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HEARING

BEFORE THE

PERMANENT

SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON

GOVERNMENT OPERATIONS

UNITED STATES SENATE

NINETY-THIRD CONGRESS

SECOND SESSION

PURSUANT TO SECTION 4, SENATE RESOLUTION 269,
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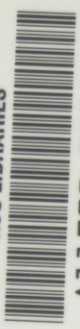


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RECYCLING OF PETRODOLLARS

WEDNESDAY, OCTOBER 16, 1974

UNITED STATES SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, D.C.

The subcommittee met at 9 a.m., in room 3302, Dirksen Senate Office Building, pursuant to Section 4, Senate Resolution 269, approved March 1, 1974, Senator Henry M. Jackson (chairman of the subcommittee) presiding.

Members of the subcommittee present: Senator Henry M. Jackson, Democrat, Washington; Senator John L. McClellan, Democrat, Arkansas; Senator Abraham A. Ribicoff, Democrat, Connecticut; Senator Walter D. Huddleston, Democrat, Kentucky; and Senator Charles H. Percy, Republican, Illinois.

Members of the professional staff present: Howard J. Feldman, Chief Counsel; William M. Knauf, Investigator; Stuart M. Statler, Chief Counsel to the Minority; Robert Sloan, Special Counsel to the Minority; and Ruth Y. Watt, Chief Clerk.

Chairman JACKSON. The subcommittee will come to order.

(Members of the subcommittee present at time of convening: Senators Jackson, Ribicoff and Percy.)

Chairman JACKSON. Today we will hear testimony concerning the growing financial and economic problems that have accompanied the artificial inflation of world oil prices by the OPEC cartel.

The quadrupling of petroleum prices within the last year is resulting in an unprecedented transfer of wealth. Consumer nations anticipate a collective "oil deficit" of some \$65-70 billion this year.

This year alone, while producer countries continue to amass staggering surpluses, rising trade deficits and higher levels of inflation not only threaten the economic growth of developed nations, but also exacerbate the already complex task of managing the international financial system.

However ominous the threats to our own economic and financial well-being, the impact of oil-induced deficits and inflation has fallen with greatest severity on the developing nations, whose peoples can ill afford "belt-tightening" while living at bare subsistence levels.

These nations face an additional oil import bill of \$10 billion, a figure that exceeds their total receipts of official development assistance. Reverberations from higher energy prices will have profound consequences—national bankruptcies, mass starvation, social upheaval, political instability—from which no nation can be isolated.

The consuming nations, including the United States, have no coherent policy for reducing oil prices in the short term. In this context, monetary authorities have been preoccupied with the subject of re-

cycling. Recycling, in brief, is the process by which the oil consumers are expected to borrow back their own money from OPEC in order to buy more oil at inflated prices.

It can perhaps best be characterized as a concept in search of some content. Recycling has been called an "escape from reality," by Dr. Burns, I believe.

It has also been called a necessity, without which the world economy cannot survive.

A massive flow of petrodollars as short term credits from producer to developed consumer nation has already begun. What has yet to be determined is how, if at all, these petrodollars can be safely relented to the poor nations, or even to developed nations with serious financial problems. In many instances it appears that the borrowers may not be able to cover the interest on such loans, much less repay them, unless new oil prices come down radically.

On October 1, Secretary Simon estimated that U.S. banks increased their lending to foreigners by about \$15 billion since the beginning of the year and expressed confidence in the continued ability of private money markets to handle the enormous influx of surplus oil funds. I am less optimistic.

Far larger sums, perhaps as much as \$30 billion, will inundate domestic and international financial institutions in the year ahead, and it is not obvious that these funds can all be placed with credit-worthy borrowers.

The somber mood of international monetary authorities, the reservations expressed by members of the banking and financial community, the absence of consensus about the appropriate means of recycling of petrodollars—all of these dictate an urgent and thorough assessment of the impact of petrodollars' flows on our financial institutions, and on the national and world economies.

We must be able to anticipate how much exposure the United States will have in the recycling of these huge flows of petrodollars. Will our financial institutions, and our Government as the ultimate insurer, bear the major financial burden of the inevitable failure of poor and developing countries and financially troubled developed nations to repay loans used to buy oil?

Will the United States again have the major stake and therefore, the major exposure in any international institution used to recycle these moneys? Or, will the OPEC countries, the United States, Western Europe and Japan share this financial burden?

If we cannot solve this immediate problem the world economy will surely disintegrate as each nation tries to protect itself with trade barriers and controls on capital movements.

But let me close by saying that it would be foolish to believe that the creation of international institutions or the perfection of the present system to handle these petrodollars is the solution to our problem.

For some time, I have believed that the basic problem, and the major cause of world economic distress, is the outrageously high price of oil imposed by the OPEC cartel.

Tinkering with the institutions by which we borrow back the tribute we should never have had to pay may only delay the ultimate collapse of the world economy. In my view, unless the price of oil comes down quickly and sharply the world will maintain a headlong course toward economic disaster.

Senator Percy?

Senator PERCY. Mr. Chairman, as I have explained to our witnesses I have to leave at 10:30. I ask unanimous consent that my complete opening statement be put in the record. I would like to extract from it those portions of it which deal with policy recommendations. I would hope that they would be commented upon by our distinguished witnesses this morning.

For the past year the oil-consuming nations of the world, developed as well as developing, have floundered in a sea of financial and economic uncertainty. A simultaneous downturn in the economies of these nations heightened fears of rising unemployment and zero or declining rates of growth.

Raging global inflation continues, even threatens to accelerate. There are growing shortages in worldwide food supplies. Commodity prices have skyrocketed.

The fourfold increase in the price of crude oil engineered by the Organization of Petroleum Exporting Nations [OPEC], is, without question, what has contributed most to international economic instability.

The international payment imbalances generated by this cartel administered price of the world's most important energy source were immediate and increasingly ruinous. More than anything else the precipitous nature of this enormous price rise prevented an orderly financial adjustment by the affected nations.

In 1972, the OPEC nations earned \$15 billion from their export of crude oil. The earnings grew to \$25 billion in 1973. In 1974, their estimated receipts will be roughly \$80 billion. The United States alone will pay \$22.5 billion for oil imports from the OPEC nations in 1974, up from \$3.6 billion in 1972 and \$6.7 billion in 1973.

The staggering price rises constitute an enormous excise tax on oil-consuming nations, rich and poor alike. Some painful adjustments have been made to the new economic and financial realities imposed by OPEC. Worldwide consumption of petroleum has declined slightly in 1974, rather than increasing at 7-10 percent rate as anticipated.

Resulting shortages of certain key products such as fertilizers, and petrochemicals have worked a real hardship in many underdeveloped nations. Meanwhile, the fires of inflation have been further fueled. And major adjustments have been made in the international financial structure to facilitate the recycling of the bulk of the surplus OPEC funds—approximately \$55 billion this year alone—back into the hands of oil consumers in order to finance further petroleum purchases.

The immediate shock of the OPEC action has been absorbed. Financial markets in Europe and the United States, as well as special lending facilities established by the International Monetary Fund, have been successful in insuring that the short-term deposits of the OPEC nations are rechanneled in the form of long-term loans to most of those nations in need. But we must not be lulled into inaction by this short-term resiliency.

In the end, the overburdened world financial system may crumble. One by one, countries could collapse economically with resulting international bankruptcy. This would hardly be beneficial to the oil producers who are desirous of industrialization, diversification, and trade.

The oil consuming nations cannot survive by merely coping with the present situation. The stated subject of these hearings, recycling petrodollars, can only probably provide a temporary answer at best. What ever means are developed, they can only deal with the problem over a short period.

Instead we need a coherent, long-term strategy to reduce oil prices and lessen the impact of higher prices. The dangers of inaction are clear. The tools for achieving this strategy are few and call for sacrifice by us all.

Withholding industrial and technological goods and services from the oil producing countries, or dramatically raising the prices for such goods and services in retaliation for the OPEC cartel policies invites confrontation that should be avoided.

Vague public threats of political, even military action, if the oil prices menace the fundamental health of the economies of the oil consuming nations are not the answer. Political or military action risk bringing about unforeseen results, and are inconsistent with our objectives to find peaceful solutions to the world's problems. So we must find another approach.

I listened very carefully to the President last night. I certainly agree with the President that our first action should be to all for voluntary restraint. But I almost have the feeling we are calling upon people not to be human beings. I don't really see the measure of determination at the present time among the American people to take broad energy conservation action on a voluntary basis, each individual making a judgment about whether it is right for the country and hoping everyone else is going to do likewise. I am just not sure that exhortations about saving 1 million barrels of oil per day, driving 5 percent less are really enough.

I have come to the conclusion now that a full display of national resolve to reduce our oil needs and a program appropriate for the crisis that we face must be developed and must be developed immediately.

The best way to accomplish this goal most consistent with the statements of the OPEC leaders, is to dramatically cut petroleum consumption. I have talked to the leaders of every single one of the oil producing countries now and all of them say conservation and cutting down this excessive demand by the oil consuming countries must be undertaken to allow reserves to last longer. Certainly it would cut down the horrendous foreign exchange cost to developed as well as developing nations.

I think we have to take decisive action to reduce dramatically petroleum consumption and we have got to begin in this country, which the President rightly said last night. The United States is, after all, the biggest nation of energy waste in the world today and everyone knows it, including ourselves.

In that regard we must make it unmistakably clear that the United States for one really means business about reducing imports and our reliance therefore upon the OPEC countries.

I think we must do it right now. Examples of what I have concluded must now be considered include: I think we ought to move on those very rapidly.

First, I have concluded that we must increase taxes on gasoline with an appropriate tax rebate that can be worked out to relieve hardship. These taxes should be at least sufficient to balance the Federal budget now and hopefully reduce gasoline consumption.

Second, a month-by-month mandatory, steady reduction in petroleum imports so as to reduce by 1976 at the latest present levels of imports by 30 percent. That would mean roughly something like 2 million barrels a day, rather than 1 million as proposed by the Administration. But it would be on a mandatory basis, not a voluntary program that I think will not work.

Third, develop mandatory reductions in gasoline consumption such as imposing at the manufacturers' level a very stiff tax on automobile production on automobiles based upon the mileage those automobiles provide.

Again I take a dim view of our working on a voluntary program hopefully increasing mileage by 40 percent. There is no better way to do it than a step-by-step tax program that provides that if gas-guzzling dinosaurs do not increase their mileage by a certain date then they will be taxed at a very high rate. My auto fuel efficiency bill, which is now in the Senate Finance Committee provides for exactly that.

I think we absolutely must have strict enforcement of the 55-mile per hour speed limit. It is a bill that I put in the Senate. Jennings Randolph cosponsored it and it is now law. It was an unpopular measure at the time. I think increasingly the people realize the necessity for it. We now have the law. Let's enforce that law with stiff penalties for those that break it.

I think we must really move towards something like mandatory, no day, no drive days or day for every American automobile. The option and choice can be the individual's. But a sticker on the back of that car saying "This car cannot be driven on Wednesdays, on Sunday, or whatever it may be, is a flexible system that I think will remove automobiles from the highways with the least possible harm to the economy and individuals.

Fourth, mandatory conservation measures, such as restrictions on commercial and home heating, cooling, lighting, and adoption of insulation standards that would be required for all new construction.

We are wasting heat and cooling by cooling the outer air and heating the outer air with the poor insulation in our homes and I think we simply have to have a stiff regulation of this.

Each of these I recognize presents inequities and risks unintended distortions in the economy. But if the United States assumes leadership among major oil importing nations by sharply reducing oil imports it will be clear to the OPEC countries that we view oil prices as our No. 1 inflationary problem and one which we are committed to solving. It will also encourage the development of alternative, non-petroleum types of energy.

I look forward very much to hearing the testimony of our distinguished witnesses. I trust they will address the question in needs for strong conservation measures however painful they may be.

I also hope that we will learn a great deal about our current international financial policies and fostering the recycling process.

Thank you, Mr. Chairman.
 [The statement of Senator Percy follows:]

STATEMENT OF SENATOR CHARLES H. PERCY

For the past year the oil consuming nations of the world, developed as well as developing, have floundered in a sea of financial and economic uncertainty. A simultaneous downturn in the economies of these nations heightened fears of rising unemployment and zero or declining rates of growth. Raging global inflation continues, even threatens to accelerate. There are growing shortages in worldwide food supplies. Commodity prices have skyrocketed.

The fourfold increase in the price of crude oil engineered by the Organization of Petroleum Exporting Countries (OPEC) is, without question, what has contributed most to international economic instability. The international payment imbalances generated by this cartel administered price of the world's most important energy source were immediate and increasingly ruinous. More than anything else the precipitous nature of this enormous price rise prevented an orderly financial adjustment by the affected nations.

In 1972 the OPEC nations earned \$15 billion from their export of crude oil. The earnings grew to \$25 billion in 1973. In 1974 their estimated receipts will be roughly \$80 billion. The United States alone will pay \$22.5 billion for oil imports from the OPEC nations in 1974, up from \$3.6 billion in 1972 and \$6.7 billion in 1973.

The staggering price rises constitute an enormous "excise" tax on oil consuming nations, rich and poor alike. Some painful adjustments have been made to the new economic and financial realities imposed by OPEC. Worldwide consumption of petroleum has declined slightly in 1974, rather than increasing at 7-10% rate as anticipated. Resulting shortages of certain key products such as fertilizers and petrochemicals have worked a real hardship in many underdeveloped nations. Meanwhile, the fires of inflation have been further fueled. And major adjustments have been made in the international financial structure to facilitate the "recycling" of the bulk of the surplus OPEC funds—approximately \$55 billion this year alone—back into the hands of oil consumers in order to finance further petroleum purchases.

The immediate shock of the OPEC action has been absorbed. Financial markets in Europe and the United States, as well as special lending facilities established by the International Monetary Fund, have been successful in ensuring that the short-term deposits of the OPEC nations are rechannelled in the form of long-term loans to most of those nations in need. But we must not be lulled into inaction by this short-term resiliency. In the end, the overburdened world financial system may crumble. One by one, countries could collapse economically with resulting international bankruptcy. This would hardly be beneficial to the oil producers who are desirous of industrialization, diversification, and trade.

The oil consuming nations cannot survive by merely coping with the present situation. The stated subject of these hearings, recycling petrodollars, can only probably provide a temporary answer at best. Whatever means are developed, they can only deal with the problem over a short period. Instead we need a coherent, long-term strategy to reduce oil prices and lessen the impact of higher prices. The dangers of inaction are clear. The tools for achieving this strategy are few and call for sacrifice by us all.

Withholding industrial and technological goods and services from the oil producing countries, or dramatically raising the prices for such goods and services in retaliation for the OPEC cartel policies invites confrontation that should be avoided.

Vague public threats of political, even military action, if the oil prices menace the fundamental health of the economies of the oil consuming nations are not the answer. Political or military action risk bringing about unforeseen results, and are inconsistent with our objectives to find peaceful solutions to the world's problems.

Thus far the American response has been to seek coordination with our European allies and Japan in formulating stockpiling and distribution programs in the event of another oil boycott. At the same time, long-term programs designed to expand domestic energy supplies and decrease our dependence on energy imports have been initiated. These are hopeful moves. Nonetheless, it is clear to me that little has been done to fashion a tough and coherent domestic energy policy which should have a desirable effect on the OPEC oil prices.

A cornerstone of our domestic energy policy must be energy conservation. To date, oil conservation efforts have been undertaken mainly in response to higher prices. American demand for oil dropped 5% during the first 8 months of 1974.

But there are unmistakable signs that oil consumers are returning to their profligate ways. Thus far token pledges have been substituted for changes in our basic consumption patterns.

While I am all for voluntary conservation whenever possible, exhortations about saving 1 million barrels of oil per day or driving 5% less are not enough. What is needed is a firm display of national resolve to reduce our oil needs and a program appropriate to the crisis we face.

The best way to accomplish this goal, most consistent with the statements of the OPEC leaders, is to take decisive action to reduce dramatically petroleum consumption in this country. In that way, we would make it unmistakably clear that the U.S., for one, means business about reducing imports. And we must do so now. Examples of what must now be considered include:

1. increased taxes on gasoline with appropriate tax rebates to relieve hardships. These taxes should be at least sufficient to balance the federal budget and hopefully reduce gasoline consumption;
2. a month by month mandatory, steady reduction in petroleum imports so as to reduce by 1976 present levels imported by 30%;
3. develop mandatory reductions in gasoline consumption such as imposing at the manufacturers' level stiff taxes based on automobile mileage, *strict* enforcement of the 55 mph speed limit, and mandatory "no drive" day, or days, for every American automobile;
4. mandatory conservation measures, such as restrictions on commercial and home heating, cooling, and lighting and adoption of insulation standards for all new construction.

Each of these presents some inequities and risks unintended distortions in the economy. But if the United States assumes leadership among the major oil importing nations by sharply reducing its oil imports it will be clear to the OPEC countries that we view oil prices as our number one inflation problem and one which we are committed to solve. It will also encourage the development of alternative non-petroleum types of energy.

I look forward to hearing the testimony of our distinguished witnesses. I trust they will address the question of the need for strong conservation measures, however painful they may be. I also hope to learn a great deal about our current international financial policies in fostering the "recycling" process.

Chairman JACKSON. Thank you.

Senator Ribicoff?

Senator RIBICOFF. Mr. Chairman, I would like to excerpt my statement and ask unanimous consent the entire statement be placed in the record.

Chairman JACKSON. Without objection.

[The statement follows:]

STATEMENT BY SENATOR ABE RIBICOFF

The recycling of petrodollars as a solution to exorbitant oil prices is a myth. It is also a vicious recycle. There is no economically or socially acceptable way for the United States to be able to absorb the vast amounts of money being accumulated by the oil-producing countries. And there is no way we can assume the burden of being creditor and banker to all the other oil-consuming nations in Europe and the Third World.

The World Bank has estimated the cumulative build-up of funds by OPEC members at \$650 billion by the end of 1980. Two weeks ago this amount would have purchased all the shares of all the American corporations publicly traded. From 1980 on the oil-producing countries will add to their financial assets at the rate of another \$100 billion a year. What we are talking about then is assets held by OPEC in excess of \$1.2 trillion by the end of 1985. And what we are talking about is a month's revenue from oil by Saudi Arabia buying up control of General Motors. Is it realistic to permit the feudal monarchies of Arabia to buy up the basic industries of the United States while pauperizing the rest of the Western World?

I totally disagree with Treasury Secretary Simon's statement that there is no reason why the strains of the OPEC surpluses cannot be dealt with by the present banking system. Certainly Secretary Simon's recent visit to the Middle East seeking lower prices was a failure. Similarly, Secretary Kissinger's hope for a \$1 a barrel reduction is not a mirage—but a token reduction in price. What costs 10 cents a barrel to deliver to the Persian Gulf should not cost us more than 10

dollars. We must face up to a question of whether we want to continue paying artificially exorbitant oil prices, and financing the debts of the rest of the oil-consuming world at the same time. At a minimum the oil producers should be willing to accept the financial obligations of any creditor, instead of having the United States and West Germany prop up the rest of the Western World. No private financial institution will assume unlimited credit risks. At a minimum the oil producers must cut their prices of oil in half. What has been quadrupled in a year can certainly be halved.

Knocking off the price of oil, \$1 a barrel means absolutely nothing both in the short or the long term.

The solution to this challenge is obvious. In March of 1973 I called on the President to convene a meeting of the oil-consuming nations of the world in order to bargain as a single unit with the oil cartel. Events of the past year and a half have demonstrated the success of divide and conquer strategy of OPEC.

The President's September 18 speech at the United Nations and his remarks 5 days later in Detroit were steps in the right direction. But hesitant steps are no substitute for effective follow through. The only effective follow through at this point would be for the United States to join with Western Europe, Japan, and Canada in planning a common negotiating policy in purchasing oil. In doing this, the United States must be willing to use its superior energy position. Oil imports as a percent of energy use in the United States are less than 9%, while they are 43% for West Germany, 88% for Japan, 43% for the United Kingdom, 70% for France, and 87% for Italy. High oil prices represent a \$45 billion economic burden on our allies and already, countries such as Italy, Greece, Denmark, and Finland—as well as Britain and Japan are running large balance of payments deficits. Italy's \$2 billion emergency loan from Germany is just an indication of where Italy is heading, and where the Western world may be heading—and that is toward bankruptcy and ruin.

It is simply not enough for the United States to go to the oil-producing countries with hat in hand begging for a \$1 a barrel price reduction. Already, some of the oil-producing countries are cutting back on production as demand from the industrialized world has slackened. OPEC is obviously playing for keeps, while we are content to live with ruinous inflation, and the economic ruin of our Allies.

The hearings today will concentrate on the problems caused by the huge amount of petrodollars flowing into U.S. banks and the European dollar market. Undoubtedly, there will be much discussion on the banking problems associated with this massive kind of recycling. The Subcommittee staff has already pointed out that the United States would have to carry a disproportionate share of the risk of the faulty loans. However, what we must come to grips with is not a banking problem. This is a political and economic problem that goes to the roots of our economic well-being and to the basis of our civilization. The Arabs have thrown down the gauntlet to the West, and we must recognize this challenge for what it is. The United States possesses immense resources and great political, and economic power. We must be prepared to use these resources, in an orderly way to bring about the negotiation of significant decreases in the price of oil. If patient negotiation fails, we must not hesitate to use the other resources at our disposal to bring about a reduction in the price of oil by other means.

Any delay in doing what is necessary here only increases the dangers inherent in the one-way flow of wealth from the Western World to the oil-producing nations. It only delays the inevitable.

I shall be listening carefully to see what solutions the witnesses will have for dealing with the petrodollar problem. Without prejudging their testimony, I must say that I would be much surprised if they can offer viable solutions—since the real solutions here cannot be found in the board rooms of financial institutions—but in the actions of heads of Government. What is decided will not only be reflected in the price of fuel, but in the future of Western civilization itself.

Senator RIBICOFF. The recycling of petrodollars as a solution to exorbitant oil prices is a myth. It is also a vicious recycle. There is no economically or socially acceptable way for the United States to be able to absorb the vast amounts of money being accumulated by the oil-producing countries.

There is no way we can assume the burden of being creditor and banker to all the other oil-consuming nations in Europe and the Third World.

The World Bank has estimated that the cumulative buildup of funds by OPEC members at \$650 billion by the end of 1980. Two weeks ago this amount could have purchased almost all of the shares of all the American corporations publicly traded.

From 1980 on, the oil-producing countries will add to their financial assets at the rate of another \$100 billion a year. What we are talking about then is assets held by OPEC in excess of \$1.2 trillion by the end of 1985.

And what we are talking about is a month's revenue from oil by Saudi Arabia buying up control of General Motors. Is it realistic to permit the feudal monarchies of Arabia to buy up the basic industries of the United States while pauperizing the rest of the Western World?

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The Arabs have thrown down the gauntlet to the West; now we must recognize this challenge for what it is. The United States possesses immense resources and great political and economic power. We must be prepared to use these resources in a systematic way to bring about significant decreases in the price of oil.

The real solutions here cannot be found in the board rooms of financial institutions, but the actions of heads of government. What is decided will not only be reflected in the price of fuel but in the future of Western civilization itself.

It seems to me that during the past year too much of our emphasis has been on the question of the production of energy, by Mr. Simon, by Mr. Sawhill, and by the President. We are now talking a little more about conservation.

The problem really is one of consumption. Conservation is the only way we are going to be able, in the short run, to take on this worldwide cartel.

My studies indicate that by the simple act of requiring Detroit to make automobiles that must deliver 20 miles per gallon we would not have an oil or energy problem in the United States.

That doesn't mean there wouldn't be problems in the rest of the world, but as far as the United States is concerned by that simple act you would save enough fuel to be able to have the United States handle its energy problems through its own resources.

We can't sit by and say to Detroit, do what you want, or do it on a voluntary basis, as the President indicated. I think it has to be mandatory. We now have a 55-mile-an-hour speed limit. With this 55-mile-per-hour speed limit, there is no necessity for these huge passenger vehicles cruising our highways to use gasoline at the rate of 7 and 8 miles per gallon.

Think of all that wasted energy, all that wasted power and all of that wasted money. In Europe the average mileage on an automobile is 26 miles per gallon.

If we are talking about a lagging economy, Mr. Greenspan, and you would change the emphasis in Detroit to building 4-cylinder cars for the American people, giving 20 miles per gallon of gas, you would

bring an era of prosperity to the United States, such as we've never seen before.

I think the emphasis by the President, by the Congress, and by those in the manufacturing business, should be on looking at the consumption side instead of the production side.

The only way you are going to beat the Arab oil producers is on the consumption side. When you don't need their damned oil, the price of oil would come down. Supply and demand will play its part.

The problem here is to conceive some realistic programs by the Executive and Congress on a no-nonsense basis. The American people will buy it. The American people will take it. I can't imagine anything better for the economy of the country than to have a program such as that.

Thank you, Mr. Chairman.

[The statement of Senator Huddleston follows:]

STATEMENT OF U.S. SENATOR WALTER D. HUDDLESTON

I commend the chairman of the Subcommittee for scheduling this important hearing on the recycling of petrodollars.

Our current energy crisis is a crisis of finance and economics, rather than one of supply, and it is perhaps more perilous than a crisis of supply only because its proportions are less obvious to us as we go about our daily tasks. Yet, embedded in this financial and economic crisis are the seeds of potential destruction for the world economic and monetary order. That that order has already changed there can be little doubt. Economic power has shifted, and with it an amount of political power as well. Rising oil prices, controlled by a cartel, have heightened the inflationary spiral throughout the industrialized world. There is great uncertainty over the future.

The industrialized nations, as well as many less developed nations remain highly dependent upon the OPEC nations for oil. The United States, in 1974, will import some 30 percent of its crude and some 16 percent of all energy supplies.

For the U.S., the cost of importing that oil is an estimated \$25 billion, not counting any additional increases which may occur or any effort the OPEC nations may make to counter what they perceive as inflationary losses. Furthermore, that \$25 billion represents an increase from \$4.9 billion in 1972 and \$8.5 billion in 1973, and it is expected to reach at least \$43 billion by 1980.

The cost of this imported oil will contribute significantly to what is now expected to be a \$5 billion deficit in the U.S. balance of payments for the year. For the industrialized nations as a whole, the 1974 deficit is expected to run between \$40 and \$50 billion, compared to a \$4 billion surplus in 1973.

Fortunately, the U.S., West Germany and a number of other industrialized nations are expected to be able to meet these difficulties this year without major dislocations, but severe strains are expected for a number of other governments.

The big question is how long nations can hold out.

The development of alternative sources of oil is at best probably five years away. This means that there is little alternative to dependence upon OPEC nations for a certain amount of supplies during that period and that financial and economic problems are likely to plague the world throughout it, unless agreements between producers and users can be worked out.

The cost of imported oil and the resulting deficits in the balance of payments are, however, only the tip of an iceberg of problems.

There is also a question of what to do with the \$60 to \$70 billion surplus which the OPEC countries will build up in this year alone. Some of OPEC's earnings will go for foodstuffs, capital goods, military equipment and producer durables. In fact, it is estimated that OPEC nations will import between \$35 and \$45 billion worth of goods, but there are limits to the goods which these nations can absorb, and reserves will continue to grow.

Some of the OPEC surplus has made its way into the Eurodollar or Euro-currency market, but there are indications that we are approaching the limits to use of that as a recycling facility. Furthermore, in a market highly dependent upon variable interest rates and rapid movements of currency, bankers must be extremely careful that short term deposits do not lead them into precarious loan

positions, especially in view of the fact that many recent Eurodollar loans have gone to government agencies themselves.

Some of the funds are also making their way into domestic financial institutions, leading to questions as to their impact on the U.S. banking and monetary system.

Other funds have gone into industry (such as Krupp steel works in Germany) and real estate (such as the purchase of Kiawah Island off South Carolina).

The problem is that this represents only the beginning.

According to a World Bank study, the OPEC nations may, by 1980, have reserves of more than \$650 billion. The use of that surplus cannot but have a profound impact upon the world financial and economic order.

It is, consequently, imperative that we confront these mammoth problems face to face and seek to devise a comprehensive policy for meeting them. Failure to do so risks not only our own economic and financial stability and our standard of living, but that of the entire industrialized world.

Chairman JACKSON. Thank you, Senator Ribicoff, for a fine statement.

Secretary Simon had been scheduled to join the panel today, but he is in Moscow in connection with certain talks in the economic area, including grain.

We are delighted to have the distinguished panel here. If there is no objection, the chairman will waive the rule of this committee that all of the witnesses be sworn. This is a study. It is not an investigation.

If there is no objection, and the Chair hears none, the rule will be waived requiring that all witnesses who appear before the committee be sworn.

I say to the panelists that, if you can keep your statements shorter than ours up here, you will be doing very well. In the interest of having as much time available for questions, and Senator Percy must leave, as has been explained earlier in connection with an engagement out of town, I hope we can move as fast as possible because I think it is questions and answers here that is going to really count.

We are delighted to have as our first witness the Secretary of Interior, Rogers C. B. Morton.

Mr. Secretary?

STATEMENT OF HON. ROGERS C. B. MORTON, SECRETARY OF THE INTERIOR

Secretary MORTON. Thank you very much, Mr. Chairman. I think it would be best, in the interest of time, if I may include my statement for the record and make a few points primarily responsive to the statements that have been made.

Chairman JACKSON. Without objection, the entire statement will appear at this point.

[The statement follows:]

STATEMENT BY THE HONORABLE ROGERS C. B. MORTON, SECRETARY OF THE INTERIOR

Gentlemen, I am pleased to testify before the Subcommittee. I understand the Committee intends to discuss particular issues, therefore my comments will be somewhat brief.

However, I should summarize some important aspects of the Administration's energy policies. The overall objective of these policies is to insure supplies of energy resources at reasonable prices. The actions of oil producers during the past year have made it impossible to achieve this objective—this year, and perhaps for a few more years.

One-third of our oil, 17 percent of our total energy supply, comes from abroad. Foreign oil is costing the United States \$16 billion more than it did just a year ago.

We must continue our efforts to bring world oil prices down. We encourage energy suppliers to act in a more responsible way; we encourage market forces.

I am aware of the financial flows from oil consumers to producers and back in the form short-term or long-term investments. This uncomfortably increases the likelihood for recessions in particular countries, disruptions of traditional trade patterns and currency instability. I am also aware of the impact on world peace, in the Middle East and elsewhere. The Administration's energy policies are inseparably linked with Secretary Kissinger's current trip to maintain peace in the Middle East and Secretary Simon's current discussions on trade and financial flows abroad.

The United States supports trade, but the ground rules must be agreed upon among trading partners. These ground rules should be based on market forces and not on the wrenching effects of cartels. We fully expect that we will continue to trade energy resources in the years ahead but the policy of the United States will be to reduce dependence upon unreliable sources by 1 million barrels per day by the end of 1975 compared to what it would have been, and more in subsequent years. We will do this by energy conservation and by encouraging development of new sources. The report of newly discovered reserves in Southern Mexico is an example of a promising new source. The reserve of 18 billion barrels could mean 2 million barrels per day added to reliable supplies in a few short years.

Policies to conserve energy

Conservation of energy usage in this country is an important element in the U.S. energy policy. Last week the President initiated a major effort to work with various sectors of our economy towards conservation of energy. This includes working with the automobile industry to significantly reduce fuel consumption next year and in subsequent years.

This includes working with the major energy consuming industries to conserve energy next year and in subsequent years. Commerce Secretary Dent, FEA Administrator Sawhill and I will meet this afternoon with leaders of the chemical, aluminum, steel, petroleum, cement, paper and textile industries to discuss their efforts to reduce energy per unit of output next year and the years ahead.

Energy saving techniques are being explored for commercial buildings and residences across the country. The President mentioned several suggestions in his speech last night.

The President has made a special appeal to regulatory commissions. They should modify their rate structures to discourage energy consumption, not to increase it.

The Federal Government must do its part. The President soon will sign an Executive Order to continue the effort to reduce energy consumption in all Federal activities by at least 15 percent in FY '75 compared to FY '73. The President has asked for an energy saving plan to be developed for FY '76 and beyond.

He called upon the Governors and Mayors across the country to join the Federal Government and cut energy consumption this year.

These cooperative efforts are in the best tradition of Americans working together. They should help achieve our objective, less energy from abroad, 1 million barrels of oil less per day by the end of 1975. However, as the President said last week:

"If all these steps fail to meet our current energy-saving goals, I will not hesitate to ask for tougher measures."

Policy to bring forth additional supplies

The Administration's energy policy also includes major steps to increase the short-run and long-run supply of energy. The Administration has encouraged increased supplies of energy resources by the following actions this year:

- (1) Approximately 2.0 million acres of Outer Continental Shelf lands have been leased so far in 1974, with another 1.4 million to be offered for sale in Louisiana this month.
- (2) Up to 10 million acres is scheduled for leasing on the Outer Continental Shelf in 1975, equivalent to all OCS lands leased from 1954 to 1974.
- (3) Oversight for the rapid construction of the Alaska Pipeline is provided, which will mean 1.2 million barrels per day by mid-1977 and 2.0 million by 1980.
- (4) Eighteen tracts in known geothermal resource areas were leased for initial development and exploration.
- (5) Four oil shale tracts in Colorado and Utah were leased this year to encourage commercial development of oil shale.

