INTERNATIONAL PETRODOLLAR CRISIS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE

OF THE

COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES

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INTERNATIONAL PETRODOLLAR CRISIS

TUESDAY, JULY 9, 1974

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTERNATIONAL FINANCE,
OF THE COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 2128, Rayburn House Office Building, the Honorable Henry B. Gonzalez [chairman of the subcommittee] presiding.

Present: Representatives Gonzalez, Rees, Hanna, Young, Johnson, Crane, Frenzel, and Burgener.

Mr. GONZALEZ. The subcommittee will come to order. I am going to announce from the outset that unfortunately many of the members of this subcommittee are also members of the Housing Subcommittee, of which I am also a member, and today the conferees on the housing bill are meeting to see if they can reconcile their views. I am sure that we will be getting additional members as they leave the conference.

But under the rules, the subcommittee is permitted to proceed. I believe that the first thing we should mention is it is a very happy occasion because Secretary Bennett will be formally inaugurated at noon, he tells me, to replace our friend Paul Volcker as the Under Secretary for Monetary Affairs, and so this is really an auspicious occasion in more ways than one.

I think we ought to explain that one of the impelling reasons for this projected series of meetings goes back to what some of us have felt very keenly from the beginning, and that is that in this area or sphere of action, the Congress sits sort of as a reacting body. The President makes an announcement, and subsequent to that we are asked to consider intricate monetary matters involving monetary legislation, the question of our continuing obligations with respect to the international financial institutions, the consequent impact on the domestic matters, and so this has relegated to this subcommittee a new area of responsibility. I was a member of this subcommittee from the first month that I came to the Congress in 1962, and to give you an idea of how the emphasis has changed, between January 1962 and 1971, this subcommittee met four times. But between 1971 and today we have met almost 20 times. So we have a relatively obscure and inactive subcommittee now confronted with some pretty heavy responsibilities in a very intricate and complex area, and one in which the Congress does not have the primacy of initiating policy, and yet we feel very keenly that we have a duty and a responsibility to discharge.

At this particular time we are very much concerned with what has developed since the oil crisis and the very heavy outflow of our moneys because of the tremendous increase in the price of the oil that we must import.

In these hearings we would like to cover the following topics, specifically: (1) what oil-producing countries will do with their new found wealth as it would have an impact on our international policies, and consequently domestic policies; (2) the potential damage to the International Monetary System and to the world economy as a result of a petrodollar glut; (3) the viability of the proposals for recycling petrodollars. We pick up the newspaper and we find that we have foreign news stating that the President in his recent trip to the Middle East either made or implied some commitments in this respect. If it is possible, the Congress would like to know at this time the details of any commitments so that we can provide at least a sympathetic background, if such becomes necessary, instead of waiting until it develops into a crisis, and then we would have knockdown and drag out legislative fights similar to the ones we had recently with IDA.

I might mention by way of parentheses here that the full committee has created an ad hoc subcommittee chaired by the Honorable Tom Rees from California that will go specifically into the oil deficit problems of the developing world.

Fourth, what the United States should be doing about the petrodollar problem and its likely detrimental effects.

As background, I would like to for the record cite a few facts and opinions that contribute, at least in part, to the calling of these hearings. Hobart Rowen, in the Washington Post, says, and I quote:

> Everything done so far in the wake of the oil crisis—for the industrial or the developing countries—including the steps taken at the C-20—the group of 20 countries—is inadequate or spineless. Untold hazards lie ahead unless there is some alteration in the vast shift of funds demanded by the oil producing and exporting nations. That requires lower oil prices.

Dr. Arthur Burns, Chairman of the Federal Reserve Board, who will appear before this subcommittee early next month, in a recent letter to me said "for the longer run, I see no viable alternative to a reduction in the price of petroleum."

World renowned oil economist Walter J. Levy, writing in Foreign Affairs, warns that we are witnessing an erosion of the world's oil supply and financial systems, comparable in its potential for economic and political disaster to the Great Depression of the 1930's.

The respected Economist magazine said, and I quote:

> The world's rich countries are digging the foundations for a major world depression. The rich are almost doing everything possible to insure a trade war and a slump.

In May, the Managing Director of the International Monetary Fund said:

> It is no exaggeration to say that the world presently faces the most difficult combination of economic policy decisions since the reconstruction period following World War II.

Prof. M. A. Adelman of Massachusetts Institute of Technology, in a speech before the National Press Club said:

> My opinion is that what's bad for the cartel is good for the United States. The burden for paying for oil imports has been exaggerated but is still very great. For most of the underdeveloped countries, it is ruinous. There is no way they can pay, and we will need to bail them out. We are embroiled with our friends and trading partners in attempts to shove the burden of higher prices on each other. Our Government denounces bilateral deals of armaments or other goods

for oil, while we, ourselves, negotiate one of the biggest bilateral deals of all. The cartel is making the world a much more dangerous place. A vast arms buildup is just beginning in the Persian Gulf.

What do the oil prices and their increases mean to the less developed countries? These countries face an additional import bill approaching $10 billion, a figure roughly equivalent to their total official development assistance. For the industrialized world, Italy is reported to be nearly bankrupt and France and Great Britain may not be far behind.

The oil producing nations will, this year, run up a trade surplus of $65 billion, compared with $7 billion last year. Bankers have expressed fears that this petrodollar glut will wreck the Eurodollar markets and cause havoc in the foreign exchange markets.

The fact is that the oil producing and exporting countries form a group that consists, and in reality is, an international oil monopoly which has quadrupled prices in a period of less than a year and threatens to do something in the way of an increase every 3 months as regular as a clock. In the Mideast, the oil prices are 70 times the cost of production. By no stretch of the English language can this be described as anything but price gouging.

I have read about the plans for recycling the oil producers' revenues through the IMF and other institutions and I feel that such plans at least are certainly necessary to be formulated, but more importantly, I have watched as we scurry about trying to find ways to channel some of this oil money back to the less developed countries. How long can the world tolerate such a situation in which we must beg the extortionist to aid his victims. I cannot see any other way to describe the poor countries but as victims. None of the proposed aid programs can even make a dent in the increased burden on the less developed countries.

Where is there a country today which would permit within its boundaries the operation of a monopoly which cruelly manipulates supply and gradruples prices? Even the most laissez-faire government in the world would have to try to cope with such a monopoly. Yet OPEC and the Secretary General threaten us when we talk about getting together with other consuming nations. The Arab oil producers make no pretense about their continuing willingness to use their oil and new found wealth as political blackmail.

OPEC points out that the prices of wheat and other goods have risen substantially, and therefore, it is all right for oil prices to go up. But the United States, Canada, and the other wheat exporters have not colluded to raise the price of wheat to a price 70 times its cost.

By exercising monopoly power over a vital commodity—power which we have never thought to be morally right—a small group of people may control by 1980, 70 percent of the world's total monetary reserves.

Here is clearly the new generation of robber barons. I feel that the oil producers are engaged in economic warfare no less serious to the continued peace and prosperity of the world than armed warfare.

The staff of this subcommittee has prepared background material which has been placed before each member. I wish to place this material in the record at this time with unanimous consent.

[The background material referred to appears at the end of the hearing, and may be found on page 123.]

Mr. GONZALEZ. We can proceed with witnesses, to whom I wish to express a profound note of thanks for their willingness to take time to be with us, and also, as I said to those who were absent at the time, today coincides with Mr. Bennett's swearing in as the replacement and our new Under Secretary for Monetary Affairs.

I think it is a happy occasion and we wish you complete success and assure you of our cooperative interest and willingness to do what we can on our level and for our part to work with you.

Mr. Bennett, would you proceed, unless a member of this subcommittee wishes to make some preliminary remarks at this time. Mr. Hanna.

Mr. HANNA. Mr. Chairman, since I have to go to the Housing Subcommittee meeting, I would appreciate it if I might put on the record about 5 minutes of observations.

Mr. GONZALEZ. With unanimous consent, and there being no objections, so be it.

Mr. HANNA. I apologize to Mr. Bennett for taking this time, but I would like to summarize for the record of this subcommittee my own extraction of information from my visits to the finance ministries of both Saudi Arabia and Kuwait. I think that at the outset one sees the history of the investment of the Arab oil countries as having two prime principles: One, liquidity, and the other, anonymity.

The Arabs have sought this over the years. In this new found wealth they realize that they have to go beyond that, and they indicated to me that they had three basic desires for the use of that money. The first was to invest in the extension of petrochemical and other related industrial activities within their own lands and for the betterment of their own people on the basic community facilities level.

The second thing they wanted to do was invest it in other Arab countries who did not produce oil, to make investments in industrialization activities, agricultural activities, and in the general improvement in housing, education, and so forth.

The third thing they wanted to do with their money was to invest it in the Muslim countries of Africa, and they had in mind some kind of an Arab fund for underdeveloped Muslim countries. They indicated to me that they were willing to include underdeveloped countries who were not Muslim so that they would not preclude some of the countries who are suffering because of the high price of oil.

The other thing they told me was their attitude toward the price of oil. They said they were pricing oil on this basis, first, to discourage the high use of it in industrialized countries, which they felt was to some degree wasteful; second, to find a competitive price to any alternative to oil and consider that as one of the hallmarks of pricing. The other thing that they were looking at was the problem of converting oil in the ground to some other kind of asset that would be equal in value and in safety to the oil in the ground.

They indicated to me that the transfer of oil in the ground to the currencies that they saw around the world did not look too attractive because those currencies were subject to float. I was there right after the French had floated down 5 percent and they had just sold a large cargo of oil to the French and they could not understand why they should take the 5 percent rap by having picked up the French currency. So they said as long as currencies are subject to these kinds of float and unless there were some kind of quick investments in the Western World or preferably they would like to see their oil, in terms of the Western World, coming back as the needed materials, technologies, manpower, machines, that would do the three jobs that they sought in terms of industrializing their own country, improving the non-oil-producing Arab countries, and in doing the work they hope to be able to do in the underdeveloped countries.

It seems to me that the United States has been somewhat derelict in not finding where the Arab mind is in these matters, and in trying to work out a cooperative program. The most promising thing, as you have indicated, Mr. Chairman, that I have seen is the willingness on the part of the Arabs to use the IMF and the World Bank and some of the others for the purposes that they have described, and particularly in the underdeveloped countries. I tried to point out to them that it is not easy to get into the business of investment in improvement, that you have to have a developed expertise in the fund that is going to hold the money and you have to have a developed expertise in the borrowers who are going to use the money. That has not been demonstrated yet in any of the places in which they have talked about doing their investments. But I personally feel very strongly, Mr. Chairman, that you are doing a great service to this Congress and to the country by these hearings, and I want to join you in welcoming Mr. Bennett to his new post and assure him that this subcommittee will take an interest in his position and him personally, as we have his predecessor. I thank you, Mr. Chairman. I thank the subcommittee.

Mr. GONZALEZ. Thank you, Mr. Hanna. We deeply appreciate your keen interest and your strong support and membership on this subcommittee. I think the members of the subcommittee have had a sense of frustration when events happen and then we have to come in after the event, and we like to feel that the Members of the Congress will have some direct input and some immediate responsibility with respect to some of these issues.

Mr. Bennett, you may proceed as you wish. I thank you once again. If you have a prepared statement, you can use your option of either reading it or summarizing it. Again, I say that we are very grateful for you taking time out, especially right before you are about to be sworn in.

STATEMENT OF HON. JACK F. BENNETT, UNDER SECRETARY OF THE TREASURY

Mr. BENNETT. Mr. Chairman and members of the subcommittee, I appreciate your kind words of welcome. As you note, these hearings are particularly opportune for me. At any time it would be a challenging assignment to succeed Paul Volcker. But it has not escaped my attention any more than it has escaped yours that conditions in the foreign exchange and financial markets and in rates of growth of prices and production are not entirely satisfactory around the world today. So it seems particularly fitting that I be subjected to some cross-examination as I enter into these new duties. But I am painfully aware that the oath which Secretary Simon will administer to me today will not make me an instant expert in all aspects of economics.

In trying to understand our present difficulties, I could perhaps make my position clear. I tend to think that primary attention should be given to two major developments over the recent years:

First, the shortfalls and cutbacks in previously anticipated levels of production of important basic raw materials, most importantly oil.

Second, a widespread tendency for governments to print more money and more government IOU's than were appropriate in such conditions of supply stringency around the world.

In my prepared statement this morning I propose to concentrate on the first of these developments, and particularly on the impact of the reduction in the anticipated levels of oil production. That impact continues to be large, and our difficulties are exacerbated by the uncertainty as to just how large the cutback will be in the future.

Last September, before the outbreak of fighting in the Middle East, the production of oil in the non-Communist world was just short of 48 million barrels a day. By November, certain governments in the Mideast and Africa had cut production back by about 5 million barrels a day, and this large cutback was naturally followed by a large increase in prices on new short-term oil sales. Even now, some of those producing countries are continuing to cut back production far below the levels of last September.

But elsewhere production has grown, so the total world production is probably now about at least September's level—within 200,000 or 300,000 barrels a day one way or another. But it is important to note that the level of actual production today still reflects restraints by certain governments which are holding total production roughly at 4 million barrels a day below the level which could be produced efficiently with existing capacity in place.

New contract oil sale prices have fallen from the temporary peaks of early this year, but some producers are still attempting to charge extraordinarily high prices. In view of these high prices, consumers both in the United States and abroad have continued to hold their consumption well below the levels predicted earlier, and in fact, below the levels of a year ago. On a worldwide basis consumption has been less than production for some time. Inventories have been building up and are now approaching the spillover point.

Under these circumstances, oil prices today are clearly under strong pressure to decline further on international markets, though not on the bulk of U.S. production, which remains under severe price control. Yet there are those in the producing countries who are urging their governments to make sharp new cutbacks in production in order to try to maintain today's high oil prices, or even to try to increase them again. The producing governments are being urged to raise prices on that portion of the oil production being sold directly by the governments and to renege on long-term contracts to make some oil available on the basis of agreed specified payments of royalties and taxes to the governments.

In my view, any new cutbacks in oil production by any government at this time should clearly be regarded by the United States and by all other consuming countries, both more developed and less developed, as a counterproductive measure. Moreover, even apart from the political and security implications for the producers, I am convinced that any such cutbacks would turn out to be economically harmful to the producers for two reasons. In the first place, the price effects of such cutbacks would inevitably lead to such further intensification of research and investment relating to alternative sources of energy and to alternatives to energy use that the effect would be to reduce the total value which the exporters would receive for their oil over the life of their producing fields. Cutbacks might bring a higher price for a short period, but they would bring a more than offsetting reduction in revenues for a long time thereafter—in view of the importers' increased commitment to alternatives.

In the second place, maintenance of present costs of export oil—even with no increases—would threaten severe economic and in some cases political damage to a large number of consuming countries to an extent which could not help but cause damaging backlash to the producers as well.

The damage to consuming countries in the first instance would be simple but real—the result of an increase in the costs of their oil imports far greater than the increase in the prices of their exports. In this regard, I realize that some officials of oil-producing countries have attempted to justify further oil price increases by reference to increases in the prices of goods imported into those countries. Providing the producers with this argument has undoubtedly been one additional damage we in the developed nations have inflicted on ourselves by our miserable performance in relation to inflation. But we should not lose our sense of proportion.

Since 1970, for example, the new contract FOB export dollar price of Saudi Arabian light crude has increased approximately 730 percent, whereas the average cost of imported goods and services into the producing countries has increased only about 70 percent over the same period. Clearly, the increase in oil prices has been about 10 times as large. On a similar calculation, the oil price increase has been about seven times as large from 1960 to the present.

This large and sudden adverse change in their terms of trade finds different nations with widely varying capabilities to adapt. For most importing nations, including the United States, the impact is reducing our standard of living and is reducing our rate of economic growth, but our lives and our institutions are not seriously threatened. In a number of other nations, however, nations whose standards of living were already at the literal margin and whose hopes for economic advancement were fragile in any case, the sudden increase in the cost of oil and consequently of fertilizer as well could be catastrophic unless there is emergency assistance. Even in some countries whose standards of living are far above the subsistence level the new prices could, in the absence of farsighted international cooperation, threaten the collapse of existing institutions.

Such severe damage to the consuming countries would create a backlash on the producers—apart from political dangers—through undermining the economies to which the oil producers must export if they are to derive the maximum value from their limited resources; and through undermining the economies in which the oil producers must temporarily invest if they are to sell their oil at the most rewarding time and spend the proceeds on equipment and services for their own diversified development at the optimal, nonwasteful pace.

Mr. Chairman, you will observe that, in discussing these implications of actual and potential oil production cutbacks, I have stressed the underlying and real economic effects. I do this because I think they are serious, because I think the world should be aware of the contrast between the deliberate cutbacks by some oil producers on the one hand, and the determined efforts being made, on the other hand, by the United States and other nations to increase to the maximum their production of agricultural and other commodities to supply world markets.

While I stress these basic effects, I do not wish to ignore the impacts of the oil cutbacks on the financial institutions and arrangements of the free world. The indirect effects have been serious and well publicized for a small number of banks, for example. Yet, in my judgment, our financial institutions and international monetary arrangements are not likely to be basically threatened by these developments in the commodity field. Current problems are real for some individuals, for particular companies, and for entire countries, but they are the problems of reduced supply of goods; they are not likely to be intensified by failure of our instruments of financial cooperation.

Neither do I feel that current developments pose a serious threat of world depression. Those who concentrate their worrying today on the possibility of world depression have brought to my mind the picture of a man immobilized in the face of a charging bull by the fear that if he tried to escape the animal by jumping sideways he might possibly brush up against an unseen rattlesnake. Certainly, rattlesnakes—and also inadequate demand for our economic production—are always conceivable dangers; but, right now, the clear and present danger before us is not inadequate demand, but far too much monetary demand facing existing capacity to produce. Efforts to draw a parallel between today's circumstances and the early 1930's seem to me farfetched. The problem then was too little demand facing large amounts of unused capacity.

The developments in the commodity markets have resulted in large changes in previous patterns of financial flows. Consumers and consuming nations are choosing to borrow a lot more than before in order to ease their transition to a world of higher cost energy. Some of the oil producers are choosing to export a large part of their oil in exchange for IOU's from the consuming countries.

There have been various estimates that the oil-producing countries in combination will increase their investments abroad by $50 billion to $60 billion during this year. I do not place confidence in any precise estimate, for it is now unclear, not only what the price of oil will be during the rest of this year, but even what it was for the first half of this year, since various negotiations on this subject are still underway.

Furthermore, at any particular price, it is unclear how much oil any particular individual consuming country will choose to buy, to what extent it will choose to run current account deficits by lightening its current economic burdens through borrowing and burdening its future with repayment obligations. Italy and France, for example, have recently taken forceful domestic measures to reduce their oil consumption and their reliance on oil imports, and many other nations will probably take steps in the same direction.

Forecasts of the rate of further accumulation of foreign investments by the oil-producing countries in future years are even more tenuous. My own expectation, however, is that the rate will decline each year, not only because of the lower oil prices which I anticipate, but also because over time the development plans of the producers will have progressed so that they are using up increasing proportions of current revenues. It has been estimated that this year oil exporters will be spending around 40 percent of their receipts for current imports; I would expect this percentage to be much larger in future years—and ultimately, it will exceed 100 percent.

Meanwhile, however, the oil producers have been accumulating what, by any standards, are large investments. By now, they quite probably exceed $30 billion; and in the early months of this year the accretions were being largely placed in short-term bank deposits concentrated in the foreign branches and foreign currency accounts which comprise the so-called Euromarket. This concentration had begun to raise questions about capital adequacy in the banks and about their vulnerability to sudden large withdrawals. More recently, strong counterpressures have begun to exert themselves. The banks have begun to reject additional short-term deposits and to insist on terms more in line with the relending opportunities available to them. The oil-producing countries, themselves, and other depositors, have become more careful to insure they were not risking their funds in institutions with an adequate capital base. There has accordingly been increased interest in investing in U.S. Treasury securities and in other longer term securities, including U.S. corporate equities. Secretary Simon and I hope to discuss these possibilities further during our trip to the Mideast starting Thursday. I suspect the time may also be coming when there will be increased interest both by foreign and by domestic investors in offering new equity for selected private banks. With the expanded banking business to be had, there will be those who wish to take advantage of the profitable investment opportunities which should exist. Obviously, new equity is the answer if banks have more business than they can handle with their existing equity base.

Secretary Simon, in his recent speech to the International Monetary Conference in Williamsburg, also recognized a governmental responsibility in this area. While noting that:

> Governmental regulation and emergency facilities can never substitute for prudent financial management,

he nonetheless emphasized that:

> In the United States, it is clear that the authorities do have a responsibility to supervise U.S. banks in both their domestic and international operations, and a major part of that responsibility is to insure that they are in a sound position to meet their total liabilities.

All of this recent attention to possible massive withdrawal of funds should not lead anyone to conclude that the oil-producing countries have been shifting their funds about in a volatile manner. In fact, their officials have shown themselves to be very conservative investment managers, well aware of the loss in the value of their investments which would result from any sudden effort to unload a large amount of their securities on a capital market or to transfer a large amount of their funds from one currency to another.

Mr. Hanna described, I thought, quite clearly the current trends of their thinking in this respect.

In relation to the foreign exchange markets, the situation must be monitored carefully, but it should be recognized that any instability which may be caused by the large holdings of the oil producers are likely to have arisen not from sudden shifts of these funds from one investment to another but rather from swings in market expectations as to where their new accretions of funds would ultimately be invested.

In view of the uncertainty on this subject, it is fortunate that before the question arose there had already been so much progress toward greater flexibility in our international monetary arrangements. In this period of change in trade and investment patterns, and in the presence of widely differing rates of inflation in different countries, an attempt to maintain a framework of rigid exchange rates would probably have led, in practice, to explosive instability. There would have been substantial changes in exchange rates since the upward spurt of oil prices began last October. Yet, these have been handled without serious interruption to the world's trade and investment transactions. A small number of banks did get into trouble in their foreign exchange dealing during this period, but their difficulties seem to have been focused in faulty internal procedures and in involvement in foreign exchange speculation out of proportion to the size of the institutions. Regrettable as their experience was, it probably has had the salutary effect of bringing other institutions to examine their foreign exchange practices more carefully. The recent *Lochouse-Herstatt* case in Germany, in particular, is leading banks to consider whether changes are desirable in interbank clearing procedures to reduce unintended risk exposure in what were intended to be essentially riskless simultaneous exchange transactions.

In recent weeks, the United States and other governments have also given consideration to the possibility of setting up a new intergovernmental agency which would be designed to borrow large amounts of money from the oil producers on commercial terms and then to relend those funds in other countries again on commercial terms. That type of agency remains a possibility, if it should be needed, but at the moment the consensus—which I think is wise—is that it would be better to rely basically on the many different channels provided by existing institutions for handling the large, new investment flows among nations.

Governments, nonetheless, have an important supportive role. In the United States, we recognized that earlier this year by removing the controls on the outflow of capital from the bilateral swap agreements by which governments stand ready to help each other in case of short-run exchange market disturbances. We and other governments recognized it by a wide range of cooperative international initiatives. At the recent final meeting of the "C–20" Ministerial Committee, there was a renewed dedication to international monetary cooperation and agreement on a new pledge to avoid restrictive trade measures for balance of payments purposes. A new facility was created in the IMF to provide 4- to 7-year credit assistance to aid nations in adjusting to higher oil prices, and there was agreement that in some cases—through a so-called extended Fund facility—the IMF should be able in special cases to provide credit of longer maturity to less-developed countries undergoing major structural changes. There is also an understanding that governments in need may sell some portion of their gold holdings into private markets or use their gold as collateral for borrowing.

All these actions were constructive responses which have strengthened our international monetary system. But we must recognize that for a small number of particularly hard hit countries these measures are not likely to be enough. I am sure that Jim Grant will later this morning be far more eloquent that I can be on the prospective plight of those countries whose standards of life were already abysmally low and now have the distinction of being the "most seriously affected" by the new oil prices. These are among the countries which have reason to be grateful to you on this subcommittee for securing passage of the IDA authorization a few days ago. Yet, those funds were intentionally clearly earmarked to be used on specific long-range development projects to raise their people from the sink of poverty. Those IDA funds will not be, and should not be, available to help pay any of the tremendous increase in the costs of oil and fertilizer for the immediate use of their struggling economies. For this purpose, these countries will be pleading, before this year is over, for some nonproject funds on a concessional basis. There is no likelihood, however, that such funds could be repaid within a few years; they will have to be on a long-term, low-interest basis. In most cases, the lack of these funds is probably not a matter of life and death this week, but that time is probably not many months away. The total sums in question for this year are not immense. I doubt that it will ultimately be decided that a large amount is appropriate in this calendar year from all sources in new forms of aid above those traditional forms of aid already scheduled.

Still, there is an organizational urgency in reaching a consensus on some analysis of the factual situation in these countries and in insuring that there is an adequate response from those countries of the world who are in a more-favored position.

Some of the oil-producing countries have begun to respond with isolated bilateral arrangements. There have also been appeals for funds by the U.N. and there have been discussions of various possible joint initiatives by some of the oil exporters, as Mr. Hanna mentioned, but little has actually been committed at this time specifically to alleviate the near-term distress of the "most seriously affected."

The oil producers have agreed to purchase additional amounts of World Bank bonds and to lend about $3 billion to the IMF, but these investments are at approximately market terms and they are effectively guaranteed as to repayment by the major developed nations, including the United States. They do not represent provision of the concessional funds appropriate for the "most seriously affected."

