods. These might include direct contributions and/or joint borrowing in capital markets. Until the full establishment of the new arrangement, there might also be temporary financing through credit arrangements between central banks.

6. Ministers and Governors agreed to recommend the immediate establishment of an ad hoc OECD Working Group, with representatives from all interested OECD countries, to prepare a draft agreement in line with the above principles. In their view this work should be concluded in time to permit approval by the OECD Council by the end of February 1975.

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*January 16, 1975.*

PRESS COMMUNIQUÉ OF THE INTERIM COMMITTEE OF THE BOARD OF GOVERNORS OF THE INTERNATIONAL MONETARY FUND

1. The Interim Committee of the International Monetary Fund held its second meeting in Washington, D.C. on January 15 and 16, 1975. Mr. John N. Turner, Minister of Finance of Canada, was in the chair. Mr. H. Johannes Witteveen, Managing Director of the International Monetary Fund, participated in the meeting. The following observers attended during the Committee's discussions of the matters referred to in paragraphs 2, 3, and 4 below: Mr. Henri Konan Bedié, Chairman, Bank-Fund Development Committee; Mr. Gamani Corea, Secretary General, UNCTAD; Mr. Wilhelm Haferkamp, Vice President, EC Commission; Mr. Mahjoob A. Hassanain, Chief, Economics Department, OPEC; Mr. René

Larre, General Manager, BIS; Mr. Emile van Lennep, Secretary General, OECD; Mr. Olivier Long, Director General, GATT; Mr. Robert S. McNamara, President, IBRD.

2. The Committee discussed the world economic outlook and against this background the international adjustment process. Great concern was expressed about the depth and duration of the present recessionary conditions. It was urged that anti-recessionary policies should be pursued while continuing to combat inflation, particularly by countries in a relatively strong balance of payments position. It was observed that very large disequilibria persist not only between major oil exporting countries as a group and all other countries, but also among countries in the latter group, particularly between industrial and primary producing countries. Anxiety was also voiced that adequate financing might not become available to cover the very large aggregate current account deficits, of the order of US $30 billion, in prospect for the developing countries other than major oil exporters in 1975.

3. The Committee agreed that the Oil Facility should be continued for 1975 on an enlarged basis. They urged the Managing Director to undertake as soon as possible discussions with major oil exporting members of the Fund, and with other members in strong reserve and payments positions, on loans by them for the purpose of financing the Facility. The Committee agreed on a figure of SDR 5 billion as the total of loans to be sought for this purpose. It was also agreed that any unused portion of the loans negotiated in 1974 should be available in 1975. The Committee agreed that in view of the uncertainties inherent in present world economic conditions, it was necessary to keep the operation of the Oil Facility under constant review so as to be able to take whatever further action might be necessary in the best interests of the international community. It was also understood that during the coming months it would be useful to review the policies, practices, and resources of the Fund since it would be appropriate to make increased use of the Fund's ordinary holdings of currency to meet the needs of members that were encountering difficulties.

4. The Committee emphasized the need for decisive action to help the most seriously affected developing countries. In connection with the Oil Facility, the Committee fully endorsed the recommendation of the Managing Director that a special account should be established with appropriate contributions by oil exporting and industrial countries, and possibly by other members capable of contributing, and that the Fund should administer this account in order to reduce for the most seriously affected members the burden of interest payable by them under the Oil Facility.

5. The Committee considered questions relating to the sixth general review of the quotas of members, which is now under way, and agreed, subject to satisfactory amendment of the Articles, that the total of present quotas should be increased by 32.5 percent and rounded up to SDR 39 billion. It was understood that the period for the next general review of quotas would be reduced from five years to three years. The Committee also agreed that the quotas of the major oil exporters should be sustantially increased by doubling their share as a group in the enlarged Fund, and that the collective share of all other developing countries should not be allowed to fall below its present level. There was a consensus that because an important purpose of increases in quotas was strengthening the Fund's liquidity, arrangements should be made under which all the Fund's holdings of currency would be usable in accordance with its policies. The Committee invited the Executive Directors to examine quotas on the basis of the foregoing understandings, and to make specific recommendations as promptly as possible on increases in the quotas of individual member countries.

6. I. The Committee considered the question of amendment of the Articles of Agreement of the Fund. It was agreed that the Executive Directors should be asked to continue their work on this subject and, as soon as possible, submit for consideration by the Committee draft amendments on the following subjects:

(a) The transformation of the Interim Committee into a permanent Council at an appropriate time, in which each member would be able to cast votes of the countries in his constituency separately. The Council would have decision-making authority under powers delegated to it by the Board of Governors.

(b) Improvements in the General Account, which would include (i) elimination of the obligation of member countries to use gold to make such payments to the Fund as quota subscription and repurchases and the determination of the media of payment, which the Executive Directors would study, and (ii) arrangements to ensure that the Fund's holdings of all currencies would be usable in its operations under satisfactory safeguards for all members.

(c) Improvements in the characteristics of the SDR designed to promote the objective of making it the principal reserve asset of the international monetary system.

(d) Provision for stable but adjustable par values and the floating of currencies in particular situations, subject to appropriate rules and surveillance of the Fund; in accordance with the Outline of Reform.

II. The Committee also discussed a possible amendment that would establish a link between allocations of SDRs and development finance, but there continues to be a diversity of views on this matter. It was agreed to keep the matter under active study, but at the same time to consider other ways for increasing the transfer of real resources to developing countries.

7. The Committee also agreed that the Executive Directors should be asked to consider possible improvements in the Fund's facilities on the compensatory financing of export fluctuations and the stabilization of prices of primary products and to study the possibility of an amendment of the Articles of Agreement that would permit the Fund to provide assistance directly to international buffer stocks of primary products.

8. There was an intensive discussion of future arrangements for gold. The Committee reaffirmed that steps should be taken as soon as possible to give the special drawing right the central place in the international monetary system. It was generally agreed that the official price for gold should be abolished and obligatory payments of gold by member countries to the Fund should be eliminated. Much progress was made in moving toward a complete set of agreed amendments on gold, including the abolition of the official price and freedom for national monetary authorities to enter into gold transactions under certain specific arrangements, outside the Articles of the Fund, entered into between national monetary authorities in order to ensure that the role of gold in the international monetary system would be gradually reduced. It is expected that after further study by the Executive Directors, in which the interests of all member countries would be taken into account, full agreement can be reached in the near future so that it would be possible to combine these amendments with the package of amendments as described in paragraphs 6 and 7 above.

9. The Committee agreed to meet again in the early part of June, 1975 in Paris, France.

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