The Administration has requested several pieces of legislation. A few have passed the Congress. The President signed into law the Energy Research and Development Administration. This Act will bring our energy research and development under one management. We are working rapidly to bring ERDA into being in the prescribed 120 days. Its leadership should be identified very soon.

The Energy Research and Development Administration created the Energy Resources Council, which the President has asked me to Chair. The Council consists of the Secretaries of Defense, State, Treasury, Commerce, Transportation and Interior, along with the Chairman of the Atomic Energy Commission, the Administrator of the Environmental Protection Agency, the Director of the Office of Management and Budget, the Chairman of the Council of Economic Advisers, the Chairman of the Federal Power Commission, the Chairman of the Council on Environmental Quality, the Executive Director of the Domestic Council, the Director of the National Science Foundation and the Assistant to the President for Economic Affairs. This Council will provide coordination and central focus for the development of energy policy. Several task forces have already been initiated.

Other legislation awaits further Congressional action. A reasonable Surface Mining Control and Reclamation Act is needed and we are hoping the Senate-House Conference Committee will complete action in November. Congressional actions are needed this year in the area of windfall profits tax, nuclear plant licensing, deepwater port siting, amendments to the Clean Air Act, and in decontrol of new supplies of natural gas.

The President has directed that oil now left in the ground in our older fields be recovered by secondary and tertiary techniques. The control program should be modified to encourage such an outcome.

The President directed me to resume coal leasing of Federal lands early in 1975. We are completing the necessary environment and economic studies so that we can do that. The United States is richly endowed with coal resources. Consequently, the President has directed us to develop a plan to lease this abundant resource for new electric power generation facilities. Coal should replace oil and natural gas for this purpose during the 1980's.

The President has directed us to complete plans to bring Alaskan gas to market. We are scheduled to complete our plans and recommend legislation, if needed, by the middle of 1975.

We believe that these actions will help reduce world oil prices. As a review of our experience with other cartels indicates, as reported by a study by the Energy Laboratory at MIT:

"The primary source of breakdown of price controls would likely be the significant additions of supply from either the 'fringe' of OPEC members, or the non-member countries, (including the U.S.) which by self-supply reduce the demands placed upon the low cost Persian Gulf States." This report concludes that if the cartel follows the pattern of the more successful cartels drawn from history, "then it would likely have a 2 to 4-year duration."

Research and development for new sources of energy

For the longer run, additional supplies of energy resources can be provided through investment in research and development. The Administration initiated a \$10 billion, 5-year energy research and development program this year. This program is three times larger than previously projected. In 1974, \$2.3 billion will be spent. Compared with 2 years ago, nuclear fusion research and development will nearly double, coal research and development has grown five-fold, expenditures for secondary and tertiary recovery techniques are up, research and development for oil shale and geothermal have increased ten times.

The Administration's energy policies are broad, but like any set of policies in a rapidly changing world, they may need to be augmented in the future. The President has promised to do this as the need is identified.

Energy policy works with marketplace

The Administration's energy policy is a complement to the actions of the private sector. Market forces bring about very large changes. When prices triple, the incentive to conserve energy is very large, the incentive to bring forth additional supplies is also large. This occurred this year and will continue next year.

This concludes my summary of the Administration's energy policies. I am pleased to reply to your questions.

Secretary MORTON. First, by way of extract from the statement, Mr. Chairman, we have moved. As you know, the President has signed the bill and issued the necessary executive orders for preliminary implementation of the ERDA Act having created the Federal Energy Council, which was mandated by that bill and has included, in addition to those statutory members, the other agencies which include the Administrator of the Environmental Protection Agency, the Director of the Office of Management and Budget, the Chairman of the Council of Economic Advisers, the Chairman of the Federal Power Commission, the Chairman of the Council on Environmental Quality, the Executive Director of the Domestic Council, the Director of the National Science Foundation, and the Assistant to the President for Economic Affairs.

He has asked me to chair the council.

The remainder of my statement deals primarily with actions that have been taken, actions that are underway and the policy framework under which those actions have been developed.

I would like simply to first respond a little bit to both Senator Percy and Senator Ribicoff's statement in which they make some very succinct proposals.

First, on the matter of tax on gasoline, this is a device for raising the price of gasoline. The difference between taxing it and letting it seek its own level in the economy, I think, comes about by reason of the fact that what I think the Senator is proposing is some sort of progressive way that this tax can be redistributed in the economy so that the hardships that are incurred by the taxation are relieved from those people who are at the lower end of the socioeconomic strata, if I am correct in that.

But I want to make sure that we do understand that what the proposal is, is a ways and means of increasing the price of gasoline, which would result in a lower consumption.

The question of lower mandatory imports, I think, is one that should be studied and should be carefully studied. One of the problems that we got into during the embargo, if you will remember, was the inequity that occurred as a result of rationing by inconvenience or unavailability of fuel.

The inequities occurred, for example, in the tourist industry. The question would be raised whether a person in New Hampshire working in a hotel, his job was of the same priority as a person working in a factory in some industrial city.

You have to be awful careful when you cut down arbitrarily on fuel and energy as to what effect you will have in the economy in terms of employment. This is one of the problems I think that you get when you arbitrarily try to manage fuel supplies and arbitrarily cut them down.

The point that I think is raised by Senator Ribicoff and Senator Percy on the miles per gallon takes as an approach of changing the automobile structure by Senator Percy versus the proposition that Senator Ribicoff made, said we should have mandatory gasoline mileage requirements of the manufacturers, I think we have got some other elements into it that should be mentioned.

The miles-per-gallon tax if applied to a generation of cars on the road would have, I think, a very serious effect on people. The very

people that Senator Percy is trying to protect by reason, with the redistribution of the tax on gasoline, because most old cars or second-hand cars which are less efficient and many of them large, are in the hands of those people who need those cars to go to work.

They are the cars that are in second and third owners, who are people who cannot afford to buy a new car, whether it be of the 10-mile-per-gallon type or whether it be of the 20-mile-per-gallon type.

If you pursue the proposition of requiring a mandatory mileage on the part of the automobile companies—I certainly think that this is one that we should study and try to accomplish—you are still dealing with about a 7-year period of time over which this generation of cars that are now on the road would be replaced by these newer, more efficient automobiles.

Senator RIBICOFF. If the Secretary would yield, is that any reason why we shouldn't start now?

Secretary MORTON. No, no reason. I am not opposing that proposition.

Senator RIBICOFF. Because every year you wait, it gets more and more complicated.

Secretary MORTON. You have to start somewhere. I couldn't agree with you more.

Senator RIBICOFF. You have a long-range problem here.

Secretary MORTON. How you do it and what the legislation would look like that would do this, I think, is something that we should discuss.

I can't find any reason why we shouldn't move in that direction. I would conclude by saying that the economic forces are beginning to do some of the things that we are trying to do here.

The increased price has had an effect on the consumption of fuel. The increased price in heating oil has had a considerable effect on the consumption of heating oil, not only in homes, but in factories and in the commercial world.

I couldn't agree more in the terms of reestablishing architectural standards and reestablishing heating standards and cooling standards for buildings.

I would point out that under the present system that we have for building office buildings in the Federal Government which is the dollar down and a dollar a week leaseback system, we have now about 60 giant office buildings under construction or on the planning stage of the United States, for the U.S. Government that are absolutely obsolete before they get off the ground in terms of heating standards and in terms of cooling standards and energy use.

We have allowed things to take place like the World Trade Center in New York, which is catastrophic in terms of energy use and in its cooling and heating systems.

So I feel that we have got to get a handle on this. In the short term, I must agree with you, Senator Ribicoff, that the only thing we have to deal with quickly is a change in consumption levels.

I think we have to put a time frame to quantify the areas in which these accomplishments can be made, so that they have the least effect on employment and have the least dislocation in the economy.

I can assure you that the Federal Energy Agency, our Department and other departments, Department of Commerce and other agencies

that have to do with this problem, are working night and day to try to bring solutions before this Congress and recommendations to the President that will accomplish the very things that you are trying to do with a minimum of dislocation and impact in the society and the economy.

Chairman JACKSON. Thank you, Secretary Morton.

We are delighted to have the Chairman of the Council of Economic Advisers, Mr. Alan Greenspan.

If you can summarize your statement, we will appreciate it. The entire statement will go in the record.

STATEMENT OF ALAN GREENSPAN, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Mr. GREENSPAN. Thank you. I would like to cover a few aspects of the subject which may not be covered by the remaining panelists.

I do request that the remainder of my remarks be submitted for the record.

[The statement follows:]

STATEMENT OF ALAN GREENSPAN, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

The Council's presentation will focus on the broader aspects of the financial and economic consequences of the large increase in the price of crude oil— aspects that at times tend to be overlooked in discussion of the so-called "energy crisis."

First, let me sketch out the broad dimensions of the problem and how it developed.

With the price of oil relative to other sources of energy remaining low over many years, oil became closely integrated into the industrial structure of the world. Oil represents between 50 and 80 percent of all energy sources used by individual industrial countries today. In the United States the compound annual rate of growth of oil consumption was 4.1 percent between 1950-1972, it was 11.1 percent in France, 16.6 percent in Germany, and 24.0 percent in Japan. In Western Europe as a whole, consumption grew at a 11.5 percent compounded annual rate between 1950 and 1972, in the Far East it grew at 14.3 percent, in Latin America at 6.9 percent, in Africa at 7.7 percent and in the Middle East by 8.0 percent. Total world consumption of crude oil ran at about 58 million barrels per day just prior to the energy crisis last year and the OPEC countries were supplying about 56 percent of that consumption.

In no small measure, the relative stability of world oil prices was the result of the dominant position of the United States as an oil producer and potential supplier. Prior to the late 1960's and extending back to the early part of the twentieth century, the United States was the marginal supplier of crude oil, at least on an emergency basis, to fill gaps elsewhere caused by supply disruptions. For example, during the Middle East war of 1967, and prior to that during the Suez crisis in 1957 and Iranian Oil nationalization crisis of 1951 the United States was able to supply the world's needs as shortages developed. The existence of surplus capacity, the relatively moderate world import needs, and the resultant capability to be marginal supplier also meant that it was U.S. crude oil which set the world crude price. The Texas Gulf price essentially was the price standard for the rest of the world.

However, as oil consumption grew at a prodigious rate, the development of new petroleum sources in the United States lagged and reserves began to dwindle. In 1950, U.S. consumption of petroleum products amounted to about 5.8 million barrels per day. By 1965, consumption was up to 11.3 million barrels per day, and in 1972 it was almost 16 million. As a result, our capacity to enlarge production quickly also dwindled.

These developments removed the United States as an effective supplier of crude oil during emergencies and, in effect, moved the locus of world crude oil price determination from the Texas Gulf to the Persian Gulf. It was this development that made the OPEC cartel, in existence since September 1960, a viable institution of price setting in recent years. Prior to 1970 when the United States

always stood ready to augment world crude oil availability on an emergency basis at least, control of production in the Persian Gulf (and, by extension, in the rest of the OPEC countries) was not a real threat. With the disappearance of our surplus capacity it soon became apparent to the Persian Gulf producers that extraordinary power to determine the level of crude oil prices had moved into their hands.

While between 1960 and 1970, the payments to oil producers per barrel increased only very gradually, posted price, and thus the "take" started to rise sharply in early 1971. In January, 1971 the posted price of the Saudi Arabian crude was \$1.80 per barrel. Thereafter, the prices moved as follows:

February 15, 1971	-----	\$2. 18
January 20, 1972	-----	2. 48
January 1, 1973	-----	2. 59
October 16, 1973	-----	5. 12
January 1974	-----	11. 65

As prices began to rise there was little resistance possible by the United States and the OPEC countries kept experimenting with higher prices and nationalization, continuously reaching for how far they could proceed. This contributed to the onset of the dramatic embargo of 1973, the tremendous increase in crude oil prices and the so far successful effort to hold production down enough to maintain prices.

Let me now turn to some of the economic consequences of this price rise.

At current price¹ and production of crude oil levels it is estimated that the OPEC countries will receive about \$105 billion in revenue from the sale of oil in 1974 and an additional \$5.0 billion income from sale of nonoil goods and services bringing total revenue of the OPEC countries in 1974 to an estimated \$110 billion, compared with about \$30 billion last year. Total revenue in 1975, has been estimated at about \$125 billion.² In addition, income from investments will probably add \$5.0 billion in 1974 and \$10.2 billion in 1975 to this total.

On the expenditure side, in 1973 the OPEC countries purchased about \$28 billion of goods and services. In 1974 such purchases are expected to rise to \$45-\$50 billion, and in 1975 to \$65-\$70 billion. Grant aid of the oil producing countries has been estimated at about \$3-\$5 billion per year in 1974 and 1975.

The arithmetic of the receipts and payments leaves a current account surplus of the OPEC countries of about \$60-\$65 billion in 1974 and 1975. There is, however a lag between the time that oil liabilities are incurred and payments are made. Consequently, the actual current account according to U.S. treasury estimates will be \$55 billion in 1974.

These current account surpluses, in effect, represent the amount of funds "left over" to the oil producers, given the current levels of world consumption of their products, the current prices, and their current capacity to spend their revenues on goods and services purchases from the rest of the world. The current account surpluses also, represent the amount of "borrowing" the oil consuming nations will be undertaking from the oil exporting countries to finance their current level of consumption of oil. The two are of course equal.

The "borrowing" takes the form of deposits, purchases of short-term money market instruments, bonds, stocks, or even purchases of real investment such as factories and real estate. The oil consuming nations *as a group* will borrow from the oil exporting countries the funds transferred to them in payment for oil and not used to purchase goods and services. The borrowings transfer claims on the wealth of the importing countries to the oil exporters. It must be kept clearly in mind that the aggregate amount of "borrowing" by the importers is solely determined by the oil import bill and the level of consumption of imported goods and services by the oil exporting nations. If one country tries to reduce the amount of its "borrowing" by, for example, increasing its exports to countries other than OPEC, then other countries in the group will simply be forced to increase their indebtedness.

This debt in the aggregate is, in effect, a mortgage taken up by the oil importers to support their current level of economic activity. The actual consumption of goods and services by the oil importing countries has not been altered initially,

¹ The average current price of the OPEC crude oil, f.o.b. Persian Gulf has been estimated at \$9.516 per barrel. This average includes the "equity oil" (40 percent of production) and "participation oil" (60 percent of production) prices, as well as taxes and royalties but not the profits of oil companies which are estimated at 40¢-50¢ per barrel. Effective October 1, the average price is to rise to an estimated \$9.845 per barrel.

² Estimated by Morgan Guaranty Trust Co. on the assumption of 3-4 percent rise in oil consumption over 1974 (which is estimated to be somewhat below the 1973 level) and a 5-percent rise in the price of oil.

except to the extent they have reduced their consumption of oil. Part of that consumption is being financed by the sale and/or mortgage of some of the productive wealth of the oil-importing economy. Wealth is measured by its yield and the transfer of yield will not occur until some future time when the capacity of the oil importing countries to consume is increased and goods and services are transferred from oil consumers to oil producers in payment of the debt.

The magnitude of the future transfers implied by the existing levels of oil consumption and prices would be of such dimensions as to pose eventually a highly explosive political problem for the world. To reduce that problem, we should put our minds to the best methods of promoting the development of alternative energy sources, remembering that the present price charged by any rational seller of an exhaustible resource is highly sensitive to the price at which in his appraisal rival products will be available in the future. After all keeping the price up requires the seller to hold more oil in the ground for future extraction.

Under existing institutional arrangements two things seem reasonably sure. Oil consumption per dollar of real GNP worldwide will continue to decline partly because the impact of higher prices on consumption is not yet complete and probably will not be complete for several years as oil users attempt to reduce energy consumption and to displace oil with other sources of energy. We have already seen a considerable amount of adjustment yet this process takes many years before facilities and production processes, some of which require substantial capital investment, fully adjust to the new energy price reality. Obviously this adjustment in consumption will also tend to put downward pressure on world oil prices. The slowing in oil consumption will be accelerated where the financing problems are most severe. Obviously unless consumption patterns can be adjusted quickly economic growth is likely to suffer if it becomes extremely difficult or impossible to finance imports of oil. There are considerable possibilities for conservation in oil use without dramatically affecting levels of production and employment but there is of necessity a limit to this, especially in those countries where oil is the major energy input and where, for example, an only relatively small part of total oil consumption is gasoline or other less essential use.

It is, of course, possible that the adjustment process may be sufficiently rapid to reduce oil consumption without significantly disrupting world industrial production levels. The probabilities, however, of such an outcome cannot be considered high. The more likely adjustment is a decline in economic activity until oil consumption falls sufficiently to be financed. Reduced consumption and/or lower prices are the key to reducing the magnitude of the long-term problem. In addition to the "real" burden imposed upon the importing countries as a whole there are some serious short-term problems.

The oil exporters as a whole must place their surplus funds in the oil consuming world but they clearly have a choice as to the particular countries in which they place these funds. Part of the recycling problem is to transfer the funds from the countries to whom the oil exporters chose to lend to countries to whom the exporters do not choose to lend. The oil exporting countries have not been willing to lend to customer-countries they do not consider to be sufficiently credit-worthy. Furthermore, they have been reluctant to lend in other than short-term commitments. This creates a problem of intermediation between short-term lenders and long-term investors and raises the question of who should accept the risks which are imposed by the inflated oil prices on the one hand, and the fact that some countries, for other reasons, are not regarded as being sufficiently credit-worthy by the oil exporters.

This is a pressing problem. No one should regard the less credit-worthy countries as "expendable". Nonetheless no country can guarantee that funds will be found to protect the countries of the world from the consequences of their oil bills and the other policies they may adopt.

A good deal of recycling has taken place through the private financial system under the influence of market forces. However, the problem is not seen as fully solved and the need for so-called multilateral recycling by official institutions is a topic of wide discussion. It is often argued that the United States, as the most important prospective recipient of borrowed oil funds, should become the major conduit through which guaranteed debt instruments can be offered to the oil exporting countries so as to relend these funds to help meet the import financing requirements of other less-creditworthy oil consuming countries. But these suggestions mean that the United States incur guaranteed debts in order to make soft loans and acquire high risk instruments. If we are to go in this direction foreign grants or subsidies to enable others to purchase crude oil should not be masked in the guise of a sound financial recycling loan arrangement.

In conclusion we are confronted with an extremely complex problem with many dimensions to which there is no single solution. But one thing is clear, we can make significant progress on a broad front in dealing with all these problems through a credible and determined effort to develop additional sources of energy and to conserve those we now possess.

Mr. GREENSPAN. Over a number of years the relative level of oil prices has been quite stable. This relative stability was largely the result of the dominant position of the United States as an oil producer and potential supplier.

Prior to the late 1960's and extending back to the early part of the 20th century, the United States was the marginal supplier of crude oil at least on an emergency basis to fill gaps elsewhere caused by supply disruptions.

For example, during the Middle East war of 1967, and prior to that, during the Suez crisis in 1957, and the Iranian oil nationalization crisis of 1951, the United States was able to supply the world's needs as shortages developed.

The existence of surplus capacity, the relatively moderate world import needs and the resultant capability to be marginal supplier also meant that it was the U.S. crude oil which set the world crude price. The Texas gulf price essentially was the price standard for the rest of the world.

However, as oil consumption grew at a prodigious rate, the development of new petroleum sources in the United States lagged and reserves began to dwindle. As a result, our capacity to enlarge production quickly also dwindled.

These developments removed the United States as an effective supplier of crude oil during emergencies and, in effect, moved the locus of world crude oil price determination from the Texas gulf to the Persian Gulf.

It was this development that made the OPEC cartel, in existence since September 1960, a viable institution of price setting in recent years. Prior to 1970 when the United States always stood ready to augment world crude oil availability on an emergency basis at least, control of production in the Persian Gulf (and, by extension, in the rest of the OPEC countries) was not a real threat. With the disappearance of our surplus capacity, it soon became apparent to the Persian Gulf producers that extraordinary power to determine the level of crude oil prices had moved into their hands.

While between 1960 and 1970, the payments to oil producers per barrel increased only very gradually, posted price, and thus the "take" started to rise sharply in early 1971.

There was little resistance possible by the United States and the OPEC countries kept experimenting with higher prices and nationalization, continuously reaching for how far they could proceed.

This contributed to the onset of the dramatic embargo of 1973, the tremendous increase in crude oil prices and the so far successful effort to hold production down enough to maintain prices.

Mr. Chairman, I will end my formal remarks of that and, of course, be open to any questions that you have at a later time.

Chairman JACKSON. You raise some very good points.

John C. Sawhill, the Administrator of the Federal Energy Administration. Dr. Sawhill?

STATEMENT OF JOHN C. SAWHILL, ADMINISTRATOR, FEDERAL
ENERGY ADMINISTRATION

Mr. SAWHILL. Thank you very much, Mr. Chairman.

This is quite an appropriate time, I believe, to be conducting these hearings, since it was about 1 year ago today that the Arab oil embargo began and probably the reasons that we are sitting here are the ramifications that that embargo has had.

You may recall that when I last appeared before this subcommittee, I pointed out in my witness statement that the old international oil supply arrangements are dead whereby most of the oil in world trade was obtained through the concessionary system.

The role of the giant international companies is clearly far different today than it was previously. While they still retain a very sizable logistics capability and marketing outlets commensurate to the needs of producers and consumers alike, the companies can no longer set prices or determine volumes.

It seems to me that this is a very significant development, one that we are studying in the Federal Energy Administration and one that we will be coming forward to the Congress with recommendations on shortly; that is, the relative role that the Federal Government should now play, given this change in the status of international oil companies.

However, this is only one important ingredient in a very rapidly changing international picture. Given the enormous costs associated with the failure of nations to deal with the current price of international oil and its effects on the world system of trade and payments, I believe that it is important for us to keep under constant review all of the options available to us.

We need cooperative action between and among consumers and producers which will assure for all consumers a secure supply of oil in adequate quantities at reasonable prices.

In this regard, I do not believe that simple discussions of supply and demand for energy will yield compelling insights into what the price of international oil should be. Instead, I believe the time has come to move the discussion into a place where the economic and the political issues blend together.

In doing so, we shall acknowledge that the appropriate topics for discussion are the objectives of the people and governments of both producing and consuming countries, and the most constructive manner in which those aspirations may be achieved.

Obviously, as both Senator Ribicoff and Senator Percy have pointed out, part and parcel of any approach must be a serious U.S. conservation effort which husbands our resources prudently, coupled with serious programs to stimulate domestic production of energy.

As I believe several of us have pointed out previously, there is very little we can do to increase domestic production in the short term, other than opening up the Naval Petroleum Reserve No. 1.

I don't see any near term possibility for expanding production and, as a matter of fact, our studies show that oil production will probably decline in this country, at least through 1977. The decline that began in 1970.

Coal production can increase and will increase, but we really can't make any major gains on the supply side. So we must make gains on the demand side.

The President, in his economic address to the Congress on October 8, recognized the importance of curbing consumption and called for a reduction in foreign oil imports by 1 million barrels per day by the end of 1975.

Before discussing this further, I might give you some figures by way of background. At present we are importing 6 million barrels per day, of which 4 million barrels are crude and 2 million barrels are finished product.

Our refiners are operating at about 90 percent of capacity, which is a level of about 13 million barrels per day. At the moment, they absorb 9 million barrels per day of domestic and 4 million barrels per day of foreign crude.

Total petroleum demand is now running between 15 million and 16 million barrels per day. If our objective is to reduce imports by 1 million barrels per day, we cannot expect to accomplish it all by reduction in crude oil, since half of the burden would fall on the transportation sector alone.

At the same time, we cannot cut just products, since virtually the whole burden would fall on the users of distillate and residual fuels. What is called for, obviously, is a blend.

Conservation must become the way of life, not only for individual homeowners and motorists, but also for business and corporate leaders and enterprises.

In addition, we have to make the swiftest possible changeover of powerplants from oil to coal to greatly reduce our dependence on imports of foreign residual fuel oil.

Much interest in recent weeks has been expressed in the so-called French Plan. That is, the fixing of a maximum level of foreign exchange that will be made available for imported oil with consequent pressures for setting priorities for consumption of available oil.

If the United States were to consider this option as well, we would be required to establish a maximum dollar figure for oil imports and open up our market for bids. The success of such a plan, however, obviously depends on the degree to which crude oil sellers, either private companies or national governments, are willing to enter the bidding contest.

There is certainly no indication at this time that producer governments would rush in with significant quantities of crude that would result in lower international prices.

Whatever we ultimately decide to do, I believe the time is now for all to think carefully of the various ways in which producers and consumers can either individually or in concert move to a resolution of our current problem.

I believe, Mr. Chairman, that we must review again the statements of the leading exporting countries to assure them that we are indeed listening. For example, we must recognize that while there are hazards in probing the question of indexed prices for petroleum because this premise may then spread to other commodities, there are also serious dangers and potential costs to be incurred if we do not give very careful thought to such an approach to price—an approach frequently mentioned by them.

In addition, some of these producing States have long urged that they be given special access to the U.S. market for sale of their own agricultural or industrial products in return for their oil.

Most such States will search for ways of guaranteeing their own overseas investments from inflation—in return for some arrangements for their oil.

Industrialized nations—ourselves included—have often shied away from such relationships believing them to be unnecessary or harmful to the freer movement of trade. This entire problem of establishing better relationships with producing countries is complicated.

In FEA, we have established a special task force to take a new look at this old problem in the hopes that some means can be found for better assuring our energy supply.

What are the aspirations of the producer countries in terms of their economic development? Their desire for access to industrial markets? Their desire to learn and apply American technology?

In the last analysis, if the high price of oil is the wrong way for Indonesia, Iran, and Nigeria to lift their people out of poverty, have we given adequate thought to suggestions for a right way?

From their viewpoint, oil may indeed prove to be their resource of "last resort." But we must find ways of persuading them that they are as much members of the international economic community as we are, and that the value of their resource depends upon its consumption.

I do not share the view of some who would argue that conversations on price may institutionalize the current price. That price is already there, and I am impressed by the need to deal with it in a broader economic and political context than we have to date.

I do not believe either that we should bring preconceptions to the kind of forum in which these matters would be discussed. I do believe that we should once again review all of the possibilities which have been suggested by both producer and consumer countries as to how we can, in a spirit of cooperation, so array the interests of all participating countries as to establish a stable long term relationship.

The timing and content of such an effort must very largely be the decision of the Secretary of State, obviously.

The importance of the options just discussed, however, does not lie simply in the expectation that the producer countries might respond to such actions on the part of the United States unilaterally, or in concert with consuming nations, by lowering price—indeed faced with reduced demand they might simply reduce production to maintain price.

The significance lies in a renewed national, and one may hope international, commitment to do something about the energy balance-of-payments.

The central issue that we have previously discussed for solving our energy problem is a vigorous and effective conservation program. The President has given us an ambitious target. He has said that he will ask for stronger action, if necessary.

I think this is an important point. The President has asked for a voluntary program by and large, but he has not hesitated to say that if mandatory steps are needed, if our voluntary approach does not appear to be achieving the million-barrel-a-day reduction that he has called for, that we must move further, under the leadership of Secretary Morton on the Energy Resources Council.

I think we are prepared to consider some of the additional suggestions that have been presented this morning.

In conclusion, Mr. Chairman, I would like to point out that as we all know the events of the past year have been harrowing to all of us.

In the consuming countries we have watched as deficits ballooned and our apprehension has deepened as we have considered the implications of continued mounting of debt. Will there be large-scale default? Will rescheduling of debt become the future order of the day?

What are the implications of this for our monetary system and financial institutions? Will such schemes for the wholesale recycling of producer government investments in favored countries come to mean only the piling up of debt on debt on a scale unprecedented in modern times?

Can we expect a small number of governments alone to assume responsibility for lending back to importers what they need to pay for their high-priced oil imports?

What could possibly be the outcome for such a course except the overloading of an already strained financial system? Granted, there are assorted devices and mechanisms to help move funds but as long as the price of oil remains so very high the danger to all—producers and consumers—of a loss of confidence in the adequacy of our mechanisms must be of common concern to all of us.

Isn't it becoming clear the United States cannot, and ought not, to be the world's banker; and equally clear that producing countries must accept more direct responsibilities?

These are clearly major preoccupations, but we must in candor ask ourselves if the great consuming nations have been as attentive to the proposals of the producer countries to solve their problems as they have been to their own proposals.

Have we really been listening? Have we given as serious consideration to the proposals of the producers as we wish them to give to ours? In summary, we are really experiencing another strategic transformation in the relations between states, a transformation which began after World War II in which the one-time colonial relationship of raw material producers underwent fundamental change.

It is essential that all of us begin to think in new terms—terms not of one-sided advantage but of common benefit. What I am asking today is that all of us once again stretch our imaginations, discard our prior conclusions and review carefully all of the various ways suggested by producers, as well as ourselves, in which we can deal with this problem.

Clearly, the cost of not doing so is enormous.

Thank you very much.

[The statement follows:]

STATEMENT BY JOHN C. SAWHILL, ADMINISTRATOR,
FEDERAL ENERGY ADMINISTRATION

Mr. Chairman, distinguished members of the committee, ladies and gentlemen: It was a year ago today that the Arab States placed an embargo on oil which set in train a series of events which have permanently changed the world.

I wish to thank you, Mr. Chairman, and the members of the subcommittee for the invitation to appear once again to discuss some of the profound consequences of that action.

We reacted to the embargo in four rather distinct contexts. The sequence of our reaction was determined by the immediacy of our problems.

Quantity was the first and most pressing issue. With a vast industrial complex to fuel and winter descending, we had to find out how much energy we had, and determine how much each of us would therefore get. A physical demand had to take top priority.

At the same time, the security of our petroleum supply became the second in our priority of concern. That has resulted in the development of Project Independence. We expect to develop a blueprint in November which will serve as a basis for a report to Congress as mandated in our legislation and aiming toward a comprehensive energy plan. The design and implementation of that effort was and remains a major preoccupation of the Federal Energy Administration. Energy security is at the heart of national security.

Third, as the embargo continued, the price pressures which shortages naturally bring about created the opportunity upon which OPEC seized in December of last year to establish a price which was triple that of the previous year. The impact of that action has been felt in every home of the United States. The price consideration has now assumed a predominance in our concern.

Finally, the impact of the new prices for oil upon other countries, industrial and other, has become a matter of grave concern. Even if we could totally secure our own position and insulate ourselves from these prices which have been established by OPEC, our welfare is inextricably bound up with that of the rest of the world and the system of trade and payments which has been so carefully erected since World War II. The destruction of that system would affect the welfare of every American.

The legislation establishing the Federal Energy Administration charges me with assuring a secure supply of energy for the United States and with the development of an energy import policy in coordination with the Secretary of State which is consonant with our congressional mandate.

It is in that context that I am appearing before you today to testify on the penetrating questions which the Chairman has forwarded to the extent that our Charter and resources in FEA allow. I would also like to pursue further some of the thoughts which I expressed to the subcommittee when I was last invited to testify on September 18, 1974.

You may recall, Mr. Chairman, that when I last appeared before the subcommittee I pointed out in my witness statement that the old international oil supply arrangements are dead, whereby most of the oil in world trade was obtained through the concessionary system. The role of the giant international companies is clearly far different today. While they still retain a very sizable logistics capability, and marketing outlets commensurate to the needs of producers and consumers alike, the companies can no longer set prices or determine volumes. Nor can they offer any assurance of durability in their contracts. This is a truly extraordinary change. Its implications to all governments—including our own—require that most careful thought be given as to how we can best assure our needs are met—what is the most effective role for government and private industry. We have undertaken a study of these options and believe it will be useful to all concerned.

However, the role of companies is only one important ingredient in a rapidly changing picture. Given the enormous costs associated with the failure of nations to deal with the current price of international oil and its effects upon the world system of trade and payments, I believe that it is important for us to keep under constant review all of the options which are available to us. We need cooperative action between and among consumers and producers which will assure for all consumers a secure supply of oil in adequate quantities at reasonable prices.

In this regard, I do not believe that simple discussions of supply and demand for energy will yield compelling insights into what the price of international oil should be. Instead, I believe that the time has come to move the discussion into a place where the economic and the political issues blend. In doing so we shall acknowledge that the appropriate topics for discussion are the objectives of the people and governments of both producing and consuming countries, and the most constructive manner in which those aspirations may be achieved.

Part and parcel of any approach however, must be a serious U.S. conservation effort which husband our resources prudently, coupled with serious programs to stimulate domestic production of energy.

The President, in his economic address to the Congress on October 8, recognized this need and called for a reduction in foreign oil imports by one million barrels per day (1 MMB/D) by the end of 1975. Before suggesting ways this might be accomplished, let me provide some rough figures by way of background.

At present, the U.S. imports approximately 6 mmb/d, 4 mmb/d of crude oil and 2 mmb/d of finished products. United States refineries, operating at 13 mmb/d of 90 percent of capacity at the moment, absorb 9 mmb/d of domestic and 4 mmb/d foreign crude. Total petroleum demand in the United States is between 15 and 16 mmb/d. Refineries in the United States, unlike their European and Japanese counterparts, have high percentage yields of gasoline, over 50 percent. As a result, U.S. imports of gasoline are insignificant. Residual fuel makes up about 60 percent of our product imports.