For them, the rescue operation, in large part, remains to be organized. For this purpose, it may well be that no new financial institution is needed; but there must be a group which is charged with being sure the job gets done. For this purpose, I am placing great hope on the new ministerial development council to be set up along the C–20 lines, in accordance with a decision taken by the ministers when they were in Washington last month for the final C–20 meeting. I certainly hope that this new group representing oil producers and oil consumers, both developed and less developed, will be small enough to function effectively and will have the competence and the conscience for the job.

The problems which that new council will face and the problems which all of us face with the new oil prices are real. The appropriate remedy is to lower those prices. Meanwhile, we must cooperate internationally to mitigate the real problems as much as we can. If we continue that cooperation, if we stay alert, those real problems will not be made worse by any freezing up of the world's financial mechanisms.

Thank you, Mr. Chairman.

Mr. GONZALEZ. Thank you, Mr. Bennett, very much.

If it is OK with the members of the subcommittee, I would suggest that we proceed to hear Mr. Grant, and then we can direct questions to both gentlemen at the time we reach the questioning period. If there is no objection, we will proceed that way.

Mr. Grant, thank you very much for being with us this morning, and without any further ado I recognize you to proceed as you see best. I notice you have circulated your prepared text. If you wish to read it that is fine. If you wish to summarize it, that is fine, too.

STATEMENT OF JAMES P. GRANT, PRESIDENT, OVERSEAS DEVELOPMENT COUNCIL

Mr. GRANT. Mr. Chairman, it is a great privilege to be with you here today and with the members of this subcommittee, and I will take you up on your offer of inserting the full statement in the record if I may and then proceed to summarize it.

Mr. GONZALEZ. Without objection, we will enter your prepared statement into the record.

Mr. GRANT. As we consider today the impact of the petrodollar crisis on the world and particularly on developing countries and our policies toward them, it is important that we recognize that this crisis is occurring in a much broader context of a newly emerging international economic and political order. The crisis is a result of the very rapid growth of the past 25 years. This is a shift that was symbolized well before the oil crisis by the soaring food prices that we saw in early 1973. As you may remember this led to a soybean embargo by the United States and led to a fertilizer embargo on new export sales in October that has been in effect until very recently. Oil prices soared fourfold resulting in the embargo, and a series of other shortages—fertilizer, cotton, and rubber. This basic set of scarcities results from two factors. On the one hand are short term and cyclical factors—the unprecedented, simultaneous boom of all of the industrial countries of the early 1970's; the unprecedented drought that went through Russia, India, Sahelian Africa, and other parts of the world in 1972 and 1973; the war in the Middle East; and the inadequate use of world information systems, with the result that we paid nearly $2 billion to our farmers not to produce food in fiscal year 1973 at a time when the Russians were depleting the world global food stocks.

But even more fundamental in our opinion are some long term secular trends which indicate that this is not just another peaking of prices as we saw after World War II—this really is the tremendous increase in demand. The gross global product of the world in the late 1940's was about $1 trillion. This year it will be about $4 trillion. In constant dollars it is roughly a threefold increase in global demand in 25 years. When we began to move into the third trillion of demand, we began to see system overloads emerging at every corner in the late 1960's. We could see it ecologically when there was the problem of pollution in the cities, and it began to reach unmanageable proportions; the problem of purification of the lakes; and in the last 2 or 3 years we have seen the overharvesting of the world fish catch, which after tripling in 25 years has declined the last three.

We have seen it in the ever-tightening food situation. Despite the world's largest crops in history last year, world food reserves actually went down again. The world food system is having trouble staying up with an increasing demand, which is double that of 20 years ago. We have seen it in the shift from buyers' to sellers' markets for goods that are not in physically scarce supply but have become sufficiently tight that the sellers have become dominant—oil, coffee, and other commodities.

That this is part of a long term trend was brought out by the fact that the World Bank was estimating that the oil prices of $8 a barrel we saw last fall and winter, would come in due course in the 1980's. They were brought up much sharper as a result of these short term cyclical trends.

Basically this increase from demand results from two long-term circumstances that will probably be with us for some time. One is the population increase which is double what it was 20 years ago, an increase of 2 percent a year. Second, affluence around the world has increased about 3 percent a year for the last 7 or 8 years. This is double the rate of increase of affluence that we had 20 years ago. These two forces together have been the basic surge behind increasing demand. For some commodities, such as food, 70 percent of the increase in demand comes from population increase, only 30 percent from increase in affluence. For other goods like oil the soaring increase in demand has come primarily from affluence and only secondarily from population increase.

As we move closer to the $10 trillion gross global product that is projected for the end of this century, with each trillion coming in ever-shorter time periods, I think we can predict a series of consequences from this:

Competition for limited resources will become considerably more intense, and there will be more and more of a linkage effect when there is a shortage in one area. As we have seen recently, the shortage of energy leads to a shortage of fertilizer; the shortage of fertilizer leads to a shortage of food. The "quick fix" and product substitution will be much more difficult in the next 25 years than in the last 25 years. And finally, as we will see, there will be a significant shift in economic as

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well as political power to the raw material suppliers of the world away from the processors. What this means as we consider the petrodollar crisis and what to do about the current issues, is that we need to look at this crisis in the broad framework and that we need a whole new set of rules, institutions and approaches to our problems in the next 25 years.

It is clear, for example, that the whole issue of access to supplies will become as important in the next 25 years as the key issue of access to markets was in the last 25. In other words, in the last 25 years the things that concerned the GATT, the UNCTAD, the Trade Reform Act of 1973, the Kennedy Round of negotiations, were all access to markets, and now we have a new set of problems, access to supplies—oil, fertilizer, food.

Second, it is very clear that there will need to be increased global efforts and machinery to increase production of goods that become in tight supply, whether in oil, as was indicated by Mr. Bennett, where we need to somehow cope with the restraints more effectively, or in food, where there is need for a global effort to increase the supply.

Finally, it is clear that we need to begin to think of ways of reducing demand in certain areas. We have seen it most notably in the area of the use of energy in this country. But clearly, there is a global shortage of fertilizer lying ahead. Grain farmers in many parts of the world cannot get even half of the fertilizer they got last year, while other parts of the world are still using indiscriminate amounts for lawns and other purposes.

All of these trends toward a new world of tight supply were well along when the energy shock came in the fall, and were farther along when the second shock came on December 22d with the additional sudden doubling of prices. This has dramatized these trends very sharply and has accelerated four major trends which I would like to discuss:

One is the energy price shock on developing countries; second, the worsening world food problem; third, its aggravation of the global recession; and fourth, its acceleration of the power shift away from some of the major manufacturing, industrial countries, like the EEC and Japan and the populous countries like India, toward the OPEC countries and the North American raw material-rich as well as industrial powers.

Turning first to the energy shock dislocations for the developing countries, as the chairman mentioned in his introductory comments, the fourfold oil price increase added $10 billion to the import bill of these countries. The aggravation of these increases was compounded as a result of the fact that in the preceding year the prices of other goods that these developing countries had to import from the industrial countries had already risen substantially. They already faced a $5 billion increase in their import bills for food and fertilizers before this $10 billion overload was added, for a total of about $15 billion.

On top of this increased import bill they faced the dangers of an economic slowdown in the West, which has already affected very substantially the tourism earnings of countries. In the Caribbean and the Mediterranean, the flow of workers from many developing countries to the European countries, and the prices of some but not many raw materials. The impact of these price rises has varied very greatly on the developing countries.

Obviously, the OPEC countries have benefited greatly, and, while we think normally of the Arab nations as the OPEC countries, there are 260 million people in this aggregation of OPEC countries. Among the non-OPEC countries, there are a group of developing countries that are net beneficiaries of the changes of the last 2 years. These are those countries which are minor oil exporters, like Tunisia and Bolivia. There are other countries such as Malaysia that will be beneficiaries of major price rises in the products they sell and they are largely self-sufficient in oil. There is a whole group of countries, including most of those in Latin America, which are not too badly hurt in a fundamental sense by the changes of the last couple of years. They should be able to ride out the difficulties assuming there is no major global recession, continuation of the IMF oil facility over a several year period, continued access to Eurodollar markets—this is a new feature for many developing countries, the access to the Eurodollar markets—and finally, continued access to supplier credits. There is no question but that a suspension of activities by the Export-Import Bank would create a whole new set of crises for the Brazils, the Mexicos, the Colombias, this category of developing countries.

And finally, this assumes an expansion of World Bank lending to these countries on its regular terms.

There is another category of countries which fits somewhat this same category. This category includes the industrial developing countries—Korea, Taiwan, Hong Kong, and Singapore. These countries have a tremendous immediate adverse impact. Korea, for example, has to pay an extra billion dollars for oil and food. But these are flow-through economies that can pass on the prices in the goods they export, so there again, if they can have a short term facility, it should tide them over.

This leads us to the hardest hit countries, which Secretary Bennett was describing as the most severely affected. We at the Overseas Development Council call them the newly emerging fourth world of some 30 to 40 of the poorest, slowest moving countries. These countries have been hit by both very large rises in the price they have to pay for oil and for food, while getting no comparable offsetting increases in the price of the goods they sell.

For these countries, as Jack Bennett brought out, there is need for a substantial amount of emergency assistance to tide them over the short run, to keep them from going under during the next 3 to 4 years. They will need some $3 billion a year to keep from going under over the next several years, and these are countries that really cannot have access to the Eurodollar market. The IMF special facility rates are too high for them to borrow any large continued amounts. The suppliers' credits are not available to them since the Eximbanks of the world do not lend to these countries.

These countries, however, need more than the short term emergency assistance of $3 billion a year. They also need additional assistance to get their economies back on sufficient keel so that they are not so dependent upon food and energy imports from the outside, and this will require another billion to $2 billion a year.

The prospects of these countries are not at all hopeless. If one takes India, for example, it has a great potential for increasing food production at low cost. Like the United States, it has great reserves of coal. But these countries have a particular capital problem which is that they pay out additional money for oil and for food, and the OPEC countries which have a money surplus have no incentive to lend it back to them at the current time. Whereas in the United States we pay out increased amounts for oil and the OPEC countries take the capital surpluses and reinvest them in the Western countries. We have a problem between us, but the capital comes back to the West. This is not true for the poorest developing countries.

This immediate oil crisis is coming in conjunction with a very serious worsening world food situation. It has been apparent for some time that there is a basic change in the world food situation from the surplus state of the 1950's and the 1960's to an era of tight demand. World food reserves have gone down from a supply of some 69 days in 1970 to 36 days a year ago, and 26 days now, and this is despite the world's largest grain yields in history. In effect, we are in a very perilous situation, and, as I said earlier, this is due to the rising demand from population and from affluence. The increase in world demand for food 60 years ago was 3 or 4 million tons a year. Then in the mid-1950's, it went up to 15 million tons a year. Now it is over 30 million tons a year.

This increase is coming at a time when the response capacity of the world to increase food is slowing. Idle land is no longer available, water is scarcer, and the benefits from the use of fertilizer are declining. When the first 40 pounds of fertilizer is put on an acre of corn, the increased yield is something like 27 pounds per acre. By the time you get to the third 40 pounds it is down to 8 or 9 pounds of increased yield per acre.

We have seen an overharvesting of the world's fish catch, and there has been no technological breakthrough in either the production of soybeans or beef. So that while the world food situation has been tightening, along comes the petrodollar crisis. This has greatly aggravated the problems of the poorest developing countries, first because of the fact that faced with serious dollar shortages they have cut back on oil imports, and on imports of spare parts, so their whole economies are working more poorly. Second, there is a world fertilizer shortage of 2 or 3 million tons a year that will continue through at least the next 3 or 4 years, and the way the world system is working the developing countries are by far the worst hit from this.

Japan and Western Europe have both cut back on their fertilizer exports. So has the United States. We have had an embargo on new export sales from October through June 30, and the FEO now estimates that the developing countries will have a shortfall of about 2 million tons of fertilizer nutrients in the coming crop year. This means that they will lose the production of 16 to 20 million tons of food, food which will now cost them some $4 billion to import in place of producing themselves.

We can see the impact of this on India, for example. Currently, India is roughly a million tons short on fertilizer over what she was prepared to buy and was unable to get because of contract cancellations, slow supply from the United States and elsewhere. The Indian wheat crop harvested this May, originally estimated to be at 30 million tons, was finally harvested at 22 million tons.

The main reason for the shortfall was the shortage of fertilizer, but also contributing was the shortage of oil, which in one province alone led to a shortfall, according to the USDA, of about a million tons. While we were waiting in our cars for an hour at gas stations to get gasoline in February and March, Norman Barlaug, the Nobel Peace Prize winner in the food area, was reporting that in the Punjab, for example, people had been waiting for 2 days at rural gas stations, little farmers with their 5-gallon tins waiting to get oil to run their irrigation pumps without which they could not grow their wheat. The impact of the oil shortage was much worse, it seems to me, on those countries than here.

So, it is quite clear now that at best the grain crop in Asia this year will be middling; that Asia will need to import more grain in the year ahead than any region in the world has ever imported in its history and that the prospects of disaster are still very close.

Last year China imported as much grain as India did at the height of the famine. The initial reports are that weather in China is poor again this year. For India, as I have told you, the wheat crop is way down this spring. The main crops, however, come this fall, dependent on the monsoon. As of the weather reports a week ago, the monsoon was several weeks late in hitting most of India.

So, there is a significant prospect of tremendous demand from these countries, for food next year. This is coming at a time when I think we can say that the United States no longer has even a semblance of a global food policy other than to maximize the profits resulting from the export of food.

Secretary Kissinger has taken a commendable initiative in urging a World Food Conference, but specific action is now needed. U.S. food aid in fiscal year 1974, just past, dropped to 40 percent of fiscal year 1972—a year in which we earned an extra $7 billion from our food exports, including more than $6 billion from the higher prices received for grain we sold. Fiscal year 1974 has also been characterized by the fact that for most of that year, the U.S. Government had an embargo on fertilizer sales, which primarily affected the developing countries. It is very clear that a new food policy is needed, not only to affect the lives of millions of people in these Fourth World countries that are so badly hit by the petrodollar and food crisis, but also, if we are ever to cope with the 2-digit inflation that we have. In the next 10 years the world will have to grow or increase its food production by some 400 million tons, from the present level of 1.2 billion, to 1.6 billion.

If we have to increase most of this production in the developed countries, it can only be done by going to much higher priced land, and much higher priced use of inputs because of declining yields from more and more fertilizer, and from a higher cost of water. The principal source of low cost production for the world in the next 10 years is in the developing countries. A responsible expert has estimated that the amount of fertilizer needed to get the next 100 million tons of food out of the developed countries would be 24 million tons of fertilizer. On the other hand, to get 100 million tons of increased production in developing countries, would take only 10 million tons of fertilizer. In other words, the comparative advantage is very clearly in terms of increasing production in developing countries. But meanwhile, what has happened is that the Japanese and the United States have restricted fertilizer exports, so they would be primarily used on the least efficient sources in the developed countries as a whole. At the same time, there has been no appeal to the American people to cut back on the use of fertilizer for nonfarm uses. At a time when the developing countries face a 2 million ton fertilizer shortage that is really critical, the United States will use some 3 million tons on lawns, cemeteries, and golf courses—fertilizer which is desperately needed by American farmers to produce food at a time of world food shortage.

As I mentioned earlier, the oil crisis has also greatly accelerated the power shift. On the one hand, it has given the OPEC countries a much larger capital surplus, and the issue of what they do with their capital surplus is now much more acute than the slow accumulation we saw 6 months ago. This creates a real problem with the oil countries, one I think warrants the attention of this subcommittee. There really has not been in my judgment, an effective dialog on this with the OPEC countries. The focus of the U.S. Government has been on the commendable objective of trying to reduce the price of oil; but the focus has been so heavy on this, that until really only very recently, has there been serious attention in a sustained major way by the U.S. Government to how one gets more contributions out of the oil countries to meet, shall we call it, damage control requirements. This raises issues which really have not been discussed yet. What is a fair share from the OPEC countries? The United Nations has a standard for assistance of .7 percent of GNP.

If we follow the .7 percent of GNP formula, the United States is roughly one-half of that. It is clear that this would bring out of the OPEC countries less than a billion dollars—far less than is needed for damage control purposes.

On the other hand, if, because of their liquidity, they should properly put up a larger amount, the issue then is what is the larger amount and for how long. This whole question of really what our fair share is, is very much at issue.

Finally, I would say, looking at the elements of a solution, first and foremost is the need to avoid a global recession. As I indicate in my statement, we are considerably more worried about this, I think, than Secretary Bennett's statements would indicate. As part of this, it is clear that an oil price rollback would be valuable; but in my judgment, the prospects of a really major oil price rollback are sufficiently slight that we should not allow it to completely preoccupy our attention at the expense of other damage control measures.

On the establishment of recycling facilities, quite clearly, as I indicated earlier, for the advanced developing countries there is the need for an expansion of the present special oil facility, but also a very important need to keep existing channels open—the Eurodollar, the supplier credit, the World Bank channels.

For the Fourth World, first and foremost, there is the need to supplement IMF and World Bank channels with an emergency assistance of at least $3 billion for the year that lies ahead.

As you know, the United Nations Secretary-General has appealed for a special emergency fund, and has asked Dr. Raul Prebisch to be his agent in rounding this up. The European Economic Community has now volunteered a contribution of $500 million toward this fund if the total reached is $3 billion and if the OPEC countries will put up half, or $1.5 billion, of the amount. Canada has indicated a willingness to provide $100 million; the Netherlands, $30 million. Reports are that Venezuela and Iran are prepared to provide $100 million each for this purpose. The Secretary-General of OPEC has stated, but without any substantiating detail, that the OPEC countries as a whole will provide 1 percent of GNP for assistance. At this moment of time, the United States has stated it will participate in the fund; but unlike the European Community, the Canadians and the Japanese, we have not indicated yet at what scale we might participate—at $100 million or a billion or $1.4 billion. This is badly overdue.

Mr. GONZALEZ. Mr. Grant, pardon me. I very reluctantly interject at this point the fact that Secretary Bennett is going to have to leave us soon because he is going to get sworn in at about 12:30. If it is all right with you, we will insert at this point in the record your complete prepared statement, and we will recognize members of the subcommittee for some brief questions.

[Mr. Grant's prepared statement follows:]

Statement of James P. Grant*
President, Overseas Development Council
Submitted to the Subcommittee of the
House Banking and Currency Committee on International Finance
July 9, 1974

The International Petrodollar Crisis
and the Developing Countries

Mr. Chairman and Members of the Committee:

I welcome this opportunity to testify at your invitation before the House Banking and Currency Subcommittee on International Finance on the consequences and implications of the international petrodollar crisis that the world recently has been experiencing and on its implications for the developing countries and for U.S. policies. My comments might be summarized briefly as follows:

First, any meaningful assessments must take into account the fact that although the oil and petrodollar crises took place earlier than anticipated as a result of major short-term factors such as drought and war, they nevertheless are primarily a consequence of the unparalleled economic growth of the past quarter century within the constraints of a largely finite physical system and of relatively inflexible political and economic structures. This long-term trend is shifting economic and political power toward commodity suppliers and creating a new international economic and political order; it requires the development of new international systems, structures, and rules.

*The views expressed in this statement are those of the individual, and do not necessarily represent those of the Overseas Development Council, or of its directors, officers, or staff.

Second, better means must be found for recycling funds in adequate amounts from the foreign exchange surplus nations (notably the OPEC countries, the United States, Canada, Germany) to the most seriously injured industrial and developing nations.

a. For those currently able to pay commercial rates, such as Italy and Korea, the Eurodollar market may serve this purpose in the short term. Over a several-year period, however, there is need for a greatly expanded version of the "oil facility" recently established by the IMF to assist hard-hit countries meet financial difficulties resulting from recent price increases, and for monetary and trade adjustments to enable the hard-hit countries to increase their earnings from the surplus countries.

b. The most severely affected developing countries require special help immediately on highly concessional terms in amounts totaling \$4-\$5 billion annually if they are not to go under and if they are to gradually regain their economic stability and growth. In addition to pressuring the richer, capital-surplus OPEC countries for major contributions toward meeting these needs, the United States, whose higher food prices and fertilizer export restrictions are also a significant contributing cause of the current disastrous predicament of these poorest nations, should respond affirmatively to Secretary General Waldheim's appeal for emergency assistance by providing at least \$1.25 billion of additional assistance. This can be in the form of food as recommended in House Resolution 1155, as well as by making available additional assistance for food production and rural development, in response to President Nixon's request for an increased authorization under the Foreign Assistance Act for FY 1975.

The Newly Emerging International Order

The emergence of the new international order was symbolized in 1973 by a growing list of shortages, including fuels, and by jolting price increases and other developments on many different fronts. Food prices soared in the United States (wheat prices alone increased more than threefold) to the utter surprise of most American economists, who had failed to anticipate the acceleration of global interdependence in food. The quadrupling of oil prices by the oil-producing countries and the implementation of an Arab oil embargo against the most powerful nation--the United States-- were an even greater surprise to many. Soaring prices for soybeans led the world's principal producer, the United States, to embargo their export, creating a major new crisis with Japan and dramatically undermining the major American effort to reduce the protectionist agricultural policies of the European Economic Community. Fertilizer shortages have led the fertilizer-exporting industrial nations to restrict shipments to the developing countries, leading already to dramatic reductions in some of their crops, with the threat of more to follow. These changes have already brought shifts, many not yet fully perceived, in economic power--and therefore political power--not only among the developed countries, and between developed and developing countries, but also among the developing countries themselves.

The changes the world has experienced in the past year have resulted from two quite different sets of circumstances--short-term and cyclical factors on the one hand, and longer-term and more permanent ones on the other. With respect to the short-term circumstances, the early 1970s witnessed an unprecedented business boom caused by the simultaneous expansion of all the industrial economies for the first time since World War II. Other major but short-term factors have included unprecedented droughts in the case of food, and the Middle East conflict in the case of oil. I believe, however, that, viewed from the perspective of ten years hence, the shortage crises of the past year--while of course accelerated by such short-term factors--will be seen as essentially the product of major long-term trends: continuing rapid economic growth taking place within the constraints of an often finite physical system and of inflexible political and economic structures.

As the global scale of economic activity has expanded--from roughly $1 trillion in global production in the late 1940s to some $4 trillion in 1974--it has begun to push the global system increasingly to the limits of its adaptive capacity. There was relatively little strain on the world system 25 years ago, but as the world approached the attainment of its third trillion dollars of global production in the late 1960s, signs of stress began to appear in many areas. We began experiencing an ecological overload, ranging from massive environmental pollution in cities everywhere to an over-harvesting of the world catch of table-grade fish, which appears to have led to a decline in the world fish catch over the past three years. Global increases in population growth (averaging 2 per cent a year) as well as increasing affluence (as measured by a 3 per cent average rise in per capita income a year) have doubled the annual increase in demand for food from some 15 million tons each year in the mid-1950s to 30 million tons now, thereby straining the productive capacity of the world agricultural system. Even in the case of many commodities for which additional productive capacity exists, for example oil and coffee, soaring world demand is bringing about shifts from the buyers' market circumstances of the last 25 years to those of a new sellers' market.

It bears remembering that the period since World War II was characterized largely by material surpluses. The central economic issue of the period was producer access to the markets of consuming nations. The international rules developed under the General Agreement on Tariffs and Trade (GATT), the Kennedy Round of trade negotiations in the 1960s, the key resolutions by the developing countries at the past three UNCTAD conferences, and the proposed Trade Reform Act of 1973 have all taken place or been developed in this context of seeking to safeguard and to increase access to markets. Recent events indicate that an equally important, or even more important, set of issues is taking shape around the question of assuring consuming nations reasonable access to essential resources--such as energy, minerals, grain, fish, and soybeans--and on the associated need to develop global approaches to the new worldwide problems arising from scarcity in the market place. The shift from traditional buyers' markets to global sellers' markets for an ever lengthening list of commodities is bringing a host of profound changes, many of which are still only remotely sensed.

Economists and foreign offices (other than those in the OPEC world) have been slow to recognize the fundamental character of the change in progress, a change which in a period of less than 12 months has resulted in energy shortages throughout much of the world, soaring food prices everywhere, a host of related shortages, and widespread speculation about the possibility of more OPEC-type situations in store ahead. At present the trend has been toward each country looking out for itself--the law of the jungle--rather than toward cooperation with others.

As a result, many countries are suffering unduly, and the resource-poor countries are suffering the most. A doubling or trebling of grain prices is for most Americans a bearable inconvenience, but for those in the cities and towns of South Asia or Northeast Brazil who have been spending 80 per cent of their income on food, it means more malnutrition and the prospect of an earlier death.

As the world moves toward more than a $10-trillion gross global product by the end of the century, one can safely predict that:

-- Competition among countries for the earth's limited resources will intensify;

-- A linkage effect will frequently set in, with shortages in one field limiting production elsewhere (as when energy shortages result in fertilizer production cutbacks, which, in turn, limit food production);

-- Product substitution will become more difficult;

-- Economic and, therefore, political power will continue to shift markedly from buyers to sellers.

In retrospect, it can be said that these trends were well advanced by early December 1973. The doubling of oil prices by the OPEC countries on December 22, 1973--which raised oil prices in 1974 to levels most economists had not anticipated until 1980--has introduced a "system overload" which may be beyond the capacity of the international order to absorb without major chaos. It has also accelerated and brought into stark relief other important trends which must now be taken into account. Four trends in particular merit special attention: the economic dislocations resulting from the oil price rises; a worsening world food situation; a deepening of the global recession already in prospect; and major shifts in the economic and political power of nation states.

