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Statement by

Arthur F. Burns

Chairman, Board of Governors of the Federal Reserve System

before the

Joint Economic Committee

November 27, 1974

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

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

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

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

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

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

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

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

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

Of the $45 billion, about $10-1/2 billion has been placed in the United States. This includes about $5 billion in marketable securities issued by the Federal Government or its agencies, chiefly Treasury bills. Most of the remainder has been placed on deposit in our banks, with scattered amounts invested in real estate, bank acceptances, and other private securities.

Of the total increase in OPEC assets of about $45 billion, by far the largest share -- about $16-1/2 billion or more than one-third of the total -- has gone into the Euro-currency market. Nearly all of this is in the form of Euro-dollar deposits, the average maturity of which is quite short. A large proportion consists of 2-day call deposits, and most of the remainder run 6 months or less. Banks located in Britain have been the predominant recipients of these deposits.

Several of the oil-exporting countries -- notably Kuwait, the United Arab Emirates, and Nigeria -- have traditionally kept part of their reserves in sterling. Those traditional ties are being maintained. During the first ten months of 1974, OPEC sterling holdings increased by the equivalent of about $6-1/2 billion. Again, most of this sum has gone into short-term assets, and only relatively small amounts have been invested in government bonds, private securities, and real estate.

The OPEC holdings thus far specified -- in the United States, Britain, and the Euro-currency markets -- account for roughly three-quarters of the total increase of $45 billion of OPEC assets. Of the remainder, an estimated $3-1/2 billion has been loaned to governmental bodies in continental Western Europe and Japan. Bonds issued by international financial institutions, or loans to the International Monetary Fund for use under the Oil Facility, account for $2 billion. Another $2 billion has been devoted to grants or credits to less-developed countries, either directly or through contributions to regional development banks. Egypt has probably been the largest recipient of such aid. The remaining increases in OPEC assets -- estimated at $4 billion -- have been scattered among other items, including private securities and real estate in continental Europe and Japan.

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

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

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

OPEC nations to the less developed countries -- are as yet quite small compared to the flow of oil revenues. While the future volume of aid by the OPEC countries is uncertain, their investment earnings promise to grow at a very rapid rate.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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