If our objective is to reduce imports by 1 mmb/d, we cannot expect to accomplish it all by reductions in crude oil, since half of the burden would fall on the transportation sector alone. At the same time, we cannot cut just products, since virtually the whole burden would fall on the users of distillate and residual fuels; i.e., private homes, commercial and industrial establishments, and power plants.

What is called for, obviously, is a blend. Conservation must become the way of life, not only for individual home owners and motorists, but also for business and corporate leaders and enterprises. Refinery yields must be altered to the degree possible to permit maximum crude runs—crude imports being cheaper than product imports—while still reflecting reduced gasoline demand. The swiftest possible changeover of power plants from oil to coal will greatly reduce our dependence on imports of foreign residual fuel oil.

Much interest in recent weeks has been expressed in the French Plan—the fixing of a maximum level of foreign exchange that will be made available for imported oil with consequent pressures for setting priorities for consumption of available oil. If the U.S. were to consider this option as well, we would be required to establish a maximum dollar figure for oil imports and open up our market for bids. The success of such a plan, however, obviously depends on the degree to which crude oil sellers, either private companies or national governments, are willing to enter the bidding contest. There is certainly no indication, at this time, that producer governments would rush in with significant quantities of crude that would result in lower international prices.

Whatever we ultimately decide to do, I believe the time is now for all to think carefully of the various ways in which producers and consumers can either individually or in concert move to a resolution of our current problem.

I believe, Mr. Chairman, that we must review again the statements of leading exporting countries to assure them that we are indeed listening. For example, we must recognize that while there are hazards in probing the question of indexed prices for petroleum because this premise may then spread to other commodities, there are also serious dangers and potential costs to be incurred if we do not give very careful thought to such an approach to price—an approach frequently mentioned by them. In addition, some of these producing states have long urged they be given special access to the U.S. market for the sale of their own agricultural or industrial products in return for their oil. Most such states will search for ways of guaranteeing their own overseas investments from inflation—in return for some arrangements for their oil. Industrialized nations—ourselves included—have often shied away from such relationships believing them to be unnecessary or harmful to the freer movement of trade. This entire problem of establishing better relationships with producing countries is complicated. In FEA, a section of International Energy Affairs is undertaking a new look at this old problem in hopes some means can be found for better assuring our energy supply.

What are the aspirations of the producer countries in terms of their economic development—their desire for access to industrial markets—their desire to learn and apply American technology?

In the last analysis, if the high price of oil is the “wrong” way for Indonesia, Iran and Nigeria to lift their people out of poverty, have we given adequate thought to suggestions for a “right” way? From their viewpoint, oil may indeed prove to be their resource of “last resort”. But we must find ways of persuading them that they are as much members of the international economic community as we are and that the value of their resource depends upon its consumption.

I do not share the view of some who would argue that conversations on price may institutionalize the current price. That price is already there, and I am impressed by the need to deal with it in a broader economic and political context than we have to date.

I do not believe either that we should bring preconceptions to the kind of forum in which these matters would be discussed. I do believe that we should once again review all of the possibilities which have been suggested by both producer and consumer countries as to how we can, in a spirit of cooperation, so array the

interests of all participating countries as to establish a stable long-term relationship. The timing and content of such an effort must very largely be the decision of the Secretary of State. But any part of government with significant responsibilities in energy must be involved in the process.

The importance of the options just discussed, however, does not lie simply in the expectation that the producer countries might respond to such actions on the part of the United States unilaterally, or in concert with other consuming nations, by lowering price—indeed faced with reduced demand they might simply reduce production to maintain price. The significance lies in a renewed national, and one may hope international, commitment to “do something” concrete now about the energy balance of payments and dependence on imported oil. In the longer run, we can, as the Project Independence Blueprint will suggest, reduce our vulnerability to foreign political and economic coercion through conservation and development of new energy resources. What is needed now is a demonstration by this country that it can reduce its consumption of oil today through restraint, more efficient energy utilization, and switching to coal. Whether or not other consuming countries join our effort and thereby augment a significant surplus of crude production capacity in producing countries, and whether or not a significant excess results in lower international oil prices can be debated. A national commitment by us today, however, will help us tomorrow, and the days after that, as we strive to solve the energy crisis and reduce our dependence on imported oil.

The central piece of a national commitment to solve our energy problem is a vigorous and effective conservation program. The President has given us an ambitious target. He has said he will ask for stronger action if necessary. We must, therefore, have additional programs held in readiness in case present programs evoke a lesser response than we anticipate.

Mr. Chairman, the events of the past year have been harrowing to all. In the consuming countries we have watched as deficits ballooned and our apprehension has deepened as we have considered the implications of continued mounting of debt. Will there be large scale default? Will rescheduling of debt become the future order of the day? What are the implications of this for our monetary system and financial institutions? Will such schemes for the wholesale “recycling” of producer government “investments” in favored countries come to mean only the piling up of debt on debt on a scale unprecedented in modern times? Can we expect a small number of governments to alone assume most of the responsibility for lending back to importers what they need to pay for their high-priced oil imports?

What could possibly be the outcome for such a course except the over-loading of an already strained financial system? Granted, there are assorted devices and mechanisms to help move funds but as long as the price of oil remains so very high the danger to all—producers and consumers—of a loss of confidence in the adequacy of our mechanisms must be of common concern. Isn't it becoming clear the U.S. cannot—and ought not to be the “world's banker”—and equally clear that producing countries must accept more direct responsibilities?

These are clearly major preoccupations, but we must in candor ask ourselves if the great consuming nations have been as attentive to the proposals of the producer countries to solve their problems as they have been to their own proposals. Have we been listening? Have we given as serious consideration to the proposals of the producers as we wish them to give to ours? In summary, we are really experiencing another strategic transformation in the relations between states, a transformation which began after World War II in which the one-time colonial relationship of raw material producers underwent fundamental change.

It is essential that all of us begin to think in new terms—terms not of one-sided advantage but of common benefit, the current terms of trade for petroleum products pose a series of global challenges which, in addition to an inflation which was already precarious prior to the increase in the price of oil, are straining our economic and political systems. Not only the industrial nations of the world are suffering; indeed the most severely affected are those developing nations which can least afford the devastating costs of petroleum, fertilizer, and petrochemicals. The debt burden of nations is already staggering, and no genuine relief is in sight.

What I am asking today is that all of us once again stretch our imaginations, discard our prior conclusions and review carefully all of the various ways suggested by producers as well as ourselves, in which we can deal with this problem. The cost of not doing so is enormous.

Chairman JACKSON. Thank you very much, Dr. Sawhill. We appreciate having your statement.

[At this point Senator Huddleston entered the hearing room.]

Chairman JACKSON. Senator Huddleston, did you want to make a comment now?

Senator HUDDLESTON. I will just put a statement in the record, Mr. Chairman.

Chairman JACKSON. All right. It will come in at the beginning of the hearing, right after Senator Ribicoff's statement.

Our final witness on the panel is Henry C. Wallich, member of the Board of Governors of the Federal Reserve System, representing the Federal Reserve.

I understand the Chairman is out of the country.

STATEMENT OF HENRY C. WALLICH, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. WALLICH. Mr. Chairman, he regrets to be unable to be here. He is going out of the country.

Chairman JACKSON. We are delighted to welcome you to the committee. You have your statement. If you choose to summarize, the entire statement, of course, will go in the record as read.

[The statement follows.]

PREPARED STATEMENT BY HENRY C. WALLICH, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. Chairman and Members of the Subcommittee: I am happy to respond to your request for comments on the wide range of issues involved in dealing with the inflated cost of oil. Your questions established a broad framework for this discussion and I will generally follow their order in responding. I intend to concentrate, however, on those aspects of the problem that fall most clearly within my knowledge, and the responsibilities of the Federal Reserve.

Your first set of questions relates to the financial and economic consequences of importing oil at current OPEC prices. Much has already been said about the severe direct economic impacts of the enormous sudden jump in oil prices imposed by the OPEC countries. These consequences would be severe at any time, but they are especially disruptive now because they add very significantly to the inflationary pressures generated by the worldwide boom that got started in 1972. Moreover, the need to adjust to these higher payments increases the possibility of recessionary tendencies in particular countries, and because of the disruption of balance of payments and threats of currency instability, interferes with progress toward a better basis for the world's monetary system.

The dangers of escalating inflation are still present in many parts of the world. The OECD has recently reported that consumer prices in OECD countries were 13½ per cent higher this August than a year ago. In the June-August period there was some slowing—to an annual rate of 12 per cent—but with food prices rising again, and new wage contracts likely to reflect past high rates of inflation, it will take the strongest determination to deal firmly with this problem. After having already had a massive upward thrust to inflation rates from the rising cost of oil, it is additionally harmful to be confronted with the constant threat that oil prices might be pushed up even further. There is absolutely no justification for the increases of last year, much less for further increases, either in terms of rising costs of production in OPEC countries or in terms of the rise that has occurred in the cost of OPEC imports. The prices of other goods have not risen even over several years in a manner to justify the 1973-74 increases in oil prices. Moreover, a very considerable part of the increases in prices in the past year, and of the increases that may come in the year ahead, in the over-all price level for food, industrial materials, and other goods produced in the oil-consuming countries, is a direct consequence of the boost in their cost of oil. The OPEC countries themselves are a principal driving force in the inflationary spiral. If there is a single action that could dramatically improve the world's economic outlook, it would be a substantial cut in the price of oil. Without such a cut, the outlook remains very disquieting.

Apart from the serious inflationary effects of the jump in oil prices, it has had a depressing effect on economic activity, as consumers use more of their current incomes and savings to pay for oil and oil-related products and services. This could be offset by an increase in investment. A shift in the use of aggregate national output toward investment, including especially investment to develop our energy resources, would have been desirable in any event. But it is very costly to have to make this shift under the pressures of an abrupt rise in energy costs. Finally, as I shall discuss later, some of the consuming countries will have very serious problems of adjustment because of the strain on their over-all balance of payments.

I turn now to the international trade aspects of the problem. In the short-run, the higher revenues of the oil producers go mainly into financial assets. This is because imports of these countries start from a relatively small base, and even very rapid expansion still leaves a substantial trade surplus for them. We understand that the Treasury will be supplying some estimates of the magnitudes of these transactions. We might note that imports of these countries totaled under \$25 billion in 1973; indications are that they are growing by 50 per cent this year, and may well grow as rapidly next year. Even so, if their annual revenues from oil exports are sustained at something like a \$100 billion level, OPEC countries would still have a trade surplus of some \$40-50 billion in 1975.

Oil-exporting countries will now be able to buy much more of the equipment and technology needed to diversify their economies, and should also be able to raise the standards of living of their populations by bringing in more consumer goods of all kinds. It is reasonable for these developments to be going forward in areas where there is abundant energy, and I certainly hope they will be successful. At the same time the additional demand on the rest of the world for capital equipment and technical skills, while it may seem marginal in the aggregate, would not be easy to accommodate when capacity is already strained in these critical areas.

For particular oil-importing countries, the need to pay much more for oil, and also for food and other commodities, is already forcing a choice between seeking unprecedented amounts of external financing or somehow reducing their trade deficits and limiting or even cutting back their real consumption levels. This immediate impact on some countries, and the inflationary consequences everywhere, are the main economic issues that need to be dealt with for the short run.

Turning to problems of the financial flows themselves, there are questions of immediate adjustments to be dealt with by financial markets and banking institutions, as well as the pressures that will mount over time if this new set of asset holders becomes a major force in international and national capital markets.

It is difficult to foresee the ways in which the OPEC countries will dispose of their funds over the next few years. It will probably also be difficult to keep track of these funds as they move through various market channels. Some of the current accruals are placed directly in the domestic capital markets of the United States and the United Kingdom, or into such visible channels as bilateral loans to governments in consuming countries or the regional or multilateral lending institutions. The greater part, so far, has been going into the Euro-currency market, where it is available to any creditworthy borrowers. Yet another channel is the flow of funds through the multinational petroleum companies that still handle the purchase and sale of most of the oil that is produced.

The Treasury has recently issued some estimates of the flows of funds by OPEC countries in the first eight months of the year that indicate the OPEC countries have placed about one-quarter of their reserve gains of \$25-28 billion in U.S. liquid assets, a smaller amount in sterling assets in the United Kingdom, and the remainder in the international markets. This pattern could change in response to relative market yields, and to the diminishing ability of particular markets and institutions to absorb funds of this type, or because of certain preferences the individual OPEC countries may have.

Regarding efforts to monitor these funds, both the United States and the United Kingdom have regular reporting mechanisms identifying the nationality of the holders of certain assets held by foreigners. Of course, we have full information on funds kept with the Federal Reserve banks. Commercial banks in the United States report monthly the deposit and other liabilities which they owe to foreigners, the financial assets that foreigners keep with them, and liabilities owed to foreigners by customers of the banks that the banks can report on. Until now most of the oil-exporting countries have not been separately identified in these monthly bank reports but good estimates can be made of the liabilities owed to the oil-exporting countries as a group. Beginning with the figures for September 30, the banks will report liabilities to each of the oil-exporting countries separately.

In addition to the bank-reported liabilities, there are monthly figures on foreign purchases and sales of U.S. corporate stocks and bonds and Treasury securities, and quarterly reports on the foreign liabilities of nonbanking concerns. Again, none of these show most of the oil-exporting countries separately, and in any case the reports show only the country from which the orders were placed.

The Bank of England has begun to publish monthly data on sterling liabilities to oil-exporting countries as a group. They show holdings of British Government bonds and money market instruments by central monetary institutions in those countries, and holdings of money market instruments by other types of holders.

For the Euro-currency market, the only published source of current information is the monthly country breakdown of foreign-currency deposits with banks in the United Kingdom, published quarterly by the Bank of England, which shows many of the oil exporters separately and the Middle East oil exporters as a group. The Bank for International Settlements collects data on the Euro-currency market as a whole which are published in the BIS Annual Report, and are available to governments more currently. These data do not provide a detailed country breakdown of funds from the oil-exporting countries.

There are, of course, a great many kinds of investments that would not be covered by these reporting systems directed mainly to commercial banks. We are pleased to see and support the efforts of the Commerce and Treasury departments to undertake comprehensive new studies that will improve our current and future information on foreign investments here as either controlling interests or portfolio investments in U.S. businesses, and in such assets as real property or mortgages.

Your next set of questions refers to the experience of private financial institutions in recycling funds. I might say that the term "recycling" is appropriate, if at all, only in the sense that the OPEC countries cannot avoid placing their surplus funds somewhere—but it tends to obscure the fact that the financing of deficits of particular oil importers is far from automatic. The process will involve over time an accumulation of debts piled on debts that will be quite different from a simple intermediation process.

Up to the present the international banking system does not appear to have been overstrained by the process of receiving and lending surplus oil revenues. Although there have been a few banks abroad that have closed in recent months, this has reflected over-extended foreign-exchange dealings and poor management, or the stresses of policy-induced credit tightening, rather than the recycling process.

However, in a longer perspective there is room for doubt that banks will be able to handle so large a fraction of persistent flows of this type. Banks are limited in the volume of deposits they can safely accept by the need to maintain an appropriate relationship between their capital accounts and over-all liabilities or assets. Retained earnings are unlikely to supply capital funds sufficiently fast.

Apart from maintaining the adequacy of banks' capital, over-all stability of the banking system requires avoiding severe mismatching of maturities of banks' liabilities and assets.

Recycling of surplus oil funds has so far meant that the banks have issued liquid liabilities to oil-exporting countries while granting longer-term credits to oil importers. As balance-sheet totals grow, so does the potential for a large absolute gap between a bank's short-term liabilities and its longer-term assets. While the extension of credit on the basis of deposits of shorter maturity is the essence of banking, a cause for concern about the liquidity of a bank arises if the deposit base consists too largely of short-term interest-sensitive funds, or of funds belonging to only a few large depositors, or of funds that may move quickly in response to potential exchange rate movements. For some time the Federal Reserve has been stressing the need for banks to review their capital adequacy and we have been concerned that domestically banks should hold down their reliance on a potentially unstable base of borrowed funds—so-called liability management. Clearly the question of banking stability is sharpened for individual banks, and for the whole system, if banks continue to be a major factor in intermediating the international flows of oil funds.

I should note, however, that while we have a general concern about undue dependence on unreliable sources of funds, the fears sometimes expressed that the banking system could be threatened by a sudden withdrawal of OPEC funds from some banks are exaggerated.

Current practices in international commercial banking provide a measure of liquidity to individual banks facing an abrupt withdrawal of short-term petrodollar deposits. For example, were the beneficial owners of petrodollar deposits to

elect to withdraw their funds from some American banks and place them with banks of other nationalities, the American banks would be faced with a need to finance their asset portfolios. At the same time as the American banks were experiencing an outflow, banks of other nationalities would be confronted with an inflow of funds since the owners of these funds would have to deposit them somewhere, or would have to purchase other assets whose sellers would then make deposits. The banks which had lost the petro-dollar deposits would be able to bid for funds from the banks which had received the large and relatively sudden inflow of petro-dollar deposits in excess of the financing requirements of their loan portfolios. As long as the outflows do not seriously affect confidence in the ability of the banks in question, there could be a relatively smooth process as banks receiving the petro-dollar deposits redeposit them with those banks losing deposits. But the possibility of such deposit withdrawals can pose serious management problems, especially for all but the largest banks.

A second and related source of liquidity to banks that experience withdrawal of deposits is the sale of assets. A bank which experienced a withdrawal of its deposits could sell some of its asset portfolio to those banks which are experiencing the deposit inflow. For the foreign branches of U.S. banks, and most major banks that participate in the Eurocurrency markets, a large proportion of the assets consist of claims on other banks of less than one year maturity. In the event of liquidity pressures the foreign branches of the banks losing deposits should be able to liquidate these assets within a short period of time.

Apart from their ability to refinance in the market, commercial banks can turn to central banks in the event of liquidity difficulties resulting from any abrupt withdrawal of funds. The great bulk of the recycling involving U.S. banks has occurred through U.S. head offices or foreign branches; the role of foreign subsidiaries or consortia in which U.S. banks participate has been minor. For instance, the assets of the foreign branches of U.S. banks are more than ten times as large as those of subsidiaries and consortia banks. Almost all of these foreign branches belong to U.S. banks which are members of the Federal Reserve System. The Federal Reserve is prepared, as a lender of last resort, to advance sufficient funds, suitably collateralized, to assure the continued operation of any solvent and soundly managed member bank which may be experiencing temporary liquidity difficulties associated with the abrupt withdrawal of petro-dollar—or any other—deposits.

Similarly, central bankers who meet at Basle issued a statement on September 9 including the following comment:

"The Governors also had an exchange of views on the problem of the lender of last resort in the Euro-markets. They recognized that it would not be practical to lay down in advance detailed rules and procedures for the provision of temporary liquidity. But they were satisfied that means are available for that purpose and will be used if and when necessary."

I shall return to questions of emergency assistance later.

You have asked about the supervision of the foreign activities, including the foreign branches, of U.S. banks. The primary means by which the overseas activities of U.S. banks are evaluated are through examinations and required reporting. The examination process, which entails a scrutiny of bank assets and operational procedures, seeks to assure that practices are being followed which minimize risks to depositors' funds and insure that the institution is a viable one, prudently managed. The concern here is primarily with solvency and liquidity, both of which relate primarily to the type and quality of a bank's assets. The examination process also seeks to verify that applicable U.S. laws and regulations are being observed. Examination responsibilities for the overseas branches at the federal level are divided between the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the FDIC. In addition to examinations, banks are required to file periodic financial statements on their overseas branch offices and soon the U.S. Treasury will be requiring weekly and monthly foreign exchange reports which will be collected via the Federal Reserve banks.

Surveillance of foreign-exchange transactions by individual American banks and their branches is part of the bank examination process. A bank examination verifies a bank's foreign-exchange records, checks internal controls, and seeks to determine whether the institution's senior management is keeping informed of the bank's foreign-exchange activities.

There are no U.S. regulations specifically governing the maximum size of any foreign currency positions banks may take, either over-all or with respect to

individual currencies. However, examiners will warn a bank if positions that are excessive by ordinary banking standards are found or if potential risks exist because of poor internal controls. In judging the prudence of a bank's foreign-exchange position, examiners consider size of the bank, volume of international business in the country concerned, currency involved, purpose of the position, and competency of the trading and executive officers. I should add that we are in the process of reviewing this system of surveillance to be sure that it, as comprehensive and rigorous as today's circumstances require.

Some of what I have already said relates to your question—"For what period can the private banking sector, unassisted, meet the credit demands of oil-consuming nations within the limits of prudent risk exposure?"

So far this year, the private sector has made large loans to oil-importing countries, but these credits have in a number of instances been supplemented by sizable official bilateral credits (the recent loan by Germany to Italy is an example) and also by sizable use by some oil-importing countries of multilateral credit facilities—notably the resources of the International Monetary Fund (including the newly created oil facility).

I would think that a good part of the financing required by oil-consuming countries can be provided through private credit markets for some time, including not only bank financing but also the sale of financial instruments to the public. For banks, there is a risk boundary, differing for each bank, which should not be exceeded. I would not want to speculate on the period of time we are dealing with, but it is clear that the piling up of extraordinary loan exposure by any bank is simply not consistent with sound banking practice. We would expect the banking system itself to take steps to protect its viability. However, if the regulatory authorities see the bounds of sound banking being exceeded, it should be incumbent upon them to step into the picture. But there is no international counterpart to the FDIC, which through its regulatory and insurance functions can clearly protect depositors against insolvency risk.

On the more general question of the relationship of the flows of oil funds to the conduct of monetary and fiscal policy, I do not foresee any likelihood that the flows will affect our ability to meet the needs of our economy. Even massive increases in foreign-owned assets in the United States should not materially affect the over-all level of the monetary aggregates, since what happens is essentially that existing financial assets are transferred from domestic to foreign ownership, or among foreign owners. Appropriate fiscal and monetary policies should be able to maintain a high level of economic activity, regardless of whether foreigners acquire assets in our country or not. There may be shifts in yields on particular types of instruments, insofar as the asset preferences of foreigners may differ from domestic preferences. In particular, we have noted that placements of OPEC funds into very liquid assets have tended to reduce yields on such assets relative to other market yields both in the United States and in the Euro-markets.

Your letter raised a number of aspects of the provision of emergency assistance. In addition to its role as lender of last resort to member banks that I have already mentioned, the Federal Reserve has legal authority to lend to solvent institutions other than member banks to meet short-term liquidity drains when the national interest requires. Such emergency loans could be made under the Federal Reserve Act, subject to the procedures set forth therein; in either case the Federal Reserve would require adequate collateral.

U.S. banks that own foreign subsidiaries, or that are shareholders in multinational consortia, have in the past carefully monitored the liquidity needs of their affiliates and provide assistance when appropriate. As I have noted, assets of these organizations are small in the aggregate relative to those of foreign branches, and we would expect that management would be watchful in supervising these operations. The Federal Reserve may, of course, provide emergency assistance to solvent member banks whether or not they are parents of foreign affiliates.

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.

Extensive discussions of the role of host and home country central banks for extensions of emergency assistance to subsidiary and multinational financial

institutions have produced a common understanding of the problem. In some countries abroad where there is no official lender of last resort, authorities have recently taken steps to strengthen the institutional framework for providing liquidity assistance to banks—in some cases by establishing new institutions and in others by arrangements involving the commercial banking community. Thus new arrangements to provide liquidity to banks, when appropriate, have recently been announced in Germany and Luxembourg.

The rapid expansion of foreign operations by U.S. banks does not appear to have caused serious difficulties for the majority of the banks that have been active in this expansion. International banking activities continue to be highly concentrated among a very small number of the nation's largest banks that have considerable experience in this area. For example, at mid-1974, nine of the largest banks accounted for about two-thirds of the total foreign activity of all U.S. banks. I believe that the overwhelming majority of our banks have conducted their foreign operations in a reasonable and prudent manner.

Another set of questions in your request for comments relates to the provision of assistance to consumer nations unable to secure funds in private money markets. We have not developed any independent estimates of the needs of individual countries, or of the aggregate non-market assistance that might be required. I believe the Treasury will respond to these questions in some detail. However, I would like to offer a few general observations.

As I noted above, private market institutions cannot be expected to go beyond the bounds of prudent risk management. This means that if the price of oil stays high a growing list of countries will meet serious difficulties as they pile up debts to pay for oil. The obvious remedy for this is the restoration of a reasonable price for oil. Far less satisfactory, and perhaps ultimately ineffective, is the provision of financing on terms that private markets could not possibly consider.

For the moment, the new oil facility at the IMF is the primary vehicle for financing the most needy countries, supplemented by some bilateral credits by OPEC countries. One of the initiatives taken at the recent meetings of the IMF was the creation of a Joint Ministerial Committee on the Transfer of Real Resources charged with the task of discussing ways of assisting the most seriously affected developing countries. There are also calls for mechanisms to help other countries as the need arises. I would like to note, however, that there is considerable need for caution in creating new credit-supplying facilities. We could find that adjustments that oil-importing countries should be making will be postponed if access to credit becomes easy and automatic. I have in mind especially the need to cut down on energy use, to intensify investment efforts to create substitute sources, and to remove as rapidly as possible balance of trade deficits unrelated to the higher price of oil.

On the other hand, there is a responsibility to consider the problem of countries already operating at a very low level of real income as they now confront adjustment to higher energy and food costs. This is the principal subject of your last group of questions. There is a danger that individual consuming countries, in trying to be prudent and avoid a buildup of debt, will take measures that can only succeed if they force other consuming countries to accept undesired trade deficits and foreign debt. There is not much evidence yet that such behavior is being followed, but it is a real and present threat to the free cooperative framework for world trade and payments that we have been trying to strengthen and extend.

I remain hopeful that the oil-producing countries will become aware of their own long-run interests, recognizing that as their actions weaken world productivity and welfare they generate a determination in other countries to resist the arbitrary use of economic power and the piling up of unneeded assets. At the very least, I should think, the oil-producing countries with surpluses far beyond their ability to spend—even in the very long run—ought to provide the funds that the poorer countries need to cover their essential needs for oil. Moreover, these funds should be provided on highly concessionary terms and without calling on other consuming countries to accept any burden of default. When other countries bear the potential risk of default, it is they, and not the oil producers, who are the real creditors.

Having said that, I would conclude by noting that with good will it should be possible to find solutions that will avoid threats to the social order and confrontations. The poorer countries surely should not bear any great part of the real burden that will be involved in improving living standards in oil-producing countries. And the major industrial countries that are oil consumers should be able to depend on a reliable supply of energy consistent with economic growth over the years ahead, and at a reasonable price.

Mr. WALLICH. If I may, Mr. Chairman, I will summarize briefly. The early pages of my statement are concerned with the general damage that the high price of oil is doing to our country and to other countries. It is causing increased inflation, imposing heavy real burdens, and raising the danger of recession.

These are matters that have all been discussed at considerable length. Therefore, I would like to focus on some of the banking and international financial market problems. The first thing to be considered is the nature of the monetary flows deriving from the increased charges of the Oil Producing and Exporting Countries (OPEC). We know that these countries cannot make purchases equivalent to the revenues they are obtaining from their oil.

They must, therefore, place their surplus funds somewhere. It is very difficult to discern how they are doing this. However, the Treasury has supplied you with data that gives you an idea as to how roughly \$28 billion—that seems to have come in during the first part of this period—has been distributed. The United States has received perhaps a quarter of that total, the United Kingdom may have received, in sterling, \$3 billion, and a large part of the rest has gone into the Eurodollar market. These proportions may change hereafter.

We have some reports that give us some information on the use of these funds, but it is clear that we need to improve our reporting system. That is underway. I won't bore you with the details, but, in the past, reporting has not been geared specifically to monitoring the flows of OPEC funds. That is being changed presently. We are getting more OPEC detail, both from the United States and from the United Kingdom.

We are moving towards further collection of international data and we are initiating new surveys by the Treasury and the Department of Commerce of foreign investment in the United States.

All of this has to be pushed in order to give us the information we need. However, it will rarely be possible to follow all of these flows in full detail.

With respect to the "recycling" problem, I used the term with quotation marks. It is appropriate, if at all, only with respect to the fact that the OPEC countries cannot help making their surplus funds available. But this does not mean, of course, that all countries that need the funds will get them. If I overspend my personal income, it does not follow that the deficit credits I put into circulation will somehow be recycled to me. In that sense—that the financing of the deficits of particular oil importers is not automatic—the term is not meaningful.

So far, however, the process has worked fairly well. The surplus OPEC money has gone into the Eurodollar market, largely, and into banks and it has been loaned out again. But what the banks can do is limited, particularly in the longer run.

Banks are limited by their capital position. They cannot accept unlimited deposits. They are limited with respect to maturities. They cannot accept short-term funds and indefinitely lend them out at medium term.

That implies that over time the contribution of the banking system, while it may continue to be substantial, can hardly take care of the whole problem.

[At this point Senator McClellan entered the hearing room.]

Mr. WALLICH. At the same time, one need not be overly concerned about withdrawals of OPEC funds and redepositing them from one bank to the next. There is considerable flexibility in this mechanism. If one bank should lose deposits, funds must go someplace else, which means they will be placed in another bank.

[At this point Senator Huddleston withdrew from the hearing room.]

Mr. WALLICH. Given the nature of the banking system, it should be possible for the losing bank to borrow money back, through interbank deposits, from the bank that gains them. Alternatively, the losing bank can dispose of assets and in that way meet withdrawals.

The Central Bank—such as the Federal Reserve—is available as a lender of last resort, prepared to supply funds provided that suitable collateral is received.

The central banks of the world are lenders of last resort. With respect to international operations, a recent meeting of central bankers involved surveyed the problem. They came to the conclusion that the means are available to act as lender of last resort in the Euromarkets.

It would not be wise to try to spell out every detail, but the means are available, and would be used, if and when that became necessary.

Next, there is something to be said about how we supervise our banks at the Federal level, with respect to their liquidity and solvency. This is a very elaborate process, to which the Comptroller of the Currency, the FDIC, and the Federal Reserve all contribute.

We examine, broadly speaking, annually. The foreign branches of American banks are examined likewise.

We are now moving toward a more detailed system of reporting of foreign exchange positions. You will note that banking problems so far have in the main been the result of foreign exchange trading and not of OPEC-related problems.

Foreign exchange is one of the areas where the position of a bank can change suddenly. That is not the case with most other aspects of bank operations.

The Treasury is instituting a system for collecting weekly and monthly data on the foreign exchange positions of banks.

Taking account of what the private financial market can do in the aggregate, I think it is fair to say the market has worked very well so far. I expect it to continue working well. However, a well-managed banking system will, of its own, avoid undue risks. Should the risks of taking on all of these deposits and making these loans become excessive, this would impel the banks to avoid the risks. Therefore, the OPEC countries would have to find other outlets for their funds and borrowers will have to find other sources of credit.

Looking to the future, I would expect the banking system to be able to take a substantial part, a good part, of the total of the OPEC funds flows. But I would not think that they can take the whole.

You had some questions about the impact of these flows on our monetary and fiscal policy. I think this aspect of the situation presents no great problems. Our money supply is not affected: under our present system, any dollar that the OPEC countries acquire has existed previously in the United States. The repatriation of such dollars does not affect the volume of money in this country.

For the same reason, decisions of the OPEC countries to invest or not to invest their surplus dollars in the United States should affect primarily the structure of interest rates. For example, if these funds are invested principally in certain short-term assets, interest rates on that type of asset will go down as we have already observed.

With respect to emergency assistance, I would like to make a particular point. This is that it is not practical to lay down, in advance, every last rule for what is going to be done. One cannot write blank checks.

On the contrary, in the interest of keeping the participants in financial markets concerned about undue risks exposure, keeping their creditors and depositors alert, it is preferable not to define and publicize the specific conditions, and the threshold of emergency assistance.

But the fact is that the lenders of last resort are there. They know their duty. They can act, and they will act.

An important question concerns those countries that are not sure of getting funds from the present flow—either through the banking system or through the open market—and what they are likely to do.

For one thing, they can make a decision to eliminate at least the non-oil part of their trade deficits, if they have one. But they may need other facilities and if it turns out there is a strong need, this will have to be looked at.

However, I would warn that it is not wise to rush in with ready offers of large credit facilities. That would reduce the normal pressure to make necessary and possible adjustments. We should be careful to avoid leading everybody to think that there are ways of solving their problem, because there may not be.

That is the conclusion I reach. Nobody can prove that this situation is not manageable. What is much more important, nobody can be sure that it is manageable. As long as the price of oil is not cut substantially, the outlook is indeed very discouraging.

Thank you very much.

Chairman JACKSON. Thank you, Governor Wallich.

If it is agreeable with my colleagues, we will limit the time to 10 minutes.

Senator Percy has to leave and others also have commitments.

We ought to divide this examination into two parts. One, of course, is the energy problem and its short term and longer term considerations.

The second part is the impact on our financial system and the economy.

To my memory, this is the first time that we have faced serious questions about our financial institutions before getting into a major recession.

Historically, it has always followed a different pattern; that is, that the business recession or the Great Depression of the thirties resulted in hundreds and hundreds of banks closing.

Now it is reversed and questions have been raised for the first time since I was a kid about the solvency of our banks. So I want to direct my questions to that area first. I will go back later on to the other topics.

It is my recollection that, starting in the late fifties American business moved abroad on a tremendous scale. Therefore we now have

a long list of companies, whether in cosmetics, soft drinks, computers, drugs, or photography, in which half of their earnings come from outside of the United States.