Energy Shock

The "energy shock" which many developing countries are experiencing comes from two quite different factors: (1) the increase in oil prices, [1/] and (2) higher prices for essential food and fertilizer from developed countries. If prices remain at current levels (which are four times those of 1972), the

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1/	1972	1973	1974 (est.)
All oil imports from OPEC (c.i.f.)	$20.0 billion	$36.0 billion	$100.0 billion
Developing country oil imports	3.7 billion	5.2 billion	15.0 billion
OPEC governmental oil revenues	14.5 billion	22.7 billion	85.0 billion
(Of which Venezuela's share)	1.9 billion	2.8 billion	10.0 billion
OPEC current account surplus	1.6 billion	6.1 billion	66.0 billion

non-oil-exporting developing countries will have to pay $10 billion more for necessary oil imports in 1974 than in 1973. Moreover, it is likely that most of this money will be "recycled"--in the form of purchases and investments by oil-exporting countries--not into the economies of the hardest-hit non-oil-exporting countries, but into those of the developed countries. At the same time, the increased cost of the food and fertilizer imports of the non-oil-exporting developing countries from the developed countries will exceed $5 billion. With wheat and nitrogenous fertilizer prices more than double those of 1972, the increased import bill of the non-oil-exporting developing countries for these two commodities alone (both imported primarily from the United States) will be over $3.5 billion.

As a consequence of these price rises, the developing countries will need to pay some $15 billion more for essential imports in 1974. The massive impact of these price increases is indicated by the fact that they are equivalent to nearly five times the total of net U.S. development assistance in 1972, and are almost double the $8 billion of all development assistance that the developing countries received from the industrial countries in the same year.

Equally important, many developing countries would be further damaged if the present worldwide economic slowdown were allowed to drift into a major global recession, further reducing their export earnings. Those countries which depend heavily on workers' remittances and on revenues from tourism--for example Mexico and the Caribbean countries--would suffer additional harm. Whether a global depression can be avoided depends on how the developed countries (notably the United States) react to the new situation.

Effects of the Price Increases on Particular Developing Countries

Beyond these general effects on all of the developing countries, however, the impact of price increases, as already indicated, varies greatly among individual developing countries. The major oil exporters are one category of developing countries which obviously benefits. These countries--whose combined population of more than one quarter billion is greater than that of North America, the European Community, or Latin America--will be in a greatly improved position to accelerate their economic growth. However, as shown in Table I attached to this statement, the degree of benefit varies sharply among the countries within this group. Thus Venezuela's increased earnings from oil alone will in 1974 more than triple its total imports of $2.4 billion in 1973. Indonesia, which is an extremely poor country within this category, now benefits only to the extent of $20 per capita from the oil price hikes; but even in this case, the additional oil earnings--in combination with the good prices it is getting for its other raw material exports--will remove foreign exchange as a major constraint on its development effort.

It must be noted, however, that increased foreign exchange availability does not remove, although it may alleviate, other major development constraints--the many social problems faced by most oil-exporting countries.

Thus in such disparate countries as Venezuela, Nigeria, Algeria, and Indonesia, the serious unemployment and income maldistribution problems which are largely a consequence of their economic and social structures and policies have not been solved, and may only be eased, by growing availability of foreign exchange. Djakarta's vast urban slums and its recent riots are vivid reminders that growing social problems can exist side by side with accelerating economic growth and increased foreign exchange earnings. Saudi Arabia and the Persian Gulf Emirates also face major problems of transition from feudal to modern structures. These countries, therefore, will need continued technical cooperation in solving their development problems, although they clearly no longer require any capital financing on highly concessional terms.

A second category of developing countries consists of those non-OPEC countries which, on balance, either have not been significantly injured by the price trends of the past two years or appear to be net beneficiaries because their advantages in other areas will largely offset the net effect of the price changes of 1973 or their balance-of-payments. Some of these countries are nearly self-sufficient in oil or are minor oil exporters; some benefit substantially from their exports of other raw materials whose prices are increasing (see Table III); and some enjoy both of these advantages.

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China,[2/] Colombia, Mexico, Bolivia--and, shortly, Peru as well--are in the first sub-group; while Malaysia, Morocco, Zambia, Zaire, and probably also Brazil belong in the second. Tunisia because of its phosphates and Bolivia because of its tin are examples of minor oil-exporters benefiting under both headings.

Mexico and Tunisia, however, also belong to a third category of countries--those which will suffer disproportionately from any economic slowdown in the industrial countries because of their close linkages with the major industrial regions of the West. These are nations which during the past 15 years have successfully capitalized on their physical proximity to the industrial countries to increase their earnings from tourism, workers' remittances, and exports of agricultural perishables. Greece, Spain, Turkey, Yugoslavia, Tunisia, and Algeria are among those who have benefited greatly from their participation in Western European economic expansion. Thus in 1973, Yugoslavia and Turkey each earned more than

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2/ China became a minor oil exporter in September 1973, and in 1974 is expected to ship some 3 million tons, valued at approximately $200 million. Its oil exports may increase gradually--to 5 million tons in 1975 or 1976--but are not expected to increase greatly in the foreseeable future. By the late 1970s, the major expansion that is now under way in its petrochemical industry is expected to require large amounts of domestic oil production. China will suffer, however, from the present high grain and fertilizer prices. China rivals India as the world's largest fertilizer importer, and its grain imports for 1974--which are unusually high--are expected to reach at least 9 million tons. In more normal years China's grain imports have ranged between 4 and 6 million tons. In 1972 the Chinese paid $345 million for their grain imports at the much lower prices then prevailing; in 1974 their grain import bill is expected to be well over $1 billion.

$1 billion from workers' remittances, and Yugoslavia earned an equivalent amount from tourism as well. Mexico and the Caribbean have been the most conspicuous gainers from proximity to the booming North American market. Mexico's tourism earnings, for example, exceeded $1 billion in 1973.

A group of countries that are related to this third category, yet somewhat different, includes countries such as South Korea, Taiwan, Hong Kong, and Singapore. These countries are closely integrated with the world economy but almost entirely through the processing of goods. The energy component of their imports is very large, and they also are substantial food importers. The combined increase of South Korea's oil and food bills in 1974, for example, is likely to approximate $1 billion. These countries clearly are affected adversely by the greatly increased prices of the energy and raw materials they need. However, the crisis period for such countries may well be of relatively short duration, since--provided that there is no major global recession and the market continues strong--they should be able to pass along much of the extra cost to the buyers of their manufactured exports. An added advantage of these countries is that in recent years, most of them have developed sizable foreign exchange reserves as well as established patterns of access to export credits and to the Wall Street and Eurodollar markets.

Because of the inherent strength of their ties to the industrial economies, the problems of this third category of countries and its special sub-group in adapting to the new price structure should not prove impossible unless the slowdown in the industrial countries is serious and long-lasting. In 1974 and 1975, many of these countries will need access to funds of a type which should be relatively easy for the international economic community to provide if the Western nations wish to accommodate the needs of these countries. Many of the measures developed for assisting the OECD countries to adjust to the higher oil prices should be applicable to these countries as well. It also should be possible to ensure their continuous access to the Euro-currency markets and export credits despite their short-term difficulties. 3/

The fourth category of countries consists of the hard core of seriously affected countries, totaling about forty in number. Most of these countries are in tropical Africa, South Asia, and the Central American-Caribbean area, but the category also includes Uruguay, and possibly Chile and the Philippines. It is important to realize that these countries together contain some 900 million people, or nearly half the population of the developing world exclusive of China. For this "Fourth World" group of countries, the consequences of the changes from 1973 are overwhelmingly negative. Most of these countries not only are the poorest in the world at present, but also

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3/ In 1973, developing countries borrowed an estimated $10 billion in the Euro-currency markets, well above the level of the preceding year. (See Table IV) Largest known borrowers were OPEC countries in Asia and Africa, and Brazil, Mexico, Colombia, and Peru in Latin America. Many countries in the second and third categories described above borrowed relatively small amounts. The impact of the high oil prices on Euro-dollar transactions with developing countries is uncertain. To the extent that Arab deposits in Euro-dollar banks are more than offset by European withdrawals to pay for oil, there will not be as much liquidity in Euro-currencies, and that may deprive developing countries of an important recent source of finance. Moreover, much of the $10 billion is callable on short notice by the lending banks, thus increasing the vulnerability of the developing countries. On the other hand, if Arab deposits leave the Euro-currency market more liquid, 1974 may yield additional large transfers to the developing countries--chiefly the more advanced ones.

have the most dismal growth prospects for the future. Their net share of the identifiable adverse effects of the recent price increases amounts to some $3 billion. In addition, these countries face imponderables such as the cost of reduced direct private investment in the wake of these economic disruptions or the decline in their export earnings due to the global economic slowdown in 1974. Finally, if the countries in this category are to maintain their development momentum, they will need major additional investments either to increase their food, fertilizer, and energy production to reduce their dependence on these high-priced imports or to establish new export industries to enable them to pay their vastly higher import bills--or both. An additional $1-$2 billion annually is needed for these purposes.

India, the Philippines, and Bangladesh, for example, probably could double their grain production in less than a decade with greatly increased research, more irrigation facilities, and wider availability of farm inputs and credit. Sri Lanka and Nepal have unexploited hydroelectric potential, and India--like the United States and several European countries--has large coal reserves which warrant development given the new high price level for energy. The poorest countries, however, always have had more difficulty than the industrial countries in shifting capital and technology from one sector to another, and this difference is even greater now because of the higher oil and food prices, which drain from the poorest countries resources that might otherwise be available for investment.

Extraordinary measures will be needed to assist these countries, as most of the means suitable for helping the third category of countries described above are not suitable for this Fourth World category. These poorer countries are unable to assume large additional amounts of short-term or medium-term credits on near-commercial terms because of their already high debt burdens and limited foreign exchange earning capacity. The new IMF oil facility has, therefore, limited value for them.

Worsening World Food Situation

It has been apparent for approximately a year now that the current international scarcity of major agricultural commodities and the major drawdown of world food reserves reflect important long-term trends as well as the more temporary factor of lack of rainfall in the Soviet Union and large areas of Asia. We are witnessing what appears to be a fundamental change in the world food economy from two decades of relative global abundance to an era of more or less chronically tight supplies of essential foodstuffs. This is so despite the return to production of U.S. cropland idled in recent years. As noted earlier, a major reason behind this shift is the fact that growing affluence in rich countries has joined population growth in the poor countries as a major cause of increasing demand for foodgrains. At the same time, overfishing has interrupted the long period of sustained growth in the world fish catch--thus limiting the supply of another important protein source.

As a consequence of these fundamental changes, as well as of the additional temporary factor of drought, global food stocks have been dropping in recent years. Global reserves have dropped from the equivalent of 69 days of consumption in 1970 to some 36 days of reserves by last summer. Despite the highest grain production and the highest grain prices in history in the current crop year, global reserves are continuing to fall and had reached the equivalent of only 26 or 27 days' global supply by June, 1974.

Food production prospects for the developing countries for the crop year that begins this month are even less hopeful than they were last fall. Most developing countries will be even more short of foreign exchange as a result of last December's doubling of energy prices, and hence will be unable to import energy, fertilizers, pesticides, and other essential farm inputs. In addition, the world is faced with a world fertilizer shortage which will last at least for several years. Barring some new governmental intervention, developing countries can expect their fertilizer supply to be cut back far more than will be the case in the industrial countries.

In the United States, the combination of new acreage being restored to production, the greater use of fertilizers because of the much higher prices for grains, and the increased use of urea for feed, has resulted in an unofficial "quasi-embargo" on U.S. fertilizer exports since last October. As a consequence of the energy crisis, Japan--in recent years the world's largest fertilizer exporter--has cut back its fertilizer production severely to the point where in recent months its output has been largely limited to meeting the demands of its politically important domestic market and to supplying Communist China.

Developing countries are hurt the most, as evidenced by the shortfall of 750 thousand to 1 million tons in India's fertilizer imports during the past crop year, which will cause a production shortfall of 7 to 10 million tons of grain. It will be at least several years before adequate new fertilizer capacity can be constructed, and under the present policies of the industrial countries the adverse consequences of this shortfall are borne principally by the developing countries. The FAO estimates the shortfall of these countries for the present crop year at 2 million tons, which will necessitate their importing as much as an additional 16-20 million tons of grain at a foreign exchange cost of some $4 billion.

The extent of global vulnerability is particularly underlined by examining the degree of global dependence on North America for exportable food supplies. Over the past three decades, North America--particularly the United States, which accounts for three-fourths of the continent's grain exports--has emerged as the world's breadbasket. Of the 95 million tons that moved in world grain trade between regions in 1973, 88 million were from North America. This contrasts with the mid-1930s, when North America provided only 5 million of the 25 million tons then moving in trade between regions. Exports of Australia, the only other net exporter of importance, are but a fraction of North America's. Moreover, the United States now is not only the world's major exporter of wheat and feedgrains but it is also the world's leading exporter of rice. Thus the United States and Canada together today control a larger share of the world's exportable surplus of grains than the Middle East does of oil.

Having embargoed new fertilizer sales because of rising domestic demand and devoid of the food surpluses on which its food aid (PL 480) program so long depended, the United States--the food and fertilizer center of the world--no longer is implementing even the semblance of a global food policy beyond that of maximizing profits for agricultural exports. U.S. food aid this year is one-third its volume of two years ago, and one-half of this greatly reduced amount goes to Indochina. At the same time, U.S. per capita food consumption continues to rise--amounting to 1,850 pounds of grain annually by 1972, as contrasted to 380 pounds per person in most of Africa and South Asia--while scarce fertilizer continues to be used for such non-farm purposes as lawns, golf courses, and cemeteries in ever-increasing amounts that already exceed the total fertilizer shortfall in the developing countries.

There is an urgent need for the United States to develop an integrated global food policy. The new era of increasinly tight supplies brings with it the need for greatly improved global management not only to avoid large-scale famine but also to increase food availability so that two-digit inflation does not become a semi-permanent fixture. Now that idled cropland in the United States has been returned to production, the opportunity for easily expanding production in the developed countries has diminished sharply. As sources become scarce, the comparative advantage in additional food production shifts toward those areas where the resources can bring the greatest gains. The increase in food output brought by a given additional amount of fertilizer or energy is far higher in the developing countries than in the industrial countries. Since fertilizers are already applied very heavily in the agriculturally advanced nations of Europe, in Japan, and in the United States, an additional pound of fertilizer applied in these nations may not return more than 5 pounds additional grain. But in countries such as India, Indonesia, or Brazil, it will yield at least an additional ten pounds of grain. Unfortunately and ironically, when world fertilizer shortages emerged in 1973 the more advanced nations acted to restrict their fertilizer exports to the poor nations, where the fertilizer would have produced much more food.

In some ways, President Nixon's proposal to double U.S. assistance for increasing food production in the developing countries under the FY 1975 Foreign Assistance Act may be described as one of the lowest cost means available to the United States for fighting inflation over the longer run. The world's principal unrealized potential for expanding food production is now concentrated in the developing countries. Soils in Bangladesh are fully equivalent to those in Japan, yet rice yields are only one-third of those in Japan. India's area of cropland is roughly comparable to that of the United States, but it harvests only 105 million tons of grain while the United States harvests 250 million tons. Corn yields in Brazil and Thailand are still only one-third those of the United States.

Power Shifts

The events of recent months have accelerated the shift of economic and political power to two power centers--North America and the OPEC countries--whose leadership role in the months ahead is uncertain, at the same time that they have weakened and demoralized the European Economic Community and Japan, which in recent years had been providing increasing global leadership.

The oil-rich OPEC countries, with a current account surplus of some $50-$65 billion annually, are an obvious source of new power. Given the new wealth and the arbitrary manner in which these countries implemented their oil price increases, it is understandable that many insist that these countries take the lead in meeting the aggravated financial problems of the poorest countries. The OPEC countries have tended to react defensively, however, and most developing countries have been reluctant to press them hard for a combination of reasons. These include some degree of self-identification with the oil producers as fellow developing countries, as well as the same "practical" politics that have led many industrial countries to seek bilateral deals with the oil producers. No major dialogue has developed as yet, therefore, between the oil countries and the industrial countries on the problems of the poor. The oil producers in their defensive reactions have noted that the price of wheat had increased nearly threefold before there was a parallel oil price increase, that most of them are not so rich per capita as the industrial countries (in 1974, Venezuela's per capita income will approximate $1,500, Nigeria's $250, Iran's $1,000, and Saudi Arabia's $3,000 versus $5,000 for the United States, $8,000 for Kuwait, and $43,000 for Abu Dhabi), and that they, solely as newly rich, should not be asked to help the developing countries to a greater extent in terms of per cent of GNP than the industrial countries. The dialogue initiated by the IMF and the World Bank with these countries is useful, but far more needs to be done. There should be particular opportunities for effective dialogue with Venezuela, Saudi Arabia and Iran. Venezuela has closer and longer established ties with the other Latin American countries than Nigeria has with the countries of its region, or the Middle Eastern countries have with Asia and Africa. Saudi Arabia appears more concerned than most of the richer OPEC countries with the potential adverse effects of high oil prices. Iran, the original instigator of high oil prices, has been conscious of the need to avoid unduly antagonizing the Fourth World countries.

The second power center strengthened as a result of recent events is the United States and Canada. Canada, with increased earnings from its oil exports to the United States to offset its oil imports for Eastern Canada, is a multi-billion-dollar beneficiary of the recent trend toward higher prices for raw materials. A less appreciated, but major result of recent events is the relatively strengthened position of the United States--as reflected in the increasing value of the dollar and the U.S. balance-of-payments surplus for 1973. This strengthening is the result of a combination of factors including high, scarcity-related prices for many of its major raw material exports; the at least temporarily improved U.S. competitive position in manufactures resulting from the currency realignments that began in late 1971; and, finally, the relatively minor dependence of the United States on oil imports compared to other major industrial countries. The oil imports of the United States represent only some 13.5 per cent of its total energy consumption. Moreover, the United States relies on imports for only 30 per cent--compared, for example, to Japan's 99.6 per cent--of its oil consumption. Moreover, vast reserves of coal and shale ensure for the United States the option of substantial energy independence over the longer run. As a consequence, the United States, despite the likely economic slowdown in 1974, is far more attractive for Arab (and other) investment than are other countries and currencies and therefore can be expected to run a large balance-of-payments surplus in 1974. In general, then, the resource-rich countries--such as the United States, China, Canada, Australia, and the Soviet Union--suffer less than do smaller, resource-dependent industrial or developing countries when wrenching changes weaken the international economic order.

Elements of a Solution

Possibly most important among the various measures required by the present situation is the need to avoid a serious global recession at a time when all major economies are simultaneously in an economic slowdown. Ways also must be found to recycle funds in adequate amounts from the foreign exchange surplus nations (notably OPEC, the United States, and Canada) to the most seriously injured industrial and developing countries. For those currently able to pay commerical rates, the Eurodollar market may serve this purpose in the very short term, but over a several-year period there is need for a greatly expanded IMF oil facility and for monetary and trade adjustments which will enable hard-hit countries such as the United Kingdom, Korea, and Taiwan to increase their export earnings.

Many developing countries, particularly those of the Fourth World, will require special help on concessional terms. Considering the stakes involved, the amounts needed--$4-$5 billion annually for several years to cover price rises and accelerated energy and agricultural development--are not large. In addition to helping the most severely affected countries meet their immediate problems in maintaining the flow of essential imports, a special worldwide effort should be launched to provide them with the technical and financial assistance necessary to increase their food production and to develop alternate sources of energy so that these countries do not remain indefinitely impaired by these price rises. The IMF's short-term capabilities can be effectively employed to help the poorest, hardest-hit countries only if they are part of a longer range package which restores the growth process in these countries. Without other action by the industrial countries, the OPEC countries, and the international community in general, the contribution of the IMF's present facilities is at best limited.

The rollback of oil prices is still an issue at the present moment. The significant price reduction being sought by the United States would clearly ease the global readjustment problem by reducing the danger of a serious economic recession and by lessening the severity of the trade deficits confronting the great majority of countries in 1974, thereby easing the task of recycling the trade surplus of the OPEC countries back to those in need. However, the moral (and logical) position of the United States in pressing for an oil price rollback would be greatly strengthened by a U.S. initiative to (1) ease the growing burden on the least developed countries resulting from the sky-rocketing prices of fertilizer and grain, and (2) assure them of access to vital commodities, particularly fertilizer. Thus there is an urgent need for reducing the adverse impact of both sets of price rises, and particularly for reducing their impact on the poorest countries.

The resolution of the United Nations General Assembly Special Session on Raw Materials in April, 1974, is important in this context. It called on Secretary General Waldheim to raise emergency assistance to help tide the most severely affected, or Fourth World, countries over the next 12 months, and outlined a procedure for developing a multi-year effort to help these countries regain their financial balance and development momentum. The Council of the European Economic Community has offered to increase its assistance by $500 million if the other rich countries will raise the balance for a fund of at least $3 billion, of which they would expect the OPEC nations to provide some $1.5 billion.

The United States Government has affirmed to Secretary General Waldheim that we will participate in this emerging effort, but without specifying any amount or share. A fair share for the United States total should be at least one quarter, probably even a third, given the fact that we are much less hurt by the recent price dislocations than the Europeans or the Japanese. A U.S. contribution in the form of increased food and agricultural production assistance totaling $1 billion will be less than one-half of the more than $2 billion we will receive in 1974 from the developing countries as a result of our higher food prices.

The Canadian and Japanese are each reported to have offered to put up $100 million, and the Netherlands $30 million. Iran and Venezuela are also reported to have each promised $100 million or more, and Dr. Raul Prebisch has been conducting a round of discussions with the Arab countries in the past two weeks on behalf of Secretary General Waldheim. The

Secretary General of OPEC has stated several times recently, but without substantiating detail, that the OPEC countries will provide assistance in 1974 in amounts greater than 1 per cent of their GNP, i.e., more than $1.5 billion. This includes, however, assistance to such countries as Jordan and Egypt which, like U.S. aid to Vietnam or Colombia, does not qualify as aid to Fourth World countries.

Immediate Next Steps

The scale of the global problems brought on by the events of 1973 is such that they cannot be coped with through a series of belated, uncoordinated, and ad hoc measures. The need is for a global cooperative effort to (1) counter the threats of a severe sustained economic slowdown by maintaining demand, and of inflationary supply shortages by increasing production; (2) enable the recycling of surplus funds from OPEC investments to developed and developing countries in need; (3) help maintain momentum in the development efforts of the poorest developing countries during these years of transition and adjustment to higher prices; and (4) start evolving a new set of rules for access to supplies.

Secretary Kissinger acted with foresight last fall in calling for a United Nations Food Conference (now set for November 1974) and in setting forth general proposals in his wide-ranging speech to the U.N. General Assembly on April 15; however, the Fourth World countries require some $3 billion of emergency assistance immediately, before governments and international agencies deliberate on medium-term and longer-range proposals, and a specific U.S. response is now overdue.

The Overseas Development Council in April proposed in its Agenda for Action, 1974, seven possible actions to address the urgent needs of the hardest-hit poor countries:

(1) Agreement by food-exporting countries to set aside a portion of their food exports for transfer on concessional terms to the poorest countries;

(2) A parallel agreement by capital-surplus, oil-exporting countries to set aside a portion of their oil exports for transfer to the poorest developing countries on concessional terms, or to set aside a small portion of oil revenues for development, or both;

(3) Agreement on a global system of increased food reserves to meet future shortages;

(4) A joint effort by the capital-surplus oil exporters and industrial countries to help the poorest developing countries with their immediate and expanding needs for fertilizer;

(5) Agreement to launch a worldwide effort to expand low cost food production, with particular emphasis on the poorest countries and early action on IDA replenishment.

(6) Agreement on a cooperative effort to help all countries find substitutes for oil, including a) an interchange of information on energy technology, and b) financing by capital-surplus countries;

(7) Agreement on such short-term financial support for the price-distressed poorest countries as debt postponement.

These actions would be mutually reinforcing if all or most of them could be secured. Their total impact would go well beyond dealing with

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immediate problems of the current economic turmoil to hold out the prospect of accelerated development.

Conclusion

In many ways, the world in 1974 is at a watershed comparable to that of the mid-1930s, when the world chose the wrong direction and proceeded on to World War II, or to that of the mid-1940s when the decisions taken led to a new cooperative world order which, for all its obvious imperfections, has taken the world to unprecedented levels of cooperation and prosperity. The need in 1974 is for a sense of vision and cooperation comparable to that of the late 1940s.

The past year has clearly indicated what can lie ahead if--whether by preference or lack of foresight--the law of the jungle rather than cooperation remains the response of nations. Many of the new problems of global scarcity brought on by rising affluence and increasing populations certainly should be amenable to alleviation, and possibly even to solution, through cooperative international action. The United States, the world's breadbasket and the major beneficiary (by over $6 billion) of scarcity-derived higher prices for its food exports, has a special responsibility to help the hardest-hit countries at least on the food aspects of the world economic crisis. By skillfully handling the world's most essential raw material--food--the supply of which it dominates, the United States might also begin to pioneer and formulate new "rules of the game" for access to supplies, for increasing production to meet demand, and for establishing global reserves--new rules that are needed for the benefit of all in managing the increasingly tight world supply of essential resources.

Table I

Estimated Oil Revenues, Per Capita GNP, Population, and Total Imports of Eleven OPEC Countries

	Estimated Government Oil Revenue ($ millions)			Estimated Per Capita Government Oil Revenue ($)			Per Capita GNP ($)	Population (millions)	Total Imports ($ millions)	
Country	1972	1973	1974	1972	1973	1974[a]	1971	1973	1971	1972
Saudi Arabia	2,988	4,915	19,400	393	630	2,456	540	7.8	806	1,229
Iran	2,423	3,885	14,930	79	123	461	450	31.5	1,871	2,410
Kuwait	1,600	2,130	7,945	1,758	2,131	7,223	3,860	1.0	678	797
Iraq	802	1,465	5,900	80	141	551	370	10.4	696	713
Abu Dhabi	538	1,035	4,800	11,700	22,565	43,636	3,150	0.1	n.a.	n.a.
Qatar	247	360	1,425	1,941	2,575	9,500	2,370	0.1	n.a.	n.a.
Venezuela	1,933	2,800	10,010	176	250	870	1,060	11.2	2,301	2,433
Libya	1,705	2,210	7,990	820	1,005	3,631	1,450	2.2	712	1,104
Nigeria	1,200	1,950	6,960	21	33	114	140	59.4	1,506	1,502
Algeria	680	1,095	3,700	45	71	233	360	15.4	1,221	1,760
Indonesia	480	830	2,150	4	7	17	80	124.0	1,174	1,458

[a]ODC estimate based on World Bank estimates for OPEC government oil revenues, population (mid-1971), and population growth rates.

SOURCES: Oil Revenue figures are informal World Bank staff estimates; GNP and Population figures are from *World Bank Atlas, 1974* (Washington, D.C.: World Bank Group, 1974); Import figures are based on *International Trade, 1972* (Geneva: General Agreement on Tariffs and Trade, 1973), Publication Sales No. GATT 1973-3.

Table II

Impact of Oil Price Rise on Selected Developing Countries, Ranked by GNP Per Capita

Country	Estimated Oil Import Bill ($ millions) 1972	1973	1974[a]	Total Imports ($ millions) 1972	1973	Estimated Debt Service ($ millions) 1974	Total Reserves ($ millions) 1973[b]	Change in Total Reserves (per cent) 1970-1973[b]	Total Exports ($ millions) 1972	1973[c]	Primary Exports as % of Total Exports 1967-1969	Net ODA From DAC Countries[d] ($ millions) 1972	GNP Per Capita ($) 1971
Bangladesh	25	35	95	929	807	n.a.	200[ef]	n.a.	n.a.	n.a.	jute, 46	200	70
Sri Lanka	35	50	150	413	536	48	77	+ 79	313	372[g]	tea, 61 rubber, 19 coconut, 13	65	100
India	265	415	1,350	3,196	4,048	550	1,403[h]	+ 40	2,401	2,477	jute, 23 tea, 12 iron, 7	606	110
Pakistan	65	85	260	1,144	1,455	278	396	+118	737	1,107	cotton, 11	318	130
Kenya	25	40	115	698	854	30	286	+ 30	364[i]	n.a.	coffee, 24 tea, 15 oil, 9	72	160
Thailand	125	180	510	1,616	1,737	52	1,267	+ 40	1,063	1,503	rice, 27 rubber, 14	53	210
Philippines	185	265	740	1,662	2,480	128	867	+245	1,105	1,955	wood, 24 sugar, 17	164	240
Ghana	20	25	70	466	570	49	223	+284	389	562[g]	cocoa, 55	60	250
Morocco	50	80	216	1,057	1,336	102	304[e]	+117	633	985	phosphate, 24 food, 17	97	270
Korea, South	205	325	1,075	2,715	3,531	332	1,034	+ 70	1,624	3,088	wood, 13 fish, 6	361	290
Brazil	425	540	1,425	5,185	7,109	329	6,462	+444	3,991	6,038	coffee, 39 cotton, 7	94	460
Uruguay	40	60	160	239	369	30	210	+ 20	197	338	wool, 42 meat, 30	21	750
Chile	n.a.	147	362	1,211[i]	n.a.	312	n.a.	n.a.	961	962	copper, 76	39	760

[a] The oil import bill was calculated on the basis of the developing country's projected oil-import consumption at approximately $9.00 per barrel c.i.f. While an oil import bill calculated in this fashion may be unrealistic in terms of what many developing countries can afford to pay, it nevertheless reflects the order of magnitude of the economic difficulties faced by these same countries.

[b] As of September 1973, unless otherwise noted.

[c] The value of total exports in 1973 are those for the second quarter of 1973 expressed in annual rates, unless otherwise noted.

[d] Composed of net bilateral ODA and concessional multilateral flows.

[e] Total reserve position as of July 1973.

[f] Total reserve figure for Bangladesh obtained from U.S. Agency for International Development.

[g] First quarter exports expressed in annual rates.

[h] Total reserve position as of June 1973.

[i] Based on *International Trade, 1972* (Geneva: General Agreement on Tariffs and Trade, 1973). Publication Sales No. GATT 1973-3.

SOURCES: Oil Import and Total Import figures are based on informal World Bank staff estimates; Debt Service figures are from Bureau for Program and Policy Coordination, U.S. Agency for International Development; Total Reserves and Total Export figures are from International Monetary Fund, *International Financial Statistics*, December 1973; Net Official Development Assistance figures are based on Report by the Chairman of the Development Assistance Committee, *Development Co-operation, 1973 Review* (Paris: OECD, 1973); GNP figures are from *World Bank Atlas, 1974* (Washington, D.C.: World Bank Group, 1974).

Table III

Price Changes in Major Commodity Exports of Developing Countries

Major Commodities	Percentage Change in Price, 1972-1974[a]	Per cent of Total World Trade, 1970[b]	Principal Exporters' Shares of World Exports of Commodity, 1970
Petroleum	355	5.04	Saudi Arabia, 15% Iran, 13%
Urea	239[c]	n.a.	n.a.
Rubber	211	.48	Malaysia, 38%
Wheat	196	1.00	United States, 32% Canada, 21% Australia, 12% Argentina, 4%
Palm Oil	147	.06	Malaysia, 44%
Rice	138	.36	United States, 27% Thailand, 11%
Cotton	137	.76	United States, 16% Egypt, 14%
Corn	114	.58	United States, 45%
Sisal	113[c]	.02	Tanzania, 33%
Sugar	105	.86	Philippines, 10%
Cocoa	103	.27	Ghana, 35%
Ground Nuts	91	.07	Nigeria, 29%
Copper	90	1.29	Zambia, 24% Chile, 21%
Soybeans	79[d]	.42	United States, 94%
Tin	72	.21	Malaysia, 50% Bolivia, 16%
Iron ore[e]	46[c]	.80	Venezuela, 7%
Coffee	36	.93	Brazil, 32% Colombia, 16%
Tea	19	.21	India, 31% Sri Lanka, 29%
Jute	17	.05	Pakistan/Bangladesh, 50%

[a]Price change from 1972 (average) to 1974 (January), unless otherwise noted.
[b]World trade equalled $280.4 billion in 1970, $371.7 billion in 1972, and $487.5 billion in 1973 (second quarter estimate).
[c]Price change from 1972 (average) to 1973 (average).
[d]Price change from 1972 (average) to 1973 (October).
[e]Data available for developing country exporters only.

SOURCES: Based on International Monetary Fund, *International Financial Statistics*, December 1973, and World Bank staff estimates.

Table IV

Announced Euro-Currency Lending to Non-OPEC Developing Countries, 1972 and 1973
($ millions)

Country of Borrower	1972	1973
Argentina	236.0	87.3
Bahamas	-	30.0
Bahrain	-	15.0
Bolivia	-	6.0
Brazil	577.4	789.0
Colombia	90.0	115.0
Costa Rica	-	11.0
Cuba	23.3	30.0
Dominican Republic	4.0	15.0
Dubai	18.3	120.0
Guinea	40.0	-
Guyana	-	12.5
Haiti	-	10.0
Hong Kong	20.0	72.6
India	-	10.0
Ivory Coast	-	95.0
Jamaica	-	35.6
Kenya	15.0	4.5
Korea, North	-	51.6
Korea, South	30.0	106.0
Lebanon	-	20.0
Malawi	-	5.3
Malaysia	76.1	-
Mexico	490.4	1,247.5
Nicaragua	15.0	102.0
Oman	-	35.0
Panama	40.0	251.0
Peru	210.0	633.6
Philippines	61.3	178.5
Senegal	-	90.0
Swaziland	3.2	-
Trinidad and Tobago	-	38.0
Zaire	90.0	346.9
Zambia	25.0	150.0
Total, Non-OPEC Developing Countries	2,065.0	4,713.9
Total, OPEC Countries	1,023.5	3,080.0
Total, Developed Countries	5,385.0	12,889.4
WORLD TOTAL	8,473.5	20,683.3

NOTE: The interest rates vary. Maturities are largely three to eight years, with a six month rollover period.

SOURCE: International Economy Division, World Bank Group.

Mr. GONZALEZ. In your statement you stated that you anticipated a reduction or a decline in the cost of petroleum, and I was wondering, this will necessarily be predicated on the fact that we would have to trust the Arab producing countries that they would not reimpose an embargo. Do you see any danger or a possibility of a reimposition of the embargo?

Mr. BENNETT. Mr. Chairman, as you know, the embargo of last year was imposed after the outbreak of the war, and had an almost exclusively political content. Of course, I am not the expert but it is certainly my hope that there will be continued progress toward a lasting peace in the Middle East, so that the occasion for an embargo will not reoccur. A general embargo for economic reasons seems to me most unlikely.

Mr. GONZALEZ. With respect to the possibilities that you say the Secretary and others will be exploring soon, what mechanism or program can be devised to try to absorb some of this excess money through the issuance of Government securities? Can you tell us if any kind of an agreement has been reached by now? Whether or not some firm proposition was developed during the occasion of the President's visit to the Middle East? And whether or not, in case such plans are in the works, it would be necessary for the administration to come to the Congress for legislation to provide for that type of mechanism, or whether or not it could all be done within the administrative processes?

Mr. BENNETT. There have been no such agreements to my knowledge with foreign countries on new investments in U.S. Treasury or Government securities. You know, of course, that we do issue special securities. For example, we have about $26 billion outstanding now, of which the largest component is held by the German authorities.

It occurs to us that it could be to the mutual advantage of the United States and to some other countries that will be accumulating large government-held foreign investments to consider similar special securities.

There is no reason that I know of why we should offer any of these investors terms more favorable than we offer other investors, including U.S. citizens. But it is, according to our experience, likely that there will be opportunities to develop securities with special features that meet our respective needs. If, for example, a Middle East country could give us some assurance of the dates over a coming period on which specific large amounts would be invested here, we in turn could design government-to-government securities. These would be on terms comparable to the private securities but would provide them the opportunity of knowing in advance they could invest on a specific day and that those funds could be recovered by them on the basis of certain periods of notice to us, just as we have done with the Germans. We have had very preliminary discussions of this sort of thing, for example, when the Saudi Arabian ministers were here recently. We agreed to discuss the matter further with them we go out there next week; but there are no agreements.

Mr. GONZALEZ. Thank you very much.

In that connection, I am sure that you would want to avoid the situation I understand prevails now with respect to the World Bank, where a country such as Iran lends to the Bank at a higher interest charge than what the Bank is lending out in return. This seems to me to be a questionable policy, and I trust that that kind of situation will be very carefully studied by the United States.

Mr. BENNETT. Yes, sir.

Mr. GONZALEZ. If you do not mind, Mr. Johnson, I am going to jump over you and recognize Mr. Crane. He has been here from the beginning and has anxiously been waiting to ask some questions. I recognize Mr. Crane.

Mr. CRANE. Thank you, Mr. Chairman.

First of all, I would like to congratulate Mr. Bennett upon reaching the position to which he will be confirmed very soon, and I appreciate his testimony before the subcommittee, as well as that of Mr. Grant.

There is one question I would like to put to you, Mr. Secretary—it may be a premature designation, but I am sure it will be flawless in another hour—and that concerns the paragraph on page 5 of your testimony in which you indicate that you do not feel that the current situation is nearly as grave as some of the remarks that we had indicated in a brief prepared for the subcommittee by the staff. I am thinking specifically of some of the quotations in Hobart Rowen's article on the deepening monetary crisis, as well as some of Mr. Levy's remarks. You go on to say, at the top of page 6, that the problem you perceive now is that the clear and present danger before us is not inadequate, but instead far too much monetary demand facing the existing capacity to produce. On the one hand, I can grasp this from the testimony of yourself and Mr. Grant, but on the other hand, it seems to me that what we are talking about, in both your testimony and Mr. Grant's, is trying to come up with a whale of a lot of money. I am not sure exactly who is going to provide it and how—particularly to help these least developed countries. That does not strike me as surfeit of money chasing scarce resources, but rather a distinct lack of money available, unless we simply crank up the printing presses and aggravate all of the existing problems. I would appreciate it if you could dilate just a little bit on that point.

Mr. BENNETT. In a time of surplus monetary demand, it would still be possible for the people of Bangladesh to be short of the ability to buy imports. I may be wrong, but I understood you to say, Mr. Grant, that the United States indicated that it would participate in the U.N. fund.

Mr. GRANT. Right. The emergency assistance effort, not in the fund; the emergency assistance efforts.

Mr. BENNETT. Yes, that is the point I wish to make. We wish to cooperate, but we have not made any commitment to put money into this U.N. operation.

I think this also may be clarified. You mentioned that the Europeans said, conditionally, that they might be able to make some money available. But that also is not to the U.N. fund; it was to assistance to these most severely affected, in response to a U.N. appeal, but not necessarily to any particular channel. But there is no U.S. commitment whatsoever to place any given amount into this effort. It may be in time that that would be appropriate or that some form of food loans might be, but there is no such commitment. It is our hope that a large proportion of this needed assistance will come from those who are today in such a liquid position.

Mr. Grant mentioned an estimate of perhaps $3 billion a year. I have a feeling that for this calendar year the need will probably not reach a billion dollars. What it will be in later years, who knows. Who knows what the oil price will be—and it is hard to estimate all of the commodity adjustments: the price of tea, the price of beef, and estimates of that type have to be rather preliminary.

Mr. CRANE. The thing that still concerns me is this point of liquidity crunch. We have unprecedented interest rates at home right now. I understand the balance of payments deficit for Italy, if it continued to run at this rate through the year, would be $13 billion, which, even if their gold is revalued upward to market price, that would totally wipe out their gold supply. England and France have these problems, though not of the same magnitude. Here are advanced industrial nations that are undergoing, I think, really severe wrenches, and then on the other hand, we have the underdeveloped countries which I do not know where they are going to come up with the money. If the OPEC countries buy World Bank bonds, what interest rates will they be paying on those bonds?

Mr. BENNETT. The bonds are in two types lately—a portion denominated in their own currency, and a portion in dollars. I believe the rates that have been negotiated lately are mostly at 8 percent.

Mr. CRANE. They are going to have to lend long at low, very low, interest rates, will they not, to the least developed countries, to try and get them through the present crunch?

Mr. BENNETT. Let me distinguish three things. The money that is going into the IMF facility to help buy oil has been coming mainly from the OPEC countries at 7 percent for relending at 4- to 7-year maturities. The World Bank bonds will be for long-term IBRD loans, and these are for development projects. IDA is financed from governmental contributions, not from the receipts of bonds.

But let me get back to your basic question: Where is all of the money coming from? Well, I guess my answer is there is too much money in total; that we are pushing up prices and pushing down the value of money. That does not mean that there may not be a need to help those who are particularly hard hit. It does not mean that some particular country cannot get into trouble with an out-of-date exchange rate or by trying to hold prices that are not consistent with the money supply. But take Italy. Italy has just put in new measures that will substantially reduce that deficit forecast you mentioned, and in fact, in recent weeks, Italy may not even have had a deficit. They have begun to take measures.

Mr. CRANE. Thank you.

Mr. GONZALEZ. Thank you, Mr. Crane.

Mr. Young.

Mr. YOUNG. I yield to Mr. Rees.

Mr. GONZALEZ. Mr. Rees, then.

Mr. REES. Thank you. Congratulations, Mr. Bennett. I hope you enjoy traveling.

I have been doing some work in this field in terms of the domestic and international monetary impact of the pricing of oil, and I noted that our balance-of-payments deficit for the month of May was $776 million. I also notice that there had been a great deal of overbuying of agricultural commodities over the past 6 or 7 months from some of the importing countries, which actually might cut down the demand for U.S. farm products for the balance of the year. We continue to import about 30 percent of our oil. Will this trade balance—of payments—continue throughout the year, do you believe?

Mr. BENNETT. I think you probably put your finger on an important component of that large deterioration in May in our trade position—the previous overbuying in agricultural commodities and the drop in agricultural prices. Of course, we do not know how much, but last year's $8 billion import bill for oil is going to look pretty small compared to this year's import bill.

It is also worth noting that the way or accounts are kept, these investments that have been coming in here increasingly in recent weeks from the oil exporting countries—these investments in U.S. Treasury securities or on deposit in the United States—are investments of official institutions; they will show up in our present method of publishing balance-of-payments statistics as an overall deficit of the United States. Maybe we ought to consider whether that is not misleading. It is really an investment; they are not so much foreign exchange reserves in the usual sense but more investments of the national patrimony they will be using down the road. They are not current balance-of-payments deficits in the old-fashion sense. But I cannot at this point give you a specific prediction of what our trade balance will be this year that would be of much worth to you. I think the important thing is that we have to remain flexible to respond to what it turns out to be. Any prediction I give you will not be worth much.

Mr. REES. What bothers me, even in light of our adverse balance of payments and the possibility that this might continue, is that we are still in better shape than most of the world because we produce so much of our energy. Italy, I understand, is borrowing on the short term Eurodollar market to solve what is basically a long-term problem. Much of the Eurodollar market today is composed of short-term money—most from the oil exporting countries. All of these various windows, whether you loan someone 8 percent money to purchase oil or whether you allow Italy to revalue their gold so that they can borrow more on the short term Eurodollar market, all of these are just solutions for 1974. What worries me is 1975. Once a country uses all of its reserves to import the bare minimum of their petroleum needs, that is it. They do not have any more reserves; they are broke. Italy has revalued their gold; they cannot revalue it again. They have already revalued it up to where they can borrow. Mr. Carli might be able to do something to discipline the Italian economy—I tend to doubt it—but what is going to happen in 1975? We have taken the initial shot, and we do not have anything to bail us out next year.

Mr. BENNETT. Well, let me take the case of Italy and illustrate some of the trends.

First of all, Italy has been borrowing some short term, but in fact, the bulk of their Eurodollar borrowing in the first half of this year was long term borrowing and not short term. In fact, they probably borrowed, in the first half of this year in total more than the entire increase for the whole year in their oil bill. Thus, obviously, there must be factors in addition to oil at work here; factors having to do with the domestic economy. So appropriate restraint on the domestic economy does provide hope for next year, and the intensity of the problem this year is more than just oil. Of course, they have taken additional measures—they just threw the other day another quarter-a-gallon tax on the price of gasoline. Those to us would seem like rather draconian measures, so I think they do provide some hope that next year will be better than this year.

Mr. REES. Just one further question. Are you going to the Middle East with Secretary Simon?

Mr. BENNETT. Yes. We are going not only to the Middle East; we will be talking to some of the finance ministers in Western Europe on the way back. Somehow I have some feeling that some of the subject matter will be the same as we are discussing here.

Mr. REES. Thank you very much, sir.

Mr. GONZALEZ. Thank you, Mr. Rees.

Before recognizing Mr. Frenzel, I would like to report that we have a third witness, Victor Kurtz, from New York, and we will listen to him after awhile.

I recognize Mr. Frenzel.

Mr. FRENZEL. Thank you, Mr. Chairman.

I do want to congratulate Mr. Bennett and wish him a long and successful career.

It was indicated that we had committed ourselves to the principle of some sort of emergency aid through the U.N., but you are criticized—or we are criticized, I guess—for not setting forth some sum. Is it not true that we could wind up by paying the lion's share of all of those emergency programs, Mr. Bennett?

Mr. BENNETT. I would like to make clear that we have not agreed in principle to contribute to a U.N. fund. We agreed to work with the U.N. to study this problem and to try to see that this problem is appropriately recognized. We have not agreed to make any contribution.

It is true in the total postwar period we provided the lion's share. Of course, there are particular cases. We have not provided the largest contribution to the Asian Development Bank, or the largest contribution to the African Development Bank. There are exceptions.

It is our hope that this new Development Council will be able to do an objective job of studying what is needed and what appropriate responses are and where it should be possible to obtain appropriate help for those who are most seriously affected.

Mr. FRENZEL. Thank you.

Mr. GRANT. Mr. Congressman, may I just—since there is a little play, apparently, here on words.

Mr. FRENZEL. If you could do it in 30 seconds, because Mr. Bennett has to leave, and you can stay, I think.

Mr. GRANT. Yes.

The United Nations is asked to work on two fronts. One, the Secretary General is trying to raise approximately $3 billion of emergency assistance for the most severely affected countries, which could be in the form of either contributions to a U.N. fund or directly, in the form of increased bilateral aid. The U.S. Government has stated to the United Nations that it will participate affirmatively in this effort.

There is a second issue of a fund to be established next year that will be designed to work on a multiyear basis. That is what we have said we would not participate in, in its present form, as I understand.

Mr. FRENZEL. Fine. If either of you two want to amplify on these remarks for the record, I would be glad to have them.

Mr. Bennett, you commented on the fact that our agricultural sales abroad are down considerably this year, and that is my experience, too. Apparently, our trading partners are eating out of the pipeline, so to speak, and that leads me to believe that world food supply figures are pretty wild guesses, at best. Is this your estimate?

Mr. BENNETT. World food prices have tended to come down, as you know, since February. Unfortunately, they have tended to go up the last few days, because some of these adverse weather reports that Mr. Grant mentioned have been coming in, which is a clear illustration of how difficult it is to forecast in this area.

Mr. FRENZEL. We have done to world food prices what we did to the stock market. Every time somebody says on television that food might be short, world food prices go up. It may have no relationship to growing conditions or what the anticipated crop is. I think Walter Cronkite raised the price of wheat last year by at least a buck, and the market is getting awfully sensitive.

But certainly, food prices are down considerably. Does that mean we are going hungry, or demand is off?

Mr. BENNETT. The Russians, of course, are not expected to be an importer this year. The Chinese are still expected to be a very large one. What the Eastern Europeans and the Indians will be is very much a difficult thing to guess at this point.

I do not want to pose as a food expert. All I would like to do is agree wholeheartedly with your suggestion that forecasting the food market ahead is a very difficult project.

Mr. FRENZEL. OK. The final point I wanted to make is that your prime interest in the trip that is forthcoming and your prime interest within the Department has been to convince the oil producers that their prices have to come down. Is that true?

Mr. BENNETT. I might clarify. This trip that I have the honor to go on with Secretary Simon is primarily to discuss economic collaboration in trade and investment with the Egyptians, with the Israelis, and with the Saudis. In the case of the Saudis, the primary concern will be collaborating with them in the industrialization of Saudi Arabia, which, as Mr. Hanna mentioned, is their No. 1 interest.

While we are there, we will take the opportunity as bond salesmen also to talk to them on the other subject.

Mr. FRENZEL. I hope you talk about prices too, because it seems to me there is not anything better than we can do, particularly for the poorest of the poor, than to try to reduce those prices. While we have been criticized a little bit, it seems to me that when food got short, we at least tried to increase food supplies in every way that was available to us, while the producers of oil took the contrary course of action.

I do not think that we are deserving the same criticism that they do, and I believe it is in their interest to see that those prices come down a little bit. They may get bigger piles of money, but they are going to spend the same way because of the inflation problem. I yield the balance of my time.

Mr. GONZALEZ. Mr. Young.

Mr. YOUNG. Yes. Mr. Secretary, before you run off, I wonder if you might just say a word about the consequences to the United States of any of the lesser developed countries actually going bankrupt.

Mr. BENNETT. I have never thought the concept of bankruptcy was extremely useful in talking about the affairs of a government. Governments, of course, can always print money. They can default on their international obligations, and as a major creditor, that is a concern to us. But I think it would be more appropriate to look at the underlying situation.

If a government loses its ability to insure some degree of economic viability for an economy, what will be the political consequences? Will the government be overthrown? Will they take violent courses or try to make alliances that under normal circumstances they would not contemplate?

I think, ultimately, we have to not only look at the humanitarian but also the political consequences of severe economic situations. Mr. Grant, I am sure, could answer this better than I.

Mr. YOUNG. I was really thinking more along the lines of—well, we saw Jamaica begin to raise the price of its bauxite in an attempt to remain somewhat stable. That government, for instance, where we have tremendous hotel travel and other kinds of American investments; should that government begin to totter, it would not only have a political impact, it would have a direct economic impact back on us.

I was thinking more in those terms, because when we talk about the Congress going along with more, or any kind of aid, in view of our touchy experience last week with IDA, that is what disturbs me about your somewhat optimistic approach. It might be very good economically and in terms of our whole world picture, but in terms of communicating any sense of urgency to Members of this House of Representatives, it does not quite do justice, I think, to the condition in which we find ourselves, a condition which affects us economically and not from just a humanitarian consideration for the rest of the world.

Mr. BENNETT. Well, there is no doubt that government in extremis can take violent measures, not only with respect to foreign investments there, or exports, but in other ways. On the other hand, we have to temper that with the realization that there has been an unusually large rash of expropriations and breaches of contract by governments that were not in extremis. You cannot say that they only occur in those circumstances.