Concurrent with that, American banks have moved overseas in their operations. The initial total in 1950 in terms of resources amounted to more than \$3 billion. Now, as of January of this year, according to the Journal of Commerce of June 4, the total of resources abroad was \$123 billion, 27 percent of the assets of large U.S. commercial banks.

The question that I pose here is the following: With this tremendous integration of the American economy into Western Europe, primarily in Japan, and other areas, are we in a whole new ball game that we have never experienced before?

Would you agree on that? I am talking in general terms.

Mr. WALLICH. Yes; I think there certainly have been some very important changes.

Chairman JACKSON. Every business cycle is different. I am submitting that based on statements such as David Rockefeller made, at one of the conferences in August, to the effect that we are on the verge of a financial panic.

In light of this situation, serious problems are already emerging. Let's take Italy, for example, which I understand got \$2 billion just to cover the cost of oil for the remainder of the year.

According to Business Week for October 12, in a rather detailed article going into the whole debt question, they say there is approximately \$10 billion in private banking loans that will come due in 1975 and a large part of it involves American banks.

Governor Wallich, how are we going to deal with these emerging problems? The American people need some assurances. This is why, for the first time, you are getting questions about the solvency and the liquidity of our banks, with the first question involving overseas operations.

Confidence needs to be restored. How are we going to handle it? We can't be the banker of the world. How are we going to proceed?

Mr. WALLICH. I would think that the first line of defense, Senator, is the banking system itself. To begin with, the banking system operates under certain laws. They are also guided by their own good sense and their desire to stay in business.

A second line of defense is the examination process to which banks are subjected. This informs the authorities and informs the bank of criticism on the part of the examiners.

Chairman JACKSON. Right at that point, can you tell the committee what kind of detail monitoring and policing has been going on with this huge expansion of banking operations overseas, tied with the movement of their clients going overseas?

I get disturbing reports that we really don't know in detail about how much in the way of private loans have been made or the status of those loans. I get reports they are marking them down. Obviously, these loans are not going to be paid on time.

What do we really know? Can you give some assurance as to the supervision of this large banking activity and total resources, \$123 billion, one-fourth of all of the resources of the large banks?

Mr. WALLICH. What I can say applies, I think, to the vast majority, over 90 percent, of foreign branches. They are quite closely supervised, just as if their operations were in the United States. That is to say, the Comptroller, the FDIC, the Federal Reserve all have examiners who examine the head office and who also examine the branches.

The Federal Reserve has 40 to 50 examiners capable of examining international matters, be it the international departments of banks here or foreign branches.

Chairman JACKSON. Do they go overseas?

Mr. WALLICH. They go overseas. The Comptroller even has an office in London. So does the superintendent of banks of New York State. We have a man traveling currently abroad. So there is no lack of detailed examination.

One must, however, distinguish the types of risks. One is the lending risk. That becomes apparent in periodic, usually annual, examinations. The other is the foreign exchange risk. That is a new magnitude of risk that has appeared largely since we went on the floating exchange rate system. That is where problems with banks have primarily occurred.

This is an area of risk where problems of fraud have also crept in. This, of course, is not easy to detect. We are moving now to improve our information in this field so that it will be on a weekly and monthly basis instead of being based primarily on periodic examinations.

I might add that the information comes in not once a year, but that all reports from banks are quarterly.

Chairman JACKSON. Can you assure us that we have as good an audit, and as good a knowledge of our banking operations—private banking operations overseas—regarding assets, liabilities, and so on, as we do in the United States? That is what people are asking.

Mr. WALLICH. I can't speak to the detail of these reports. I can tell you that the branches of banks are examined as a part of the banks. We ought to know as much about them as we know about banks at home.

Chairman JACKSON. But when we have \$123 billion in resources overseas that could have a real impact on the liquidity of banks in the United States, I think the public needs to know.

This is a major issue, a major question, because I have serious reservations whether there is that detailed supervision overseas.

[At this point Senator Huddleston entered the hearing room.]

Chairman JACKSON. If you say it is, you should know. It is primarily the Comptroller's responsibility, is it not?

Mr. WALLICH. The Comptroller supervises national banks, which hold well over half of total commercial bank deposits. The Federal Reserve supervises State-chartered member banks, with roughly a fifth of commercial bank deposits, and nearly all the rest are under FDIC supervision.

In addition, of course, to the regulatory and supervisory apparatus, there is the responsibility of the central bank as the lender of last resort. Further, as we have seen, the FDIC is very effective in dealing with cases of insolvency.

The Federal Reserve, if I say it myself, seems to be effective in dealing with liquidity problems, and I think we are pretty well prepared to do so.

Chairman JACKSON. If we ask them for details regarding the loans, assets, liabilities, and whatnot of the branches and operations of American banks overseas, we will be able to get that?

Mr. WALLICH. Yes, but with some qualifications. There are a few countries where examination by U.S. examiners is not permissible. But in those instances we have available head office records.

Chairman JACKSON. Of course, we have not covered the other situation, and that is where the banks are a part of a joint venture. They may have 10 percent in the loan and then you are in another ballgame, are you not? So you can't get at it. Isn't that true?

Mr. WALLICH. In those cases there is no direct examination. However, in the case of subsidiaries the parent can be required and is required to have data available at the head office. So the subsidiaries are examined in the United States through this process.

Chairman JACKSON. My time is up. Senator Percy?

Senator PERCY. Thank you very much, Mr. Chairman. I have heard disturbing authoritative reports that the monetary system of the world could collapse by mid-1975 if we continue, the United States and other major oil consuming countries, to continue to import oil at the present prices and at the present level of consumption.

Mr. GREENSPAN, is that an overstatement, or are you concerned or alarmed?

Mr. GREENSPAN. Senator, I certainly am concerned. I don't know whether the timeframe is correct. I don't think we know enough about the capability and the flexibility of the international financial system in absorbing the types of strains that may occur to put a firm date on the period of significant difficulties.

Nonetheless, I think that commonsense and arithmetic indicate that we are building up an accumulation of debts in the system. On a very temporary short term but indeterminate basis, you can finance them.

It is fairly obvious that a number of countries will, and in fact, already have run into difficulty in financing the current volume of oil imports at the current prices.

It is very difficult to avoid the conclusion that these difficulties will worsen and the only question that I have is the particular time at which these further difficulties will appear. I do know that there is no way to say with any great assurance that it is mid-1975, mid-1976, or even conceivably later, but the possibility of a significant and undesirable interruption in the system does exist and I, myself, am very much concerned about it.

Senator PERCY. This next question I direct to all of the panelists. But in the interest of time possibly you could give a one-word reply. It is in two parts really.

Do you feel that a substantial decline in oil consumption in the United States is essential for two reasons: (1), improvement of balance of payments and trade and (2), create a better climate for lower crude oil prices?

The second question is, in the short term, is there any other really effective strategy available to us?

Mr. GREENSPAN. I think that we have to reduce oil consumption. I know of no alternative way.

Secretary MORTON. I would agree with that. I think the difficulty is to put the opinion on the graph as to where and how much mobilization of the economy is required to achieve that. I think that is what we are all groping with.

I don't think you can argue against the reduction. I don't think we have decided in our own mind how much mobilization, how much discipline, how much control, how much regulation will be required in the society to achieve a reduction and how much reduction is actually required to have the effects of relief in terms of the discussion we have had here this morning.

Senator PERCY. As a distinguished long-time leader, however, in the legislative and executive branch of Government, is that the function of the leadership, to determine those things and set a course?

Secretary MORTON. I think it is.

Senator PERCY. Or are we to make their minds up—210 million people, none of them who really have the kind of facts that are available to us.

Secretary MORTON. The other thing, too, I think the answer to that question is this is a function of leadership. One of the things is to understand the art of the doable. Let's take an example of the de-regulation of natural gas. Natural gas perhaps is the fuel, is the fuel—I am very confident—that we can have most responsive increase in production of any of the fuels that we use in our normal energy mix.

Yet, the only way you are going to get natural gas increase in supplies is through creating an economic climate within the natural gas industry that will (a) Attract the capital, and (b) Will actually result in the liberation of natural gas from more difficult structures and deeper in the earth's crust where we know it is. Yet we have not been able to do that.

One of our problems, I think, that we face as a Nation, there is certainly nothing partisan about this, but one of our problems is that the Congress and the Executive have not really been tracking together. That is why I welcome these kinds of hearings, as the chairman and the gentlemen here are conducting because out of this we may be able to get a clearer understanding of the art of the doable, what we can do.

Senator PERCY. That is why I felt it essential to state my conclusions.

Secretary MORTON. I think they are very good for all of us to have. I look at the struggle that we had to develop a delivery system from the Arctic.

Senator PERCY. But do you accept the fact that as designated by the President the buck stops with you. You are going to have to really bite the bullet and come down on this?

Secretary MORTON. No question about it.

Senator PERCY. This is a major part of your responsibility?

Secretary MORTON. Not only the buck stops there but a great many of the things that we are talking about, the things that Senator Ribicoff and you talked about in your preliminary statements, are going to require legislation. Then we get into the art of the doable.

Senator PERCY. The administration can send it down anyway and we can reject it.

Secretary MORTON. And have.

Senator PERCY. We can't act many times unless really there is a signal.

Secretary MORTON. That is right. But take deregulation of gas as a basic part of this package. It has been here for 2 or 3 years.

Senator PERCY. Mr. Sawhill, on the original question?

Mr. SAWHILL. In response to your first question, I would certainly say yes, that conservation is very important, particularly if the United States embarks on a very significant conservation program because that, indeed, would have an impact on our balance of payments and it would go beyond that. It would set an example for the rest of the world. I believe that we, as a country, need to show leadership to other nations in the way that we respond to this energy situation.

I might add to that, that it is not only conservation of energy, but we might also look beyond that to what I might call demand management, that we have to manage the way in which we consume energy so that we begin consuming our abundant resources that is, coal and nuclear and cut down on our consumption of oil.

That is one of the reasons that the President, in his message, called for a switch from oil- to coal-fired utilities. I believe it is that type of thinking that we have to do also.

In supporting what Secretary Morton said, I might add that we have had a bill which we sent to the Congress early last year for the mandatory labeling of appliances. Certainly it is not a bill that I think would be objectionable to most Americans, yet it could do some good in the area of conservation.

The Congress has failed to act on that bill. So the stronger measures, the Senate has passed the bill—yes.

Chairman JACKSON. Yes. That bill was passed over a year ago. Of course, we have on the calendar the bill for standby authority on dealing, as you know, with all of the conservation measures, because of the veto of a year ago we have never been able to find out what the policy was.

Mr. SAWHILL. The bill was in the two branches of the Congress. The House has not seen fit to pass that bill. Senator Percy described some very tough conservation measures. If we can't get a labeling bill passed it is going to be difficult to get some of these tougher things passed. There is no question about it.

Senator PERCY. Mr. Sawhill, I have just 2 minutes left. I would like very much to move on to the next question. I assume your answer and Dr. Wallich's answer is that there is no real alternative to cutting consumption. Dr. Wallich, I would like to throw the last question out and get some idea from you as to how much elasticity there is in demand for gasoline based on price.

The New York Times indicates that Secretary Kissinger's suggestion that we cut consumption by 10 to 14 percent has fallen on deaf ears. And yet Britain has reduced oil consumption by 10 percent, namely by higher prices, and France is going to reduce their intake by 10 percent by an arbitrary \$10 billion import ceiling. So it is a mandatory program.

We have to cut consumption. How much elasticity is there if we increase prices?

Mr. SAWHILL. We estimate that each 1-cent increase in the price of gasoline above the current levels would cut consumption approximately 25,000 barrels a day.

Senator PERCY. And bring \$1 billion more revenue in so it would take \$4 to \$5 billion, 4 to 5 cents to wipe out the budget deficit.

Mr. SAWHILL. Yes. Each cent would bring up approximately \$1 billion, slightly less than \$1 billion of revenues and reduce consumption approximately 250,000 barrels a day immediately. But then you would have some longer term impacts that you would probably get an additional 25,000 barrels a day as people begin making adjustments in the kind of automobiles they drive.

Obviously, there is a short-range impact, if people just drive less and the long-range impact is they begin to buy smaller cars and adjusting their lifestyle, moving closer to their place of business.

Just again to support something that Secretary Morton said in response to Senator Ribicoff's point, we estimate that the immediate impact of a 20-million-per-gallon standard would be a savings in the first year of about 100,000 barrels per day; within 2 years it would increase to 200,000 barrels a day; by 1980, to about 600,000 barrels a day.

So you would gain a lot more in the short range by an increase in price than by this standard, although over time the standard would become more effective as Secretary Morton pointed out.

Senator PERCY. For the record, did you say 25,000 or 250,000?

Mr. SAWHILL. I said 25,000 barrels a day so that a 10-cent increase in price would immediately reduce demand we estimate approximately 250,000 barrels a day.

Senator PERCY. Thank you very much.

Secretary MORTON. If I could express it another way which is the way we do it over at the Department, that a 10-percent increase in the short run of price of gasoline will result in a 2.5-percent decrease in consumption.

Over the long pull, a longer term, a 10-percent increase would result in a two-thirds-percent increase. It increases a little as you go downstream.

Senator PERCY. Thank you.

Chairman JACKSON. Thank you, Senator Percy. Senator Ribicoff?

Senator RIBICOFF. Just a couple of questions. I am puzzled. If it is wrong for the Arabs to keep their oil in the ground unless they get a higher price, why is it right for American oil companies to keep their oil and gas in the ground in order to get a higher price for it?

Mr. SAWHILL. I don't think we are seeing cases today where oil is being kept in the ground that is economical to produce.

Senator RIBICOFF. My understanding is that when you talk about deregulation of natural gas as we are being warned by everybody that the only way you are going to get that gas out of the ground is by increasing the prices.

Isn't the purpose of this administration in deregulating gas, to get more production? What is the difference between the position of the American gas producers and the position of the Arab oil producer?

Mr. SAWHILL. No. I think we are talking about a different thing, Senator Ribicoff. When we are talking about deregulation of natural gas we are saying that is some gas reserves which are so expensive to

drill for and produce that the current low price of natural gas doesn't make it economical to do so.

If the price went up, there would be the economic incentive to drill down to 30,000 feet out in the basin in Oklahoma and produce that gas.

Senator RIBBICOFF. Is that really the entire issue? Isn't there gas being kept in the ground as a hedge against an increase in the price and that this gas isn't any more expensive to drill for than present gas resources?

Mr. SAWHILL. I am not aware of that.

Secretary MORTON. We have tried every way to determine that. The question always comes up. Every time we do a survey of the gas wells, Geological Survey knows where they all are, we find that they are all producing. There is a certain downtime of any well for repairs, cleaning up and so forth. But there doesn't seem to be any shut-in gas that would be available to the interstate market.

I think there perhaps is some shut-in gas awaiting hookup in the intrastate market. That is gas that does not move. It moves at an entirely different price. It moves at a much higher price within the State that it is produced.

But the fact is that there is very little expansion going on in the natural gas exploration and development business because the return on investment at the low price at the wellhead just is not there.

Senator RIBBICOFF. Is there any way to know how much shut-in gas there is available at the present price?

Secretary MORTON. You mean shut-in—

Senator RIBBICOFF. It is the term you have been using.

Secretary MORTON. Shut-in in terms of gas that is actually available by turning a valve, or bringing out—

Senator RIBBICOFF. By normal exploration.

Secretary MORTON. The Geological Survey after exhaustive study has told me that it is an insignificant amount. It is virtually very, very low.

Chairman JACKSON. If the Senator would yield, not to come out of his time, the Federal Power Commission staff said there are proved but shut-in reserves, mostly in the gulf area of 4.7 trillion feet with probably 3.3 trillion feet in addition to that.

Secretary MORTON. This is a different term.

Chairman JACKSON. I know. This is shut in. No. It is available.

Secretary MORTON. It is available if you drill for it.

Chairman JACKSON. But it is identifiable.

Secretary MORTON. Right.

Chairman JACKSON. I think this does raise, as Senator Ribicoff has said, the key question here on a price rollback on our petroleum. It deals with this pricing question on natural gas because we are asking the OPEC countries to cut back. We all agree, every economist that I have talked with, that the real issue in our economy is the price of oil. Senator Ribicoff is referring now to the price of gas.

Senator RIBBICOFF. It is related.

Chairman JACKSON. That is right. They all tie together. Unless we set an example, how in the world are we going to ask the Canadians to reduce prices? They are our largest single source of petroleum. Canada, at 1 million barrels a day with Venezuela second. They put on the big tax. We complain.

They say: "well, we put the tax so that it is equal to what you are allowing your producers of petroleum unregulated to get, \$10.75."

I think this goes to the heart of the problem that we must face on a bipartisan basis, regardless of what happened to the bill last year.

Mr. SAWHILL. The price that Canada is selling to us is significantly higher than the average of price of oil in this country because we are continuing to control oil prices of the so-called old oil at \$5.25.

Chairman JACKSON. No. I referred to new production.

Mr. SAWHILL. Yes. New production.

Chairman JACKSON. And the barrel that is deregulated with each new barrel.

Senator RIBICOFF. I look to you, Senator Jackson, as the leading expert in this country on this problem. You have already done a lot of good work in this field. You will have to do a lot more in the months ahead.

I look forward to working with you very closely on all of these problems. Without question, the cost of food and energy are the two most important inflationary pressures in the world.

Chairman JACKSON. This is the problem facing the United States. There needs to be an adjustment in the price of natural gas. But I don't think it ought to be deregulated. It ought to more clearly reflect the cost. But I am concerned about the fact that we as a nation ask other countries to bring the price of oil down to realistic levels and are not rolling back prices at home.

Mr. SAWHILL. Yes. But I don't think, Senator Jackson, that changing the price of U.S. oil, bringing it down, is going to cause the OPEC nations to change their price one bit.

Chairman JACKSON. With massive conservation, with massive production, it will make a difference.

Mr. SAWHILL. We agree with you on the need for conservation and production.

Chairman JACKSON. Why in the world should we be talking about market forces as we do—we use it loosely—we talk about the marketplace and market forces when we are talking really about a rigged market. The market for uncontrolled oil is rigged, period.

It is whatever they decide by decree. That is the heart of the problem that we face. This is what is destroying the free enterprise system if it continues.

This is a question we asked——

Secretary MORTON. Before you get away from natural gas, I think we have sort of a confused thing as to what should the price of gas be and what these market forces are. The wellhead price of natural gas today is about 33 cents. This is not enough to encourage expansion. There is nobody trying to deregulate all natural gas.

What we are trying to do is deregulate new gas so that these reserves that are identified, that are deeper, that are more expensive to get to, can be developed and put in the interstate market.

I think that there has got to be some confusion here as to what we meant by deregulation of natural gas.

Chairman JACKSON. My point is that the gas is there. We can make adjustments without deregulating. That is all I am saying about the price of natural gas. But unless the price, the world price—that is our price now—comes down, is there anyone at this table who

can say what is going to happen, if it stays at this level, for the next 3 years to the economies of the Western countries?

[At this point Senator Percy withdrew from the hearing room.]

Chairman JACKSON. If it stays at the current level, that is the hypothesis, over the next 3 or 4 years, what will happen?

Mr. GREENSPAN. I think there are several things we can say, Senator. First, the consumption in relative terms, relative to say real GNP worldwide will continue to decline. I think we have already seen a significant decline in the world oil consumption strictly in response to the price.

We have not as yet in my view seen the full effect on displacement of oil from the price hike. It will take a while. We are already seeing in the United States, for example, substantial changes in capital investment for the purpose of displacing oil or energy generally because of price change.

The same phenomenon is going on throughout the rest of the world. So that under the assumptions which you suggest we will see a continued decline in unit oil consumption, not necessarily in total, but relative to the physical volume of production of goods and services.

The basic difficulty that I see from the present level of prices is in the longer run. Although the adjustment process will go on, and the value of petroleum imports required by the free world will begin to ease off largely because of the reduction in consumption, it is nevertheless indisputable, as I indicated to Senator Percy previously, that even at these somewhat reduced levels we will be generating debt piled on debt.

What we may then see as a secondary consequence, is that some nations will not be able to finance the amount of oil they need even on the lower adjusted amount of consumption.

Chairman JACKSON. But won't some countries simply go bankrupt?

Mr. GREENSPAN. I don't think one can rule that out. I think that it is very difficult to say what it means for a country to go bankrupt. There are obvious difficulties but I think what you have is particular borrowers in severe difficulty. You have loans extended where particular organizations go under.

But I don't think we are about to see any nation as such default on its debts.

Chairman JACKSON. In other words, can the industrialized countries first weather this storm at the current price levels over the next 3 to 4 years?

Mr. GREENSPAN. No. I would certainly not say that, Senator. You mean by weather it, you mean without significant disruption and distortion?

The answer is no.

Chairman JACKSON. Its impact is worldwide. They stopped buying American goods. The first priority will be food. They are going to shut down on American imports.

What happens to all these companies that I referred to at the outset?

Mr. GREENSPAN. I am certainly not suggesting that there is some simple way by which this whole thing will adjust.

Chairman JACKSON. This is why I get to the central issue, this is what I argued when we had the veto. I said it wasn't the price at the pump that was the sole issue.

It is the question as to whether or not our economy can stand it. I said the utilities are going to get clobbered first. You know what it is now. The equity market is not there. They are going into the banks on short-term loans. So the banks are squeezed.

The all persuasiveness of petroleum pricing is my concern. We are seeing it day by day. I hope that from these hearings we can identify some areas where on a bipartisan basis we can give and take and try to get some point of agreement that will at least help to stabilize what is an otherwise deteriorating situation.

That is all I want to say. I hope we can identify some of these areas.

Secretary MORTON. I think we have some points of agreement that have been very well brought out by members of this committee. I think everybody agrees and everybody at this table agrees that a substantial reduction in consumption is a thing that we need.

The question is where does that reduction stop without it in itself producing serious dislocations in the economy and unemployment, and so forth?

If we agree on that, I think everyone has also agreed, Mr. Chairman, that we should increase supplies through all of the devices that are available and stimulate industry to do this through a better economic climate for the attraction of capital and for the actual investment process.

The thing that you are getting at, and I think is worthy of further discussion, is this question of how much, what are the hopes for reduction of the world oil price or the OPEC oil price?

One of the things that has not been mentioned is that in other parts of the world today, outside of OPEC, there is substantial discovery going on. The whole Norwegian plateau has great potential. There has been a new discovery as reported, as you know, in the press, of a large discovery in southern Mexico.

Chairman JACKSON. But that involves a vigorous international strategy. The Norwegians already have a very high standard of living. The problem is they are sitting on all of that oil and all of their farmers and fishermen, some of my relatives, are taking off to the oil rigs.

I have been talking to some people about that. They are going off to the oil rigs. That is what is worrying them.

They should play a more major part in this. We through diplomacy should get them to expand their operation. There are 100 billion barrels of oil between the English and the Norwegians all the way up to Spitzburg.

Secretary MORTON. Mr. Chairman, if you have enough relatives over there, you are the man to do it.

Chairman JACKSON. They are just not in a hurry to do it.

Mr. GREENSPAN. Mr. Chairman, if I might just reinforce some of the remarks that the Secretary suggested, I think it is important to differentiate between two types of declines in consumption. One is the longer term displacement of oil in the production process by introducing different types of production processes and the like.

This obviously is not disruptive. After the adjustment is completed it will not have a major effect upon employment and real income. It is merely a reversal of the historical shift in the United States from coal to oil.

I think it is important to note that the shift often requires new facilities and this is a slow process. The other type of decline is a

forced reduction in oil consumption and this tends almost inevitably to also affect the levels of real GNP and employment.

We saw, for example, even with the decline in gasoline consumption in the United States the secondary effects on employment levels in many recreational areas, and in a number of gasoline-related sectors of the economy that were often quite severe.

So I think that there is a two-pronged question here: One, let's get consumption down certainly, but let's focus on promoting efficient and enduring adjustments in the structure which have the smallest adverse effects upon the levels of employment and income.

Then finally, I think that we must not overlook the terribly important issue which you have been discussing, namely the expansion of supply.

While I do think that reduced consumption is critical, if we do this without looking at the mechanisms to expand supply we are missing what has to be the long-term solution to this problem.

Secretary MORTON. Mr. Chairman, I would like to add as far as the first point that Mr. Greenspan made, as to where we can do this with a minimum effect on the economy, this very afternoon I am going to meet with the chemical people, aluminum, along with John, steel, petroleum, cement, paper, textile industries to see where we can make some gains in reduction of energy in those industries without any substantial effect on employment by just simple conservation and efficiency techniques.

I think we have got to pursue that across the board because the program for each one of these industries is slightly different. They have to approach it in a different way.

Mr. WALLICH. Mr. Chairman, may I make a comment?

Chairman JACKSON. Very well. It is all coming out of Senator Ribicoff's time. He made the mistake of yielding.

Dr. Wallich.

Mr. WALLICH. I am glad to yield.

Chairman JACKSON. No. Go ahead.

Mr. WALLICH. I wanted to say that if we are successful in substituting domestic resources, and that has the desired effect of bringing down the foreign price of oil—which is really what that action should be directed to—we must consider what will happen to domestic investors. Since they will also have in mind the contingency that their action may bring down the price of oil, thought has to be given to the means by which investment in substitute facilities can be stimulated under conditions in which ultimately lower prices are envisaged.

Senator RIBICOFF. Most of you on the panel seem sympathetic, and Senator Percy was sympathetic, to increasing the taxes on oil and gasoline to get consumption down.

Yet, I wonder. The price of gasoline in the last year has gone up about 15 cents a gallon, but consumption hasn't gone down.

What makes you think the consumption would go down significantly if we put another 10 cents a gallon tax on it?

Mr. SAWHILL. That is not correct. Actually, consumption has declined slightly for gasoline.

Senator RIBICOFF. Slightly.

Mr. SAWHILL. What has really happened is the normal year-to-year increase we get has not occurred.

Senator RIBICOFF. What bothers me is the basic unfairness involving those who can afford the extra 10 cents a gallon and who have no restriction on their lifestyle or the type of vehicle they would drive.

The middle income person and the poor are being socked—the individual who uses a car as a matter of necessity. He would find himself faced with giving up other necessities of life in order to keep his automobile going so he can get to his job.

That concerns me deeply.

Mr. SAWHILL. We are not proposing a tax on gasoline. As a matter of fact, the President explicitly rejected that in his speech before the Congress.

Senator RIBICOFF. I think you did make a statement that in the short run, if you would increase the tax on gasoline, you have some figures of what savings you would get. How would the consumption go down if you increased the price 1 cent, or 2 cents. You took that line on the question of consumption.

Mr. SAWHILL. Yes.

Senator RIBICOFF. Mr. Secretary, I would assume you are going to have the overall direction over ERDA basically?

Secretary MORTON. I think the job as I visualize it is to coordinate the activities of these agencies. We have a great many agencies in Government that have some part of the responsibility for energy management and development from the Government point of view.

I think what the Federal Government needs today is a forum and a coordinating mechanism that let's each one of these agencies do their thing with a minimum of overlap, a minimum of confusion and a minimum of turf battle between it and other agencies.

I see the role not as trying to dictate the policies of these agencies, but try to coordinate them so that we get the most effective results out of each agency.

Senator RIBICOFF. If you go along with Dr. Greenspan, he says don't forget the supply. No one wants to forget the supply, but again, in the world that we live in, the only way you are going to bring prices down over the next few years is by reducing consumption.

Do you believe that we can affect consumption on a voluntary basis or are there going to have to be some mandatory regulations or laws in order to conserve the use of energy?

Secretary MORTON. Whether you do it by mandatory means or laws or whether you do it by letting the economic forces prevail in price, I think you are going to have similar hardships or changes or adjustments in lifestyle in the economy.

I feel that every time we have attempted to manage the economy or control a society that the opposite reaction to that action and force has always been sort of a detrimental, had a detrimental effect on the economy.

I am in hopes as the President said, that we can start a new energy ethic and a new saving ethic going without all of these mandatory regulations which are going to have to be very, very broad in nature in order to work, but as he said, if this doesn't work he is going to have to, I think his words were present a menu of tougher turkey, and hopefully we are not going to have to really manage everybody's life.

Senator RIBICOFF. Do you think that Detroit will voluntarily build automobiles that will give us 20 miles per gallon of gas without a law requiring them to do so?

Secretary MORTON. I think if they won't agree to do it we might need a law to make them do it. You have got to remember that the reason the European car is so much more efficient in terms of gasoline consumption is the fact that in Europe gasoline has been over \$1 a gallon for a long time. People adjust to that. They want a smaller car.

Senator RIBICOFF. Don't we have to adjust to that reality because of our balance of payments, our inflation and our costs? Don't we have to look at it that way? After all, Detroit did have the opportunity to build smaller cars. They were contemptuous of the small car until they woke up to the fact that Americans liked the small car. Then when Volkswagen, Datsun started to flood the American market, they started to look for a small car. They felt large cars were much better for them on a profit basis, they could make a lot more money in selling a \$5,000 automobile than selling a \$2,000 automobile—which is true. They could.

So while we have this great affluence, they neglected completely the small-car market until they realized they were losing competitively.

What do they do if we feel that we could become self-sufficient in energy in the United States if our automobiles gave us 20 miles per gallon of gas and Detroit would not supply us with automobiles giving us 20 miles a gallon?

Secretary MORTON. There is nothing inhibiting the European car today in the American market. I think you have to recon with the American people in their own choice. I think the American people now are choosing smaller cars. First, they are in style. The American people respond to style.

But secondly, they better fit the family budget under today's individual economic circumstances of the family.

I think the trend is certainly that way. The American manufacturers today are making small cars that do compete with Volkswagen, Volvo, the Japanese cars in terms of their weight and in terms of size and in terms, hopefully, of the efficiency, though I don't think we have quite made it yet.

I think the climate is right and the marketplace is right for the small car. But it is very hard to, if you told everybody in the country that they had to wear a brown suit, you would be in some real opposition.

Senator RIBICOFF. Isn't that invidious comparison, telling everybody to wear a brown suit or a red tie when what you are dealing with is the future of the country. Inflation, energy, the balance of payments could all be solved by building a car that gives us 20 miles per gallon of gas.

Is that exactly the same as telling people to wear a brown suit?

Secretary MORTON. No, it is not. The reason it is different, though, is because of the state of mind of the American people and the desires of the American people and the American people are just beginning in my view of really understanding what this very high price of foreign oil and the amount of foreign oil that we are importing is beginning to—how it is beginning to affect the country and affect the rest of the world. The message is beginning to get over.

I think the American people are beginning to respond. I don't think you could have passed in the last Congress or in the last few years any sort of laws that would be as restrictive as the kind of legislation that it is going to take to accomplish what your desires are.

Senator RIBICOFF. That is the job of leadership. That is the job of a President, of a Senator or a Secretary to give that leadership. Part of your job and mine is to educate and tell the people back home what the problems are. If they don't know how serious a problem is they are not going to react. If they know how serious the problem is, they will.

This is a problem that we have to run away from, or face it. So far I haven't seen any indication that that is the intention.

Secretary MORTON. Senator Ribicoff, I think that is unfair, because take the President's basic speech before the joint Houses, take his speech last night before the Future Farmers of America, the whole thrust was on the conservation of the energy and on those things that the individual can do to fight, win the battle of inflation.

I think that your own leadership in the Senate are doing the same thing. It is very difficult when you think of world oil prices over long periods of time which are \$1.50, \$2 a barrel, half of the domestic price all of a sudden changing, lifestyles all of a sudden changing all over this country in response to that.

I think we are moving pretty well. Hopefully by the end of this year, or the end of certainly 1975, we are going to be in a climate when these changes can be made and can be made first without undue resistance in the Congress and; secondly, without undue resistance in the American public.

Senator RIBICOFF. Let me ask you, Dr. Greenspan, going back, do you think phase II worked?

Mr. GREENSPAN. I don't know what you mean by working.

Senator RIBICOFF. I mean the difference—

Mr. GREENSPAN. To keep prices down?

Senator RIBICOFF. It worked in this respect: Do you think that the inflationary rate has increased significantly since phase II was eliminated, or torpedoed?

Mr. GREENSPAN. You are talking about phase IV or II?

Senator RIBICOFF. I am talking about phase II.

Mr. GREENSPAN. I would say that part of the inflation we are now experiencing is in my view a consequence of the whole series of phases and freezes. To be sure, the rise in the price levels as measured by the increase in the consumers price index did come down during phases I and II.

But I think that what we also severely inhibited the expansion of capacity and supply which one would normally expect.

[At this point Senator Jackson withdrew from the hearing room.]

Mr. GREENSPAN. I think the suppression of the expansion of capacity in each of a number of our basic materials industries goes back to the controls which we had at that time.

So in a strictly statistical sense, if you asked did phase II show a pattern of price change, which was less than we had previously or since had, the answer, of course, is yes.

Would I consider that a measure of success? Most certainly not, because I think that one can always mandate that type of result in the short run.

Basic to that question, however, is whether or not the controls were in fact an effective anti-inflationary policy, and I would submit that they were not.

[At this point Senator McClellan withdrew from the hearing room.]

Senator RIBICOFF. It was interesting reading Gunnar Myrdal's comments when he was awarded the Nobel Prize in Economics. He said that he was very depressed and sick over the future of the world economy.