Mr. YOUNG. My colleague here passed a note to me saying you can only legalize the purchase of gold once.

Mr. REES. How are we going to get the next bill through?

Mr. GONZALEZ. We might have special drawing rights, domestic special drawing rights.

Mr. YOUNG. Thank you very much.

Mr. GONZALEZ. Mr. Burgener.

Mr. BURGENER. I have no questions.

Mr. GONZALEZ. Mr. Johnson?

Mr. JOHNSON. I, too, Mr. Bennett, want to congratulate you on your appointment and hope you have a very lovely swearing in ceremony today. It certainly is a big highlight in your career.

Mr. BENNETT. I look forward to a calm life.

Mr. JOHNSON. You think you will survive it all right? I am quite interested in one statement in your speech where you said:

> Neither do I feel that current developments pose a serious threat of world depression.

Then Mr. Gonzalez in his statement quotes the respected Economist magazine, saying that:

The world's rich countries are digging the foundations for a major world depression.

I realize those statements are contrary to each other, and first of all, would you comment on your statement that you do not think it poses a threat of depression?

Mr. BENNETT. Well, it was with statements such as that of the Economist in mind that I thought it was appropriate to put in such a phrase. Earlier in the statement, I had pointed out that the oil and other economic developments have led to a cut in our standard of living and have led to a reduction in our rate of growth. But to refer to that as a recession tends to be misleading.

That is because of a shortage of something real. It is not the type of recession we normally think of, since we all studied or grew up in the 1930's, in which there was just plain a lack of money to purchase the goods and to keep the plants working. That type of recession just does not seem relevant to think of at this time.

Second, I see no evidence that governments at this point are overdoing their fight against inflation to the extent that they are unnecessarily restraining production, or that one country is overdoing it and that will reflect on and harm the next country. In fact, it is hard to find a government that has been able to pull itself together to go far enough in fighting inflation. That is our problem, not the reverse, not that governments are overdoing it and that is hurting us, or that we are overdoing it and that is hurting other governments.

Mr. JOHNSON. I could ask you more questions, but I want to get you downtown. I want to get you to the church on time. Thank you very much.

Mr. GONZALEZ. Thank you, Mr. Bennett. We wish you well.

Mr. BENNETT. I am sorry I cannot stay here and argue with Mr. Grant, but I appreciate your consideration.

Mr. GONZALEZ. I did want to mention to the subcommittee that we had the third witness, Victor Kurtz, here, and we will allow Mr. Grant to finish his summation, because we interrupted him. But I do want to point out we have our third witness, and I would like to see us remain here——

Mr. KURTZ. I am sorry I cannot question Mr. Bennett, because I have accused the administration of terrible, basic errors, which are responsible for the crisis.

Mr. GONZALEZ. Well, Mr. Kurtz, what I was going to suggest is we allow Mr. Grant to finish his summation, and then we will recognize you for the presentation of whatever statement you have, and also have you introduce yourself to us and give us a little background and the like.

May I say by way of explanation that Mr. Kurtz has been in touch with us for more than a year and had wanted to appear before the subcommittee a year ago but had to go to Europe at the time, and he could not make it.

So, Mr. Grant, we indulge a little bit further on your good kindness and will come back to you and leave it up to you how you wish to sum up. You were in the process of sunmming up your presentation, and I regret the interruption, but we did want to see Mr. Bennett leave in time for his swearing in. So you have the floor.

Mr. GRANT. Well, Mr. Chairman, I can be very brief, because I was at the end of my statement.

In essence, it is that for the most severely affected countries, the Fourth World, they clearly require major emergency assistance, for which the present mechanisms are not adequate. There has been an appeal by the Secretary General for an emergency effort over the next year, to be supplemented by a longer term arrangement.

I would only say on this that while it is clear that the oil countries need to play a very major role in providing the resource flow, that so does the United States. This is, in part, because the financial crises that the countries of the Fourth World are in, are in part due to the higher prices that we ourselves are charging today for the goods that we sell. We will earn more than $2 billion extra from the higher prices for food that we are selling to the developing countries this year.

If we would clearly move affirmatively in providing additional assistance to these countries to partially compensate for the impact of the higher prices that we are charging, it will then become vastly easier to get the OPEC countries to come through with compensatory financing for the somewhat larger burden that they are imposing.

Finally, we do see, looking over the next 4 or 5 years, that the countries which have a capital surplus are, in the first instance, the OPEC countries, but in the second instance, the OPEC countries are going to invest much of that capital surplus in countries like Canada and the United States, which are much better investments than, let us say, Italy or the United Kingdom, for their money; so that ultimately part of the recycling problem is not only how to get money from the OPEC countries directly to the Fourth World and the developing countries, but also how do we get some of the capital surplus from North America and Australia to the countries that are in short supply.

Mr. GONZALEZ. In other words, would it be correct and fair to say that what you are telling us is that without America not only participating but taking the leadership in evolving a world approach, or a cooperative venture, in respect to helping these nations in distress, that there is very little optimistic outlook for a successful venture, either by the U.N. or by a combination of the other countries?

As I gather it, the thrust of what you are telling us is that American leadership is very essential, necessary, and that without it, really, in effect, we may not solve this problem?

Mr. GRANT. You are absolutely right, Mr. Chairman. The events of the last 2 years have in many ways returned the United States to the sort of economic and political preeminence that we had 10 or 12 years ago. The pattern that we have witnessed in the late 1960's and the early 1970's where the Europeans and the Japanese were taking an ever-larger share of the burden, they currently have had their stuffing knocked out of them much more than we have, and, really, looking over the next 10 years, we are relatively—as the world's largest raw material producer—we are in a relatively much more advantaged position.

The OPEC countries are raw, nouveaux riches. They do not know what to do with their money yet. It will take, I think, several years to get fully responsible behavior out of them, at best. If during this period the United States does not take a vigorous lead, then the fears of a 1930's type situation to me are very, very real.

Mr. GONZALEZ. I was very much interested in what you said on page 21, I believe, of your statement, with respect to Canada. This is a very little discussed subject matter, and you, I think, very wisely pointed out the fact that Canada has been one of the beneficiaries in its exportation of oil to the United States, and also happens to be one of the great world grain dealers.

Could you explain a little bit further your reference to Canada's increased earnings and what you mean by offsetting that with the oil imports from eastern Canada?

Mr. GRANT. Well, Mr. Chairman, Canada is both a major oil exporter to us and a major oil importer in eastern Canada to meet its requirements.

Mr. GONZALEZ. Well, why is this not more developed in our national consciousness? Seldom do you hear any mention about Canada in this role, or what its politics has been, or whether there has been a change in its politics with respect to the United States in the recent months because of our added importation of oil from Canada.

Do you have any statistics on the increase, or what that trade figure represents?

Mr. GRANT. I do not have an exact figure. What we do know is that the substantially increased import bill she pays for oil she brings into eastern Canada is offset by the very substantially increased export bill she gets for oil. She is then a major net gainer in terms of the much higher prices of grains, timber, ores, that she exports.

If you look at the five or six countries in the world that have really gained from the recent shifts, two or three of the Arab countries, the OPEC countries, would be first, and then Canada comes in there as the fifth or the sixth principal beneficiary.

Mr. GONZALEZ. Pardon me, Mr. Grant. We have a signal that a quorum call is on. May I very respectfully and earnestly solicit my colleagues to take this quorum call and, if possible, return so that we can wind this up by giving Mr. Grant an opportunity to complete and also to hear Mr. Kurtz present his testimony.

I am sure it would not take long, and we could come back and wind it up. I think we will have that opportunity after this first quorum.

Is there any objection to doing that? If not, we will temporarily recess to take this quorum call, and return.

[A brief recess was taken.]

Mr. GONZALEZ. The subcommittee will resume.

I expect to have some additional members of the subcommittee coming back from the quorum call, and I take this opportunity to thank Mr. Hanna and Mr. Young for being here, and Mr. Grant, we were involved on this question of the role of Canada and its impact on the United States and how much potential there is. In other words, we like to think in terms of Europe and distant nations, and we tend to overlook our own neighbors. I wanted to go over some of the specifics.

Mr. GRANT. We do tend to underestimate—as one who was born a Canadian, Mr. Chairman, I am conscious of the fact that we do tend to take our neighbor to the North for granted. It is not commonly recognized, for example, that we have as much trade with Canada as with all of Europe and Japan put together.

Mr. GONZALEZ. No; that is not known at all, I would say, to the average American. I would say that is a fact that is significant because of how it has been overlooked. If it is all right with you and if it is all right with my colleagues. I think we ought to give Mr. Kurtz an opportunity to present his statement, and let me advise you——

Mr. YOUNG. Excuse me, may I just ask Mr. Grant one point?

Mr. GONZALEZ. Oh, absolutely, absolutely. Please feel free.

Mr. YOUNG. In the whole talk on agriculture, one thing that we ran into en route to Africa was the presence of American agribusiness concerns moving into Senegal and Gambia.

Do you have any indication that there is an export of American agribusiness to the Fourth World, and would this in any way help to deal with the problem you mentioned about balancing some of the yields or utilizing some of the more fertile land?

Mr. GRANT. There clearly has been quite a large degree of activity by American agribusiness in the developing world. However, most of it has been, until at least very recently, has been directed at producing products for export out into the industrial economy. It has not tended to focus on the basic food crops that are so indispensible to these economies that have been lagging. It is quite clear to me that if we are to seriously address this question of how the world gets another 400 million tons of increased agricultural food production a year within 10 years from now that we need to harness far more effectively than we have the skills of agribusiness, including their research facilities, to go into the developing countries, because as I indicated in my testimony, the low cost potential food producing areas today are the developing world. We can increase food here, but with ever rapidly increasing costs. For that, agribusiness corporations are a very important means of technology transfer.

Mr. HANNA. Mr. Chairman?

Mr. GONZALEZ. Mr. Hanna?

Mr. HANNA. I think that it ought to be said here that in considering this question of the petrodollars that we might very well make the point that the energy crisis which has brought the petrodollar thing into focus is more properly seen if we realize that the energy crisis is twofold: One is the fuel for the human body and the other is the fuel for human activities. But it is an energy problem and the crisis in the world, I think, is to take the increased volume of money being produced by the increased prices of oil and seeing that a considerable portion of it is directed toward the other face of the energy crisis, which is to increase food production, because it occurs to me that so long as all foods contain a considerable amount of sugar they also can be turned into fuel through the process of making methanol or alcohol as a substitute for oil and gasoline, and I do not think that has been stressed sufficiently to make us see this thing in its totality.

Mr. GRANT. Right, and Mr. Hanna, it is not generally recognized, for example, how much energy it takes today to produce food, and it used to take 1 calorie of energy to produce a calorie of food in this country, 50, 60 years ago. Now it takes 10 calories of energy, and we are at a point of rapidly diminishing returns in this. This is one more reason why, if we want to get cheap food production over the next 10, 15 years, we have to put more into the devloping countries which have not yet reached the point of diminishing returns.

Mr. HANNA. Thank you, Mr. Chairman.

Mr. GONZALEZ. Thank you, Mr. Hanna.

Mr. Burgener, do you have any questions?

Mr. BURGENER. No.

Mr. GONZALEZ. If there is no objection. I think it would be proper to recognize Victor Kurtz, and I am going to make a request, Mr. Kurtz, that you give us a brief autobiographical sketch. My understanding is, from correspondence with you and the fact that you were interested in appearing before our subcommittee for more than a year, that you have intimate associations and dealings with the international financial situation. So we are interested in having a little bit of your background and in hearing from you. If I may suggest a brief summary of your statement, though. If you have a prepared text you can introduce it for the record of the proceedings of this subcommittee, and I suggest this only because we cannot foretell when we will have another vote since the House now is in session.

STATEMENT OF VICTOR KURTZ, ELVIC IMPORT CORP., NEW YORK, N.Y.

Mr. KURTZ. Thank you very much Mr. Chairman. I appreciate very much the courtesy you gave me for inviting me to appear before your committee.

For many years I have been in contact with the administration, many Senators and Congressmen, but all I got were very polite letters but no action.

I was born and brought up in Vienna and studied international economies at the University of Vienna. I have been interested in geopolitics since my youth.

I also lived in Paris for many years.

Naturally I speak fluently French and German.

I am a businessman and I have been going for more than 25 years—at least once a year for 4 to 6 weeks—to Western Europe where I have excellent connections and therefore I am well informed about the economical, political situations in those countries. Furthermore, I get every week the most important French and German weekly magazines—24 hours after they appear in Europe.

In January 1968 I had a meeting in Frankfurt with one of the highest officials of the German Federal Reserve Board (Bundesbank) about the gold crisis and discussed my ideas with him.

Following some correspondence, Mr. Califano, special assistant to the President, invited me in February to Washington, to a meeting with their gold expert.

The student unrest in France in May 1968 and the flight of capital from France solved the crisis for us at that time.

In your statement, Mr. Chairman, you speak about "potential for economical and political disaster as of the 1930's." I think the danger is even greater.

Before we discuss the causes of our difficulties and ways to solve them, we have to ask: Who is qualified to speak and make decisions for us?

I don't blame the managers of ARAMCO—EXXON formerly

Standard Oil N.J., Standard Oil California, Texaco, Mobil Oil—to accept the order of their King not to supply our Armed Forces with oil anywhere.

But the managers of the domestic companies who own ARAMCO have no right to decide our policy because they have too many contrary interests.

The same concerns international bankers.

Mr. Chairman, you said the oil producers will have a surplus this year of $65 billion instead of $7 billion last year. It could even amount to $100 billion if Iran's pressure to raise oil prices prevails.

This means, by next year the foreign exchange reserves of the Western World—about $165 billion—will be gone. This is an intolerable situation.

We are not interested in recycling oil money. We want private investments, not foreign government investments. Oil money is foreign government money. The oil price has to be broken. A possible new embargo danger cannot be tolerated.

How did we come to this situation? As leading political, military, and economical power, we must have a respected strong money. But somehow Mr. Milton Friedman and Mr. Reuss decided that only a devaluation could help our trade and payment balance.

The truth is that our trade balance for the first time was negative because of the shipping strike in 1971. Because of the shipping strike we could not export our grains, soybeans and heavy machinery, while goods came in from bonded warehouses and consumer goods by air. But we had an active trade balance with Europe.

The 1971 trade deficit of $2 billion was mainly with Canada and Japan. But in 1972 our trade deficit was 300 percent greater because our imports cost more and the exports received less. But half of our trade is with countries which did not want a cheaper dollar: Canada, Mexico, Central America, nearly whole of South America, many countries in Africa, Israel, Pakistan, India, Philippines, Yugoslavia, Greece, Turkey stayed with us. But because Germany introduced in 1968 the value added tax, a big inflation started there, following the French example.

There are in France 3 million foreign workers: 1 million Algerians, 500,000 Portuguese, Spaniards, Italians.

There are in Germany 3 million foreign workers: 1 million Turks, 500,000 Yugoslavians, Italians, and Spaniards.

All these foreign workers wanted higher wages and got it, so European prices went up and up, while in spite of the Vietnam war, inflation here was extremely small.

Because of our big investments in Europe, there were many Eurodollars there, but according to the U.S. Tariff Commission of March 1973: "U.S. foreign affiliates own about $190 billion of liquid assets in international markets."

It would have been possible to use our foreign assets to support our money in an emergency—the same as the British did in World War II.

While in 1971 our trade balance with Europe was $1½ billion in our favor, in 1972 it was negative with $140 million. For the whole year 1972, our trade deficit tripled from $2 billion to $6 billion.

Our official position was, we had not enough devaluated and the Dow Jones ticker reported the following:

On February 6, 1973:

Representative Reuss said: The Monetary crisis in Western Europe demonstrates that the dollar is patently overvalued again and said the United States can't expect the Smithsonian Agreement of December 1971 to hold things together much longer.

On February 12, 1973:

We are of the view that parity of the dollar should be fixed by the market rather than the fiat of central.

A tremendous speculation on the foreign exchange market followed this news. The deutsch mark and Swiss franc went up and Chairman Stein reported on February 12, 1973 to the President, we have to devaluate again.

Again, about 50 percent of our foreign trade—specially our neighbors Canada and Mexico—maintained the same relation with our money than before.

Today we know the tremendous power of the speculation.

At a bankers convention in San Diego, in April of this year, the following was reported:

Is the giant worldwide market for exchanging national currencies being rigged? Banks are disrupting the foreign exchange market through excessive speculation.

If the German and Swiss banks for instance take a position of $500 million, there is no way you can go against it.

Following the oil embargo, as it was found out that we depend on much less oil imports than Europe, the dollar went up about 30 percent. That was the reason that our trade balance in the last 3 months of 1973 was in our favor because of the higher value of our export dollar and the lower price for our imports. But as end of January 1974 all restrictions for capital outflow was lifted, and the dollar was again under speculative pressure and went down 20 percent.

The tremendous amount of speculation is proven by a German regulation that starting June 1, 1974, all foreign exchange transactions in "Forward Trading" have to be reported to the authorities.

The deutsche bank, the biggest, reported for 1973 foreign exchange transactions for over $300 billion—778 billion D.M.

That was only one, the biggest bank. There are 350 other banking institutions in Germany.

The foreign exchange trading in New York was about $5 billion per day.

The tremendous losses in foreign exchange speculation which one of the big three Swiss banks recently reported, and also the second biggest bank in Germany followed now by the bankruptcy of one of the biggest private banks in Germany (Herstatt), showed the extent of speculative trading which involved here the Franklin National Bank and others till now unknown.

I don't think more proof is necessary after the public knows now about the mystery of forward foreign exchange speculation that Mr. Milton Friedman is dead wrong in saying in Newsweek of April 23, 1973:

The private speculation that the governments deplored was socially useful and had desirable effects. The official speculation in which the governments engaged was socially harmful and had undesirable effects.

The Bank of England does not permit speculation against the pound. It is imperative that we immediately stop permitting to trade against the dollar.

Since 1971 the German mark went up from 25 cents (U.S.) to about 40 cents (U.S.).

In July of last year, the mark was nearly double in value but at the same time the German trade balance got better and better. The German export to the United States rose in the first 3 months of this year by 18 percent—the imports only 9 percent. The next months were even better for German exports. But our export items are also wanted and will be bought regardless of the value of the dollar. Only if the dollar is strong, there will be less commodity speculation, less flights from the dollar, less inflation.

Only recently German inflation is smaller than ours.

In general, Western Europe had overemployment, while we had underemployment; so the price pressure was greater there.

We cannot afford a budget deficit because we need international confidence in our money.

Because the oil producers received less money for the dollar they received for their products, they asked always compensation with higher prices. The oil importers did not fight it, because their tax break got greater with each price raise.

The result, the arrogance of the oil producers showing their strength leading to an embargo and the attack of the Shah of Iran to raise oil prices because he says the oil companies make exhorbitant profits and his own imports went up tremendously in price. In the meantime, to stop dollars from leaving our country interest rates going higher and higher.

The stock market goes down, the big board alone shows a reduction in value since last year of about $150 billion to about $600 billion. This means that the assets of our big public owned corporations can be picked up extremely cheap from foreign oil governments. This has to change.

Following the Herstatt crisis, the German authorities to stop a market collapse offered money with 9 percent per annum against stocks (Lombard Credit), what we need here. Furthermore, our gold stock should be a weapon for us, not against us. The fact that trading is $25 million a day against about $160 billion in official gold reserves at the market's price is true. Trading in the key places in Frankfurt and Zurich is even less.

The British Finance Minister, Mr. Denis Healey, thinks that additional demand from American citizens would temper the possible price-depressing effects of new IMF sales of gold and—gold sales from Central Banks—then the American public would just be paying a high price. So Americans would just be the suckers to buy gold at $150 an ounce—maybe drive the price up to $200 then the speculation would unload and force the margin buyers to sell—and would buy back at half the price or even lower.

The French weekly magazine "L'Express" writes now in its July 8 edition:

Gold in danger: Gold stock correspond to 30 years of difference between production and consumption. At least 50 percent of it, is speculation. If Italy starts to sell its gold stock, the market could collapse. Our hope is that American citizens will now be able to buy gold. Why should the Americans buy gold, if it is no more a secure investment? (ask L'Express).

So obviously a much higher gold price would again devaluate the dollar more tremendously and create a fantastic commodity speculation. The Commodity Exchange Inc., N.Y., New York Mercantile Exchange, Chicago Mercantile Exchange, Chicago Board of Trade are ready to trade in gold and are waiting for the suckers.

Now Mr. Simon says, his first step is to fight inflation, but we cannot fight inflation if we permit Americans to buy gold; 75 countries do not permit their citizens to buy gold, including the United Kingdom, Australia, Norway, and Denmark. The citizens of these countries do not lose their freedom because they don't have the right to buy gold.

The French and German have the right, but we should not permit it because the American is the most speculative. If only a few million of Americans buy one ounce of gold, the gold price will go up and then our commodities will go up. Then Iran will again want to raise prices for their oil because the price they pay for soybeans and wheat, et cetera, will go up.

Only Mr. Yamani, the oil minister of Saudi Arabia, sees the danger for the world's economy with higher oil prices, but all the other oil producers are more or less greedy. They want to give us a lesson that we should reduce our standard of living. But we feel we don't have to reduce our standard of living—we have to break this undeserved monopoly that ruins the Western World. We have now an excellent foreign policy situation.

We have a friendly relationship with the most important oil producer, Saudi Arabia. We have the détente with Russia and China.

Iran wanted to raise the price for natural gas to Russia. Russia buys this natural gas and sells it with profit to Europe. As Russia refused the higher price, Iran doubled it. Russia is extremely dissatisfied, like us, with Iran's price policy.

We have now in the key countries in Europe, a change in government, favorable to us. Mr. Schmidt, the German Bundeskanzler will make a more pro-American policy than his predecessor. Mr. Giscard D'Estaing, the smartest of the European politicians is not a French chauvenist. On the contrary, he smashed the Gaullist Party in the shortest time since he came to power and is more pro-American than he admits to his people.

We should tell our European friends that a break in the price of gold would have a long-range positive influence on their oil imports, because the most important thing now is to break the oil price which went up about 400 percent since last year with no end in sight. Over 700 percent since 1970.

If we sell from our gold stock—$11½ billion—about $2 billion—over $6 billion at today's market price—it would still leave us with a higher gold stock than France, Switzerland, England, and Japan. This amount would break the gold price and would have a tremendous effect on the Middle East countries which hoard gold.

While France and Germany made big contracts with Iran, what France sold to Iran will take them 10 years to deliver, but the amount that France will sell to Iran in 10 years corresponds to a 1-year deficit in their oil imports. The new leaders in Europe realize that only a common policy with the United States can reestablish the situation and not giving in to the oil producers in every respect.

The underdeveloped countries are in an extremely bad situation because of the high oil price. They will never be able to pay for it, and ask us for help. All these countries first supported the embargo of the oil producers against us, but now they realize the damage to their economy—they are most unhappy.

It is extremely important to help these countries, but before we can help them, they can help us with strong moral pressure on the oil producers, to give up their greediness. It is not satisfactory that the oil producers offer to loan them a trifle of their income.

We, the United States, with our European allies and with the underdeveloped countries have to force a showdown with the greediness of the oil producers.

Only recently Algeria said, if their new price for natural gas which is about three times the previous price, is not accepted, they will start an embargo again, so France is most uphappy, and American companies which made contracts with Algeria do not have the slightest idea how these contracts will be honored.

Iran wants to be the biggest power in its area and place very big weapon contracts with us. We should, in agreement with our European allies, suspend all weapon deliveries to Iran if Iran insist on higher oil prices. In the meantime, weapon suppliers here should be paid by the Government, otherwise there will be tremendous pressure not to suspend the deliveries, because of economic difficulties.

In the last analysis, if the Shah of Iran, whom the CIA brought back from Rome to his throne, continues to be the leader in asking for always higher oil prices and menacing to reduce production, we will have to let him know that we can always make in desperation, an agreement with the Soviet Union. We have to let him know that to save Western civilization and Western prosperity, if he should continue in his policy that we will have to remember the famous agreement of 1939.

Mr. Chairman, you took the leadership with your committee to look for solution in our present crisis. It would be important that Congress does not permit in the future, hysterical statements which are unfounded to go over the Dow Jones ticker and start a tremendous speculation which forces then policy decisions which are against our national interest.

On February 6, 1973 the Dow Jones ticker said:

Monetary—Reuss—the dollar is patently overvalued again.

On February 9, Mr. Reuss said:

German export lobby likes the legalized dumping inherent in an undervalued mark. Washington had joined in this reckless process. Overstimulate German export which then fracture the jobs of American workers.

On February 12, 1973 the Dow Jones ticker said:

Monetary—Reuss—we are of the view that parity of the dollar should be fixed by the market rather than the fiat of central bankers.

Since this time, all officials and private experts agreed that the February devaluation was unnecessary. There was never a German export lobby and there were no undervalued mark in February 1973.

But the result was that after our money was devaluated again, the oil producers started to raise their prices nearly every month to make up for their losses. Only the successive price capitulation of the oil importers showed the oil producers their political strength and started to give them the idea of the oil embargo. I hope we will not commit similar errors again.

I hope you will succeed to bring Congress to its senses and overturn the gold law which only play in the hands of the oil producers again because of the new devaluation danger. Only with strength can we break the oil producers' unity. In the last analysis, if absolutely necessary, a cooperation with Russia has to break Iran's oil blackmail.