I notice he made the point, that he didn't believe that we in this country could solve the problem of inflation without price and wage controls.

Under what circumstances would you feel that it was justified for a country to have wage and price controls or do you feel it is never justified?

[At this point Senator Jackson entered the hearing room.]

Mr. GREENSPAN. I believe that my justification would require me to believe that controls were actually an anti-inflationary policy. I think in fact it is the opposite. A policy of controls tends to trade off some short term price stability for very significant acceleration of inflation in the longer term.

I think that is the type of trade-off which the American people don't like and don't want. I don't mind saying that.

Senator RIBICOFF. The American people, do you think they don't like it or Alan Greenspan doesn't like it?

Mr. GREENSPAN. I will put it to you this way: I think that if the American people fully understood the consequences—that is, a full accounting of the inflationary effects of these types of policies over the longer term—I think they would recognize the effects and I think they would be against them.

Senator RIBICOFF. How much worse can it get than it already has? I have had the experience of being home in Connecticut and talking to people and accompanying my wife to the supermarkets to see the attitude of the people. I felt the anxiety on their part, when you go into the store as I did last Saturday. There was a woman with a big shopping basket telling me she doesn't know how much longer she can go into a market to buy enough food for her family the way prices are going up.

How much more rapidly can inflation rise and still have the American people survive.

Now, is what concerns me. You talk about the long term. The long term, doesn't have much hope either. In the short term, you are reluctant to act because that impacts on the long term, yet the short term is running into the long term. I think it was Keynes who said, "In the long run we are all dead."

How long does it take to be economically dead? When are some decisions going to be made, short term, or long term? What do you do for a person on a day-to-day basis, a week-to-week basis?

Mr. GREENSPAN. Senator, I think first of all, the long term we are talking about in this particular context is a year, a year and a half, not 10, 20 years.

The problem, unfortunately, is that inflation can get worse. We see it. It is worse, for example, in Western Europe than it is here. It is worse in Japan. I, myself, think that the United States cannot structurally hold together with a medium, double digit inflation rate. We see what is happening to our thrift institutions and our whole financial structure.

We have built this economy and this financial system essentially on low single digit inflation and our system, as it is now constituted, requires that.

It is because I agree that we cannot continue the way we are going without very major disruption that I think it is very important to come to grips with the fundamentals of the inflationary pressures and not look for palliatives which do no more give you the illusion of coming to grips with the problem.

I think we have now run out of time for these types of solutions. I think it is important to return to the fundamentals of the inflation problem largely because we do agree that the American system can't really function very much longer in a viable way with double digit inflation.

Senator RIBICOFF. I am sorry I got off the subject of petrodollars, Mr. Chairman.

Chairman JACKSON. Senator Huddleston?

Senator HUDDLESTON. Mr. Chairman, I would like to get back onto the problem of petrodollars. We have pretty well covered the supply and demand problem, I think.

First, the chairman very well outlined the fact that several years prior to the oil pricing question there had been a considerable movement on the part of American industry toward making investments abroad. This was followed in turn by a similar movement on the part of many of our banks. We now have a situation where a larger number than ever of our major banks have substantial operations in foreign countries.

Mr. Wallich, in your opinion has this development improved our ability to cope with the situation that we are faced with now on the balance of payments and the large amount of oil dollars that accumulate in other countries?

Has this improved our ability to cope with that situation or has it been detrimental to it?

Mr. WALLICH. I think one has to take that in parts, Senator.

The situation has been improved in some aspects but perhaps not in others. One aspect in which we are better off is the fact that there are large American banks abroad that finance firms which are, essentially, the same firms they service at home. I would assume that it improves our position, our balance of payments, if these banks can lend to their clients abroad deposits obtained abroad, instead of having to bring the funds from the United States. That would be one example.

It is also true, I think, that it has improved our situation in that a substantial flow of profits comes from abroad. If you take the profits of nonfinancial corporations from domestic sources and eliminate the inflationary inventory element, and under-depreciation, it turns out that there are no profits left after paying dividends, that is, retained profits have become negative.

[At this point Senator Ribicoff withdrew from the hearing room.]

Mr. WALLICH. Thus most of the profit in excess of dividend payments, for nonfinancial corporations, really comes from abroad. So there are some benefits.

On the other hand, there is the fact that when you have larger operations there are more places in which you may encounter the possibility of something adverse happening.

But, while the risks that banks accept also become larger, their capital increases.

So I wouldn't say that the absolute risk exposure of banks necessarily increases. But as the chairman said, there is an aspect of a new ballgame to this.

Senator HUDDLESTON. You don't see any indication that if this trend continues or increases that it may affect the availability of capital in this country that in turn may affect our capital expansion and production expansion successes?

Mr. WALLICH. No. Actually, Senator, what I see ahead, is that, over time, there may be an increased availability of funds for investment. If, over a period of time, there is less spent on nonoil goods, while more is spent on imported oil, a kind of purchasing power gap is created in the economy and there is at least the possibility of turning that to good use for increased capital formation.

Senator HUDDLESTON. I agree with the effort to cut consumption in this country. The 1 million barrel a day goal is something that I think Secretary Morton can probably help us reach.

But how would a 1 million barrel a day reduction in consumption balance out compared to perhaps a dollar-per-barrel reduction in the price, from the OPEC countries, as far as our balance of payments are concerned?

Mr. SAWHILL. We import about 6 to 6.5 million barrels a day. If we got a uniform across-the-board dollar reduction, that would be about \$6.5 million, whereas 1 million barrel reduction in imports would be \$10 million.

So the reduction in imports would have a twofold effect: First, it would bring pressure to decrease the price, and second, it, in itself, would reduce the balance-of-payments deficit by more than the dollar a barrel reduction.

Senator HUDDLESTON. IMF created a special fund to help countries to help their balance of payments difficulties caused by the increase in price of oil. Does the very existence of this fund give some sort of de facto approval to what is basically an unreasonable price increase? Does it have a tendency to eliminate efforts of not only this country, but other countries in the world to secure price reductions from the OPEC countries?

Mr. WALLICH. I think, Senator, that is a question one has to consider. I would think that a \$3.4 billion facility doesn't go very far in that direction. But massive facilities that held out a possibly illusory hope that this money can just be made to go round-and-round and come out in the right places is something that might be counter productive, in terms of the objective of getting down the price of oil.

Senator HUDDLESTON. I know you discussed the ability of the banking system to handle this problem. Do you believe that this special fund is necessary in the IMF?

Mr. WALLICH. I think the special fund meets a special purpose. It is not large. It is a place where countries can draw on financing in moderate amounts. I would not want to see the banking system exposed to the pressure of being practically the only supplier of funds.

I think the banks are pretty good judges of the risks they can run. If they do not have the capacity to handle the whole of the lending

involved—and I do not think that they can—then one should not put them in a position where they will feel pressure to try to do so.

Mr. SAWHILL. I think the real issue is who is going to take the risk. To the extent that the facilities are created to put the risk back on the producer countries themselves, that is where it belongs.

As I pointed out in my statement, the United States can't just be the vehicle for this recycling and international financial institutions which are dominated by the consuming countries can't be that vehicle either.

I think we have to put the burden back where the burden belongs, because it was the producing countries themselves that created the burden in the first place.

Senator HUDDLESTON. The United States would share in disproportionately because we make a disproportionate contribution.

Mr. SAWHILL. Correct.

Senator HUDDLESTON. Mr. Wallich, what size fund would you recommend? Sir Dennis Healey, of the United Kingdom, has suggested a \$30 billion fund.

Mr. WALLICH. I would look at the principle of the thing carefully, but I cannot offer any initial ideas about magnitudes.

Senator HUDDLESTON. What if such funds were to come entirely from the OPEC countries? Is that a possibility?

Mr. WALLICH. As Mr. Sawhill suggests, a fund supplied by the OPEC countries and loaned out to the oil importing countries would have a logical risk distribution. The OPEC countries would bear the risk.

Such a procedure would also reflect the basic economics of the situation which is, that the OPEC countries cannot be paid until they are ready to import in amounts equal to their exports. Until that comes about and permits the oil importing countries to pay in terms of exports, the OPEC countries must, in some form, finance their excess exports.

Senator HUDDLESTON. What is that doing, though, if the recycling of the petrodollars comes from importing into the OPEC countries goods and services from other industrialized nations that are already in an inflationary situation and already finding shortage situations within their own country?

Is this contributing further to the inflation in these other countries?

Mr. WALLICH. It certainly does; yes.

Senator HUDDLESTON. The OPEC countries seem to prefer to put their funds in larger banks because they presumably consider them to be sounder. Is this depriving smaller banks of funds which they need in order to compete?

Mr. WALLICH. The period of maximum pressures in the Eurodollar market seems to have passed. But it is true that large banks have some advantages. However, they, in turn, cannot accept deposits without limit. Presumably, they will defend themselves by offering lower rates of interest and by accepting only longer maturities. This would be a normal expectation of what would occur as financial institutions adjust to growing inflows.

Senator HUDDLESTON. We have expressed a lot of concern about the immediate situation. What is happening down the road with the OPEC countries if oil prices stay approximately at the level they are now?

These investments that they are now making will begin to earn dividends and more profits. Are we again worsening our situation as far as our deficits and balance of payments are concerned?

Mr. WALLICH. As you say, that would be the consequence. The underlying economics is that these amounts cannot be transferred in real terms to the OPEC countries until they import sufficiently to meet both their oil exports plus their investment income.

Consequently, they are compelled to relend not only part of their oil income but also interest realized on it—their investment income. The problem is, if they try to put the money where there is no risk, how will the funds reach the countries where it is most needed, where the risk is considerable?

Senator HUDDLESTON. Thank you, Mr. Chairman.

Mr. Chairman, I might make an observation on the question of increased taxes to control consumption which presumably has been scrapped by now.

In discussing deregulation and other mechanisms to increase production capacity and investments, aren't we telling the American people that there is hardly any alternative to their paying more for their energy, whether it is through a tax or increased prices?

The deregulation of natural gas to make it more profitable to attract more capital means higher prices to the consumer.

Nobody absorbs these prices as you go along. The man on the street eventually winds up paying for it. As Mr. Greenspan indicated when you have price controls and wage controls to the extent that we have, you are just postponing that inevitable time when somebody has to pick up the bill.

Mr. SAWHILL. I think that the time has really come when we have got to be honest with the American people and tell them that we have entered a new era as far as energy is concerned.

Senator HUDDLESTON. Is that what you want to tell them?

Mr. SAWHILL. Yes.

Senator HUDDLESTON. That they have got to pay it one way or the other?

Mr. SAWHILL. The fact is the prices of energy in the future are going to be higher than they were in the past. There is no sense in trying to fool people into thinking that is not the case.

Secretary MORTON. Let me add to that, if I may. In analyzing inflation, the current inflation rate is contributed to 40 percent by energy, 40 percent by food, and 20 percent all other. Where I think your theory breaks down is the fact that if we can increase supply to the point where we are no longer in a seller's market, particularly in food and fuel, we are going to have a very big impact against inflation.

The thing that I believe will happen if we are able to increase supply at reasonable prices, the level of those increases will tend to level off and not be inflationary. We are not going back to 22-cent gas at the wellhead. We are not going to go back to 18-cent gasoline.

But if we can increase supplies of food and we have already given the word, the word is out for agriculture to go all out, and I am sure they will, because that is the nature of the American farmer, if we can provide an economic climate so that there will be enough capital and enough return on capital to attract the investor to the energy field. We are going to increase supplies and those increased supplies will tend to stabilize price.

We are and, I think, what Mr. Sawhill says is absolutely right, we have got to tell it like it is. If you put a tax on of x cents a gallon or if you deregulate, you are going to get some increase in price. There is no question about it.

Senator HUDDLESTON. I agree with that. I think there is one area where some influence ought to be brought to bear; that is, to rule out price increases that are brought about without relation to the costs, but simply because a commodity happens to be in short supply.

This is affecting our manufacturing processes from one end to the other.

Mr. SAWHILL. That is the very reason that we are controlling the price of old oil. That is the very reason that Secretary Morton said we are only asking for decontrol of the price of new natural gas.

We don't want to give a windfall to the owners of the old natural gas. We want to give an incentive to people to drill for more new natural gas. I think there is a real logic in that position.

Senator HUDDLESTON. The OPEC price, of course, is a classic example of an arbitrary price increase without relation to what it costs them to get the product out and sell it.

Secretary MORTON. Sure. It is a political surcharge.

Senator HUDDLESTON. To a much lesser degree perhaps, this is happening in a number of commodities and materials that affect the final price that the consumer has to pay.

If there is any way to eliminate that from our pricing structures, we would have a substantial improvement, while, at the same time, providing adequate investment return.

Thank you, Mr. Chairman.

Chairman JACKSON. Right on that point. I don't buy the pricing argument in a cartel environment. When we had the fight on the veto on the price rollback bill, I argued at the time that—and my colleagues on the other side argued the opposite—that price at this time has no bearing on the amount of oil you are going to get and that the real issue is the shortage of oil rigs and material. In that legislation we had authority for the President to allocate materials.

Gentlemen, the situation is right now, we put in the budget the funds for Petroleum Reserve No. 4 (Pet. 4) to provide for exploratory work. They have got equipment up there. They can't get the rest of it. We can talk until we are blue in the face about price being the regulator here, but we are in a national emergency and why in the world shouldn't we have mandatory authority for the President to be able to allocate critical materials?

Secretary MORTON. We have, Mr. Chairman. We had the Defense Production Act.

Chairman JACKSON. They used it on the pipeline, but not on Pet. 4. That is an unlawful use of the Defense Production Act because you have to declare a national emergency in relation to a war. We went through that.

Mr. SAWHILL. Not on establishing priorities, I don't believe.

Chairman JACKSON. My understanding, we went through it, that was one of the arguments we had, if it is, why aren't you using it all over the oil-drilling area?

Mr. SAWHILL. Senator Jackson, we did establish a voluntary allocation program for pipe, which was in very short supply in the early part of this year.

As far as I know, that program worked very well and most of the independent producers who were the beneficiaries of this program were quite satisfied because they did get supplies of pipe they needed. As a matter of fact, I had Alf Landon call me up late one night about four wells he wanted to drill.

He is a small, independent operator in Kansas. We were able to make some pipe available to him. So I just give that as an example. The program worked quite well.

Chairman JACKSON. Mobil has been drilling and they came up Montgomery Ward, \$800 million of it.

I want to be fair. Let's get to the heart of this problem. The American people feel that there is a lack of expressed sense of urgency. I am being very forthright about it. I have been traveling all over the country and I sense it from Republicans, Independents, Democrats alike. There is not the sense of urgency in what we are doing here. I hope that we can identify some areas in which we can get moving.

Mr. Secretary, you are eager to answer now. Let me ask you this—

Secretary MORTON. Yes, I am.

Chairman JACKSON. Why didn't the administration ask for the funds for the exploratory work for Pet. 4? Why did the Congress have to put it in? Why did we have to do it a second time?

Secretary MORTON. Because I don't think that the Congress was—

Chairman JACKSON. I know you were for it.

Secretary MORTON. That is right. But we are talking about really billions of dollars to do the job up there. We should open Pet. 4 up and one of the reasons we can't open it up is the congressional reason. You know that, sir.

Chairman JACKSON. Mr. Secretary, let's not confuse the issue. Let's be specific, \$72 million, \$60 million, one of it for Elk Hills—this is to get it right up to 400,000, 500,000 barrels a day production. The other \$12 million, that is in the previous one; the \$12 million was for exploratory work on Pet. 4.

But my point is that the administration didn't even ask for the money. Senator McClellan was here a minute ago. He had to leave. We put that in the budget. We are spenders. We are spenders, but here is an emergency. We are talking about Pet. 4 with a minimum reserve of 30 billion barrels. We carry on our books about 35 billion barrels. I am trying to explain very candidly and very honestly that I don't think there is that sense of urgency yet and I believe that we should have the authority to allocate materials.

You are not getting anything done on Petroleum Reserve No. 4. They have got equipment lying on the ground up there, they tell me, and there is nothing really moving yet, despite the fact that funds were appropriated a year ago because they can't get the equipment.

Secretary MORTON. I don't want to challenge you on that. But I am having a meeting tomorrow with the Secretary of the Navy and the Secretary of Defense on this issue. I think holes are being drilled. We had the National Petroleum Council make a complete study of oil country goods.

Chairman JACKSON. You say there is drilling going on on Pet. 4?

Secretary MORTON. Exploratory work.

Chairman JACKSON. But not even exploratory drilling, I believe.

Secretary MORTON. It is the exploratory scientific work that is precursor to the actual development of oil, to determine whether the oil is there.

I can give you a complete report on what they are doing. This priority within the military budget is one and certainly, sir, you know the difficulties of determining priorities in the military budget. At the time that budget was made to be very honest, I don't think there was a sense of urgency.

We had had an awful hard time. I tried to open up Elk Hills way back during the Santa Barbara crisis in order to get this done. I put a bill up there. The Chairman of the Armed Services Committee said, "Little boy, take your briefcase back downtown. We are not going to do this."

I think what you have done has brought the priority up. Sir, I commend you for it, but we are not going to have, I don't think, up there any curtailing experience as far as oil country goods is concerned that is going to limit that production.

If there is, we will certainly invoke the Defense Production Act.

Chairman JACKSON. Mr. Secretary, you are right in saying there is a problem to go to production. That is actually move it out. That is the problem with the House Armed Services Committee.

Secretary MORTON. We have to have a delivery system or you don't have a reserve up there.

Chairman JACKSON. We can't talk about production if we don't get the drilling and whatnot going on Pet. 4. That is what I am trying to say.

Secretary MORTON. I couldn't agree with you more. Hopefully, before the end of the year, we will have a lot of work done in that area. I think we have to go one step further than that.

I think we have to market enough oil out of Pet. 4 to warrant the development of the delivery system because you know how long it takes, sir, to put a pipeline and a corridor system there in Alaska. You are up against every political proposition that you have heard of.

Chairman JACKSON. I understand that fully.

Secretary MORTON. We have got to have it. I think we ought to be getting 4 to 5 million barrels a day out of that part of the world.

Chairman JACKSON. I hope that we can because the American people demand of the Congress and demand of the executive branch that we try to find these areas where the country is in trouble and reach agreements to solve the problems. I want to try to find them.

Secretary MORTON. I would like to say, too, there is a sense of urgency and I hope we can translate it to everybody, for the deregulation of the gas, for the strip-mining bill, for the implementation of the deep-water ports bill and all of the other bills that are here.

Certainly, these are things that hopefully the new Congress, I realize at the end of the string here, but the new Congress can take up and get out in the early part of next year.

Chairman JACKSON. You are aware that we have been in a long conference on strip mining. I think, hopefully, we can get it resolved. The deepwater port is going to conference. Both Houses passed it, but the real urgency that I see a lack of is, that you are going to get—I am talking now just of the political facts of life and this involves people.

If you are going to get the kind of exploratory work underway on the Outer Continental shelf, your agency will have to do that exploratory job.

I don't think the public believes the findings of the oil companies. I am being very candid. You know you have got a delicate problem, starting with your State running on up to Jersey, up that canyon.

You have the problems on the west coast. The bill that we passed in the Senate, it is over in the House now, gives you that authority. I am not saying the Government will do it by force. Let out contracts.

I think we have to identify these areas that can be developed and get the facts so that the people can make the hard choice. There are some hard choices here. They have to decide whether they are going to take some risks as far as the environment is concerned as against a cold winter.

Secretary MORTON. I am meeting with the Governors just as soon as I can get them all together on this issue. As you know, on the Atlantic side, I have been in a long and involved legal hassle.

I think we have got to not only explore and develop if oil is there these good structures in the Atlantic, but also in the Gulf, Alaska, and also in the Pacific.

Chairman JACKSON. There is a difference, I am afraid, unless I understand now the administration would undertake to do this. I am talking about—

Secretary MORTON. Who does it?

Chairman JACKSON. Yes. Who does it?

Secretary MORTON. I think again we get down to dollars. Exploratory drilling and the development of first production wells, is as you know, a gigantic proposition.

We have also got the question of do we give away these resources and how we handle that issue. I think if we are going to put the Government in the well drilling business either by contract or by owning the rigs themselves, we are looking at dollars that I see no hope of getting into the budgetary process.

We are looking at billions of dollars. If you will add up what the oil companies are spending today in those offshore areas that are already under exploration and development programs you will see that this is a tremendous amount of investment that is being made, not just front money, but the actual exploration and development money.

I think the Government has to face up to that. We are not talking about \$100 million or even \$500 million. I think we are talking about billions of dollars to do this.

Chairman JACKSON. May I say that I think last year we took in about \$7 billion from sales of leases primarily in the Gulf of New Mexico.

I just feel that one way to really get this moving is for the geological survey to supervise, let it out on private contract, but identify these areas, find out whether it is there. I think it is going to make a lot of difference. The public doesn't believe the claims as to what is or isn't there. That is your fundamental problem.

Secretary MORTON. As you know, we are rewriting the disclosure regulations and this matter of proprietary information that has been a very closely guarded thing over the years is the thing that is under reconsideration.

How we maintain a competitive situation and we want to certainly do that, the whole thrust today is much more stringent policies governing the enforcement of our antitrust laws so that we insure competition.

If we suddenly make the people who have all of this proprietary information disclose it, we are doing something that discourages competition. So these things have to be weighed.

I wish it were as simple as it sounds, that we could go out and hire a bunch of rigs and put down some holes in the Baltimore Canyon and in the Gulf of Alaska, and so forth, and solve the problem. It is far from being that simple.

Chairman JACKSON. Getting a price reduction, getting our petroleum reserves up to speed are absolutely essential.

In other words, we need a massive effort on the leasing of public lands. Alaska has got enormous potential, as we know, and so does over half of the Outer Continental Shelf, over 50 percent, 56, or 57 percent, of the Outer Continental Shelf of the entire country.

Moving on those things for the near term—that is what we are really struggling with here. The long term problems are bad enough. What we are right up against the wall on now is the economic impact of all of this, the pervasiveness of its impact on the economy.

I was just handed an AP wire from London. A large British banking group announced today it was in trouble. This is another in a series of financial setbacks that have shaken business confidence in Western Europe.

The British financial group, Jessel Securities, listed banking, insurance, and other assets worth \$1 billion in 1972. Today the company admitted a cash crunch and asked the London Stock Exchange to suspend trading in its shares. The announcement followed business failures and scandals of recent months involving important banks in the United States, Britain, West Germany, Belgium, Italy, Switzerland, Israel, and so on.

They point out that their cash position was in doubt because the policies of its insurance subsidiaries were linked to the stock market investments which have fallen rapidly in the last 2 years.

Jessel owned shares with a 1974 high of \$1.50, but were down to 24 cents today just before trading was suspended.

Then they list all of these other failures. I address this to Mr. Greenspan and to Dr. Wallich. Isn't this a part of the scenario that we are going to see more of unless something is done?

Our problem is that our business and economy are so tied to the economies of Western Europe that we have to make some hard decisions as to what is going to be our role and how we can protect ourselves.

We can't be the banker for the world, but it is like unscrambling the egg here. The American marketplace is no longer the 50 States. It is the 50 States plus the industrialized nations of the world and the public doesn't fully understand this.

This is the peculiar business cycle. We have what I call a financial crisis—some say a financial depression—and a business recession going on at the same time.

Historically it has been the other way around. We had the business recession going in a depression then hitting financial institutions.

The public is bewildered and they don't understand. The Seattle First National Bank in the Pacific Northwest—it is the 25th or 26th largest bank in the country—had a big loss on currency activity.

The banks under the one party Holding Act can engage in all of these nonbanking activities. Here is a classic example of what happens where they get out of the banking business and they are over in the insurance business dealing in the stock market. That is true of other banks in the United States as well.

What can you say? What do we do about it? We want to be constructive and responsible. We are kind of floating here and many different ideas are being examined. No one really knows.

The fact is that the United States must take the lead, but I believe our partners have to engage in some discipline here and some responsibility. Otherwise, we are headed for very serious trouble.

Do you want to lead off, Mr. Greenspan?

MR. GREENSPAN. Senator, I must say that I am terribly sympathetic to your point of view on this issue. I think that probably we need a crash program to come up with a full understanding of the various forces that are now working, and also the types of potential policies which are necessary to fend them off. I don't think there is any disagreement that what we see out there is not an equilibrium solution. It is not something which is just going to fall casually into place and all will be fine.

It might happen that way, but I think the probabilities are small.

Chairman JACKSON. We can't move over to economic isolationism. On the other hand, we can't do it all ourselves. It is like NATO. Secretary Morton knows from his service in the House, the problems we have had. We have had to take the lead, but our biggest problem has been burden sharing in the military side.

We must provide the leadership. They are going to look to us, but there must be burden sharing here that is equitable and fair with the the United States taking the lead. Otherwise, there won't be any leadership.

MR. GREENSPAN. I agree with that. I think the most important thing which is lacking is an understanding—a factual understanding of precisely what is going on.

In Dr. Wallich's formal remarks, he discusses the types of data which are available on the Eurodollar flows and on the various types of miniflows which are going on throughout the world.

I would say at this moment that data is inadequate. I would say we do not know enough on a sufficiently detailed basis to fully grasp what is going on. I would say that is the very first action we must take.

Chairman JACKSON. That is what I want to hear. We have to share this blame. This started under the Democrats. We haven't paid any attention. The beginnings were in the Eisenhower Administration but the big thrust, the movement, to overseas was in the sixties.

You look at the earning records of the companies, over half of their earnings are from overseas. That is why they are being hit in the market.

Secretary Simon submitted an answer to one of our questions that during the 1960's U.S. banks expanded their overseas operations dramatically. In 6 years the number has increased to 83 national banks with 581 foreign branches.

As I mentioned earlier, the resources figure was \$3 billion in 1960, and now it is \$123 billion. But on down in the statement it says this: "Moreover, in the interest of economy and in view of the concentration of branches of U.S. banks in London, the Comptroller's Office in September 1972 assigned three bank examiners to the American Embassy in London to make examinations of London banking offices in coordination with the examinations being conducted in the 14 domestic regions."

Three examiners to keep track of what is going on now is to me inadequate.

Maybe Dr. Wallich, you would want to comment on that. This is what really troubles me, the enormous expansion, so fast, and a real doubt in my mind as to whether we know fully what is going on. We are maybe getting more bad news on some of these things.

You get the ripple effect that could be devastating on confidence. That is what is worrying people. The first time since I was a kid people were writing in and calling and asking "Are the banks safe?" That hasn't happened before in any recession since the great depression.

Mr. WALLICH. Mr. Chairman, I can't speak to the Comptroller's arrangements. The three examiners mentioned may well be thought of as just a part of the general supervisors forces that are brought to bear on the international financial matters. The Federal Reserve System which examines far fewer institutions than does the Comptroller has close to 50 examiners in the international area, although they are not stationed abroad. That is one aspect of the situation.

A second aspect is seen, I think, if you look at the size of the units involved. Among national banks, there are many that are very small. The big full-service operations that the Comptroller supervises number roughly 2 dozen. The Federal Reserve has roughly 1 dozen such big banks. These are the banks chiefly engaged in international operations.

I would think that a businessman would regard international diversification as a safety factor. You don't put all of your eggs in one basket. Eggs here are pretty well spread around.

Diverse operations also produce some new types of risks. One does not know the local scene, for instance. Or, the branch manager does not inform head office management adequately of his operations.

There are problems of that order. But by and large, I think, the diversification, both at home and internationally, is not a high risk problem but rather a risk reducing element.

Chairman JACKSON. Dr. Wallich, this is page 39 of the Secretary of Treasury's comment. It is a Q and A if you have that there, and I will read it. It is very short.

What surveillance or control mechanisms exist to prevent unduly, risky foreign exchange transactions by U.S. banks?

This is the area where the trouble is coming more and more to the fore.

Answer: Apart from the authority available to the bank regulatory agencies the Comptroller of the Currency and Board of Governors of the Federal Reserve, there are no control mechanisms which could be used to prevent unduly risky foreign exchange transactions by U.S. banks.

That is a pretty rough comment and this is where the banks have been getting into some trouble. I mean American banks on the handling of foreign exchange.

They are saying and he is saying here, that there are no control mechanisms which could be used to prevent unduly risky foreign exchange transactions by U.S. banks.

Mr. WALLICH. If the examiner finds out when he looks at what has been done during the year that the bank took an undue exposure, he will bring this to the attention of management and, if necessary, to the banks' board of directors.

Chairman JACKSON. That is after the facts, though.

Mr. WALLICH. You are perfectly right, Senator, and in a trading room there is a man sitting with a telephone and he can make commitments. Management gives him a line, stating how much he is allowed to do.

There have been cases where traders have ignored this. There have been cases where traders have not even put transactions on the books, but these are the exceptions. The banks have become aware of this possibility now. I think the banks are very much bent on controlling that risk.

Chairman JACKSON. I understood the Federal Reserve Board has a special steering committee on foreign operations, chaired by Mr. Mitchell.

Are they not working on this question of limiting the risk of exposure of our banks which have become involved in nonbanking activities? Are they looking into this now?

Mr. WALLICH. Yes, there are several such things going on, one of them being an effort to get together with the regulators and with the examiners of the banking system of other countries, so as to exchange information and see how we can tighten up.

Chairman JACKSON. Dr. Wallich, all I am saying is that with this tremendous expansion that is taking place and in view of the critical international financial economic situation that is descending upon us, due primarily to this sudden infusion of highly priced oil that I would think the Federal Reserve and Treasury, and to the extent that it is applicable, the FDIC, would really move and move fast least we not have the facts.

We need to know what we are dealing with. How many of these loans that have been approved by our banks overseas and what condition they are in, that immediately affect the liquidity of the companies over here.

I just make that appeal and ask this final question: Do you need any additional legislative authority to deal with what we have discussed here this morning?

Mr. WALLICH. I think that any new legislative authority would need to be of a broader kind, and that if there were any move, these matters would be only a part of the objective. But right now the most immediate need, I think, is for information.

Such information is being obtained, in addition to the measures I have already mentioned, by the new weekly reporting system of banks to the Treasury on their foreign exchange exposure. This will be much faster than examination reports. There will also be broader monthly reports.

Chairman JACKSON. As far as you know, there is no request by the Board for new legislative authority to deal with the role of our banking institutions overseas.

Mr. WALLICH. Not at this time.

Chairman JACKSON. You have not requested any authority. You feel that you can handle it under existing legislation at this time?

Mr. WALLICH. We are studying this. The next steps, as I have noted, are to get together with foreign authorities and see what they are doing. The matter has also been looked at in the meetings of The Bank for International Settlements. The reactions there were pretty satisfactory.

Chairman JACKSON. If I go back to the Secretary, there has been a lot in the paper about the Mexican oil find; the size of the reserves, and so on.

I notice the first purchaser will be Cuba and that, according to the newspaper this morning, they will sell at the OPEC price.

Will this find help the present situation overall?

Secretary MORTON. Yes. I think it will, Mr. Chairman. I think any world discoveries are going to help and the increased world supplies are going to help the situation.

As you will remember in 1937, I think it was the Mexicans, the Government took over the American oil companies. This was quite a cause celebre for them. I think one of their principal national holidays is in commemoration of that Act.

I think that the meeting between President Echeverria and President Ford is very timely. I have asked Mr. Bob Anderson if he would stop by tomorrow on his way west, Chairman of the Board of ARCO, who has been heavily involved, and is a contractor in that, to brief the President from his knowledge of this discovery.

Again, if we are through diplomatic relationships and diplomatic abilities able to keep Mexico out of the cartel, and if she joins other nations in noncartel marketing of this oil, it inevitably will increase world supplies and then when world supplies are increased there will be great pressure for the reduction of price.

We must remember that this oil is not oil that is owned by any foreign or national oil company. It is owned by the Government of Mexico.

Chairman JACKSON. They nationalized, of course, many years ago, back in the early thirties.

Secretary MORTON. 1937, I think, sir is the date.

Chairman JACKSON. I have here before me the October 14 edition of the Petroleum Intelligence Weekly. They make this comment:

To the dismay of oil consuming nations, the world's biggest oil exporting country has again reversed itself on the matter of holding down prices after publicly disassociating itself from the last two oil cost hikes decreased by OPEC in Vienna last month and Quito last June, Saudi Arabia suddenly notified Arabian American Oil, Aramco, that it now expects to pay both increases.

The net result is that the Aramco companies are in a complete quandary at the moment as to just what their oil costs are either currently or retroactively for any month this year.

Apparently, as I understand it, the Saudi Oil Minister reiterated that his previous notice in late August of a boost in Aramco's buy-back costs still stands; that is, Aramco is expected to pay the highest of either one.

The buy-back price attained by the neighboring Gulf States are, too, highest price received by Saudi State Oil Agency in its small spot sales to third parties. This policy, the Oil Minister stated, goes

retroactively back to the beginning of 1974, with further retroactive claims to September 1 of 1973.

Mr. SAWHILL. Senator, we have been in constant touch with Aramco during this period of their negotiations. I would say the latter part of that statement about the demands that have been made by Minister Yamani are generally accurate, but the total article, I think, gives a mistaken impression that these negotiations have been concluded.

I think the whole question of a price to Aramco is still under discussion. There have been no conclusions reached as yet.

Chairman JACKSON. We are getting conflicting reports. These things are very hard to follow because there was some indication that there might be some hope of lessening of the price pressure.

Mr. SAWHILL. These representations that were made by Yamani to the Aramco companies were several weeks ago. Perhaps there will be a change in the Government's posture as a result of the recent statements by the King.

Chairman JACKSON. This is from the Oil and Gas Journal of October 14, by Ambassador Akins' statement:

He says Saudi Arabia's "lone voice" within the Organization of Petroleum Exporting Countries (OPEC) has been instrumental in keeping OPEC crude oil prices from rising to 50 percent above current prices, according to James E. Akins, U.S. Ambassador, Saudi Arabia.

That part of it, I wouldn't disagree. The Saudis have been very responsible. But it goes on here in the article. The Saudis are trying to do something. If the Saudis and the Shah would get together, we could get the price down.

They are the two keys to this problem on price. What disturbs me is that they refer in his interview to this. In reference to the 400 percent increase in OPEC crude oil price he said, "I say the price increase was not too high but much too sudden."

Gentleman, this sort of conflict doesn't help the situation when you get this kind of a statement out.

Mr. SAWHILL. I think we would agree that it is not only too high, but also too sudden.

Chairman JACKSON. On both counts?

Mr. SAWHILL. Yes.

Chairman JACKSON. I appreciate that frank statement.

Mr. Statler, counsel for the minority, had a couple of questions he wanted to ask.

Mr. STATLER. Mr. Greenspan, following up on the Chairman's question of Dr. Wallich and following up on part of your own testimony, I thought I heard you say that we must know more about the foreign operations of U.S. banks.

Mr. GREENSPAN. I am sorry. That is not exactly what I said. But what I was implying was that we must know more about the full process of the financial system abroad, meaning more specifically tracking precisely as best we can the flows of petrodollars, where they are going, what the impact is and what the total structure of the financial system is.

As it turns out, the data that come from the American banks is rather quite extensive in the total sense. In fact, it is quite far superior to the remaining data that we have abroad.

[At this point Senator Huddleston withdrew from the hearing room.]
 [The letter of authority follows:]

U.S. SENATE,
 PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
 OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
 Washington, D.C.

Pursuant to Rule 5 of the Rules of Procedure of the Senate Permanent Subcommittee on Investigations of the Committee on Government Operations, permission is hereby granted for the Chairman, or any member of the Subcommittee as designated by the Chairman, to conduct hearings in open session without a quorum of two members for administration of oaths and taking of testimony in connection with the Recycling of Petrodollars, on October 16, 1974.

HENRY M. JACKSON,
Chairman.

CHARLES H. PERCY,
Ranking Minority Member.

Mr. GREENSPAN. For example, our knowledge of the total Eurocurrency markets depends largely on data from the Bank for International Settlements. There are significant amounts of data published now, and in an expanded form, by the Bank of England.

The Federal Reserve publishes very useful data on the balance sheets of the branches of American banks abroad partially segregated by region and currency of obligation.

These are all exceptionally useful pieces of information. What I was trying to suggest is that with all of the information we now have available, we still don't have a fully comprehensive feel of developments in those markets.

I submit that we have to have more information prior to getting a firmer grasp on various types of policies.

Mr. STATLER. That is what I thought you were saying. My question is, what your recommendation is as to how we might get that information.

Mr. GREENSPAN. First of all, I think there is a great deal of information currently available in raw form which is not in my view properly analyzed.

I think statistical techniques can be brought to bear on information such as the weekly New York City Clearing House reports of the total deposits of the foreign branches of New York City banks which, as you know, comprise a fairly large component of the Eurocurrency market.

Those data in themselves are very useful. If we had other similar types of information I think we would get a much better feel of what is going on.

So it is not only more data but I think we have to start to really embark upon a much broader type of analysis of these numbers than we have today.

Mr. STATLER. Is there any data that is being withheld from you, either by foreign governments, foreign banks, or financial institutions in this country, that you could use?

Mr. GREENSPAN. I really can't answer that. I am certain it is not true about U.S. institutions. We obviously have very considerable access to them. There are obviously huge amounts of information which have never been collected. I don't think they probably can as a practical matter be collected.

I wouldn't say that the problem is of that sort.

Mr. STATLER. Just whose responsibility is it, in your view, to collect and collate the very data you are talking about? Is it the function of your Council or is it the Fed's responsibility? Who is the "we?"

Mr. GREENSPAN. As far as the "we" is concerned at the moment the Council is going to be doing some of this, hopefully, in the forum which I find useful for reasons I suspect different from either the Treasury or the Federal Reserve.

There is a huge amount of information which they have available and, of course, as you are well aware, there is an extraordinary detail in the reports which they have.

I think there are a number of economic problems which truly are more in the realm of either the Federal Reserve or the Treasury than the Council of Economic Advisers.

Mr. STATLER. Above and beyond the question of getting more or better information, do you have any recommendations as to, again relating to the chairman's question, how we might or whether we should better or more rigidly regulate the foreign operations of U.S. banking institutions and, if so, how we might go about doing that?

Mr. GREENSPAN. I have no view on the issue of regulations since the Council does not, of course, get involved in it. The whole area is something of which I have only peripheral knowledge.

Mr. STATLER. Returning immediately to the question at hand today, petrodollar situation, is there any indication in your reading of the reports that OPEC funds are now moving into longer term securities or longer term investments?

Mr. GREENSPAN. The only data I have at the moment is what the Treasury has made available in its answers to the questions submitted by this subcommittee.

That has been, so far as I can see, the best breakdown of the data that I have seen. I would suggest that that is at the moment the best source of that type of information.

Mr. STATLER. Going back to Senator Percy's opening remarks concerning the problems of Italy, in your analysis, over the next 6 to 8 months, what other countries should we be looking to for signs of instability as a result of the petrodollar problems, or perhaps above and beyond "instability," some kind of international insolvency or bankruptcy?

Mr. GREENSPAN. Let me put it this way: If I knew the answer to that, which I don't, I don't think it would be appropriate to discuss it in the first place.

Mr. STATLER. But I take it the information is available in terms of looking at who is importing what.

Mr. GREENSPAN. Yes. It is always very easy after the fact to say we should have known this well in advance because you go back and you look at the data and it clearly indicates to you that they were in trouble.

Hindsight is wonderful in this respect. What we fail to realize is there have been many, many companies in many, many countries which have gotten into severe difficulty and gotten out of it. So there is no inevitable sequence of events which once underway leads directly down the specific path which leads inevitably over the cliff.

So that even if we were to have the information I would like, in

its entirety, that still doesn't give us an accurate way of pinpointing where the problems are.

It does, however, give us some general views of where the danger points are and where our monitoring efforts should be focused.

Mr. STATLER. One final question to you, Mr. Secretary, and to Mr. Sawhill: If we were to assume a significant worldwide drop in consumption levels, could you describe a scenario by which you would expect the OPEC cartel price to drop?

In other words, could you describe for this committee what the tie-in is. I would ask you particularly to address yourselves to the question of shut-in reserves.

Secretary MORTON. I think it is a crystal ball proposition to try and say where you break the price of a cartel. I think cartels, historically, have fallen apart for various reasons. I think one of the very succinct remarks of the chairman was that if we could see some sort of agreement between Iran and the Saudis, this might have more of an effect than reduction in consumption to a certain point.

I think it is very difficult to say, but let's just use the figure of about 5 percent, a worldwide 5-percent reduction in demand for consumption, this obviously would have considerable effect on production.

I would ask John Sawhill because of the information he gets from his office of oil and gas to address the question of the scenario that you would use to achieve this.

I would have the feeling that something in the neighborhood of a 5-percent worldwide reduction in oil import purchases from the OPEC countries would begin to shake them. This is purely a political conjecture.

I don't see that there is any criteria whatsoever to really back it up.

Mr. SAWHILL. The only thing I could add to what Secretary Morton said is you really have two kinds of countries in the oil-producing nations. You have those that don't have a need for revenues and you have those that desperately do need revenues, such as Iran, would be in this category to some extent, Nigeria, Indonesia, and so forth.

It would seem to me that you might have a scenario something like this, and that is if we really did and were able to achieve a reduction in consumption of this country in the range of 1 million or 1.5 million barrels a day, the rest of the world was able to achieve a reduction in consumption of about the same amount or even greater, then what you might see would be in line with the ending of the concession system the OPEC countries beginning to lower their prices down towards the taxpaid cost; that is, the revenue that the OPEC nations themselves get on their equity, on the equity oil owned by the oil companies.

In other words, they can reduce those prices down and squeeze them.

Mr. STATLER. What would be the force compelling them to do that?

Mr. SAWHILL. I think the force compelling them to reduce the prices is you would have an excess of overconsumption. If you had storage tanks filled up, you would get some reduction in price because the weaker nations, the ones that you mentioned that need revenues would not cut back their production as a result of the decline in consumption.

Mr. STATLER. Is it in that respect that the shut-in reserves tend to have a great bearing on just how direct the relationship is or how elastic it is between consumption and this kind of cutting back?

Mr. SAWHILL. The other day when Senator Jackson and I were on a panel with Sheikh Yamani, I asked him specifically what would happen if world consumption reduced by 3 million barrels a day. He said, "We would not reduce our production."

The Iranians chimed in that they would not reduce their production. So if you didn't get either of those two countries reducing their production, certainly you would probably continue to get expansion from countries that need revenues, like Nigeria and others, and that would then lead to a lowering in price.

The mechanism I am suggesting through which it would happen is that as you are getting an ending to the concession system you can have these countries begin lowering their price without necessarily having to lower their take, so to speak.

They don't have to significantly lower their revenues. What is happening is that the major oil companies are losing their concessions.

Mr. STATLER. Thank you.

Chairman JACKSON. May I thank each of you for a very helpful presentation and I look forward to continuing this dialog to see if we can't find some answers as we go along the way.

I trust that we can, Mr. Secretary, identify the key areas where we can agree.

May I say the President deserves a lot of credit for pushing on food. There is a countervailing force here to petroleum, and that is food.

It is all-pervasive, too, like petroleum. People do have to eat. I hope that we can have not only massive production, massive conservation, but a massive food production program underway.

In looking down the road there are terrible shortages facing us worldwide. Food can be a critical force in all of this. I am not saying how we should use it. But it can be a countervailing force as far as one of the options that we can have available to us that could be useful.

I hope that we can work out a program which will protect the farmer and provide for the kind of incentives for massive food production because it can be a decisive factor in all of this.

I want to commend the President for that part of his economic message on this point.

The details obviously have to be worked out, but this is something that ought to be pushed hard because of its obvious impact internationally.

I want to thank each and all of you.

Secretary Simon's statement and responses to our questions will be included in the record.

[The statement referred to appears in the appendix beginning on page 69.]

[Whereupon, at 12:15 p.m., the subcommittee recessed, to reconvene subject to the call of the Chair.]

[Member present at time of recess: Senator Jackson.]

APPENDIX

THE SECRETARY OF THE TREASURY,
Washington, October 11, 1974.

DEAR MR. CHAIRMAN: I regret that a long planned meeting of the U.S.-U.S.S.R. Trade and Economic Council in Moscow will prevent me from appearing personally before the Subcommittee on Investigations on October 16 to discuss the recycling of surplus funds accruing to oil exporting nations. This is an issue of widespread world concern and one which I, as chief economic spokesman for the Administration, am happy to examine with the Congress.

You will recall that I submitted to the Subcommittee, in conjunction with my testimony on September 18, a statement on "The Financial and Economic Consequences of the Quadrupling of the Price of Oil." This statement summarized the information available to the Executive Branch concerning the funds accruing to oil exporting nations and the uses to which those funds have been put thus far this year. It contained comments on the capacity of the oil exporting nations to increase their imports so as to obtain payment for their oil in real resources on a current basis. That statement reviewed current recycling problems and the economic outlook for oil importing nations. Very little additional information has become available in the three weeks since that statement was submitted.

In the interval I have, however, discussed the problems created by the oil price increases with officials of many other nations, principally oil importing countries. At the annual meeting of the Boards of Governors of the IMF and the IBRD last week, there was general acceptance of the view I had earlier expressed that the complex of existing financial arrangements, private and official, had worked well to date and that considerable potential remains within the framework of these arrangements. A number of officials expressed concern, however, that these existing channels might not prove fully adequate in the future. Thus it was agreed that there should be examination of the possible need for supplementary arrangements. The new policy level "Interim Committee" of the IMF has asked the Executive Directors of that organization to examine the adequacy of existing arrangements and to report on the possible need for new facilities at the next meeting of the Interim Committee scheduled for mid-January.

You may be sure that I am continuing to follow developments in world financial markets and the financial problems facing individual countries with the greatest care. My views are set forth in the address which I made to the Governors of the IMF and the IBRD on October 1. You may wish to place the text of this address in the record. But a number of the specific questions raised in your letter of October 3 cannot be answered. We must recognize that OPEC countries are not prepared to inform fully the United States Government, other countries, or international agencies as to the nature and location of their investments throughout the world or their future plans for imports of goods and services. Furthermore, several of your questions ask for projections of future developments that cannot validly be made. The lack of comprehensive, detailed information on OPEC investments in other countries does not, however, prevent us from formulating the necessary policy decisions.

In order to contribute as much as possible to your hearings, however, I have asked my staff to prepare responses to your specific questions insofar as information is available. I would be happy to have these staff responses, which are attached, included in the record of the hearings.

The Comptroller of the Currency, Mr. James Smith, has participated in the preparation of the responses to the questions concerning the international activities of U.S. banks and concurs in the statements made.

In transmitting these responses, I would like to stress a point I made in stating my views on the oil price problem to the Subcommittee on September 18. Lower oil prices are in the long-run interests of both producer and consumer nations.

Oil price increases have fanned inflation, adversely affected living standards, distorted economies and created payments problems. They have brought oil exporting countries exceptionally high incomes in the short run but also the danger of a drastic erosion of their income in the long run. Oil prices will come down, and the sooner they come down the less will be the damage to the world economy.

Again, Mr. Chairman, may I express my regret in being unable to appear in person before your Subcommittee. I hope the information we are providing contributes to better understanding of one of the central problems of the world economy today.

Sincerely yours,

WILLIAM E. SIMON.

Enclosures.

[Department of the Treasury News]

ADDRESS OF HON. WILLIAM E. SIMON, SECRETARY OF THE TREASURY, BEFORE THE 1974 ANNUAL MEETINGS OF THE BOARDS OF GOVERNORS OF THE INTERNATIONAL MONETARY FUND, INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT, INTERNATIONAL FINANCE CORPORATION, AND INTERNATIONAL DEVELOPMENT ASSOCIATION, OCTOBER 1, 1974

Mr. Chairman, Mr. Witteveen, Mr. McNamara, Fellow Governors, Distinguished Guests:

Our recent annual meetings have reflected encouraging changes in the international economic scene. Three years ago, our attention was focused on the New Economic Policy introduced by the United States to eliminate a long-standing imbalance in the world economy. Two years ago we launched a major reform of the international trade and payments system. Last year we developed the broad outlines of monetary reform.

This year circumstances are different. We face a world economic situation that is the most difficult since the years immediately after World War II.

Our predecessors in those early postwar years responded well to the great challenges of that period. I am confident we can also respond appropriately to the challenges of our day. But first we must identify the issues correctly.

Let me declare myself now on three of these key issues.

First, I *do not* believe the world is in imminent danger of a drift into cumulative recession—though we must be alert and ready to act quickly should the situation change unexpectedly. I *do* believe the world must concentrate its attention and its efforts on the devastating inflation that confronts us.

Second, I *do not* believe the international financial market is about to collapse. I *do* believe that situations can arise in which individual countries may face serious problems in borrowing to cover oil and other needs. For that reason we must all stand prepared to take cooperative action should the need arise.

Third, I firmly believe that undue restrictions on the production of raw materials and commodities in order to bring about temporary increases in their prices threaten the prosperity of all nations and call into question our ability to maintain and strengthen an equitable and effective world trading order.

THE INFLATION PROBLEM

With respect to the first of these issues, it is clear that most countries are no longer dealing with the familiar trade-off of the past, balancing a little more or less inflation against little more or less growth and employment. We are confronted with the threat of inflationary forces so strong and so persistent that they could jeopardize not only the prosperity but even the stability of our societies. A protracted continuation of inflation at present rates would place destructive strains on the framework of our present institutions—financial, social and political.

Our current inflation developed from a combination of factors: in addition to pressures emanating from cartel pricing practices in oil, we have suffered from misfortune—including bad weather affecting crops around the world; bad timing—in the cyclical convergence of a worldwide boom; and bad policies—reflected in years of excessive government spending and monetary expansion. As financial officials, we cannot be held responsible for the weather, but we must accept responsibility for government policies, and we must recommend policies that take fully into account the circumstances of the world in which we find ourselves.

In today's circumstances, in most countries, there is in my view no alternative to policies of balanced fiscal and monetary restraint. We must steer a course of

firm, patient, persistent restraint of both public and private demand, and we must maintain this course for an extended period of time, until inflation rates decrease. We must restore the confidence of our citizens in our economic future and our ability to maintain strong and stable currencies.

Some are concerned that a determined international attack on inflation by fiscal and monetary restraint might push the world into a deep recession, even depression.

I recognize this concern, but I do not believe we should let it distort our judgment.

Of course, we must watch for evidence of excessive slack. The day is long past when the fight against inflation can be waged in any country by tolerating recession. We must remain vigilant to the danger of cumulative recession. But if there is some risk in moving too slowly to relax restraints, there is also a risk—and I believe a much greater risk—in moving too rapidly toward expansive policies. If we fail to persevere in our anti-inflation policies now, with the result that inflation becomes more severe, then in time countermeasures will be required that would be so drastic as to risk sharp downturns and disruptions in economic activity.

There is a tendency to lay much of the blame on the international transmission of inflation. Certainly with present high levels of world trade and investment, developments in any economy, be they adverse or favorable, are quickly carried to other economies. But that does not absolve any nation from responsibility to adapt its financial policies so as to limit inflation and to shield its people from the ultimate damage which inflation inflicts on employment, productivity and social justice in our societies.

RECYCLING AND THE STRENGTH OF CAPITAL MARKETS

In addition to inflation, public concern has centered on methods of recycling oil funds and on whether we need new institutions to manage those flows.

So far, our existing complex of financial mechanisms, private and intergovernmental, has proved adequate to the task of recycling the large volumes of oil monies already moving in the system. Initially, the private financial markets played the major role, adapting in imaginative and constructive ways. More recently, government-to-government channels have increasingly been opened, and they will play a more important role as time goes by. New financing organizations have also been established by OPEC countries. Our international institutions—and specifically the IMF and World Bank—have redirected their efforts to provide additional ways of shifting funds from lenders to borrowers. The IMF responded rapidly in setting up its special oil facility.

In our experience over the period since the sharp increase in oil prices three points stand out:

First, the amount of new investments abroad being accumulated by the oil-exporting countries is very large—we estimate approximately \$30 billion thus far in 1974.

Second, the net capital flow into the United States from all foreign sources, as measured by the U.S. current account deficit, has been small, about \$2 billion so far this year. During the same period our oil import bill has been about \$12 billion larger than it was in the comparable period last year.

Third, markets in the United States are channeling very large sums of money from foreign lenders to foreign borrowers. Our banks have increased their loans to foreigners by approximately \$15 billion since the beginning of the year, while incurring liabilities to foreigners of a slightly larger amount. This is one kind of effective recycling. And while some have expressed concern that excessive oil funds would seek to flow to the United States, and would require special recycling efforts to move them out, the picture thus far has been quite different.

No one can predict for sure what inflows of funds to the U.S. will be in the future. But it is our firm intention to maintain open capital markets, and foreign borrowers will have free access to any funds which come here. The United States Government offers no special subsidies or inducements to attract capital here; neither do we place obstacles to outflows.

Nonetheless, some have expressed concern that the banking structure may not be able to cope with strains from the large financial flows expected in the period ahead. A major factor in these doubts has been the highly publicized difficulties of a small number of European banks and one American bank which have raised fears of widespread financial collapse.

The difficulties of these banks developed in an atmosphere of worldwide inflation and of rapid increases in interest rates. In these circumstances, and in these relatively few instances, serious management defects emerged. These difficulties were in no way the result of irresponsible or disruptive investment shifts by oil-exporting countries. Nor were they the result of any failure in recycling or of any general financial crisis in any country.

The lesson to be learned is this: in a time of rapid change in interest rates and in the amounts and directions of money flows, financial institutions must monitor their practices carefully. Regulatory and supervisory authorities too must be particularly vigilant. We must watch carefully to guard against mismanagement and speculative excesses, for example, in the forward exchange markets. And we must make certain that procedures for assuring the liquidity of our financial systems are maintained in good working order. Central banks have taken major steps to assure this result.

Although existing financial arrangements have responded reasonably well to the strains of the present situation, and we believe they will continue to do so, we recognize that this situation could change. We should remain alert to the potential need for new departures. We do not believe in an attitude of *laissez-faire*, come what may. If there is a clear need for additional international lending mechanisms, the United States will support their establishment.

We believe that various alternatives for providing such supplementary mechanisms should be given careful study. Whatever decision is made will have profound consequences for the future course of the world economy. We must carefully assess what our options are and carefully consider the full consequences of alternative courses of action. The range of possible future problems is a wide one, and many problems can be envisaged that will never come to pass. What is urgently needed now is careful preparation and probing analysis.

We must recognize that no recycling mechanism will insure that every country can borrow unlimited amounts. Of course, countries continue to have the responsibility to follow monetary, fiscal and other policies such that their requirements for foreign borrowing are limited.

But we know that facilities for loans on commercial or near-commercial terms are not likely to be sufficient for some developing countries whose economic situation requires that they continue to find funds on concessional terms. Traditional donors have continued to make their contributions of such funds, and oil-exporting countries have made some commitments to provide such assistance. Although the remaining financing problem for these countries is small in comparison with many other international flows, it is of immense importance for those countries affected. The new Development Committee which we are now establishing must give priority attention to the problems confronting these most seriously affected developing countries.

TRADE IN PRIMARY PRODUCTS

For the past two years, world trade in primary commodities has been subject to abnormal uncertainties and strains. Poor crops, unusually high industrial demand for raw materials, transport problems, and limited new investment in extractive industries have all contributed to tremendous changes in commodity prices. Unfortunately, new forms of trade restraint have also begun to appear.

In the past, efforts to build a world trading system were concentrated in opening national markets to imports. Clearly, we need now also to address the other side of the equation, that of supply.

The oil embargo, and the sudden and sharp increase in the price of oil, with their disruptive effects throughout the world economy, have, of course, brought these problems to the forefront of our attention.

The world faces a critical decision on access to many primary products. In the United States we have sought in those areas where we are exporters to show the way by maximum efforts to increase production. Market forces today result in the export of many items from wheat to coal which some believe we should keep at home. But we believe an open market in commodities will provide the best route to the investment and increased production needed by all nations.

We believe that cooperative, market-oriented solutions to materials problems will be most equitable and beneficial to all nations. We intend to work for such cooperative solutions.

PROSPECTS FOR THE FUTURE

In the face of our current difficulties—inflation, recycling, commodity problems—I remain firmly confident that, with commitment, cooperation and coordination, reasonable price stability and financial stability can be restored.

The experience of the past year has demonstrated that although our economies have been disturbed by serious troubles, the international trade and payments system has stood the test.

Flexible exchange rates during this period have served us well. Despite enormous overall uncertainties, and sudden change in the prospects for particular economies, exchange markets have escaped crises that beset them in past years. The exchange rate structure has no longer been an easy mark for the speculator, and governments have not been limited to the dismal choice of either financing speculative flows or trying to hold them down by controls.

Another encouraging fact is that the framework of international cooperation has remained strong. Faced with the prospect of severe balance-of-payments deterioration, deficit countries have on the whole avoided short-sighted efforts to strengthen their current account positions by introducing restrictions and curtailing trade.

In the longer run, we look forward to reinforcing this framework of cooperation through a broad-gauged multilateral negotiation to strengthen the international trading system. In the "Tokyo Round," we hope to reach widespread agreement, both on trade *liberalization* measures—helping all countries to use resources more efficiently through greater opportunities for exchange of goods and services—and on trade *management* measures—helping to solidify practices and procedures to deal with serious trade problems in a spirit of equity and joint endeavor. It is gratifying that more and more governments have recognized the opportunities—and the necessity—for successful, creative negotiations on trade.

We in the U.S. Government recognize our own responsibility to move these negotiations along. Early last year we proposed to our Congress the Trade Reform Act to permit full U.S. participation in the trade negotiations. It is clear that in the intervening months the need for such negotiations has become all the more urgent. We have therefore been working closely with the Congress on this crucial legislation, and we shall continue to work to insure its enactment before the end of this year.

In the whole field of international economic relations, I believe we are beginning to achieve a common understanding of the nature of the problems we face. There is greater public recognition that there lies ahead a long, hard worldwide struggle to bring inflation under control. Inflation is an international problem in our interdependent world, but the cure begins with the policies of national governments. Success will require, on the part of governments, uncommon determination and persistence. There is today increasing awareness that unreasonable short-term exploitation of a strong bargaining position to raise prices and costs, whether domestically or internationally, inevitably intensifies our problems.

Finally I am encouraged that our several years of intensive work to agree on improvements in the international monetary system have now begun to bear fruit. The discussions of the Committee of Twenty led to agreement on many important changes, some of which are to be introduced in an evolutionary manner and others of which we are beginning to implement at this meeting.

For the immediate future, the IMF's new Interim Committee will bring to the Fund structure a needed involvement of world financial leaders on a regular basis, providing for them an important new forum for consideration of the financing of massive oil bills and the better coordination of national policies. The Interim Committee should also increasingly exercise surveillance over nations' policies affecting international payments, thereby gaining the experience from which additional agreed guidelines for responsible behavior may be derived.

Moreover, discussions in the Interim Committee can speed the consideration of needed amendments to the Fund's Articles of Agreement. These amendments, stemming from the work of the Committee of Twenty, will help to modernize the IMF and better equip it to deal with today's problems. For example, the Articles should be amended so as to remove inhibitions on IMF sales of gold in the private markets, so that the Fund, like other official financial institutions, can mobilize its resources when they are needed. In order to facilitate future quota increases, the package of amendments should also include a provision to modify the present requirement that 25 percent of a quota subscription be in gold. Such an amendment will be a prerequisite for the quota increase now under consideration. And the amendment will be necessary in any event for us to achieve the objectives shared by all the participants in the Committee of Twenty of removing gold from a central role in the system and of assuring that the SDR becomes the basis of valuation for all obligations to and from the IMF.

Preparation of an amendment to embody the results of the current quinquennial review of quotas offers us still another opportunity to reassess the Fund's role in

helping to meet the payments problems of member nations in light of today's needs and under present conditions of relative flexibility in exchange rates.

The trade pledge agreed by the Committee of Twenty provides an additional framework for cooperative action in today's troubled economic environment. It will mitigate the potential danger in the present situation of self-defeating, competitive trade actions and bilateralism. The United States has notified its adherence to the pledge, and I urge other nations to join promptly in subscribing.

The new Development Committee, still another outgrowth of the work of the Committee of Twenty, will give us an independent forum that will improve our ability to examine comprehensively the broad spectrum of development issues. We look forward to positive results from this new Committee's critical work on the problems of the countries most seriously affected by the increase in commodity prices and on ways to ensure that the private capital markets make a maximum contribution to development.

THE WORLD BANK AND ITS AFFILIATES

International cooperation for development is also being strengthened in other ways, notably through the replenishment of IDA. A U.S. contribution of \$1.5 billion to the fourth IDA replenishment has been authorized by Congress, and we are working with our congressional leaders to find a way to complete our ratification at the earliest possible date. A significant new group of countries has become financially able to join those extending development assistance on a major scale. We would welcome an increase in their World Bank capital accompanied by a commensurate participation in IDA.

The United States is proud of its role in the development of the World Bank over the past quarter century. We are confident that the Bank will respond to the challenges of the future as it has so successfully responded in the past.

One of these challenges is to concentrate the Bank's resources to accelerate growth in those developing countries with the greatest need.

A second challenge is to continue the Bank's annual transfer of a portion of its income to IDA. The recent increase in interest rates charged by the Bank is not sufficient to enable the Bank to continue transfers to IDA in needed amounts. We urge that the Bank's Board promptly find a way to increase significantly the average return from new lending.

A third challenge is that the Bank find ways to strengthen its commitment to the principle that project financing makes sense only in a setting of appropriate national economic policies, of effective mobilization and use of domestic resources, and of effective utilization of the private capital and the modern technology that is available internationally on a commercial basis.

I should mention also that we are concerned about the Bank's capital position. We should encourage the Bank to seek ways to assist in the mobilization of funds by techniques which do not require the backing of the Bank's callable capital.

Within the Bank Group, we are accustomed to thinking mainly of the IFC in considering private capital financing. While now small, the IFC is, in my view, a key element in the total equation, and should be even more important in the future. But the Bank itself needs to renew its own commitment to stimulation of the private sectors of developing countries.

Finally, let me emphasize that the capable and dedicated leadership and staff of the World Bank have the full confidence and support of the United States as they face the difficult challenges of the current situation.

CONCLUSION

Ladies and Gentlemen, the most prosperous period in the history of mankind was made possible by an international framework which was a response to the vivid memories of the period of a beggar-thy-neighbor world. Faced with staggering problems, the founders of Bretton Woods were inspired to seek cooperative solutions in the framework of a liberal international economic order. Out of that experience evolved an awareness that our economic and political destinies are inextricably linked.

Today, in the face of another set of problems, we must again shape policies which reflect the great stake each nation has in the growth and prosperity of others. Because I believe that interdependence is a reality—one that all must sooner or later come to recognize—I remain confident that we will work out our problems in a cooperative manner.

The course which the United States will follow is clear. Domestically we will manage our economy firmly and responsibly, resigning ourselves neither to the inequities of continued inflation nor to the wastefulness of recession. We will strengthen our productive base, we will develop our own energy resources, we will expand our agricultural output. We will give the American people grounds for confidence in their future.

Internationally, let there be no doubt as to our course. We will work with those who would work with us. We make no pretense that we can, or should, try to solve these problems alone, but neither will we abdicate our responsibility to contribute to their solution. Together, we can solve our problems. Let me reaffirm our desire, and total commitment, to work with all nations to coordinate our policies to assure the lasting prosperity of all of our peoples.

Question 1. What are the short, middle and long-term financial and economic consequences for the U.S. and other industrialized oil consuming nations of importing oil at current OPEC prices, and what are the consequences for the less developed countries?

A. What are the current rates of inflation, by country, for industrialized oil consuming nations and for the less developed countries? What are the projected rates of inflation for these countries?

Answer. The financial and economic consequences of the oil price increase were described in Secretary Simon's statement to the Subcommittee of September 18. Data on current rates of inflation in various countries are provided in Table 1, from the International Monetary Fund's publication, *International Financial Statistics*. Information on projected rates of inflation is not available for most countries. Projections prepared by the Organization for Economic Cooperation and Development for seven major industrial countries are provided in Table 2.