[The following articles, and letters were submitted by Mr. Kurtz for inclusion in the record:]

[From the New York Times, January 17, 1974]

Pricing Impact Called Global

ENERGY ECONOMIST SAYS RESULT MAY BE DEPRESSION

(By William D. Smith)

Unless the sharply higher prices recently imposed by the oil-producing countries are quickly cut to a level that the oil-consuming countries can afford to pay, the end result would be a global depression, according to Walter J. Levy, one of the world's leading energy economists.

Mr. Levy, a consultant to both governments and companies, is not particularly sanguine about the possibilities of solving the problem. "The time to act was yesterday," he said in an interview. "The seriousness of the situation cannot be exaggerated."

A point of critical importance, he said, is that a reasonable balance be struck between the ultimate price for oil and the immediate foreign-exchange cost that would have to be met. He declined to specify what he thought would be a fair price. Producer nations have quadrupled prices in the last three months.

If an understanding can be worked out jointly between consumer and producer nations it should be possible to alleviate many of adverse effects now anticipated, Mr. Levy said.

As a first step, Mr. Levy calls for international cooperation among oil-consuming nations, as he has been since November, 1972, when in a speech to the American Petroleum Institute he urged a "concerted effort by the United States and Western European governments and their industries to try to protect as best they can their security and prosperity which depends so decisively on energy availability on acceptable political and economic terms."

On President Nixon's invitation, a conference of oil-consuming nations will be held Feb. 11 in Washington. Members of the European Economic Community have jointly accepted the invitation, which went also to Canada, Japan and Norway.

Mr. Levy asserted:

"The high prices that the Organization of Petroleum Exporting Countries have been able to extract for their oil may result in disruptive trade and monetary policies including currency restrictions as well as social and political upheavals that will be most harmful to both oil-producing and oil-consuming countries."

SPREADING CONSEQUENCES

The strongest card consumers have is to make the producing nations aware that they will suffer the same terrible consequences as the industrialized nations if the world economic system crumbles, Mr. Levy said.

Some believe that this is why Saudi Arabia's Oil Minister, Sheik Ahmed Zaki al-Yamani is reported to have said recently that the price of oil is now too high and that the production cutbacks of the Arab producing nations have been too severe.

Mr. Levy asserted that the enormous increases in world oil prices since mid-October threaten to disrupt the economic and monetary structure of all oil-importing countries in 1974 and that because of the world's economic interdependence, no nation would be able to escape the consequences.

COST LIMITS

The economist said that there were real limits on the ability of consuming countries to meet added costs of oil imports out of current monetary reserves or increased export earnings.

"The balance would have to be covered by capital flow from oil-producing countries resulting in a buildup in financial claims on the oil-importing countries, but this would take place over a relatively short period of time and on an unprecedented scale," he continued. "The resulting strains on international financial markets and institutions would be extremely great.

"What would really be involved would be a massive transfer of wealth from oil-importing to oil-exporting countries. The oil-exporting countries would become owners of a rapidly increasing share of the economic resources of the rest of the world based on what is fundamentally a monopolist rent for their oil resources amounting to some 50 to 60 times the actual cost of producing their oil.

"Moreover, as revenues from the governments of oil-exporting countries, investments made with these funds in oil-importing countries would be predominantly owned and controlled by foreign governments. It is unlikely that this state of affairs could provide a stable basis for the world economy or would prove acceptable to the industrialized countries."

"ROLLBACK" NEEDED

Mr. Levy said that in order to contain the serious, if not disastrous, economic impact of the oil cost explosion, it would be necessary to "roll back" oil prices to a level that could be managed by the various importing countries without severe economic dislocations and possibly even a worldwide depression—"indeed a most difficult undertaking," he conceded.

A price rollback should be handled on two levels—through the establishment of a coordinating policy among the major oil-importing countries and through discussions, review and negotiations with the important producing nations.

Some idea of the staggering increase in costs to the consuming nations is given in a study by Mr. Levy's consulting firm. It presents data on the cost of oil imports, exclusive of transportation and related charges, for 1972 and shows that costs in 1974 for imports at the 1972 volume would be four or more times higher. The figures, in billions of dollars, follow:

	1972	1974
United States	5	21
Western Europe	11	51
Japan	4	16

On the same basis, government revenues of the oil-producing nations in the Middle East would increase from $9-billion in 1972 to about $5.7-billion in 1974. Iran's income from oil would go from $2.5-billion to $16-billion and Venezuela's revenues would climb from under $2-billion to about $10-billion.

The increased cost of oil imports would play havoc with balances of payments and reserves of foreign exchange. In the case of the United States, the indicated 1974 level of oil imports would be enough to swing the trade balance from surplus into a $13-billion deficit, more than the nation's total gold and foreign-exchange holdings. The increased cost for Japan would almost equal her gold and foreign-exchange holdings of $13-billion as of October, 1973.

[From the Wall Street Journal, April 11, 1974]

FOREIGN EXCHANGE ABUSES BY SOME BANKS ALLEGED AT CONVENTION, SPURRING DEBATE

(By Charles N. Stabler)

San Diego, Calif.—Is the giant, world-wide market for exchanging national currencies being rigged?

Some international bankers here for the annual convention of the Bankers Association for Foreign Trade say the answer is yes. In an unusual, last-minute press briefing called by convention officials, several bankers warned that certain banks are disrupting the foreign exchange market through excessive speculation.

"The abuses are picking up in speed, size and importance," warned George H. Chittenden, senior vice president of New York's Morgan Guaranty Trust Co. He described some recent market activity, which has caused large and rapid changes in currency values, as "almost sinister." Mr. Chittenden and other bankers at the press conference called for tighter self-policing of the market.

In private talks during the convention, some other bankers have cited what they refer to as "combines" or "syndicates" of banks, mainly West German and Swiss, which apparently engage in concerted attacks on the market. "It's a kind of pooling operation, where they suddenly flood the market with orders, driving up the price of say, the German mark a few points—and there is no way you can go against it," complains one U.S. banker.

A GRAIN OF SALT

But some other bankers here take such warnings with a grain of salt. For example, Arthur Meehan, an international executive of Boston's New England Merchants National Bank, discounts talk of market manipulation. He describes the wide fluctuation in currency rates as a natural outgrowth of the floating rate system, in which currencies fluctuate largely, according to market forces.

Mr. Meehan also noted that European bankers traditionally are willing to take big risks in the foreign exchange market, "American banks are much more conservative," he says.

For example, a foreign exchange trader at a major U.S. bank would normally be restrained from taking a risk in a single currency of more than $20 million or so. For a German or Swiss bank, exposed positions of up to $500 million wouldn't be uncommon, bankers here say.

One foreign banker here suggests that even for German banks this kind of risk taking is currently declining. Diether H. Hoffman, a director of a major Dusseldorf bank, says: "I would think it isn't much of a problem now, because some sizable losses were taken by some banks late last year."

In addition, some executives of smaller U.S. banks here say they suspect that warnings of problems in the foreign exchange market by major banks may just be calculated to frighten off competitors. "I think the New York banks sometimes aren't above issuing pious warnings about possible dangers in this or that market just because they want to hang onto a good thing," says one Georgia banker.

At the press conference, neither Mr. Chittenden nor other participants suggested that possible abuses of trading were widespread. However, Robert F. Leclerc, vice president of Continental Bank International, an affiliate of Chicago's Continental Illinois Corp., said the speculating banks were taking positions large enough to artificially influence exchange rates. Mr. Leclerc is head of the Forex Association of North America, a professional association.

Mr. Leclrec blamed the problem on top-level management of some banks rather than the traders themselves. He said some banks are putting intense pressure on their trading departments in a search for "windfall profits."

"When they expect a trader to make millions of dollars in foreign exchange dealing, he can't do it through normal business," he said. "You have got to go out and gamble."

[From the Journal of Commerce, July 11, 1974]

CONTROLS PUT ON CURRENCY MART TRADE

(By Jess Lukomski)

Frankfurt—The Bundesbank evidently subscribing to the old tenet that "confidence is good but control is better" has moved to acquire from some 350 West German banking institutes full data on their foreign exchange transactions in forward trading.

Compulsory registrations of such deals went into effect on July 1.

This requirement provides the Bundesbank with full insight on the volume of forward trading in foreign exchanges and permits it to gauge the difference between delivery and purchase commitments made by the nation's banks.

Moves in this direction had been anticipated in the banking circles for some time and came as no surprise. But a distinct possibility that the Bundesbank might take in the future even bolder and tougher steps to control foreign exchange activities is of considerable concern here.

REASONABLE LIMITS

Since the Bundesbank feels rather strongly that "the risks connected with forward trading in foreign exchanges must be kept within reasonable limits, the extension of its new regulations to foreign subsidiaries of German banking institutes cannot be ruled out—point out foreign exchange market sources.

The decision of the Frankfurt monetary managers to supervise more closely foreign exchange dealings of commercial banks has been triggered by their enormously intensified involvements in this field.

German bankers have grasped early in the floating game their dwindling earnings in the classical lending business suffering under the "brutally restrictive credit policies pursued by the Bundesbank" could be compensated by highly lucrative foreign exchange transactions.

The 1973 business reports of the big German commercial banks show strikingly the enormous expansion of operations in foreign exchange and they reveal to what extent the handsome profits from those dealings have enriched their overall earnings.

50 PERCENT GAIN

The Deutsche Bank transactions in foreign currencies have reached last year DM778 billion, a sum which is equivalent to West German GNP in 1971. In the past two years the foreign exchange business registered a 50 percent gain while the number of people employed in this field was increased by one-fifth.

The Commerzbank which employs today nearly one-third more foreign exchange experts than two years ago managed to expand its turnover by 27 percent in 1972 and another 20 percent in 1973. And the Dresdner Bank's foreign exchange deals rose by 50 percent last year alone with only a slight upward adjustment in the number of employes working in this field.

This development is not unique to the three big German commercial banks, the Girozentrale or savings banks, and the cooperative banking associations have plunged into foreign exchange transactions to join in the biggest game in the banking business."

With most world currencies floating more or less cleanly the range for speculative transactions is almost unlimited and temptations to engage in them often irresistible.

German bankers insist that "speculation in foreign exchange trading is taboo." There is no firm evidence suggesting that this claim is exaggerated. Yet the very risk of miscalculating the development on the foreign exchange market is formidable and even decisions based allegedly on nonspeculative consideration can be extremely costly.

PAINFUL MISTAKE

The Westdeutsche Landesbank Girozentrale made a painful mistake last year by miscalculating the future development on the foreign exchange markets and had to pay a DM100 million penalty for its misjudgment.

The failure of the large private Herstatt bank is another case in point. It was said to have lost well in excess of any other bank here or elsewhere as a result of unauthorized dealings in foreign exchange.

It seems that German commercial banks have not overlooked the clear warning that the chance of making a killing on foreign exchange dealings is not any greater than the risk of being caught short. In days of fixed exchange rates with the central banks pledged to support the parities both the chances of making spectacular gains and risks of absorbing heavy losses were narrowly "defined" by the central banks obligation to intervene. Today this obligation applies to a handful of currencies floating jointly in the European "mini-snake," and costly miscalculations in trading in all other foreign currencies must be seriously considered.

This does not mean at all that German commercial banks are abandoning foreign exchange dealings, but the developments in the past several months suggest that they have become more cautious even though their less hectic activity in this area has been strongly influenced by tapering off Euro-money market business which in the past has tended to trigger multicurrency transactions.

Some German bankers suggest that the decision of the Bundesbank to supervise more closely banks' forward trading on the foreign exchange market might reinforce further this trend.

THE WHITE HOUSE,
Washington, February 5, 1968.

MR. VICTOR KURTZ
Elvic Import Corp.,
15 West 38th Street,
New York, N.Y.

DEAR MR. KURTZ: Many thanks for your follow up note of January 30. I think it might be helpful if you would be willing to run down sometime and discuss your views with Ed Fried who is the Senior International Economist on the White House staff and who stays on top of the gold problem for us on a day-to-day basis.

Mr. Fried will await your call and set up an appointment with you.

Sincerely,

JOSEPH A. CALIFANO, Jr.,
Special Assistant to the President.

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C., August 16, 1969.

Mr. VICTOR KURTZ,
Elvic Import Corp.,
15 West 38th Street,
New York, N.Y.

DEAR MR. KURTZ: Thank you very much for your support of my position against the unnecessary increase in the prime lending rate. I hope you realize how much the support of the people means on an issue like this.

High interest rates are a destructive force and they can be brought down only if the people are willing to take the time to make their voices heard against the special interests. I hope sincerely that you are letting other people know about your feelings on this very vital issue.

Enclosed is a speech which I recently made on this prime rate increase.

Sincerely,

WRIGHT PATMAN.

UNITED STATES SENATE,
Washington, D.C., May 5, 1971.

Mr. VICTOR KURTZ,
Elvic Import Corp.,
15 West 38th Street,
New York, N.Y.

DEAR MR. KURTZ: I certainly appreciated your recent message and I wanted to let you know that I value very much the points you made.

It is vital for me to get the thoughts and opinion of people like yourself. It helps me make up my mind on the vital issues which the Senate must decide.

Once again, thanks so much for letting me know what you think and I appreciate your taking the time and effort to write to me as you did.

Best wishes.

Sincerely,

WILLIAM PROXMIRE, U.S.S.

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., October 4, 1971.

Mr. VICTOR KURTZ,
Elvic Import Corp.,
15 West 38th Street,
New York, N.Y.

DEAR MR. KURTZ: Thank you for your letter of the 23rd. I appreciate your including the detailed recommendations you have prepared on suggested ways for overcoming the present international monetary crisis. I have passed these recommendations on to the Joint Economic Committee staff for their review and appraisal.

Sincerely,

WILLIAM PROXMIRE,
Chairman.

Mr. HANNA [presiding]. I appreciate your statement I think we need to adjourn now, subject to the call of the Chair.

[Whereupon, at 1:10 p.m., the subcommittee was adjourned, subject to the call of the Chair.]

INTERNATIONAL PETRODOLLAR CRISIS

TUESDAY, AUGUST 13, 1974

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTERNATIONAL FINANCE
OF THE COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:15 a.m., in room 2128, Rayburn House Office Building, Hon. Henry B. Gonzalez (chairman of the subcommittee), presiding.

Present: Representatives Gonzalez, Reuss, Fauntroy, Stark, Johnson, Crane, and Burgener.

Mr. GONZALEZ. The subcommittee will come to order.

In order to conserve time, and I apologize for the lateness of the hour in getting started—first, Governor Wallich, may I thank you for taking time to be with us and for an obviously very good statement.

I might point out to you that at the latest count that I made—and I could be a little bit in error on the conservative side—there were over 17 committees, subcommittees on Capitol Hill in the Congress going into some general aspects of the main thesis that we outlined to you in the letter when we invited you.

However, this subcommittee has more of a direct relationship with the aspects of the problem, the oil price increase, the concomitant problems attending that, because it has been in this area of our legislative life that we have had to deal with such things as the devaluation of the dollar. We will have to continue to decide how we are going to arrive at a continuation of our policy with respect to the international financial institutions that we have committed ourselves to belonging to for some time.

Recently, we had the IDA bill, and we will have to confront the question of the Asian Development Bank bill, which this subcommittee approved and for which we obtained a rule last January that is pending before the House. However, it may be that we have reached a point where the Congress has got to, in the light of developments, reevaluate and reappraise this basic policy involved in its belonging to these international financial institutions.

Today's hearings are a continuation of those that we initiated earlier. Today, in continuance thereof, we are very proud to have you as an outstanding witness.

In July we pointed out that some of the international monetary and economic results of this fourfold increase in world oil prices, the accumulation of massive amounts of excess capital by the members of the Organization of Petroleum Exporting Countries really poses a continuing problem, if not a threat, to every one of us.

I, for one, since long before I thought I would be a chairman of the subcommittee, have been very much concerned about the fact that the Congress seems to have very little role except as an after-the-event agent such as we did in the case of devaluation. We were asked to come in and present on two different occasions a par-value modification bill.

We have been asked on diverse occasions to come in with these bills on the world financial international institutions, and each time it becomes increasingly difficult for us to assure the administration, which, in turn, tells us that these programs are a must for the basic national policy, to obtain an adequate congressional reception and approval.

Since our last hearing we have had additional data that has been presented to us. We have had very interesting material presented by various individuals who appear to be experts in this area. They are all very disturbing and without any objection, I would like at this point to introduce into the record excerpts from an article in the Washington Post and one by Walter J. Levy in the July Foreign Affairs, just very brief excerpts, not over two paragraphs.

[The excerpts from the articles that appeared in the Washington Post and the July edition of Foreign Affairs, follow:]

[Excerpt from an article in the Washington Post]

An article in *The Washington Post* said that a World Bank study estimates that by 1980 the accumulated reserves of OPEC countries will be $653 billion (compared with $20 billion in 1973) and will be $1.2 trillion by 1985. The study said that the excess reserves of Kuwait, Qatar, Saudi Arabia and the United Arab Emirates will be about $1 trillion by 1985.

[Excerpt from an article in the July edition of Foreign Affairs by Walter J. Levy]

Today, governments are watching an erosion of the world's oil supply and financial systems, comparable in its potential for economic and political disaster to the Great Depression of the 1930's, as if they were hypnotized into inaction. The time is late, the need for action overwhelming.

In sum, the short-to-medium term implications of the present situation are simply not bearable, either for the oil-importing countries—especially the nations already needy—or for the world economy as a whole. . . . The fact is that the world economy—for the sake of everyone—cannot survive in a healthy or remotely healthy condition if cartel pricing and actual or threatened supply restraints of oil continue on the trends marked out by the new situation.

Mr. GONZALEZ. Therefore, perhaps with not a lot of ado and publicity, but nevertheless, with a background of what I consider to be considerable importance and interest to those of us that serve on this level, we welcome our witness, Hon. Henry C. Wallich, member of the Board of Governors of the Federal Reserve System, this morning. Once again, thank you for taking the time out.

I am going to suggest that Mr. Johnson, who is our minority ranking member, make use of the mike if he wishes, and then I would say that you may proceed in one of two ways. It is up to you. You have an excellently prepared statement. If you wish to read it, that is fine. If you wish to summarize it, well, you use your discretion.

Mr. Johnson?

Mr. JOHNSON. Yes. I, too, want to welcome you here this morning, Mr. Wallich.

I cannot help but compliment the Fed for the great cooperation we have received from you people in the last month. We have had, I believe, practically every president of the Federal Reserve bank in the United States in here to testify. Of course, Dr. Burns has been here frequently and comes at the slightest request. We are very glad to welcome you here this morning. Thank you.

Mr. GONZALEZ. Does any other member wish to make a prefatory remark? If not, Mr. Wallich, you have the floor and we welcome you.

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

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

I appreciate your remarks, and I also appreciate your offer to let me summarize the statement. It is perhaps unduly long, and so I would like to ease the task of going through it for the subcommittee members, if I may, by summarizing.

The text I have submitted is, of course, my official statement.

Mr. GONZALEZ. Fine. For the record we will just permit you to submit the entire statement, which will appear in the record as you prepared it.

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

I think I do not need to go into much detail about the nature of the international balance-of-payments surplus of the oil-exporting countries. It is a subject that has been widely discussed. These countries are likely to have something like $100 billion of revenues from their oil exports, an increase on the order of $80 billion. This leads to a surplus in their transactions on the order of $50 billion to $60 billion, because some of the exporting countries, at any rate, will not be in a position to increase their imports enough to absorb the proceeds of their increased exports. This likewise leads, of course, to a very great increase in the bill for oil of the oil-importing countries. With some exceptions for a few countries whose oil production and oil needs are well balanced, this includes all countries that are not net oil exporters. This situation leads almost necessarily to a deficit on trade account for these countries.

Several types of responses have been suggested to this unprecedented situation. One that is very important is our domestic supply response. We have entered into Project Independence aimed to reduce, and hopefully eliminate, our dependence on imported oil. This effort will help us. It will help the rest of the world. Although I regard it as a major policy response, I will not focus on it today because I do not think it is germane to the discussion here.

A second suggested response on the part of the United States and other importing countries arises from the concept that in the increased prices for oil they find themselves confronted with what is very similar to an excise tax on oil. If the current rise in the cost of oil were due to the action of the government of an importing country, it would have the same effect as an excise tax. But in the present case the proceeds go abroad.

This quasi-oil tax, first, has the effect of reducing aggregate demand. In itself, in a period of inflation, this effect is by no means a bad thing.

But, as time goes on inflationary forces are brought under better control, we will need to watch the deflationary implications of this—I say it in quotation marks—"oil tax."

By reducing demand in the economy, this quasi-tax will make room for some substitute demand. This could take the form of more investment. Additional investment will be both appropriate and needed, first to take up slack in demand as world inflationary forces are brought under control, and second because it is needed to bring about new oil production. The problems of growth also require it. Finally, there is the fact that inflation will be better contained if we have the larger capacity to produce that added investment can provide.

There is, therefore, an opportunity here as well as great risks. That opportunity is more investment and more growth. The risks I will deal with in greater detail. The present situation concerns the OPEC countries as well as the oil importing countries because both are interested in world stability and the soundness of our financial markets and institutions. But the oil importing countries have an unavoidable deficit in the short run.

A corollary of this unavoidable deficit is that there is also automatic financing of it. This has been much discussed. In measure as the exporting countries act to create surpluses, they cannot avoid the necessity of putting the proceeds of these surpluses somewhere. Wherever these proceeds go, they can be borrowed. But what is sometimes overlooked is that they cannot be borrowed by everybody. It takes good credit standing in order to have access to these funds.

There is thus an automatic recycling in the aggregate, that is, for the oil-importing countries as a group. But this automatic financing of deficits is by no means available to every country, nor for every institution that wants to participate in the market.

The unavoidability of a sizable aggregate deficit for the oil-importers has another implication. If some countries try to reduce these deficits to zero, and do it very aggressively, they are likely to reduce their own deficit by increasing that of some other countries. This is because the OPEC countries cannot, in the short run, buy a great deal more than they were already likely to do. If country A cuts down its deficit, it probably does so at the expense of country B, by policies that curtail the exports, or drive up the imports, of country B. So we may see a game of musical chairs played with the deficit.

That does not mean the importing countries should not watch their balance of payments. In particular, they should try to eliminate those payment deficits that result from payments for things other than oil. There have been many balance-of-payment deficits in recent years, before the cost of oil became an unavoidable source of deficits. Some of these have been large deficits. But over and above elimination of non-oil deficits, the oil deficits have to be accepted—by someone. There is a real problem where these deficits are going to end up. Moreover, it is not clear that this is a situation which can be smoothly adjusted to without a decrease in the price of oil. A decrease would undoubtedly greatly ease all aspects of the situation.

Among the importing countries there is a group that is worse hit than others. Some of them are developing countries. Others are those of the industrial countries that have special difficulties in dealing with their deficits. These are problems that give one pause.

The problems of the less developed countries exclude such questions as the question whether they are going to have enough food. Oil leads to fertilizer, fertilizer leads to food. If a country cannot import enough oil or if it cannot import enough fertilizer instead of making it at home from oil, there is a consequence for its food supply. This affects the price of food throughout the world. We are thus all involved in the problems of the developing countries.

Industrial countries, in some cases, face very large deficits because their ability to reduce their use of oil is limited. This is the case when a country does not have a large automobile population, or it does not use oil for a number of uses that are compressible. In such cases the problem of the increased cost of oil hits their industrial output and creates problems there.

I will come back to some of those problems in a minute. First, let me say a couple of words about the U.S. balance of payments, as a part of this overall picture.

We have done very well in the improvement of our balance of trade. After the successive devaluations through the end of 1973, we achieved a surplus at an annual rate of a little over $4 billion. But that has now been converted into a deficit on the order of $7 billion by the middle of the present year. If we eliminate from this deficit the increased cost of oil, and if we also leave out of account the special advantages we have had from high prices on our agricultural exports, we see that there has been a real underlying structural improvement in our trade situation on the order of $11 billion per annum.

I do not say this as an excuse for the deficit. The deficit is there. But if we want to see the underlying structure of our foreign trade, then we have to make this calculation, and it does show a substantial underlying improvement.

At the same time, we have seen significant fluctuations in the rate of the dollar. To some extent these fluctuations reflect trade and payment developments. The most helpful view is not the dollar's relationship to this or that currency, but is, rather the so-called effective rate. This is the weighted average of our dollar exchange rate with respect to many other currencies.

That is, I find the familiar representation of the exchange market—the dollar is down, the dollar is up, it is down again with respect to one or only a few currencies—largely misleading. If we look at the average, at the effective rate, we see that the dollar's exchange value is down about 17 percent compared to the period before the revision of the whole exchange rate structure.

That 17 percent refers to the industrial countries. When we look at the world as a whole—including both industrial and developing countries—the exchange rate of the dollar is down only 12 percent. The reason, in particular, is that developing countries have acted to keep their currencies closer to the dollar. It is mainly the industrial countries that have appreciated, especially Europe and Japan, that have let their currencies appreciate with respect to the dollar. The dollar was down severely for part of last year, then up quite sharply early this year; down a little again, and has now been quite stable for some time.

We have been helped in living with these fluctuations by the system of floating rates. In fact, it is hard to see how, without floating rates, we would have handled the situation. On the other hand, floating rates generate problems of their own, and we cannot ignore them. They are problems special to this new financial regime.

Before floating exchange rates became general, one concern was that in a regime of floating rate countries would try to gain export advantages by allowing their currencies to depreciate. But, it is interesting to observe that this has not happened. On the contrary, if I read the record correctly, countries have been eager to see their exchange rates remain high.