TABLE 1.—CHANGES IN CONSUMER PRICES

	Percent change in 12 months ¹																
	1974											July					
	1967	1968	1969	1970	1971	1972	1973	Oct.	Nov.	Dec.	Jan.		Feb.	Mar.	Apr.	May	June
INDUSTRIAL COUNTRIES																	
United States.....	85.0	89.6	94.4	100.0	104.3	107.7	114.4	7.9	8.4	8.8	9.3	10.1	10.2	10.2	10.7	11.1	11.5
United Kingdom.....	85.2	89.2	94.0	100.0	109.4	117.2	128.0	10.0	10.3	10.6	12.0	13.2	13.5	15.2	16.0	16.5	-----
Industrial Europe:																	
Austria.....	90.4	93.0	95.8	100.0	104.7	111.3	119.7	7.0	7.9	7.9	8.1	8.5	8.9	9.8	9.6	10.2	13.7
Belgium.....	90.3	92.8	95.2	100.0	104.3	110.0	117.7	6.8	6.7	7.3	7.5	8.4	9.5	10.4	11.6	12.6	-----
Denmark.....	83.9	90.6	93.9	100.0	105.8	112.8	123.3	10.3	11.3	12.6	14.4	13.6	13.8	14.2	14.3	-----	-----
France.....	85.1	89.0	94.4	100.0	105.5	111.7	119.9	8.0	8.4	8.4	10.3	11.5	12.2	13.2	13.5	13.9	-----
Germany.....	93.4	94.9	96.7	100.0	105.3	111.1	118.8	6.5	7.4	7.8	7.4	7.6	7.2	7.1	7.2	6.9	-----
Italy.....	91.6	92.8	95.3	100.0	104.8	110.8	122.8	11.1	11.5	12.6	13.2	14.2	15.2	15.5	15.4	16.6	19.3
Netherlands.....	86.7	86.9	90.5	100.0	107.5	115.9	125.2	7.9	8.0	8.2	8.1	8.8	9.2	8.9	8.8	8.9	-----
Norway.....	87.7	87.0	90.4	100.0	106.2	113.9	122.4	7.4	7.7	7.6	8.5	8.9	9.0	8.8	8.7	8.2	8.8
Sweden.....	83.0	84.0	93.0	100.0	107.0	114.0	122.0	7.0	8.0	8.0	8.0	10.0	11.0	10.0	10.0	9.6	9.8
Switzerland.....	82.0	82.0	90.5	100.0	106.6	113.7	123.6	7.0	10.8	11.9	11.6	10.0	9.6	8.8	8.8	10.9	11.3
Canada.....	89.0	89.0	96.8	100.0	102.9	107.8	116.0	8.6	9.3	9.1	9.1	9.6	10.4	9.9	10.9	11.4	-----
Japan.....	83.7	88.3	93.3	100.0	108.3	111.4	124.5	13.2	14.9	17.2	20.7	23.6	21.7	23.3	21.3	21.7	-----
OTHER DEVELOPED AREAS																	
Other Europe:																	
Finland.....	88.0	94.0	97.0	100.0	106.0	114.0	126.0	13.0	13.0	15.0	15.0	16.0	17.0	18.0	18.0	18.0	-----
Greece.....	94.4	94.8	97.1	100.0	103.0	107.5	123.8	23.2	28.3	30.6	33.5	33.5	33.4	32.7	31.9	30.2	31.7
Iceland.....	64.0	72.0	88.0	100.0	107.0	117.0	131.8	-----	29.0	-----	-----	32.0	-----	-----	43.0	-----	-----
Ireland.....	82.2	86.0	92.4	100.0	108.9	118.4	131.8	-----	17.9	-----	-----	13.4	-----	-----	16.3	-----	-----
Malta.....	92.4	94.2	96.4	100.0	102.3	105.8	113.9	6.5	5.9	6.2	5.7	6.1	6.1	5.9	5.7	5.7	-----
Portugal.....	81.4	85.4	94.0	100.0	101.9	123.9	139.9	16.6	17.0	19.0	19.3	23.2	28.7	26.7	25.5	15.3	-----
Spain.....	88.2	85.4	94.6	100.0	108.2	117.2	130.6	13.9	13.8	14.2	14.0	14.2	15.7	16.6	16.4	-----	-----
Turkey.....	92.6	92.6	94.6	100.0	101.9	117.2	149.1	17.7	17.1	16.7	16.7	16.7	16.7	16.6	16.4	-----	-----
Yugoslavia.....	81.0	85.7	93.7	100.0	115.7	129.2	162.0	17.0	17.0	21.0	22.0	20.0	19.0	19.0	18.0	19.0	20.0
Australia.....	91.0	85.0	90.0	100.0	115.0	135.0	122.9	-----	13.2	10.2	-----	-----	-----	-----	-----	-----	-----
New Zealand.....	85.8	89.5	96.2	100.0	106.0	112.2	127.7	-----	10.2	10.2	9.0	9.4	9.7	9.6	9.7	9.7	-----
S. Africa.....	91.2	93.1	96.1	100.0	105.7	112.5	123.3	9.3	10.2	10.2	9.0	9.4	9.7	9.6	9.7	9.7	-----

LESS DEVELOPED COUNTRIES

Latin America:														
Argentina.....	76.0	82.0	88.0	100.0	135.0	213.0	344.0	52.4	44.7	43.7	29.4	22.4	14.3	
Bolivia.....	89.2	94.1	96.2	100.0	103.6	110.3	145.1	51.7	24.6	34.7	16.0	19.0	22.0	25.0
Brazil.....	55.0	67.0	82.0	100.0	120.0	140.0	458.0	12.0	43.0	14.0	529.0	652.0	699.0	746.0
Chile.....	46.0	58.0	75.0	100.0	120.0	213.0	966.0	528.0	329.0	508.0	23.0	23.4	27.8	24.1
Colombia.....	80.3	85.0	93.6	100.0	109.0	124.6	183.0	18.1	17.7	21.1	25.0	25.4	27.8	17.0
Costa Rica.....	89.4	93.0	95.6	100.0	103.1	107.8	129.5	18.1	17.1	17.3	15.3	15.2	17.2	16.6
Dominican Republic.....	95.4	95.5	96.3	100.0	104.3	112.5	132.2	19.9	17.5	20.3	22.8	22.2	26.7	29.7
Ecuador.....	85.8	89.4	95.2	100.0	108.4	117.0	132.2	8.4	8.8	7.9	9.1	10.2	13.1	16.2
El Salvador.....	95.0	97.5	97.3	100.0	100.5	102.0	108.5	8.4	17.9	17.9	21.2	18.2	19.1	18.2
Guatemala.....	93.9	95.6	97.7	100.0	99.5	100.1	113.9	24.0	21.6	17.5	7.6	9.1	7.5	10.6
Honduras.....	80.9	85.7	91.1	100.0	101.8	105.5	110.8	1.4	3.5	3.1	30.4	29.1	29.3	28.8
Jamaica.....	89.7	91.7	95.1	100.0	106.7	111.9	134.6	26.2	24.9	29.6	21.3	22.2	22.2	22.6
Mexico.....	97.9	93.6	100.8	100.0	105.8	111.1	123.6	14.8	15.1	20.3	21.3	23.7	30.2	27.2
Paraguay.....	75.3	89.6	95.2	100.0	104.9	114.6	129.2	9.9	13.5	14.2	21.0	23.7	30.2	25.0
Peru.....	87.9	95.2	97.5	100.0	107.1	114.5	125.4	12.4	14.0	13.7	14.3	16.1	15.6	16.3
Trinidad-Tobago.....	32.0	71.0	85.0	100.0	103.5	113.0	129.8	20.0	23.9	24.3	21.6	21.2	22.0	23.0
Uruguay.....	82.0	87.0	92.0	100.0	124.0	218.0	430.0	94.7	78.0	71.5	5.2	5.6	5.6	5.4
Venezuela.....	94.0	95.2	97.6	100.0	103.2	106.1	110.5	4.9	5.5	5.7	5.2	5.6	5.6	5.3
Middle East:														
Cyprus.....	92.0	95.4	97.7	100.0	104.2	109.2	117.7	10.4	11.0	9.8	11.6	15.9	17.0	17.7
Egypt.....	89.7	93.2	96.3	100.0	103.1	105.3	117.7	16.3	14.1	12.9	11.1	11.0	13.4	14.0
Iran.....	94.4	95.0	98.3	100.0	104.2	110.9	121.8	3.1	3.3	2.9	3.7	5.9	3.9	9.5
Iraq.....	88.7	90.6	95.8	100.0	103.6	109.0	114.3	21.7	24.9	26.4	28.5	37.5	27.5	8.7
Israel.....	90.1	92.0	94.2	100.0	112.0	126.4	151.6	9.5	33.5	18.6	17.9	17.2	17.2	9.6
Jordan.....	87.1	86.8	93.6	100.0	119.7	129.4	142.9	9.5	33.5	18.6	17.9	17.2	17.2	9.6
Syria.....	93.0	97.0	96.0	100.0	105.0	106.0	127.0	20.8	23.4	24.1	13.9	13.9	13.9	9.6
Other Asia:														
China, Republic.....	85.3	91.9	96.5	100.0	102.6	107.5	121.6	26.9	31.0	28.6	37.9	61.1	63.0	58.5
India.....	91.0	94.0	95.0	100.0	103.0	109.0	128.0	21.0	23.0	24.0	25.0	25.0	28.0	28.0
Korea.....	72.5	80.6	88.7	100.0	112.4	125.6	129.4	12.8	3.2	4.3	15.3	17.7	21.6	24.5
Malaysia.....	98.7	98.5	98.1	100.0	101.6	115.5	115.5	15.5	17.8	18.2	18.3	21.9	21.2	19.2
Pakistan.....	94.4	94.3	95.7	100.0	107.7	117.2	143.8	31.3	35.5	25.4	32.1	32.9	37.6	36.4
Philippines.....	83.8	86.7	87.4	100.0	114.6	126.3	140.2	16.8	32.5	27.3	27.6	32.0	33.4	36.5
Sri Lanka.....	85.1	87.9	94.4	100.0	102.7	109.2	119.4	14.0	14.1	13.4	19.6	19.9	21.4	14.1
Thailand.....	93.1	97.1	99.1	100.0	102.0	106.0	118.4	12.6	14.5	16.5	18.7	19.9	21.4	25.4
Vietnam.....	47.0	61.0	73.0	100.0	118.0	148.0	214.0	52.0	57.0	59.0	63.0	64.0	68.0	68.0
Other Africa:														
Ghana.....	81.6	89.1	94.3	100.0	102.6	116.4	131.9	192.0	7.2	18.4	11.4	15.9	19.6	66.0
Ivory Coast.....	83.1	87.5	91.4	100.0	98.5	98.8	109.7	14.5	12.6	14.8	16.1	15.9	19.6	66.0
Libya.....	85.3	89.0	96.1	100.0	104.5	105.6	109.7	9.1	8.8	10.5	14.9	14.9	14.9	18.0
Morocco.....	96.5	95.8	96.7	100.0	104.1	108.0	112.5	9.1	8.8	10.5	14.9	14.9	14.9	18.0
Nigeria.....	80.2	79.9	87.8	100.0	116.1	119.3	144.0	11.0	12.0	13.0	12.0	14.0	16.0	17.0
Senegal.....	93.5	93.9	97.7	100.0	102.6	106.2	114.0	9.0	18.2	19.1	24.1	28.9	29.0	18.0
Suriname.....	94.9	85.4	96.2	100.0	101.4	112.7	128.9	3.5	3.6	6.9	10.1	8.3	1.9	1.9
Tunisia.....	92.7	95.0	98.9	100.0	105.7	107.9	112.7	8.1	8.0	8.1	8.4	10.2	9.2	9.2
Zambia.....	85.9	95.1	97.5	100.0	160.0	111.6	118.2	8.1	8.0	8.1	8.4	10.2	9.2	9.2

Source: International Financial Statistics, International Monetary Fund.

Computed over corresponding month of preceding year.

TABLE 2.—OECD ESTIMATES: CONSUMER PRICES IN SEVEN MAJOR COUNTRIES¹

[Percentage changes, seasonally adjusted at annual rates, estimates and forecasts]

	Average 1959-60 to 1970-71	From previous half-year								
		From previous year			1973		1974		1975	
		1972	1973	1974	I	II	I	II	I	
Canada.....	2.2	3.5	5.6	10	4.9	8.7	11½	8	7¼	
United States.....	2.4	2.6	5.3	10	5.4	7.9	11½	9¼	7½	
Japan.....	5.6	4.9	11.8	24¼	10.3	19.2	29¾	20¼	15	
France ²	4.1	6.2	7.3	14	6.2	9.8	15	16	14	
Germany.....	2.8	5.6	7.2	8½	6.8	7.7	7¾	11¼	9¼	
Italy ²	3.9	5.7	10.8	19	12.1	11.0	19½	25	18	
United Kingdom.....	3.5	6.7	8.6	15	8.5	9.3	16½	18½	12	
Total of above countries ³	3.2	4.1	7.2	13¼	6.9	10.0	14¾	13	10¼	

¹ National accounts implicit price deflator.² Consumer price index.³ 1973 weights and exchange rates.

Source: Economic Outlook, Organization for Economic Cooperation and Development, July 1974.

Question I.A.1. What merit, if any, is there in producer country claims that recent price rises merely compensate them for the increasing cost of foodstuffs, manufactured goods, and other commodities?

Answer. The facts do not bear out OPEC contentions that the recent oil price increases were justified by increases in the prices of goods they import. Chart 1 following shows that oil price increases have far outstripped rises in other major commodity prices, as measured by three commodity price indexes taken from *The Economist*. In the same chart, a comparison between Saudi Arabian government revenues per barrel and an index of OAPEC (Organization of Arab Petroleum Exporting Countries) import prices constructed by the Treasury Department suggests that OPEC terms of trade improved substantially from 1955 through the 1960's. As of January 1974, a barrel of OPEC oil in effect "bought" nearly five times as much as in 1955.

Such comparisons can, of course, be based on a number of different price indices, base years, etc. But regardless of the base year used, our data indicate that the October 1973 price increases made OPEC's terms of trade more favorable than ever before (pre-1955 terms of trade were doubtlessly less favorable than in 1955). The January oil price increases, then, represented an enormous further improvement in OPEC's already historically favorable terms of trade.

Question I.A.2. What dollar amounts have been expended by OPEC nations for the importation of goods and services, by country and by classification (e.g., industrial goods, commodities, armaments and military equipment), for each year beginning in 1971?

Answer. Complete and comparable information on the current accounts of the OPEC countries is not available for the years requested. Table 3 provides data on total merchandise imports for the years 1971-73, based on information reported by the OPEC countries' trading partners. Information on the commodity composition of imports and the source of imports for 1972 is presented in Table 4. The trade shares for 1972 closely approximate those for the neighboring years. Available information on armaments purchases is provided in Table 5. The categories shown in available trade statistics, however, do not permit identification of significant items such as military aircraft, armored vehicles, and artillery. Table 5, therefore, at best only suggests the focus of some countries' arms sales; for example, the United States and Iran, France and Algeria, Italy and Libya.

TABLE 3—IMPORTS
[In millions of U.S. dollars]

	1971	1972	1973
OPEC countries, total.....	11,211	14,919	20,088
Algeria.....	1,221	1,472	2,342
Ecuador.....	340	317	517
Indonesia.....	1,110	1,458	2,783
Iran.....	1,871	2,410	3,442
Iraq.....	694	713	898
Kuwait.....	650	797	1,042
Libya.....	699	1,038	1,904
Nigeria.....	1,511	1,505	1,876
Qatar.....	80	124	170
Saudi Arabia.....	920	1,380	1,893
United Arab Emirates.....	300	423	784
Venezuela.....	1,815	2,202	2,437

Source: Direction of Trade, Annual 1969-73, International Monetary Fund.

TABLE 4.—PERCENTAGE DISTRIBUTION OF IMPORTS OF OPEC COUNTRIES, BY CATEGORY, BY COUNTRY, 1972

	Total	Consumption goods	Manufactured goods	Raw materials	Machinery and transport	Other
Total OPEC.....	100	14	29	12	42	3
United States.....	20	3	3	2	10	2
Canada.....	2					
Japan.....	13		7	1	5	
United Kingdom.....	10		3	1	6	
West Germany.....	10		3	1	6	
France.....	8	1	2	1	4	
Italy.....	7		3		3	
Other Western Europe.....	11	2	3	1	4	
Other.....	19	6	6	2	4	
Algeria.....	100	16	28	14	43	
United States.....	7	2			4	
Canada.....	2	2				
Japan.....	2		1		1	
United Kingdom.....	6		1		4	
West Germany.....	16		5	1	10	
France.....	34	3	9	5	16	
Italy.....	11		6	2	4	
Other Western Europe.....	18	3	7	3	5	
Other.....	4	4				
Ecuador.....	100	14	26	16	42	1
United States.....	46	11	12	5	18	1
Canada.....	2		1			
Japan.....	13		5	1	6	
United Kingdom.....	6	1	1	1	3	
West Germany.....	11		2	3	4	
France.....	3		1		2	
Italy.....	3		1		1	
Other Western Europe.....	12		3	2	6	
Other.....	5	3		3		
Indonesia.....	100	15	23	19	40	1
United States.....	21	6	2	4	8	
Canada.....	1					
Japan.....	42	1	16	5	18	
United Kingdom.....	3			1	3	
West Germany.....	8		1	1	5	
France.....	2					
Italy.....	1					
Other Western Europe.....	7	1	1	2	4	
Other.....	15	6	1	6	2	

See footnotes at end of table

TABLE 4.—PERCENTAGE DISTRIBUTION OF IMPORTS OF OPEC COUNTRIES, BY CATEGORY, BY COUNTRY, 1972—Continued

	Total	Consumption goods	Manufactured goods	Raw materials	Machinery and transport	Other
Iran.....	100	10	29	10	44	7
United States.....	20	3	2	1	9	6
Canada.....	1				1	
Japan.....	12		6	1	4	
United Kingdom.....	9		2	1	6	
West Germany.....	15		4	2	10	
France.....	5		1		3	
Italy.....	5		1		3	
Other Western Europe.....	11		4	1	5	1
Other.....	21	5	8	2	5	
Iraq.....	100	19	33	14	34	1
United States.....	3				1	
Canada.....						
Japan.....	4		2		2	
United Kingdom.....	9		2	1	5	
West Germany.....	4			1	2	
France.....	10	1	2	1	6	
Italy.....	4		1		3	
Other Western Europe.....	15	2	3	1	9	
Other.....	51	16	21	8	5	
Kuwait.....	100	21	39	7	33	
United States.....	16	2	2	1	11	
Canada.....						
Japan.....	17		9		7	
United Kingdom.....	10	2	3	1	5	
West Germany.....	8		2	1	5	
France.....	4		2		1	
Italy.....	5		3		1	
Other Western Europe.....	9	2	3	1	2	
Other.....	32	14	15	2		
Libya.....	100	19	25	9	44	2
United States.....	8		2		6	
Canada.....						
Japan.....	5		3		3	
United Kingdom.....	10		3	1	6	
West Germany.....	10	1	2	1	7	
France.....	12	2	2		8	
Italy.....	29	2	12	4	10	1
Other Western Europe.....	10	3	3	2	2	
Other.....	15	9		3	3	
Nigeria.....	100	10	35	12	40	1
United States.....	8	1	1		4	
Canada.....	1				1	
Japan.....	8		4		3	
United Kingdom.....	25	1	7	4	12	1
West Germany.....	10		2	2	6	
France.....	5	1	1		3	
Italy.....	3		1		3	
Other Western Europe.....	12	3	4	1	4	
Other.....	27	3	14	4	7	
Qatar.....	100	19	24	7	48	1
United States.....	9		1		7	
Canada.....						
Japan.....	11		6		4	
United Kingdom.....	21	2	5	1	13	
West Germany.....	5		2		4	
France.....	6	1	2		4	
Italy.....	2		1		1	
Other Western Europe.....	7	1	1		3	1
Other.....	38	16	6	3	12	

See footnotes at end of table.

TABLE 4.—PERCENTAGE DISTRIBUTION OF IMPORTS OF OPEC COUNTRIES, BY CATEGORY, BY COUNTRY, 1972—Continued

	Total	Consumption goods	Manufactured goods	Raw materials	Machinery and transport	Other
Saudi Arabia.....	100	24	25	9	41	3
United States.....	27	4	3	1	17	2
Canada.....	1					
Japan.....	21		12		8	
United Kingdom.....	10	1	2	1	4	
West Germany.....	7		2	1	4	
France.....	4		1		1	
Italy.....	5		1		3	
Other Western Europe.....	10	3	3	1	3	
Other.....	16	14		2		
United Arab Emirates.....	100	13	42	6	36	3
United States.....	14		3		10	
Canada.....						
Japan.....	19		13		6	
United Kingdom.....	14	1	3	1	8	
West Germany.....	3		1		2	
France.....	1				1	
Italy.....	1					
Other Western Europe.....	5	2	1		1	
Other.....	43	9	21	3	8	2
Venezuela.....	100	9	26	15	49	1
United States.....	43	6	8	6	21	1
Canada.....	7		1		4	
Japan.....	8		5		3	
United Kingdom.....	5	1	1	1	3	
West Germany.....	10		3	2	6	
France.....	4		1		1	
Italy.....	6		2		4	
Other Western Europe.....	11	1	4	2	4	
Other.....	6		2	2	3	

Notes: (1) Details may not add to totals because of rounding. (2) indicate a negligible amount of imports. (3) Other Western Europe excludes data for Greece, Iceland, Ireland, Portugal, and Turkey.
Source: OECD trade statistics.

TABLE 5.—PARTIAL DATA FROM OFFICIAL TRADE STATISTICS RELATING TO OPEC COUNTRIES' PURCHASES OF ARMAMENTS FROM OECD COUNTRIES 1972

(Million United States dollars)

Importing country	Exporting country					Other Western Europe ¹
	United States	Canada	West Germany	France	Italy	
Total OPEC.....	175.437	0.002	0.206	0.052	20.841	24.852
Algeria.....	.070			.048		.001
Ecuador.....	.298		.074			.026
Indonesia.....	1.956		.034		.001	.001
Iran.....	148.813		.003		3.265	24.528
Iraq.....					.173	
Kuwait.....					13.823	
Libya.....	1.422					
Nigeria.....	.031			.001		
Qatar.....					.428	
Saudi Arabia.....	18.382		.003		.605	.001
United Arab Emirates.....			.001	.003	.440	
Venezuela.....	4.465	.002	.091		2.106	.295

¹ Does not include Portugal, Greece, Turkey, Ireland, or Iceland.

Note. Data for the United States are the difference between total exports to the indicated countries and the exports included in SITC 0 through 9 in OECD trade statistics. This difference corresponds to the Special Category exports included, in official United States export totals. Data for France are from official French trade statistics. The Canadian, West German Italian, and other Western Europe data are SITC 951 (Firearms, munitions, military items) from OECD trade statistics.

Question I.A.3. What are the projected dollar amounts to be expended by the OPEC nations on imports, by country and by classification, for the years 1974, 1975 and 1976?

Answer. Because of the enormous increase in the OPEC countries' liquid assets, uncertainties over future oil consumption and oil prices, and uncertainties about the speed and nature of real adjustments in both the oil exporting and the oil importing countries, projections of OPEC country imports are not feasible.

Question I.B. What are the present and anticipated future trade deficits for industrialized oil consuming nations and the less developed countries, by country, at current and prospective rates of inflation?

1. To what extent and in what amount do increased oil prices account for these deficits?

Answer. The U.S. is likely to have a trade deficit in the second half of 1974 approaching \$5 billion, with some further increase in the deficit expected in 1975. OECD estimates of trade balances for selected other industrial countries are provided in Table 6. Similar projections of trade balances are not available for most developing countries; U.N. estimates of current account balances for selected developing countries are provided in Table 7. (The effect of the oil price increases on countries' trade balances is impossible to determine accurately. Any assessment must take account not only of the direct impact of such price increases on oil consumption and oil import volumes but also of increases in exports to oil exporting countries and of changes in trade flows caused by indirect effects of the oil price increases in the importing countries—e.g., higher prices for exports with a high petroleum content, and reduced levels and growth of national income.)

TABLE 6.—OECD JULY 1974 ESTIMATES OF TRADE BALANCES

[Dollars amount in billions, f.o.b.]

Country	1974	1st half 1975
Canada.....	1.7	0.7
Japan.....	-2.3	.2
Germany.....	20.3	8.5
France.....	-4.1	-1.5
United Kingdom.....	-12.2	-5.2
Italy.....	-10.1	-3.4

Source: "Economic Outlook," OECD, July 1974.

Question I.C. What volume of world petroleum exports, if any, is being made for soft currencies or in barter arrangements, and what is the outlook for expansion of such exports to less developed countries (and illiquid developed nations)?

Answer. In general, the oil producing countries have adhered to OPEC policies and avoided granting price discounts to consumers. Instead, they have relied largely on aid arrangements to afford some relief to selected developing countries. Nonetheless, several barter arrangements are under negotiation, but our knowledge about their terms is extremely limited. Given the small number of developing countries engaged in these negotiations, the potential volume of oil involved will be in all likelihood less than 1 percent of annual world oil exports.

There are to date no reports of oil purchase agreements involving repayment in soft currencies, although several developing countries may be purchasing oil at discounted prices.

Question I.D. What have been the net volume of oil producer funds, by country, flowing into various money markets: Eurodollar deposits, U.S. bank deposits, Federal securities, industrial bonds and commercial paper, etc.?

1. What are the projected volumes of such funds, by country and by market, for the years 1974, 1975, and 1976?

2. What, if any, mechanisms exist to monitor the influx of these funds under the existing regulatory scheme and what future monitoring mechanisms are contemplated?

3. What impact in these markets has the influx of oil producer funds had on interest rates, and what future impact is anticipated?

Answer. Estimates of OPEC investments made between January 1 and August 31, 1974, and available detail on the form and location of these investments are provided in Tables 8-11.

TABLE 7.—UNITED NATIONS SEPTEMBER 1974 ESTIMATES OF CURRENT ACCOUNT BALANCES FOR SELECTED DEVELOPING COUNTRIES

[Millions of dollars]

	Current account deficit ¹	
	1974	1975.
Bangladesh.....	612	657
Central African Republic.....	39	49
Chad.....	68	80
Dahomey.....	23	30
Democratic Yemen.....	70	-----
El Salvador.....	78	-----
Ghana.....	-7	85
Guinea.....	92	70
Guyana.....	74	48
Haiti.....	50	67
Honduras.....	84	104
India.....	1,919	2,270
Ivory Coast.....	153	203
Kenya.....	197	274
Lesotho.....	2 87	2 95
Madagascar.....	88	82
Mali.....	53	46
Mauritania.....	26	28
Niger.....	31	23
Pakistan.....	485	513
Senegal.....	133	109
Sierra Leone.....	70	62
Somalia.....	56	59
Sri Lanka.....	152	185
Sudan.....	90	122
United Republic of Cameroon.....	43	67
United Republic of Tanzania.....	229	218
Upper Volta.....	82	73
Yemen.....	54	-----
Total.....	\$ 5,004	\$ 5,524

¹ Minus sign indicates surplus.² Balance on trade account.³ Sum of listed amounts excluding Lesotho.

Source: United Nations.

OPEC surpluses are now accruing at a rate of roughly \$5 billion per month. Future rates of accrual will, of course, be dependent on oil prices, the volume of oil purchased from OPEC countries by the oil importing nations, the capacity of the OPEC countries to absorb imports of goods and services, and the ability of the oil importing countries to supply the goods which OPEC countries seek to buy.

We cannot project with sufficient validity to be useful the volume of oil producer funds which may be placed in any particular money market in the future. Our expectations as to OPEC investment strategies were discussed in the statement submitted to the Committee on September 18.

Oil importing countries maintain widely varying systems to monitor capital imports. Even with the more comprehensive systems, it is often impossible to identify with certainty the ultimate beneficial owner of invested funds. In virtually all countries, banks are allowed to preserve confidentiality with respect to the identity of their depositors, and other types of assets can be purchased through nominees.

Countries in which the major financial centers are located generally obtain reports in varying detail from banks, other financial institutions, brokers and corporations concerning the magnitude of changes in their liabilities to foreign residents. By this means they monitor the flows of various types of foreign funds. These flows are usually compiled by country of the nominal investor, and there is no assurance that the nominal investor is the actual owner of the asset.

In recognition of the need for more and better information on foreign investment in the United States than is now available, the Administration has supported S. 2840 and companion legislation in the House which would require the Treasury and Commerce Departments to undertake a comprehensive study of existing foreign portfolio and direct investment in the United States. In anticipation of the passage of this legislation, the Treasury and Commerce Departments are making preparations for a comprehensive survey to determine the extent of foreign investment in the United States as of the end of 1974. In addition, these agencies, in accordance with the provisions of the pending legislation, (1) will

study the adequacy of information, disclosure, and reporting requirements and procedures on foreign investment in the United States and (2) will make recommendations on methods whereby information and statistics on foreign direct investment can be kept current.

A number of agencies have continuing responsibility to collect data on investment inflows. The Bureau of Economic Analysis of the Department of Commerce collects data, on a continuing basis, on foreign direct investment in any U.S. business enterprise, including commercial firms and real estate. Intermediaries must report on behalf of foreign owners.

The Treasury Department collects data on a monthly basis from U.S. brokers, dealers and bankers on transactions in U.S. and foreign long-term securities, both for their own account and for customers; also, U.S. firms are required to report to the U.S. Treasury direct dealings in securities with foreigners.

The Securities and Exchange Commission has reporting requirements applicable to all investors, and no distinction is made between foreign and domestic investors. Any investor who acquires more than 5 percent of the beneficial ownership of a class of registered securities of a corporation must file a report identifying the investor, his residence and employment, the source of funds for the acquisition and the purpose of the transaction. In addition, an issuer of registered securities must disclose the identity and holdings of each person, whether domestic or foreign, who owns or records or beneficially 10 percent or more of any class of its stock.

Under the industrial security program, defense contractors handling classified material are required to inform the Department of Defense whenever foreign investors own more than 6 percent of their equity. Moreover, a number of Federal regulatory agencies obtain information on the industries for which they have jurisdiction. These regulatory agencies include the Civil Aeronautics Board, Federal Communications Commission, Federal Maritime Commission, Federal Power Commission, Federal Trade Commission, Interstate Commerce Commission, and the Securities and Exchange Commission. While the reporting criteria used by these regulatory agencies are not necessarily uniform, an enormous amount of detailed information regarding corporate ownership by U.S. and foreign interests is obtained. A description and evaluation of these separate reports is found in "Disclosure of Corporate Ownership" (Senate Doc. 9362, March 4, 1974) prepared for the Committee on Government Operations.

With respect to future mechanisms for monitoring foreign investment, the Securities Exchange Commission, beginning November 12, 1974, will conduct public hearings concerning, *inter alia*, the beneficial ownership of securities and the takeover and acquisition of U.S. corporations by foreign and domestic investors. In its proceeding the Commission will examine whether there is adequate disclosure to the investing public of the ownership of voting rights and other benefits of ownership of the securities of publicly owned corporations, and whether there is adequate disclosure and guidance respecting acquisitions and takeovers. The objectives of the proceeding will include development of information on the necessity or desirability of recommending to the Congress legislation with respect to the possible lowering of the reporting and disclosure thresholds, and determination whether there is a need to provide for other means of reporting beneficial ownership in publicly held corporations.

In the light of the widespread interest in foreign investment in the United States, the Executive Branch intends to undertake a study of the adequacy of the present data-acquisition programs conducted by various U.S. Government agencies. In the course of this study, we should be able to discern any significant gaps in our present reporting systems, to determine to what extent confidentiality provisions prevent disclosure of specific information, and to ascertain what remedial action, if any, is necessary.

The influx of oil producer funds has probably not affected the level of U.S. interest rates, since the Federal Reserve has been able to offset the impact through open market operations. Since the level of Euro-dollar rates tends to parallel that of domestic U.S. rates, the influx of funds has also probably not significantly affected the level of Euro-dollar rates. While the spread between Euro-dollar rates and U.S. rates did widen this summer, most observers attribute this phenomenon to the effects of the collapse of the Bank Herstatt and related market uncertainties, rather than to recycling of oil producer revenues.

The term and risk structures of U.S. and Euro-dollar interest rates have, however, been altered. With respect to the term structure, this reflects the different preferences of oil producing and oil consuming countries. Oil producing countries have favored short-term, liquid assets, while the oil consuming countries with current-account deficits have generally sought to borrow on a long-term basis.

These preferences have reduced short-term interest rates in relation to long-term rates.

The risk structure of interest rates has been altered, in part, by the strains imposed on banks from the redistribution of deposits from oil consumers to oil producers, which have concentrated their deposits in the largest banks. Many smaller and even some large banks have had a problem in attracting deposits and redeposits. To compete for funds, these banks have had to pay an interest premium. It is possible that the structural effects may lessen over time as oil producing countries widen their selection of investment instruments, both with respect to maturity and risk, for a given set of interest rates.

TABLE 8.—ESTIMATED OPEC INVESTMENTS MADE BETWEEN JAN. 1 AND AUG. 31, 1974

	Billions of dollars
In the United States (of which over \$4,000,000,000 perhaps \$5,000,000,000 in the U.S. Treasury bills and other marketable Government securities).....	7.0
In the United Kingdom (British Government securities and other sterling assets).....	3.0
In other European countries and Japan (largely direct placement loans to official or quasi-official agencies some real estate and private securities).....	2.0
International institution bonds.....	.5
LDC's.....	2.5
Euro-currency markets.....	13.0
Total	28.0

Source: U.S. Treasury Department/OASIA.

TABLE 9.—RECENT MONTHLY CHANGES IN BANK AND MONEY MARKET ASSETS OF OIL PRODUCING COUNTRIES IN THE UNITED STATES

[Increase or decrease (-); in millions]

1974	Venezuela	Indonesia	Other Asia ¹	Other Africa ¹	Total
January.....	-\$8	\$53	\$104	\$29	\$178
February.....	176	-11	-110	207	262
March.....	100	66	249	291	706
April.....	561	64	497	165	1,287
May.....	-49	-85	-56	203	13
June.....	460	37	687	237	1,421
July.....	-108	606	1,062	101	1,660
August.....	400	-77	2,838	215	2,1376
January to August total.....	1,531	653	2,270	1,449	2,6903

¹ Other Asia and other Africa groupings include and are strongly dominated by the Middle-Eastern and African OPEC countries respectively—for which individual data have not up to now been collected on a month-by-month basis.

² Includes \$200,000,000 purchase of medium-term U.S. agency bonds.

Source: Treasury Bulletin and Treasury foreign exchange reports.

TABLE 10.—RECENT MONTHLY CHANGES IN OFFICIAL STERLING HOLDINGS OF OIL PRODUCING COUNTRIES IN THE UNITED KINGDOM

[Increase or decrease—; in million dollar equivalents]

1974	Banks and money market			Medium term United Kingdom Government securities	Total
	Deposits ¹	Treasury-bills	Subtotal		
January.....	434	75	509	100	609
February.....	-374	121	-253	235	-18
March.....	-59	247	188	61	249
April.....	1,235	67	1,302	12	1,314
May.....	-637	460	-177	-12	-189
June.....	-35	197	162	51	213
January to June total.....	564	1,167	1,731	447	2,178

¹ Includes banks, local authorities, and hire-purchase finance companies.

Source: Bank of England Quarterly Bulletin, September 1974.