I believe that the motivation is a conviction that keeping the exchange rate high is a means of helping to hold down inflation. The higher the exchange rate, the less is the cost of imports, and the less imports affect the price level.

This has removed some of the concern about floating rates. Of course, we cannot be sure that the situation is going to stay as it is. If world conditions change, if demand in world markets diminishes, countries might begin to adopt different policies.

It is fortunate, therefore, that in this picture of floating rates the Committee of Twenty of the IMF has proposed a set of guidelines for floating. The aim is to help in limiting extreme fluctuations, and in avoiding inappropriate intervention, or intervention at cross purposes. Let me turn now to the financial consequences of the oil deficit and the capital flows associated with it.

Foreign direct investment in the United States has been high. Port folio investment has been relatively quiescent. Bank investment—both bank lending abroad and the import of funds through our banks—have expanded. The two amounts come fairly close to offsetting each other.

These developments reflect both the removal early this year of restrictions on international capital movements and effects of the oil financing needs of other countries. It is perhaps of some interest to point out that these international capital movements into and out of the United States do not change the volume of dollars in this country. No dollar creation occurs due to such capital movements. What happens is that the foreigner, wishing to bring capital to the United States, buys dollars from an American who wants to own foreign currency. If there are no ready sellers of dollars on the American side, the effect of the foreigner trying to buy dollars is to raise the exchange rate, that is, to raise the price of dollars with respect to other currencies. But the number of dollars, with some exceptions, is always the same.

Another easily demonstrated feature of the capital movements we are observing arises from the fact that capital is very mobile. Except in those countries where there are restrictions on capital flows, we have an international capital market that is only slightly compartmentalized. That reduces the importance of any particular dollar amount or amount of any unit of currency that lodges in any particular part of this market.

If money flows into, say, the U.S. compartment of the international capital market, it will have the effect of displacing capital that is already there, or of discouraging other capital from coming in. Thus, capital tends to be rather evenly distributed over the whole range of the market.

However, capital would not go where it feels exposed to excessive risks. That is, lack of compartmentation of the international capital market does not mean that capital will go everywhere.

That leads me to say something about the OPEC countries as capital exporters. These countries are quite different from traditional capital exporting countries in the degree of their financial experience, in the degree to which they are likely to accumulate reserves, and in the reserves of wealth—oil reserves—they now have. All this makes, of course, for policies potentially different on their part from those we know.

What we have observed so far is that they have employed very cautious investment methods. They choose high liquidity, and very low risk assets. Also, they have acted responsibly as investors. That leads one to ask how things are going to develop if OPEC money piles up further and further in the same markets and in the same financial instruments.

It is helpful, I think, to compare magnitudes. We are talking about an OPEC flow of perhaps $50 to $60 billion a year. Some of this will not go into the international capital markets but into bilateral and other aid to the less developed countries, or into other nonmarket channels. The amount that is left will go into markets which annually raise something on the order of $400 to $600 billion. That is the magnitude of the credit raised by the nonfinancial sectors of national capital markets.

In the United States the amount of credit raised by nonfinancial borrowers is some $200 billion. So the $50 billion or thereabouts is considerably smaller than the annual flow into these markets. This leads us to hope that the petrodollar funds will be manageable. A similar impression arises when you look at the Eurodollar market, which was expanded by some $50 billion in 1973.

What we have, therefore, is not an overall problem, so much as problems relating to the effects of petrodollar flows upon particular markets, institutions, and countries. But these problems are serious—in some cases, very serious.

One aspect of the problem that arises in particular markets is that interest rates will change. If an investor wants to invest in only the highest grade assets he will drive down interest rates on those assets. One thing is clear—as I said before, an inflow of capital does not change the money supply, except in special circumstances. So this does not affect the Federal Reserve's ability to maintain its overall monetary policy.

If the flow of funds into a particular market is larger than the increased payments resulting from oil there will be an impact on the exchange rate. It will raise the value of the local currency unless that country decides to recycle through its market. Most of the so-called recycling we have seen has taken place through the Eurodollar market, but of course recycling could take place through national money markets, including the U.S. money markets. The effect, however, of such recycling is that it leaves the recycler in the position of intermediary. He has borrowed and he has lent. His future is therefore tied up with the future of his creditor and his debtor.

There are advantages to that situation. But there could be disadvantages to countries that get less capital than their oil bill amounts to. These countries have a variety of adjustment possibilities. They can borrow from surplus countries provided their credit standing is good enough. They could borrow from the OPEC countries or international institutions if they are of a mind to lend. I would think that in particularly difficult situations the OPEC countries, inasmuch as they are the cause of the situation, would feel a responsibility to help.

In addition to borrowing, there is a possibility of balance-of-payment adjustments. These could run the gamut from moderate measures to very drastic measures, and possibly we would ultimately be forced to accept the idea that there is no measure that will produce any tolerable situation.

For any one financial institution problems arise when depositors insist upon very high liquidity. When funds are put into an institution mainly on an overnight basis, this poses familiar problems in making use of the funds. However, such institutions do have means of defending themselves. They can cut down the interest rate that they pay and thereby make short-term deposits less attractive. They can adapt the nature of the investments they make with such money to its characteristics. They can ultimately stop accepting such funds. However, that means leaving part of the problem to the rest of the market or to official institutions.

In this respect, it should be noted that private markets may not be able to handle the whole problem. The monetary authorities have an obligation to see to it that markets function. They have to safeguard the liquidity of markets even though they do not necessarily bail out every individual institution that may have trouble. Thus, in that area where the liquidity of markets is tending to disappear, or where markets begin to malfunction, there is a place at which private markets may not be able to handle this problem, and it would have to be left to some kind of official action.

Let me conclude, Mr. Chairman, by getting back to the domestic area. All of these problems would be greatly eased, of course, by a reduction in the price of oil. It is certain that they would be eased by successful action against domestic inflationary forces, that is, those not arising from the increased cost of oil. That is a key problem everywhere. Finally the petrodollar problems will be eased by whatever we can do to step up the rate of investment in the means of substituting for oil, and in the economy generally.

Thank you very much.

[Mr. Wallich's prepared statement follows:]

Prepared

Statement by

Henry C. Wallich

Member, Board of Governors of the Federal Reserve System

before the

Subcommittee on International Finance

of the

Committee on Banking and Currency

U.S. House of Representatives

August 13, 1974

Mr. Chairman and Members of the Subcommittee:

I welcome the opportunity to discuss with you some of the problems created by the enormous increase in the price of oil in the past year. As a result of that increase, oil-consuming nations will be paying out over $100 billion a year to the oil-exporting (OPEC) countries at current prices and volumes, an increase of some $80 billion in the revenues of these countries in one year. Even after allowing for a steep rise in their expenditures for imported goods and services, the OPEC countries will be left with a surplus of funds available for investment of some $60 billion. This surplus will almost certainly diminish as time goes by, either because the price of oil is reduced to levels more compatible with a stable world economy, or because the OPEC countries will use a greater share of their increases to buy capital and consumer goods and services from other countries, and to provide assistance to countries most severely affected by rising costs of oil. Nevertheless, without trying to project into the more distant future, we must address our attention to the likelihood that the OPEC countries will have huge surpluses for some time to come.

In analyzing the consequences of this enormous new flow of funds in the world it is helpful to look first at the real impact on income and investment in the consuming countries and then to consider the financial problems related to managing this flow of funds. These two aspects of the oil situation are interrelated, of course, and if the financial mechanism does not prove equal to the demands that will be placed upon it the consequences will enormously aggravate the already severe problems of the real sector.

Effects on Economic Activity

The first immediate and obvious effect of higher prices paid for OPEC oil is that funds are pulled out of the income stream in the consuming countries, and, since as a group the OPEC countries cannot for some time spend more than a fraction of these funds on current output, there is a relative reduction in consumer demand. You will recall that last October we also confronted a reduction in supply, when we were faced with a cut in oil imports, which would also have reduced production capabilities. This situation set in motion an effort at planning in individual countries, and multilaterally through the follow-up on the energy conference held in Washington in February -- to share research programs, to reduce dependence on imported petroleum and to share oil in the event of further embargoes. In the U.S., Project Independence got underway. I would regard it as a serious mistake if we should allow the more relaxed supply situation to cause us to slow down these efforts. For the United States in particular, the most effective way to deal with the energy problem is to mount a strong national program for holding down energy use and moving as quickly as possible to develop substitutes for imported oil.

Not only will this give us some leverage in dealing with the present price and supply problems -- it will move us in the right direction for the long-run benefit of the country.

In some ways the effect of the jump in payments for oil can be likened to an excise tax -- cutting down consumption of oil itself as the price rises, and cutting consumption of other goods to the extent more is spent for oil -- directly and indirectly. But there are important differences: the quasi-tax is levied by foreign governments rather than by a domestic government, and the use of the funds is not under our control, although, as I shall point out later, we can nevertheless guide the shifts in demand and output that will result from the quasi-tax. As I shall point out, the desirable shift of production is in the direction of more investment.

It is important to note that while these payments to OPEC countries tend to dampen consumption demand in the oil-consuming countries, and may cause severe sectoral dislocations in some countries, they do not in themselves reduce our over-all productive capabilities. Recall that when the oil price change was occurring the United States and other industrial countries were approaching together the crest of a remarkable boom in world demand -- accompanied as you know by an explosion of world prices as our economies were being driven at near to full practicable capacity. By the fall of 1973 nearly all governments were trying to put a lid on this boiling over of demand, and were adopting more restrictive fiscal and monetary policies. In that context, there was no reason to be concerned about the demand-depressing effects of higher oil payments, so that any advocacy of expansionary policies to compensate for them was clearly misplaced. Now, as we and other countries are experiencing an abatement of the boom, we must be increasingly aware of the fact the rise in oil prices has consequences that depress activity, as well as those observed initially that were inflationary.

One result of the contraction the oil situation has caused in aggregate consumer demands, and in investment demands of some sectors depending on petroleum, is that there is some additional room for investment elsewhere to take place. This substitution does not automatically take place -- we need to take whatever steps we can to shift more of our economic activity from consumption into investment. Such a shift will redress the imbalance between demand and potential supply that underlies the problem of inflation. Stepping up investments in the energy sector is especially important. The financial requirements of such ventures are huge and we should give thought to the problems of financing these investments, which we have the economic capacity to make.

I would now like to turn from questions of reordering our domestic priorities to the more general problems of all oil-importing countries, and shall focus first upon those countries that are hardest hit, many of them less developed, but some also among the industrial countries. If the less developed countries that are severely affected cannot afford to buy the oil they need, or the food and fertilizer they need, their present already low standards of living will fall further, and their hopes of making some gains by industrializing will in many cases have to be shelved. Unless adequate ways to help these countries are found, an important part of the real cost of adjusting standards of living to pay for oil will fall on those countries least able to bear such a burden. Food prices are now rising generally, and the added problems of paying for fuel and fertilizer may well reach the point of depriving some countries of their minimal subsistence needs, posing very harsh alternatives. It can cogently be argued that the additional problems of these developing countries should be the responsibility of the oil-exporting countries.

We can see how the burden of high oil prices will impact if we look at the way in which the balances of payments of different groups of countries are likely to be affected unless these prices come down. The OPEC countries will have a huge surplus in their current account -- an export surplus -- amounting to perhaps $60 billion or more per year at current prices. They will dispose of this surplus in various ways; some will go into bilateral aid programs, or into the international institutions, and this can help take some of the strain off the poorer countries; but the bulk of the funds will be placed in the capital markets of the wealthier industrial countries. The industrial countries, as a group, will have a large current account deficit with the OPEC countries. In the aggregate, however, this will be automatically financed -- if my presumption about capital investment plans of the OPEC countries is correct -- by a capital inflow from OPEC countries. This is another way of saying that these wealthier countries as a group will not have to, and will indeed not be able, to pay for their full oil imports by exporting goods and services, until such time as the OPEC countries can absorb imports equal to their exports; and indeed they will not be able to repay their debts, again as a group, until the OPEC countries begin to run trade deficits, perhaps after the exhaustion of their oil or its replacement by alternative energy sources that the high oil price is likely to encourage. This is not to say there will not be problems of adaptation in the industrial countries of the sort I mentioned a moment ago. It does mean that, provided the oil deficits can be financed, real incomes need not be much different from what they would have been without the rise in oil prices. But that is not true for those industrial as well as developing countries that will not, through the workings of the market, or through public policy measures, be able to attract an inflow of capital that will take care of their new import requirements. These countries can in some cases run down existing reserves. After that, they would face drastic adjustments unless they receive support. Taking these three groups of countries as aggregates, we find one group, the OPEC countries, very much better off both in terms of current incomes and in terms of their claims on future world production; we find a second group, the wealthier countries with attractive capital markets, or good capacity to borrow, that are very uncomfortable perhaps about a rising debt to OPEC countries, but would be able to cope with the relatively small loss of real incomes that might occur; and we find another group of countries -- some counted as LDC's and some counted in the ranks of industrial countries -- who will face serious difficulties. Their difficulties may in turn react adversely upon the countries originally in a more favorable position.

I remarked just now that some of the wealthier countries may be increasingly uncomfortable about a rising debt to OPEC countries. In fact, some countries dislike the idea so strongly that they may resolve to avoid it by bringing their current account into balance -- that is, they may try really to pay for oil by either increasing exports or decreasing other imports well below the levels that would otherwise be observed. This sounds very virtuous -- we all feel that going into debt should be limited and should be for some productive purpose. But the rest of the world happens to be in a unique situation vis-a-vis the OPEC countries -- until those countries as a group buy more than they sell, they can only pile up financial surpluses abroad. Thus, if each consuming country -- acting in what appeared to be a rational fashion -- tried to avoid going into debt there could only be a greater debt accumulation by other consuming countries. In real terms, the countries avoiding debt would be paying for their oil currently, while other countries would find that their trade balance being driven into deficit more than would otherwise be the case and that their debt was increasing. In effect, some countries would be unloading their deficits upon the rest. They might do this either by using direct controls to affect their trade balance, or manipulating their exchange rate to depreciate it, or taking some extra measure of restraint to hold down domestic demand. The holding down of demand may in many cases be entirely desirable in order to curb inflation or eliminate any payments deficit arising independent of the oil situation. Such deficits exist now, and the countries experiencing them should indeed eliminate them. But if many countries try to eliminate those deficits resulting from the rise in the price of oil, we would, I believe, be in serious danger not only of a major setback in world economic activity but also of a breakdown in the rules for fair trade among nations that could take us back to the practices of the 1930's.

We have not come near to such a state of turmoil in the world trading system. I believe we can avoid it. But it is difficult to predict the decisions of nations when they find themselves confronted with major difficulties. Some countries may well consider the problems confronting them insolvable at the present price of oil. In the absence of a substantial reduction in that price unforeseeable conditions could develop that could make the situation difficult if not impossible to manage.

I would like to turn now to the U.S. balance of payments, and to the effects of the oil crisis on our international position. Our trade balance has already felt the weight of the sharply higher cost of imported fuel -- in the second quarter of this year we were paying $28 billion at an annual rate for fuel imports -- about $20 billion more at an annual rate than we were paying a year ago. This is almost entirely a price effect -- in volume terms imports of fuels were nearly unchanged. Mainly because of rising fuel imports, our trade balance for all goods has worsened sharply from a surplus at an annual rate of $4.2 billion (balance-of-payments basis) in the fourth quarter of last year -- when we reached the high point of recovery from the deep deficit in 1972 -- to a deficit at an annual rate of nearly $7 billion in the second quarter of this year. However, our underlying trade balance, that is, abstracting from the arbitrary increase in oil prices and also leaving out the extraordinary jump in agricultural exports, has shown considerable strength, moving steadily from a deficit at an annual rate of about $12 billion in the first quarter of last year to a deficit of only about $1 billion in the second quarter of this year. In volume terms we have done even better, with export volumes rising and import volumes no higher than they were early in 1972.

So far as our merchandise trade is concerned, we seem to have made the kinds of gains in competitive position that could be expected from the depreciation of the dollar since 1970, and this, together with the extraordinary rise in the value of agricultural exports, has helped to offset the huge jump in oil imports. However, like other countries we must be concerned with achieving an over-all balance in our accounts, including capital movements, that will underpin a stable dollar in exchange markets. The part of that underpinning that must come from an appropriate net inflow of capital from abroad could be significantly less than the extra $20 billion in payments due to the higher price of oil, if it turns out that there are sufficient improvements in the rest of our accounts.

There have been considerable gyrations in the exchange value of the dollar since the second devaluation in February last year. But since about mid-May the dollar has held fairly stable against a weighted average of the currencies of the countries that are our major competitors in world markets. As it stands now, the dollar has depreciated about 17 per cent against those currencies since May 1970, and has moved up slightly in recent months. On a broader measure, taking into account the movement of the dollar against a weighted average of nearly all foreign currencies, the devaluation of the dollar has been appreciably less -- amounting to perhaps 12 per cent since 1970. The smaller depreciation measures the dollar's so-called "effective rate," against the world as a whole. The reason for the difference between the two measures is that while the currencies of most of the major industrial countries have appreciated quite sharply against the dollar, those of numerous other countries, including most of the developing world, have tended to stay with or near the dollar. It is the average rate relationship that comes closer to representing the longer run effects on our balance of payments, rather than changes from time to time against particular foreign currencies.

Recent relative stability of the dollar has of course been gratifying. It has materialized within an environment of floating exchange rates, in which very wide swings had occurred during the 12 months following the breakdown of the fixed rates system in February-March 1973. Rate flexibility has proved its usefulness in times of severe disturbance. It has given rise, on the other hand, to new concerns. Among these has been the fear that flexibility might be abused to engage in competitive depreciation as a means of stimulating exports. So far nothing of the kind, and indeed perhaps the very opposite, has happened. Faced with strong demand for exports, and with domestic inflation, most countries have had a motive to keep the value of their currencies high. That holds down the price of imports and helps restrain domestic inflation. Downward fluctuations of the dollar, such as occurred in the middle of 1973 and in the early months of this year, must in the light of this nexus be regarded as harmful to our efforts to curb inflation in the U.S. Of course one cannot anticipate that national preferences as regards exchange rates will always be the same and will always favor a high rather than a low value for the local currency. If demand in international trade should slacken, or if some countries should begin to make strong efforts to eliminate their oil deficits, national preferences and the trend of foreign exchange rates may change.

It is of considerable interest, therefore, that as part of the effort to reform the international monetary system, certain guidelines for floating rates have been proposed. The reform effort has met with only limited success, which was to be expected once skyrocketing oil prices and universal inflation engulfed the world. No long-run reform has been agreed upon, although valuable preparatory work has been done. But among the immediate steps that were agreed upon by the Committee of Twenty of the International Monetary Fund, the proposal establishing guidelines for floating provides some hope that extreme and inappropriate rate fluctuations can be contained.

The recent stability of the dollar in the exchange market, within a context of floating rates, indicates that the net movement of capital to the United States has increased sufficiently to just about offset the deterioration in our balance on goods and services. Unfortunately, we do not yet have actual data in detail to support this inference, but certain patterns were showing up earlier. In the first quarter, U.S. direct investors' net outflows were quite low, while there was a very large inflow of capital from foreign business concerns acquiring businesses in the United States. This pattern of direct investment may well be continuing. Portfolio investments involving international dealings in securities seem to have dropped off sharply this year, with Americans buying only a small volume of foreign securities even though the Interest Equalization Tax on such purchases has been dropped, while foreign purchases of U.S. corporate stocks -- an important type of inflow in the past few years -- has also paused. Moreover, new issues of bonds in the international markets outside the United States have been less this year than in any recent year.

By contrast, there has been an extraordinary surge so far this year in international capital flows through banks in both directions -- we see it in our own data and also in terms of new loans arranged in the Eurodollar market. U.S. banks, including the U.S. agencies and branches of foreign banks, increased their foreign assets by about $9 billion in the first five months of this year, spread over many countries but especially directed toward Japan. A simultaneous massive rise in liabilities reduced the net outflow

-- which measures the net impact on our international balance and on our domestic credit markets -- to only about $1-1/2 billion.

I would associate part of the increased international activity of U.S. banks with the removal or reduction of barriers to such transactions that occurred both here and abroad early in the year. At times, differences in relative interest rates have also been important, with U.S. rates moving up relative to foreign rates after the early part of the year. But I believe much of the heightened activity was a result of the new oil situation, which generated a demand for loans by some countries to help meet the higher costs, and at the same time resulted in an added supply of liquid loanable funds in international markets as OPEC countries placed their revenues with the Eurobanks.

In examining these manifold flows of capital, it must of course be borne in mind that an inflow or outflow of funds does not ordinarily influence the amount of bank reserves in the U.S. banking system or the American money supply. Foreign capital does not bring any new dollars from abroad. Every dollar of foreign capital "flowing" to the U.S. was in fact in the U.S. before. It simply shifted ownership. This shift could have taken the form of an American selling dollars to the foreigner, in which case the inflow was matched by an outflow as the American acquired whatever foreign currency or assets the buyer paid him with. Or it could have represented a shift among foreign holders, for instance if the foreigner acquired dollars from a foreign central bank which had held them previously as part of its reserves. What changes as a result of changes in capital flows, under our present regime of flexible exchange rates, is the exchange rate, as a rise in the demand for dollars, in the case of capital inflows, or in the supply in case of outflows, shifts the balance of the market in favor or against the dollar. Only in special cases is a different interpretation appropriate.

One further conclusion that I would draw from the variety of offsetting capital flows that have occurred is that under today's conditions, capital is highly mobile. The world's national money and credit markets are more open to shifts among countries -- sometimes via the Euro-markets, than they have been since before the 1930's. Hence the system of national and international capital markets constitutes in effect something like a large and only moderately compartmentalized pool, rather than many separate watertight compartments. As a result, any move of capital in one direction is quite likely to be offset by movements in the opposite direction. A large outflow from the United States tends to drive down interest rates abroad, which makes American capital markets relatively more attractive and causes other funds to come to the U.S., and inversely. To pour capital, whether owned by OPEC countries or others, into any one part of this market does not mean that the net supply in that market is increased by the full amount. Capital already present there tends to be pushed elsewhere, thus tending to even up the supply elsewhere. Of course, these equalizing movements will take place only if conditions are otherwise propitious. When there are heavy risks of a credit, exchange, or political sort, the movements will not occur, or will occur only in response to severe declines of exchange rates or increases in interest rates, or both. The evidence that in today's markets capital is highly mobile should be kept in mind in examining the possible effects of placement of OPEC money in any one particular market.

This leads me to some comments on the more specific aspects of the flows of funds derived from OPEC revenues, and their impact on financial institutions and structures. I believe it is worth emphasizing that there will be great disparities among the OPEC countries in their ability to utilize this new wealth to improve their own countries, and in their plans for investment of this huge cash flow in foreign capital markets. We see already that Iran has made plans for industrialization and is developing ties with countries that can be helpful in that process. We know that Kuwait, for instance, has been thinking through the requirements of an acceptable investment portfolio for some time, and is probably fairly well diversified. In the case of Saudi Arabia, the initial reaction, which was simply to let funds accumulate in liquid forms in the Eurodollar market, seems to be moving already in the direction of finding more permanent lodging in such investments, perhaps, as special issues of U.S. Treasury obligations. According to IMF data, the reported increase in monetary reserves of the OPEC countries in the first half of 1974 was about $15 billion, but the gains were accelerating, and were $3-4 billion per month in May and June, with larger increases still to come.

These funds should not be regarded as a monolithic mass of maneuver, poised to shift this way or that for speculative or political reasons. There are many individual OPEC governments involved and there is no evidence that they are taking any unnecessary risks with their funds. Working with their financial advisers, these countries are likely to distribute their funds over a wide range of investments, always mindful of the need for security and stability. In return for continued rising levels of oil output in OPEC countries, those countries understandably wish to be provided with suitable ways of holding their accumulating assets. I doubt that there will be attempts to attain dominance over particular large companies or economic sectors in the industrial countries, since this would expose them to considerable economic and political risks. At the same time, the amounts involved are formidable by any normal standards of international capital flows. Questions naturally arise about the ability of capital markets to absorb such flows without suffering severe dislocations. I believe some of these concerns are justified, but that others are exaggerated.

There are a number of ways in which an annual flow of funds of, say, $50 billion can be compared with over-all flows of funds in financial markets. In the United States alone the total of funds raised by nonfinancial sectors in U.S. credit markets are now close to $200 billion a year; for all industrial countries together the total is two to three times that amount. By far the greater part of these flows of funds is between domestic sectors of the economy, though at times the flow of funds vis-a-vis other countries can have a significant effect on capital markets in individual countries. Also, in recent years the Euro-currency markets have grown in importance as a mechanism through which funds move to and from national money and credit markets. The Euro-markets have now taken on increased importance, since a large part of the receipts of the OPEC countries is being deposited in their accounts in these banks, and in turn will be loaned by this group of banks to borrowers in national markets. The record shows that the Euro-currency market has been capable of very rapid growth in the past. For instance, the net size of the Euro-currency market (that is, after eliminating claims of one bank on another within the eight countries usually considered as forming "the market") grew by $25 billion in 1972 and by $50 billion in 1973. There is an estimate that a further net growth of $30 billion has occurred this year to mid-May, bringing the net size of the market to about $185 billion.

It seems to me that if we have problems in handling the flows of funds associated with higher payments for oil, it will not be so much because of the sheer size of the amounts involved, but because of several kinds of potential dislocations.