TABLE 11.—RECENT MONTHLY CHANGES IN EURO-CURRENCY HOLDINGS OF OIL PRODUCING COUNTRIES IN BANKS IN UNITED KINGDOM

[Increase (+) or decrease (-); in millions of dollars equivalent of]

	Venezuela	Middle East oil producers ¹	Algeria	Nigeria	Indonesia	Total
1974:						
January.....	1	500	51	-8	-23	522
February.....	18	874	77	-18	3	953
March.....	21	908	107	-2	-4	1,030
April.....	130	1,651	34	1	157	1,973
May.....	-58	984	137	-1	59	1,122
June.....	40	1,244	82	0	42	1,407
January to June total.....	152	6,161	488	-28	234	7,007

¹ Includes Libyan Arab Republic.

Source: Bank of England Quarterly Bulletin September 1974.

Question I.E. Which other industrialized consumer nations and in what amounts, have received substantial surplus funds of oil producing nations?

Answer. Our information on the investment of OPEC funds in other nations is very incomplete. From the information available at this time, we believe other industrial nations that have received substantial inflows of capital from OPEC countries include the U.K., France and Japan. Some funds have apparently been invested in Germany.

All of the foreign exchange receipts of OPEC countries that are not spent for imports of goods or services must be invested somewhere in the non-OPEC countries in some form. The OPEC countries have an extremely wide choice of types of investment and of geographic locations for their investments. Presumably each OPEC government or official agency receiving the foreign exchange will make its own independent choice as to where it places its money and in what type of instrument.

Question I.F. What proportion of future surplus oil revenues will be offset by the export of goods and services from consumer nations to the oil producing countries?

1. What is the nature and estimated dollar volume of these projected exports by consumer nations?

2. To what extent and in what amounts will oil producers absorb surplus revenues in internal economic development?

Answer. As indicated in the answer to question I.A.3., we are unable to provide the projections requested.

Question II. To what extent are existing private financial institutions successfully accommodating the near-term recycling of surplus oil revenues?

Answer. The bulk of oil-producer accumulations to date has been placed with banks and other private financial institutions. The private financial markets have, in our view, proved broadly adequate to the immediate task of recycling and have shown ingenuity in devising new techniques to adapt to and cope with strains arising from the massive increase in capital flows.

Question II.A. What is the dollar amount of surplus funds that has been recycled by the international banking system, i.e., transferred from oil producing to oil consuming nations, during the last year, and what are the amounts expected to be recycled in the coming year?

Answer. Private estimates of overall growth in the Euro-currency market, broadly defined, are provided in Table 12. It is estimated that between January and August 31, 1974, some \$13 billion of OPEC investments was placed in the Euro-currency markets (see Table 8).

Tables 13-15 provide estimates of medium and long-term international lending activities. There are no estimates as to the proportion of these loans taken up directly or indirectly by the OPEC countries.

TABLE 12.—RECENT ESTIMATES OF WORLDWIDE EURO-BANKING MARKET

[Estimated foreign currency liabilities of banks in major European countries plus Bahamas, Canada, Japan, and Singapore; in billions of dollars]

	Gross	Net ¹
Outstanding liabilities at end of:		
1973		
June.....	235	125
September.....	265	140
December.....	295	155
1974		
March.....	330	170
June.....	360	185
July.....	370	190

¹ Adjusted to exclude double counting that results from interbank redepositing.

Source: World Financial Markets, Morgan Guaranty Trust Co.

TABLE 13.—AVAILABLE MONTHLY INDICATORS OF INTERNATIONAL BORROWING ON MEDIUM- AND LONG-TERM CAPITAL MARKETS

[In millions of dollars]

	Europe and other non-U.S. markets			Memo: U.S. market	
	New issues of European and other foreign bonds	Medium-term European bank loan commitments	Total	New foreign bond issues (mainly Canada)	Change in long-term U.S. bank claims
1974:					
January.....	0	2,150	2,150	327	(- 59)
February.....	239	1,784	2,023	144	51
March.....	309	2,898	3,207	189	176
April.....	64	¹ 4,854	¹ 4,918	273	613
May.....	279	² 4,989	² 5,268	50	46
June.....	154	2,317	2,471	556	294
July.....	128	1,290	1,418	336	(- 24)
August.....	176	1,293	1,469	28	(- 30)
Total.....	1,349	21,575	22,924	1,903	1,067

¹ Of which \$1,700,000,000 to Italy and \$1,500,000,000 to France, leaving \$1,654,000,000 and \$1,718,000,000, respectively, for other.² Of which \$2,500,000,000 to United Kingdom, leaving \$2,489,000,000 and \$2,768,000,000, respectively, for other.

Sources: Bond issues: World Financial Markets, Morgan Guaranty Trust Co. Euro-bank commitments: IBRD. U.S. bank claims: Treasury Department.

TABLE 14.—NEW INTERNATIONAL BOND ISSUES, 1974
 [Millions of dollars]

	January	February	March	April	May	June	July	August	September	Total January-September
Foreign bonds issued in the United States.....	327	144	189	273	50	556	336	28	325	2,228
Foreign companies.....	25	25	64	52	50	147	77	18	---	394
State enterprises.....	124	35	64	35	---	100	184	10	---	702
Governments.....	30	84	125	185	---	309	75	---	---	783
International organizations.....	148	---	---	---	---	---	---	---	---	148
Euro and foreign bonds issued outside the United States.....	---	239	309	64	279	154	128	176	115	1,464
Companies.....	---	104	59	50	94	63	56	125	64	615
State enterprises.....	---	43	108	11	69	19	72	10	51	383
Governments.....	---	91	34	3	3	72	---	33	---	235
International organizations.....	---	---	108	---	113	---	---	8	---	229
Total.....	327	383	498	337	329	710	564	204	440	3,792

Source: World Financial Markets, Morgan Guaranty Trust Co.

TABLE 15.—MEDIUM TERM EURO-CURRENCY CREDITS, 1974

In millions of dollars]

	January	February	March	April	May	June	July	August	January to August
Developed countries.....	1,335	1,146	1,734	3,584	4,135	1,102	572	924	14,532
Less developed countries.....	815	638	1,164	1,270	854	1,215	718	369	7,043
	2,150	1,784	2,898	4,854	4,989	2,317	1,290	1,293	21,575

¹ Not included is \$869,000,000 lent to nonmembers of IBRD, mainly Eastern Europe.

Source: IBRD.

Question II.B. What effect has the process of recycling surplus oil revenues had upon the stability of the international banking system?

Answer. Concern for the soundness of the international banking system has stemmed largely from well publicized instances of difficulties of a few banks in the U.S. and abroad. Yet those banks' financial difficulties have been the result of factors unrelated to the large increase in oil exporter investment funds in the international banking system. They arose in an atmosphere of rapid inflation and rising interest rates and were associated with management problems.

In fact, banks and other financial institutions have generally performed well in handling sharply increased capital flows and in adapting to the new situation. But there have been, and will be, strains.

One source of strains on international banks is the oil exporters' preference for short-term placement of their excess revenues, while banks conventionally lend longer term. In this situation prudently managed banks have become more selective in accepting placements, thus reinforcing a recent tendency on the part of oil exporters to make longer-term placements with banks and to arrange direct placements with borrowers outside the banking system.

For the international banks, shifts in ownership of monetary assets from oil importing to exporting countries have probably also resulted in a greater concentration or ownership of deposits. This development also gives banks reason for caution.

At the same time, oil exporters have become more selective in the choice of banks with which to deal, seeking out the larger and more secure financial institutions. These banks have been able to obtain funds from oil producers at interest rates below the market. At the same time, smaller banks have experienced difficulties in obtaining funds, leading to a "tiering" of the interbank market.

Finally, banks now appear more selective in their lending practices. While this greater selectivity may increase the difficulties facing some borrowers, this practice also serves to insulate the international banks from the strains created by the higher oil prices.

Question II.B.1. What specific regulatory mechanisms exist to evaluate the performance, solvency, and risk exposure of foreign branches, subsidiaries and consortia engaged in the recycling process abroad?

Answer. The central bank governors of countries that are members of the Group of Ten¹ agreed to intensify the exchange of information between central banks on the activities of banks operating in international markets and, where appropriate, to tighten regulations governing foreign exchange operations. They also reviewed the problem of the lender of last resort in the Euro-markets and concluded that means were available for that purpose and could be used whenever necessary. The Federal Reserve Board may wish to comment further on this question.

In the United States, responsibility for the evaluation of the performance, solvency, and risk exposure of the foreign operations of U.S. banks is shared between the Federal Reserve Board and the Comptroller of the Currency, if the U.S. bank is a national bank, as most of the large U.S. banks are. The Federal Reserve will comment on its regulatory procedures; the following comments are directed to the activities of the Comptroller of the Currency.

¹ Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom and the United States. Switzerland, while not a member, also participates.

Since its creation in 1863, the Office of the Comptroller of the Currency has been an integral part of the national banking system and has been responsible for the examination of national banks on a regular basis. These examinations include the evaluation of all the bank's assets, both domestic and foreign. Examinations also include an evaluation of the soundness and solvency of the bank and, for banks engaged in international business, an evaluation of the country risks taken by each bank.

During the 1960's, U.S. banks expanded their overseas operations dramatically. As of January 1, 1967, only seven national banks had overseas branches; in six years the number had increased to 83 national banks with 581 foreign branches. Concomitantly with this expansion in overseas banking, the Comptroller's Office adapted its supervisory activities. During the late 1960's, the Comptroller's Office developed detailed instructions and forms to be used in obtaining information from foreign branches and foreign affiliates of U.S. banks, and requirements as to supportive data were notified to national banks in early 1970. Generally these data include the names, amounts and credit information pertaining to all investments and to 70-80 percent of all extensions of credit. The examiner's report on the foreign operations of a bank is combined with a simultaneous report on the domestic operations to give a statement of the examined bank's overall position.

Direct examinations are also made overseas. More than 150 bank examiners from the 14 domestic regions form a cadre for periodic overseas detail to conduct examinations of original records, collateral documents, borrowers' financial statements, operational and internal control procedures at the foreign facility, and examination of foreign exchange activities. Since the first of this year, direct assignments of examiners to the international departments of 100 of the largest U.S. banks reinforce the effectiveness of the overseas examination. Moreover, in the interests of economy, and in view of the concentration of branches of U.S. banks in London, the Comptroller's Office in September 1972 assigned three bank examiners to the American Embassy in London to make examinations of London banking offices in coordination with the examinations being conducted in the 14 domestic regions.

Other countries have similarly tightened their examination procedures. For example, the German authorities, who had earlier established new procedures and guidelines to limit foreign exchange transactions by banks, have established a "liquidity bank" and have proposed revisions to their banking legislation. The Luxembourg authorities and the Bank of England have also developed more precise guidance for indigenous banks and foreign facilities, in particular consortia banks, to protect the safety and soundness of their banking systems.

Question II.B.2. To what extent do present banking and governmental arrangements assure the continued liquidity of banks facing a potentially abrupt withdrawal of short-term petrodollar deposits?

Answer. As indicated above, central bankers recently reviewed this question and concluded that means were available for this purpose and could be used as necessary. To ensure the liquidity of banks, however, is not the same as ensuring the solvency of individual institutions.

Question II.B.3. What surveillance or control mechanisms exist to prevent unduly risky foreign exchange transactions by U.S. banks?

Answer. Apart from the authority available to the bank regulatory agencies—the Comptroller of the Currency and the Board of Governors of the Federal Reserve System—there are no control mechanisms which could be used to prevent unduly risky foreign exchange transactions by U.S. banks. With regard to surveillance mechanisms, the Treasury Department is about to put into effect a new reporting requirement under which banks in the United States, including the agencies and branches of foreign banks, and the foreign branches and subsidiaries of U.S. banks, will provide weekly and monthly reports on their position in nine major foreign currencies. These reports are provided for in the September 1973 amendment to the Par Value Modification Act, and arise from concern over the position of the dollar in the exchange markets rather than concern over the risk exposure of individual banks. The weekly reports will enable us to monitor current developments in the foreign exchange markets as they might affect the exchange value of the dollar, and the monthly reports will give a more comprehensive view of the banks' positions in major foreign currencies. The monthly reports are sufficiently detailed so that they will be of some value to the bank regulatory agencies by providing a general indication of a bank's foreign exchange exposure and of changes in its activities in these currencies.

Question II.C. For what period can the private banking sector, unassisted, meet the credit demands of oil consuming nations within the limits of prudent risk exposure?

1. What is the potential for an adverse impact on the domestic operations of U.S. banks in the absence of assistance for recycling surplus oil revenues?

2. What monetary and fiscal policies are needed to complement the recycling effort and will these precipitate further deterioration in the domestic economy?

Answer. We do not expect the private banking sector alone to meet the credit needs of oil consuming countries. As explained in more detail elsewhere, this role has been played by a complex of mechanisms, and we expect that numerous channels for financial flows will continue to be utilized in the future. It is reasonable to anticipate that private channels will continue to play a major role.

So long as banks follow prudent banking practices and manage their operations carefully, there is no reason to expect their domestic operations to be adversely affected by the problems of recycling. Banks are not pressured to lend against their own judgment. We have encouraged our banks and our bank regulators to exercise vigilance in the face of abrupt increases in the volume of international capital flows. The banks themselves are very much aware of the need to follow sound banking practices. There is a need to be sure that capitalization is adequate to deal with substantially expanded volumes of operations, and banks will have to be particularly careful in evaluating their foreign lending, but these are problems to which banks are well accustomed. These problems are not peculiar to foreign lending.

There is no reason to expect that significant adjustments in U.S. monetary and fiscal policies will be undertaken for the purpose of the recycling effort. The Federal Reserve System takes into account capital inflows and outflows in executing its monetary policies, but both fiscal and monetary policy must continue to be directed at controlling inflation within the context of appropriate growth rates.

Question III. To what extent do existing statutory authorities and legal regulations compel or enable Federal agencies, foreign central banks, or other world organizations to provide funding and assistance to private financial institutions facing problems of short-term liquidity, or imminent collapse and bankruptcy?

A. What provision has been made, by or between government agencies, to assist the foreign branches of U.S. banks with such problems?

B. What provision has been made, by or between government agencies, to assist foreign subsidiaries of U.S. banks and multinational consortia in which U.S. banks participate?

(1) To what extent and under what circumstances will government agencies assist these foreign branches, subsidiaries and consortia, and what domestic or international repercussions might such assistance entail?

(2) What domestic or international consequences would follow the denial of such assistance?

C. What international agreements, if any, clarify the responsibility of the host and home countries with regard to subsidiary and multi-national financial institutions?

D. What problems have accompanied the expansion of foreign operations by U.S. banks, and what specific regulatory adjustments have been required to deal with these difficulties?

E. What new proposals have been or are being studied to assure adequate supervision of foreign banking activities, and when will additional regulations, if any, be promulgated?

Answer. The response to this question will be provided by the Federal Reserve Board.

Question IV. What policy or set of policies, bilateral or in cooperation with international authorities, has been devised to alleviate the plight of consumer nations unable to secure funds in private money markets?

Answer. A variety of channels, both bilateral and multilateral, is available and has been used to assist those countries which may not have adequate access to private markets to meet their needs. Currently available information is summarized below:

The IMF oil facility, presently having about \$3.5 billion in resources borrowed from oil producers, has begun operations and has made loans totaling \$0.7 billion to 23 countries, developed and developing. In addition, net drawings on the IMF's regular resources have amounted to about \$1.7 billion thus far in 1974. Substantial amounts remain available through the oil facility, and through the Fund's regular facilities—which can be supplemented by the existing "General Arrangements to Borrow," presently totaling some \$6.6 billion.

The Federal Reserve swap network, totaling some \$20 billion, remains virtually unused.

In June, the major industrial countries agreed in principle that gold could be used as collateral for international loans, and pursuant to this agreement Germany has extended a \$2 billion credit to Italy.

The EC member states have agreed to provide Italy a further extension of an existing \$1.9 billion loan, and discussions are underway concerning a possible medium-term credit.

The EC is also considering a joint borrowing from oil exporters to assist member states with their financing needs.

The oil producers have made direct loans to a number of developed countries, including Iranian credits of \$1.2 billion to the U.K. and of \$1 billion to France. Press reports suggest that Japan has also obtained a credit of \$1 billion from an oil producing country.

The OPEC countries also have made commitments totaling \$18 billion for the year ending September 1, 1974, to developing countries and multilateral lending institutions. Although the terms of these commitments vary greatly and disbursements will probably extend over a number of years, we believe that \$3 billion (including \$500 million in purchases of IBRD bonds) is a reasonable estimate of actual disbursements for the 1974 calendar year to August 31, 1974.

Question IV.A. What is the impact on industrial consumer nations of allowing existing market conditions to determine credit allocations?

Answer. The key question is not the impact of particular financial arrangements but the impact of the price increases themselves on the real incomes and living standards of the oil importing countries.

We believe the private financial markets have performed well in absorbing large flows of funds from the oil producers and allocating those funds among countries. The markets should be expected to continue to perform this function for the bulk of the flows. However, the private markets are not the exclusive means of recycling oil related capital flows. Inevitably, the private financial markets played the major role in the immediate aftermath of the oil price increases. More recently, government-to-government channels have increasingly been opened, and they may well play a more important role as time goes by. New financing organizations have also been established by OPEC countries, and the IMF and World Bank have redirected their efforts to provide additional ways of shifting funds from lenders to borrowers.

Although existing financial arrangements have responded reasonably well to the strains of the present situation, and we believe they will continue to do so, we recognize that this situation could change. If there is a clear need for additional international lending arrangements, the United States will support their establishment. Since the range of possible future problems is a wide one, and many problems that can be envisaged will never come to pass, what is urgently needed now is careful preparation and probing analysis of the adequacy of existing mechanisms and proposals for new supplemental arrangements.

Question IV.B. What is the impact on the less developed countries of allowing existing market conditions to determine credit allocation?

Answer. The answer to the foregoing question applies generally to the better off developing countries. However, it is generally recognized that the private market and existing official mechanisms are not adequate for the most seriously affected and poorest of the developing countries. These countries have limited debt service capacities and cannot afford to assume greater debt burdens. These countries must have access to highly concessional or grant financing if they are to avoid serious set-backs to their development programs and economic well-being. This issue is to be given urgent attention by the newly created joint IMF/IBRD Ministerial Committee on the Transfer of Real Resources.

Question IV.C. Which of these industrialized or less developed countries if any, are confronted with the potential of near-term bankruptcy or financial collapse?

Answer. At present, the major industrial and better off developing countries are obtaining the financing they need from the existing complex of private and official sources. While situations can arise in which individual countries face serious problems in borrowing to cover oil and other needs, it is impossible to say what future conditions may be and which of the more advanced countries may face difficulties. For that reason all must stand prepared to take cooperative action should the need arise. Much will ultimately depend on the degree of success in curbing inflation, conserving energy use and developing alternative energy supplies, and the future course of oil prices.

With regard to the most seriously affected developing nations, the danger is very serious disruption of economic activity, production, development and growth. As noted in the answer to the previous question, this problem is being given

priority attention. The United Nations has identified some twenty-nine (29) countries which may not be able to finance a desirable level of imports during the current year. These are Cameroon, Central African Republic, Chad, Kenya, Lesotho, Malagasy Republic, Mali, Mauritania, Niger, Sierra Leone, Somalia, Sudan, Tanzania, Upper Volta, Bangladesh, India, Pakistan, Sri Lanka, Haiti, Senegal, El Salvador, Guyana, Honduras, Dahomey, Ghana, Ivory Coast, Guinea, the Yemen Arab Republic, and the Democratic Republic of Yemen.

Question IV.C.1. What emergency or contingency planning exists, whether bilateral or in cooperation with international authorities, to assist countries in the event of such bankruptcy or financial collapse?

Answer. Existing channels to assist more advanced countries in meeting their financing need have been described earlier. U.S. views on the question of new arrangements is contained in the responses to questions IV.A and IV.E.

Emergency or contingency plans to assist the most seriously affected developing countries will be discussed in the newly established Joint Ministerial Committee on the Transfer of Real Resources, as noted above, as well as in the United Nations. The President announced a three point U.S. program: (1) an increase in the value of our food aid, (2) an increased emphasis in our traditional and continuing foreign aid program upon improving agricultural capacity in developing nations, and (3) an international effort regarding food reserves.

Question IV.C.2. In what amounts might assistance be required and through which institutions would it be channeled?

Answer. The UN estimates the additional critical requirement for the most seriously affected developing countries will be in the range of \$2 billion in each of 1974 and 1975 as a result of the oil price increases.

A variety of channels is being used to funnel resources to these countries. The oil exporters have made commitments of concessional assistance totaling \$1.9 billion over a period of years, of which as much as \$700 million may be disbursed in the short-run. The U.S. will be providing almost \$1 billion in ordinary and fast-disbursing assistance. New aid pledged for disbursement through the U.N. Emergency Operation is in excess of \$100 million, consisting of contributions from Venezuela, Algeria, Iceland and the EC. The EC has promised \$150 million, of which \$30 million will be available for disbursement by the UN. The EC has indicated willingness to increase its commitment to up to \$500 million (although it is not clear that this is all new incremental assistance), contingent upon the pledge of proportional quantities from the U.S., the oil exporters and others. The IMF oil facility could provide up to a maximum of \$1.7 billion in credits to the most seriously affected developing nations if sufficient funds are available to the facility, though the terms of loans from the oil facility do not meet the need for concessional financing on the part of the most seriously affected developing countries.

Other donor bilateral assistance is continuing and, in some cases, increasing. In the aggregate, the reaction to the identified need has been formidable, but according to most estimates, including our own, insufficient to the requirement. We estimate that after all known commitments are provided there will remain a gap of somewhat less than \$1 billion spread among a small number of countries.

Question IV.C.3. What impact would the giving of aid have for the economies of the donors and what consequences would follow the denial of such assistance?

Answer. The provision of aid by the U.S. and other industrial countries is intended to accomplish a transfer of real resources from the donors to the recipients and, other things being equal, should mean an increase in the total demand for the former's goods and services for export to the latter. However, if our estimates of \$1-2 billion of assistance required are accurate, this aid will have only a marginal effect on total demand in the donor countries. Aid from the major oil producing countries should have no significant impact on the donors' economies, since it would simply represent a change in the oil producers' portfolios of financial assets.

If means were not available for individual countries to finance their higher-cost oil imports they could be forced to take measures to reduce the growth of domestic income and the level of both oil and non-oil imports. The countries least able to obtain financing or adjust to higher oil import costs are typically those already at the lowest levels of development and per capita income. Without outside assistance, some of them might be pushed below subsistence levels of income.

Action on a significant scale by countries of a substantial size designed to reduce imports in the face of large oil deficits would have important secondary effects, in that a resultant contraction of world trade would be reflected in the reduced exports of other countries, which might in turn be forced to take deflationary or competitive steps to offset the deterioration of their own external positions. This

general problem is by no means exclusive to the developing countries and was noted in the following terms by the Committee of Twenty at a meeting in Rome immediately following the oil price increases:

"Members of the Committee began by reviewing important recent developments, including the large rise in oil prices and the implications for the world economy. They expressed serious concern at the abrupt and significant changes in prospect for the balance of payments structure.

"They recognized that the current account surpluses of oil producing countries would be very greatly increased, and that many other countries—both developed and developing—would have to face large current account deficits. In these difficult circumstances the Committee agreed that in managing their international payments, countries must not adopt policies which would merely aggravate the problems of other countries. Accordingly, they stressed the importance of avoiding competitive depreciation and the escalation of restrictions on trade and payments. They further resolved to pursue policies that would sustain appropriate levels of economic activity and employment, while minimizing inflation. They recognized that serious difficulties would be created for many developing countries and that their needs for financial resources will be greatly increased; and they urged all countries with available resources to make every effort to supply these needs on appropriate terms. The Committee agreed that there should be the closest international cooperation and consultation in pursuit of these objectives. They noted that the International Monetary Fund, the World Bank, and other international organizations are concerned to find orderly means by which the changes in current account positions may be financed, and they urged that these organizations should cooperate in finding an early solution to these questions, particularly in relation to the difficult problems facing non-oil producing developing countries."

Question IV.D. What special programs, bilateral or under the auspices of international authorities, currently provide credit to oil consuming nations and what dollar amounts have been extended under them?

Answer. These programs have been described in the answers to other questions.

Question IV.E. What new programs are anticipated and what estimated dollar amounts will be required to meet the future credit needs of oil consuming nations?

1. What analysis has been undertaken to assess the adequacy of an expanded special oil facility under IMF supervision, and what conclusions and policy options are suggested thereby?

2. What analysis has been undertaken to assess the feasibility of organizing the proposed Fund for Capital Recycling, and what conclusions and policy options are suggested thereby?

3. What analysis has been undertaken to determine the need for other cooperative international action, such as a special petrodollar recycling facility massively funded by thirty or more billions of dollars?

4. What analysis has been undertaken of proposals to use the financial leverage of the economically strongest oil consuming nations, including a possible limitation of incoming oil surpluses to a level not exceeding the deficits of their own oil balance of trade.

Answer. The question is impossible to answer with any precision or confidence at this time. The prospective size of oil exporters' surpluses is marked by great uncertainty concerning oil prices, energy conservation and diversification in the oil-importing countries, the pace of import expansion in the oil exporting countries and the rate of real adjustment to higher oil prices that individual oil-importing countries will want to achieve. The possible need for new, supplemental credit programs is subject not only to these uncertainties, but also to questions about the geographical distribution of oil producer investments in the future and the extent to which the existing private and official channels will be adequate to handle any needed redistribution of funds.

These questions were a focal point of the discussion at the IMF/IBRD annual meetings two weeks ago. It was generally recognized that the private financial markets and other existing financial mechanisms had worked well to date, and that considerable potential remained within the framework of these arrangements. There was also a widely expressed concern that existing channels might not prove fully adequate in the future, and that preparatory work on possible supplementary arrangements should be undertaken. Several proposals were put forward for further study and elaboration, including expansion of the special IMF oil facility, a separate new IMF oil facility, an oil-importing country mechanism and a joint consumer-producer investment agency.

The needed analysis of the problem and of these and other proposals is under way. At its inaugural meeting October 3, the new policy-level "Interim Committee" of the IMF requested the Executive Directors to consider as a matter of

urgency the adequacy of existing private and official arrangements and to report on the possible need for additional arrangements, including through the IMF. The Executive Directors will consider this question on a priority basis and are expected to report in time for the next meeting of the Interim Committee, scheduled for mid-January 1975.

Question V. What are the long-term implications of recycling and the concomitant transfer of wealth, and which nations will bear the ultimate burden?

Answer. The increase in oil prices poses a real economic burden on oil importing countries, which must transfer an increased portion of their national output to pay for imported oil. It is the unwillingness of countries to assume this real cost which will lead them to undertake energy conservation and development of alternative supplies in order to reduce their dependence on imported oil priced at unreasonable levels. Even if countries borrow now to pay for oil imports, they will continue to be faced with the real economic costs as their accumulated debts are serviced and paid.

Question V.A. In what amounts and on what terms have oil producing nations extended credit to the consuming nations, whether directly or through international agencies?

Answer. Available information on the aggregate amount of oil producer credits and direct loans to industrial countries is incorporated in the answers to preceding questions. Examples of some of the major credits from OPEC countries, principally to developing countries, include the following.

Loans to the IMF oil facility totaling the equivalent of about \$3 billion, from Abu Dhabi, Iran, Kuwait, Oman, Saudi Arabia, and Venezuela. The IMF pays seven percent interest for the use of these funds over a period of 4-7 years.

In July 1974, the Kuwaiti Parliament formally approved a \$3 billion increase in the paid-in capital of its Economic Development Fund (from \$340 million to \$3.38 billion).

According to Iran's Chief OPEC Delegate, Iran has concluded bilateral agreements involving soft loans of some \$1.5 billion over the next three to five years. This assistance is divided between project aid and financing for oil purchases by several developing countries, including India, Pakistan, Afghanistan, Morocco, Senegal, and Jordan.

The charter of the Islamic Development Bank, to be capitalized by oil exporters and others, has been formally approved. It is expected to begin operations in late 1974 with capital of \$3 billion. Loans will be extended interest free.

An Arab Fund for Africa has received pledges of \$200 million. Paid-in capital as of mid-July 1974 amount to \$130 million. It will be a revolving fund used to finance the oil purchases of the poorest African countries.

The United Arab Emirates tripled the capital of the Abu Dhabi Development Loan Fund from \$169 million to \$500 million in May 1974. The UAE government also responded to an appeal by UN Secretary General Kurt Waldheim for emergency assistance to the hardest-hit less developed countries. Foreign Affairs Minister Ghobash pledged that his country will strive to extend bilateral and multilateral grants totaling \$400 million during 1974.

OPEC country purchases of IBRD bonds totaled approximately \$700 million during the year ending June 30, 1974. Approximately \$675 million of this amount involved purchases of World Bank bonds. Generally, the OPEC countries receive near-commercial rates of interest (8%) on these investments.

Question V.B. Under what conditions, if any, will oil producing nations share in bearing the risk of defaulted loans made to consumer nations of questionable credit worthiness?

Answer. In the broadcast terms, the value of OPEC financial claims depends upon a prosperous world economy and a stable international financial system. There is no way they can avoid this risk, no matter what specific types of protection they seek. They have recognized their interest in a stable financial system and have acted as prudent and conservative investors. On credits provided directly to borrowers or through investments in private markets, the oil producers must assume the risks of defaults as would any other investor. As members of international financial institutions, the oil producers will also assume a proportionate share of any risk these institutions assume.

Question V.C. To what extent have oil-induced trade deficits compelled importing nations to adopt mutually damaging trade, investment and monetary policies, and to what extent are such policies anticipated?

Answer. The oil importing nations have in general not sought to offset oil-induced trade deficits by introducing trade, investment and monetary policies which would transfer the burden of adjustment to other oil importers. The major

trading countries have instead tried to avoid such measures. (See also answer to question IV.C.3.)

Their commitment to avoid self-defeating beggar-thy-neighbor trade policies was given form in the OECD pledge undertaken at the Annual Ministerial Meeting, May 29-30, 1974. The members of the OECD, a group which includes all the major industrialized trading nations, unanimously pledged for one year to avoid recourse (1) to measures of either a general or specific nature to restrict imports or other current account transactions, (2) to measures to stimulate artificially exports or other current account transactions, and (3) to export restrictions contrary to the objectives of the declaration.

In the same spirit the IMF's Committee of Twenty recommended consideration of an amendment to the Articles of Agreement of the Fund to provide that no member government would, without prior IMF approval, introduce restrictions or subsidies on merchandise trade or services for balance of payments reasons. Until such an amendment could be adopted, the Committee of Twenty and the IMF have invited countries to pledge themselves on a voluntary basis not to introduce or intensify trade or other current account measures for balance of payments purposes that are subject to the jurisdiction of the GATT, or to recommend them to their legislatures, without a finding by the Fund that there is balance of payments justification for such measures. The U.S. and a number of other countries have adhered to the pledge and we expect it to take effect shortly.

The major trade restriction taken to correct a balance of payments deficit in part due to oil-price increases is Italy's system of import deposits. These deposits are now being phased out.

Other trade restrictive measures have also been taken recently, but they were imposed for reasons other than to correct balance of payments difficulties resulting from oil imports. Examples are Japan's, the European Community's and Canada's import restrictions on beef in response to low domestic prices and world beef surpluses.

There have also been some trade restrictions by less-developed countries at least in part due to oil-induced trade deficits, such as the tariff increases by Brazil, but they have been relatively few and of limited trade impact.

In general, the cooperative and responsible trade, monetary and investment policies of the oil-importing countries have been most encouraging. Countries' behavior to date provides healthy indications of the widespread recognition of the dangers of competitive actions and of countries' determination to resist the pressures for mutually damaging and ultimately self-defeating policies.

Question V.D. To what extent will the failure to provide adequate international recycling facilities induce oil exporting nations to reduce future production, and to what extent will the provision of such facilities signify the abandonment of efforts to reduce the price of oil?

Answer. As long as their investments are secure, the OPEC countries have only a limited interest in ensuring that each individual country is able to meet its financing needs. (This interest relates to the impact on demand of retrenchment in oil consumers due to financial difficulties.) With ample opportunities for attractive investments presently available, the financial incentives for oil producers are clearly on the side of production and investment today rather than leaving oil in the ground. Today's \$10 per barrel of oil, if left in the ground as an investment alternative to financial assets earning 8 percent, would have to rise in price to \$21.59 per barrel by 1984, an unlikely prospect. And the longer uneconomic prices are maintained, the greater the loss will be to consumers and producers alike. In fact, oil producers may well find that oil left in the ground will be unsalable in the future even at lower prices, as consumers seek to protect the investments made in developing new oil supplies and alternative energy sources.

The availability of mechanisms to assist oil importing countries to meet their financing needs will not eliminate the real economic costs of higher oil prices or the incentives to reduce dependence on imported oil. The amounts borrowed today will have to be repaid later in real goods and services.

Question V.E. Assuming no agreement upon adequate recycling mechanisms, nor any reduction in the price of oil, what will be the short and long-term impact on the less developed countries and the stability of international social order.

Answer. As noted earlier, the question of assistance for the developing countries, especially the most seriously affected by the oil price rise, is separate from the general financing questions associated with the issue of recycling. The impact of failure to provide the concessionary assistance many developing countries require has been discussed earlier.