In the first place, the normal stream of investment into financial assets in a given country will reflect the existing asset preferences of investors and institutions in those countries -- a mixture of corporate debt and equity, financing of government at various levels, mortgages, and deposits in financial institutions. On the other hand, the investment preferences of OPEC governments may be quite different; I would expect them to be more interested in assets that are relatively liquid, widely traded both nationally and internationally, and backed by the strongest guarantees. That would imply some shifts in the yields on different kinds of financial assets in national markets, reducing yields on more liquid assets relative to yields on, say, mortgages. In the case of the United States, if there should be a large inflow to major U.S. banks and to Treasury obligations, as seems possible, some downward pressure may result on yields in those sectors. That does not mean necessarily that the rate of growth of the monetary aggregates will be significantly affected, but it does mean that yield relationships could be changed for some time to come. The Federal Reserve could establish and maintain any desired degree of over-all restraint or ease in monetary policy.

Another kind of irregularity in flows that could be troublesome is that OPEC countries are likely to prefer assets based directly or indirectly on the countries with the strongest economies and the broadest markets. So may the banks that receive OPEC deposits in the Eurodollar market and lend them out to governments and private borrowers all over the world. The problem of the weaker countries is obvious -- they will sooner or later find it difficult to attract funds from the market as their debt burdens reach the limits which the market should and probably will place on their borrowing capacity.

However, if they do not succeed in attracting funds to cover their deficits, it must be that some of the stronger countries are attracting more than enough funds to cover their own deficits with the OPEC countries. If a few countries with strong economies and broad capital markets attract a disproportionate share of OPEC investments -- and the United States could well be one of them -- a number of adjustments are possible. First, other countries needing to borrow to cover their deficits would be able to take advantage of the additional liquidity available in these surplus countries -- that is, capital markets in these countries could do a considerable part of the recycling job. Also, countries receiving inadequate financing could allow their currencies to depreciate, so that part of the adjustment could come through changes in the trade balance. After a point, however, these accommodations through the market mechanism would not take care of the problems of countries whose debt capacity was running out or who could not adjust their trade balance beyond some point of necessity.

To deal with such situations the most logical solution would clearly be for the responsible parties -- the OPEC countries -- to relieve the burden. The total amount of aid required would not be large relative to the mounting OPEC reserves, and it might be a more fruitful investment in terms of the stability of the world economy than a continuing accumulation of financial assets in the stronger countries. If the OPEC countries do not meet this challenge, should we expect those countries that receive OPEC funds in excess of their needs to act as financial intermediaries, borrowing from OPEC countries at market rates and with assurance that these assets of the OPEC countries are sound, while extending aid to cover the cost of oil to countries who cannot borrow at market terms? I raise this question not because I believe the industrial countries should cease to contribute to the economic progress of poorer countries -- quite the contrary -- but rather to emphasize that there is now a new burden on these countries that should call forth a new set of aid donors.

There has already been a considerable amount of activity by the OPEC countries that may ultimately relieve the burden for some of the LDC's, but though the list of proposals for new funds or institutions is quite long, it is not clear how well the actual disbursement of funds will meet the needs of particular countries. Nevertheless, if the OPEC countries are willing to do their share and the industrial countries are not left with an untenable intermediary position, we should be able to provide mechanisms for aiding countries when market sources are not available.

Finally, another aspect of the flow of petrodollars causing concern is the impact of these flows on the institutions in world financial markets. In particular, will untenable strains develop from a flood of OPEC funds coming in as very short-term liabilities for which banks must quickly find outlets that are usually much less liquid? It would be unwise to be complacent about this question -- bad judgments may be made and things can go wrong for individual banks. We must be prepared to meet these risks, by obtaining and providing up-to-date information, by careful regulation and supervision, and in the last resort by action that would safeguard the liquidity of markets and the integrity of the payments mechanism by keeping possible problems of any one institution from creating problems for the entire system. But given proper caution on all sides, I believe that fears sometimes expressed of financial difficulties are greatly exaggerated.

Banks and their OPEC customers have already begun to rationalize the flow of funds: there are reports that on the deposit side the maturities are stretching out, or yields are dropping enough to cause OPEC governments to seek out other assets; banks are assisting these countries to find more suitable outlets for their funds; on the asset side, some of the problem of liquidity is alleviated by the practice of making term loans whose interest rate can be adjusted at intervals to reflect changing conditions in the market. So far, it appears that the leading banks have dealt with these flows efficiently and relatively smoothly. Countries in need of funds have been able to raise very large sums in the Eurodollar markets -- anticipating their requirements for some time ahead. For instance, in the first half of this year, publicly announced medium- and long-term Euro-currency bank credits totaled about $20 billion -- almost as much as in all of 1973 and far more than in any earlier year.

Nevertheless, to express faith in our financial institutions does not mean to say that they can meet any and all demands on them. On the contrary, if they are to act prudently, they will have to keep the scale and kind of their operations within the limits of acceptable risks. Given present oil prices, this may leave substantial investment needs of the oil exporters and borrowing needs of the importers to be met through other channels. There can be no assurance, at this time, that the problems, particularly of the borrowing countries can be met without a substantial cut in the price of oil.

Whether the problems I have discussed relating to petro-dollars become acute or not depends in good part also on our ability to get control of inflation and generate more investment in the areas of greatest capacity shortages. If we can make progress on those fronts, we can be more hopeful that special problems of adjustment to high oil prices, or to other unexpected strains, will not degenerate into serious impasses.

Mr. GONZALEZ. Thank you very much. In your statement, on page 17, you first discussed the question of the investment flow of this money, excess money if we want to call it that, and that perhaps some kind of special issues of U.S. Treasury obligations—you point out that the IMF data shows a reported increase in monetary reserves of the OPEC countries in the first half of 1974 of about $15 billion. Secretary Simon had told us on the eve of his departure to the Middle East that this was one of the things that probably would be discussed and that is the attraction of some of this money into the United States and to official paper through some type of a special security. But then I think you reflect the fact that since then an Arab finance minister has stated that one reason they have been slow in doing that is that they want to make sure that if they do it will be on some kind of paper that is inflation proof. I think you reflect that on page 19 by saying that you would expect and I quote "them to be more interested in assets that are relatively liquid, widely traded both nationally and internationally and backed by the strongest guarantees." What kind of securities would that be, Mr. Wallich? What would be an example?

Mr. WALLICH. As you know, Mr. Chairman, the interest rate to some extent inflation proofs a security. This is particularly so in the case of a short term security because it has to be issued repeatedly. At each reissue, the interest rate can be put at the level that current market conditions require. To the extent, then, that interest rates move with inflation there is considerable protection in the short-term instruments.

Mr. GONZALEZ. So an interest yield high enough to make it interesting would be one of the things?

Mr. WALLICH. Yes.

Mr. GONZALEZ. On page 20 you say the Federal Reserve could establish and maintain any desired degree of overall restraint or ease in monetary policy in case the impact was such that it would have or tend to have an impact that would have to result in some kind of a policy and you seem to be very confident about the ability of the Federal Reserve to develop that strong policy in the light of what Dr. Burns said just last week, which was to a layman like myself it was utterly astonishing. In case, he said, the current policies were to result in a 6 percent unemployment, then as a must the Government would have to go into the public works arena but now this is what he and others have been saying has been the cause of the bad inflationary tendencies to begin with so it seems to me rather tragic to say we are going to admit to a policy that is going to bring about unemployment so in case it gets to a politically unbearable degree, well we will get to the old nostrum and have public works. Is not that a self-confession of contradictory policies and results? Would not the same thing happen here?

Mr. WALLICH. Before trying to respond to your question let me explain what I meant to say in that part of my prepared text to which you refer. I have heard it said that inflows of oil money would affect the U.S. money supply and therefore monetary policy. I merely meant to explain that technically that is not so. The money supply does not change—it just changes hands. The Federal Reserve's ability to control it is not altered, broadly speaking. As far as particular specific monetary policy such as Chairman Burns was talking about, I think that monetary policy has one principal objective now, and that is to bring inflation under control. It can do this job more effectively if some of the undesirable byproducts of anti-inflation policy can be prevented. One such action would be to supply public service jobs so that the unemployment rate is kept down.

Mr. GONZALEZ. On page 22 in mentioning one other aspect of this flow and some consequences in case you have, as you very well point out, OPEC funds coming in as very short-term liabilities which would of course create a problem for the institutions, the bank institutions. You say in that case, we must be prepared for this risk by obtaining and providing up-to-date information, by careful regulation and supervision and in the last resort by action that would safeguard the liquidity markets and the integrity of the payments.

My question is, should we not now be anticipating that as a very, very real possibility we could have this influx of short-term liabilities or capital and what is it that we could be doing in the meanwhile in anticipation? Would it require legislation or is this something that would be an administrative policy now within the confines of the regulatory agencies, or would they have to have some legislation from us.

Mr. WALLICH. Insofar as I can foresee the problem, I belive that it can be handled under existing powers. The problems raised by petrodollar flows relate not only to information about our domestic banking system, and the situation of our financial markets. It relates to banking and to financial markets worldwide, because the operations of banks and financial markets are worldwide. We are in the process of strengthening our information domestically and internationally, particularly with respect to the foreign exchange positions of banks. Thus, I think the work that you suggest, Mr. Chairman, is going forward.

Mr. GONZALEZ. Our final question. Is there any possibility that our country could develop any kind of muscle, any kind of pressure if you want to use that word on the oil-producing nations to bring about some reason? There is no question they have been gouging us unmercifully. You know, an increase of 400 percent is just not within the realm of reasonable or justifiable, in the normal sense that we use that word. Do we have to? Is the country powerless? Is the political situation such that our country does not exert pressures that it might otherwise be able to in this area of oil pricing?

Mr. WALLICH. I would say our best bet is to go forward in developing our own sources of supply—developing an increased capability and thereby reducing our dependence on foreign sources. This will have two effects. One will be the reduction of demand for oil in world markets. That will tend, according to the laws of economics, to bring the prices down. The other effect, by making us more independent in our policies will be to give us more leeway for action.

Mr. GONZALEZ. It seems though that Project Independence in the effort to make ourselves sort of fortress America is that respect is not one of easy realization, or at least not in the very near foreseeable future. All the experts seem to indicate that there is this reliance on this Middle East oil. What I do not understand is for example, the reports that some of the countries in the Arabian producing world such as the Saudis would be amenable to a reduction in price but are kept so by such obdurate attitudes as those reflected by the Iranians, and there

I am asking a question and perhaps it is one that really we should address to other officials and that is, is it politics that is keeping us from talking turkey to the Iranians?

Mr. WALLICH. Let me begin with the first part of your question. As I have said, I think a reduction in the price of oil is necessary in order to be sure the petrodollar problems are manageable. With respect to Project Independence, it must be realized that, to a potential investor in a substitute energy source, these plans may imply that possibly the price of energy sources will go down. In that case, his incentive to make the investment will be less. There are two sides to the subject of the potential decline of oil prices. It may help on the OPEC side, but it does not help on the side of domestic investment.

As far as the OPEC countries are concerned, I am not a specialist in this area. My impression is that different countries are quite differently situated with respect to the price of oil. Countries that have reserves of only limited size are more interested in obtaining a high price for their limited supplies. For them, the flexbility lies in decisions as to whether the oil should be brought above ground now or later. But, countries that have virtually unlimited reserves can be less concerned about price because it applies to an unending flow. So there are varying conditions here and it is difficult to judge how an approach could be made and its effect.

Mr. GONZALEZ. Thank you very much. Mr. Johnson?

Mr. JOHNSON. Thank you, Mr. Wallich. I wish I had had time to really read your statement. It certainly is a very scholarly statement and has an awful lot of meat in it as they say.

I am thinking of one of the statements you have made that this year our purchases of oil abroad will jump from about $5 billion to about $25 billion. That is a $20 billion increase in cost and no doubt a great strain on our banking system. These firms in the United States that are buying this oil, how are they financing this $20 billion extra cost that they are going to be faced with?

Mr. WALLICH. Ultimately, of course, it comes from the consumer; we are all paying for it. The oil companies presently have to carry higher inventories. As they are very strong companies, I do not doubt that they have good credit facilities. I am concerned about the fact that when the oil price goes up, if they are on a first-in, first-out accounting basis, this gives them a very large visible profit which is not a real profit; it is just a capital gain on which they pay tax. Actually, their liquidity is reduced as a result of having had this runup in the price of their inventory. But I have never heard that the oil companies have had any difficulty in financing these inventories.

Mr. JOHNSON. I read over the weekend that there is a greater demand for bank loans today than at any time in history. Is this huge demand for bank credit the result of a demand for oil loans? All of a sudden we need $20 billion extra to buy oil from the Mideast?

Mr. WALLICH. I cannot say specifically with respect to the oil inventories. With respect to all inventories I think there is a very good case to be made that with the rise in the price of inventories, and the taxes levied on them, the liquidity of corporations has been reduced. This would force them into the banks.

Mr. JOHNSON. I was trying to think, as you have been delivering your statement, how the Federal Reserve banks can enter into this picture and be helpful as far as financing the purchases of the oil. You can rediscount the notes from a bank that loans money to a big oil company to buy oil, can you not?

Mr. WALLICH. That is right. There has been a very significant expansion of credit, particularly commercial and industrial loans. There has also been a significant expansion of the money supply, although currently at a lower rate. Consequently, I do not think there has been any lack of financing for the oil companies.

Mr. JOHNSON. Now also, these OPEC countries are of course being the recipients of large inflows of cash. Where would they deposit that money? Are they partial to American banks over there like Chase Manhattan, and First National City Bank, and Continental, and some of the big banks, or do they deposit in their own local banks?

Mr. WALLICH. It has been tending to go into the Eurodollar market and to a lesser extent into banks in the United States. American banks have branches in the Eurodollar market, which is mainly but not exclusively situated in London. They have a very important share of that market. So in those two senses money is going into American banks from OPEC countries.

Mr. JOHNSON. The reason I asked that is it seems to me that I read where Chase Manhattan Bank was anticipating deposits maybe to the extent of $25 billion. Of course they would have to in some way handle, and as you mentioned in your statement, provide liquidity for it because they are in the nature of very, very short-term deposits.

Mr. WALLICH. Yes, that is a problem for banks. So far, they have been getting predominantly short-term deposits. That puts a constraint on them regarding the maturity of the use that they can make of these funds.

Mr. JOHNSON. This month Saudi Arabia very wisely agreed with Mr. Simon to hold an oil auction and they have set the target date. They will ask for bids for the sale of 1½ million barrels of oil a day for 16 months, and I think Mr. Simon and everybody is hoping that by reason of the 2 billion barrel a day glut right now in oil markets that those bids might be as low as a reduction of $2 a barrel. Do you have any input on that? Do you think that is possible under the present situation wherever there is a tremendous overproduction of oil in the world?

Mr. WALLICH. There is certainly room for a decline in the price of oil. Whether this particular mechanism is likely to produce it, I have no means of judging. I am no expert on this subject. One has to bear in mind of course that an increased supply from any one country could be offset by reduction in the supply from others. This would be the case unless the country that is expanding its production has such great productive capacity that its expansion would result in an increase in aggregate output even though others were cutting back. These are complexities that we cannot see through very effectively at this time. But actions designed to bring down the price of oil will certainly bear exploring.

Mr. JOHNSON. Well, is it not true as Mr. Gonzalez mentioned that we have not used any political pressure as is nonexistent? About the only thing that is going to bring down the price of oil is the law of supply and demand and the inability of the Arabians to sell the oil. I understand the storage facilities are just jammed full all over the world and we may see a surprising drop in the price of oil. I know someone said they can curtail their production. I come from the Pennsylvania oilfields and if you curtail production of a prolific lease by reason of proration or something, when you want to restore production back again, why paraffin has set into the oil sands and you don't get the production back. That could well happen to these people over there although I do not know the character of their oil sands, whether a precipitous curtailment of production would cause the sands to fill up with paraffin and asphalt.

Mr. WALLICH. I lack expertise here also. I always thought of the main pressure on the price of oil as coming from the development of substitute sources of energy, not only of oil but of other sources. But conceivably, such a thing as storage limitations may have a much greater impact.

Mr. JOHNSON. Thank you. I believe my time has expired.

Mr. GONZALEZ. Mr. Reuss?

Mr. REUSS. Thank you, Mr. Chairman; and Mr. Wallich, thank you for a masterful paper. I have several hours of questions but I will compress them into 5 minutes.

On page 2, you say, toward the bottom of the page, "for the United States in particular, the most effective way to deal with the energy problem is to mount a strong national program for holding down energy use, and moving as quickly as possible to develop substitutes for imported oil." I certainly agree, and I want to put to you what, to me, is the most worrisome thing about the oil supply price import situation; and let us see what your reaction is.

I am not primarily worried—and I know you are not, either—about Middle Easterners acquiring investment interest in the United States. I think we can protect our interests there, all right. Nor am I primarily worried about Middle Easterners who now hold enormous reserves, and will hold even greater reserves, bringing the temple down by destructive dumpings of dollars or some other currency; because for one thing, they would hurt themselves about as much as they would hurt their intended victim. What I am concerned about—and I wondered whether you share my concern—is simply this: here we are, in the United States—we will just talk about our country though the same situation prevails in most of the other industrial countries—here we are, on an essentially business-as-usual, oil consumption-as-usual basis. We are trying some conservation, but not much, as anybody who is driving down the highway can plainly see; and meanwhile, the OPEC countries are accumulating horrendous reserves. You gave us the arithmetic on that, and because they are not going to spend them all currently, they are going to invest them. Those reserves are going to grow. They are keeping their poker chips on the table, in short, and their pile is growing higher and higher.

If, in 5 or 10 or 15 years, about the time we hope, if we are lucky, in reaching something like Operation Independence of our own—if about that time the Arab countries decide to spend for imports into their country these fantastic accumulations; and particularly if that time coincides, as well it might, with an increased scarcity of materials worldwide, are we not likely to have in this country, with really no option about it, a serious diminution in our real income, because of the necessity to part with these resources which we ship overseas; and/or a boiling inflation as domestic demand and foreign demand coincide?

In short, it seems to me that we are not in the lucky situation we were in in the 1960's, when by and large we let the Germans and the Japanese maintain an overvalued dollar exchange rate, and then supply us with enormous quantities of Volkswagens and Minolta cameras at cheap prices; and they did not know, until it was all over, how they would be frustrated by 2½ devaluations of the dollar, much depreciation of the dollar plus much inflation. I do not think the Arabs are going to be that shortsighted. We are floating, so we cannot devalue. And if we continue to inflate, our creditors will start buying while the buying is good.

Do you share my concern that this is the real thing we ought to be concerned about, and that unless we want to impose on the American people a no-choice alternative in, say, 10 years, of having to undergo a considerable diminution in national income and the individual standard of income, we should take more seriously the need to conserve imported oil now?

Mr. Wallich. Congressman Reuss, I have been very conscious of this problem, but with a slightly different emphasis. I have looked at it in the following terms. We are incurring a great debt, which will require service. Someday it will have to be repaid, presumably when the OPEC countries can accept trade deficits instead of having surpluses. The way to put us in position to service this debt, and ultimately repay it, would be to accumulate more capital in the real sense. That is, use the leeway created in the economy now by this oil "tax," the drain it creates on consumer demand, in order to step up the rate of capital formation. Then we will have a bigger capital stock. The return on that stock will help to pay interest on the debt that is outstanding. Ultimately it could serve, also—although I doubt that would happen—to repay the debt. So, by doing this, I think we would in the main meet the problem that you are concerned about.

However, since such a process never works completely smoothly, I think it is certainly true that whatever we can do to reduce the oil deficit in the first place will be all to the good.

Mr. Reuss. On two of the factors which are likely to keep things from going as smoothly as you and I would like, the first one is that the OPEC countries are not likely to supply as much of the funds which they have skimmed off from us in higher prices back here in the form of investment and equipment as may be needed; and second, both the capital goods, the tools and equipment that you mean when you say capital investment, and the things they make, will have an increasing proportion of high-cost imported components—copper, bauxite; you know the whole list. Well, would you agree that those are possible variables which may throw off your hope a bit?

Mr. Wallich. They are definitely variables, and they present difficulties. I would add just one thing. Suppose the OPEC money should not come to the United States—although in fact there is no particular reason to think that we will not get some reasonable share of it, having good capital markets. But even if that should happen, so long as demand is reduced by the payment of high prices for oil and by the flow of money abroad, there is of course a gap in the economy, in real terms.

This can be filled by some other form of demand. An increase in investment is just as good, or even a better way of filling that gap than raising consumption spending. The market will tend to bring it about, although one cannot be sure that it will bring it about completely. This will happen due to a fall in interest rates and by other circumstances—such as the limitations placed upon industrial capacity. These factors will encourage investment and bring about the needed increase in capital formation.

Mr. REUSS. Thank you.

On another subject, you speak approvingly—and I surely join you—in what the Committee of Twenty has done in its recommendations with respect to rules of the road and guidelines on flexible exchange rates; so far, so good.

I am concerned, however, about another recommendation of the Committee of Twenty; namely, that despite all that we have learned, we should now, in effect, plan a return to the stable but adjustable rates of Bretton Woods days, and thus apparently deprive the United States of the opportunity to float, as it is now floating, when in its sovereign judgment we determine that it is the thing to do. Instead, it would be up to the IMF to decide this question.

If I read the C–20 right—and I think I do, because I have read it again and again—shouldn't the Congress now serve notice that it simply will not ratify any amendment to the IMF articles that would envisage such an improvident impairment of our right to make our currency flexible?

Mr. WALLICH. The output of the Committee of Twenty is not a final agreed-upon report. It is simply a report that states the positions which the group had arrived at when it dissolved.

Mr. REUSS. And will recommend to the Governors?

Mr. WALLICH. Yes; but what it recommends to IMF's board is essentially a series of short-run interim steps. Those short-run objectives do not include a return to stable but adjustable rates. That is part of the longrun perspective. I would be concerned about something that compelled the United States to give up a floating posture so long as the United States thought that there was an advantage in maintaining it. On the other hand. I see considerable advantages, over the long run, in stability of exchange rates. I believe everybody does, and if we can create conditions in which stable rates are possible, then I would see a return to them as quite feasible. That is, I can envision circumstances in which stable rates would be in our interests. But this is a conjectural matter. One cannot foresee how conditions will develop, and that is one reason the C–20 never settled this point in reaching interim agreement.

Mr. REUSS. Then it is your view, as you read the C–20 recommendations of June of this year, that they do not recommend a return to stable but adjustable rates; that they are simply talking about the sweet by-and-by, and something that should be talked about, and that Congress will not be confronted with new articles of the IMF for ratification which adhere to stable but adjustable rates?

Mr. WALLICH. Not as a result of this negotiation. I think it is fair to say that there was a spirit in the committee approving the general idea of stable but adjustable rates, but that the circumstances at the time were so uncertain that no proposals of that kind are going to be made to legislatures.

Mr. REUSS. Thank you. I have not been told, but I suspect my time is up.

Mr. GONZALEZ. Yes; well, the Chair is being liberal with the members.

Mr. Crane?

Mr. CRANE. Yes; thank you, Mr. Chairman. I would like to welcome Mr. Wallich before the subcommittee, too.

Mr. Wallich, in your testimony on page 2, you made reference to a relative reduction in consumer demand, and that this relative reduction in consumer demand could help to alleviate some of our problems. But I am wondering about a reduction, say, in demand for food, where we are faced with the prospect of heightened demand worldwide because of shortages and increased food needs. This summer, unfortunately, we are faced with the prospect of a major drought.

The last figures I saw contended that we are going to be about 30 million tons of grain short of our anticipated yield this year. We also have other significant problems in housing and, with a growing number of the young people who were a product of the post-World War II baby boom in the process of family formation, it seems to me that there are additional and inevitable strains there.

There is the further problem of job creation to avoid rather significant unemployment rates—and I am thinking again of that post-World War II baby boom population, and the need by industry to absorb almost twice as many people into the work force today as they have been doing for the past 7 years. As I understand it, that is to continue for about another 7 years before we get back to normal job creation in a highly industrialized society, where it costs about $25,000 to create a job.

The question I am wondering about is, how you achieve reduction in consumer demand when you are stuck with those givens.

Mr. WALLICH. Let me say something about how I visualize the impact on demand. I think that it would be very widely spread. People are very likely to cut back a little here, a little there. They are going to cut back on what they spend on gasoline; perhaps not in dollar terms, but in terms of the amount of gasoline, and in the other forms of oil which they use. A reduction in demand for food is not involved, I believe. Food is mainly a supply problem at this time.

How does that fit into an overall aggregate demand policy? I quite agree with you, we need a proper balance. We have had substantial excess demand, and that has contributed to inflation. It needs to be cured. On the other hand, we have to be careful not to develop an overall demand weakness which would make it difficult to absorb growth in the labor force. That is a problem of the medium term, I would say. The demand trend has to be sufficiently upward to absorb new entrants to the labor force.

Mr. CRANE. Another question that came to my mind that Congressman Reuss touched upon, concerns this necessity for developing substitutes for imported oil; and one of the concerns that I have—and in fact a number of my colleagues do—is over the impact of some of the environmental legislation that we have passed in significantly increasing demand for this product. Then, such delays as construction of the Alaskan pipeline, and so forth—I am wondering if, in your judgment, there should be a continued effort at relaxing and extending the timetable for implementation of some of our efforts at controlling pollution of the environment.

Mr. WALLICH. As an economist, I like to see balanced adjustments. We have had the misfortune at a time when we took what seemed to be desirable environmental action, we experienced an unforeseeable rise in the cost of these policies. It seems appropriate that on the one hand we pay a little more, and on the other, demand a little less. That way we will bridge the gap.

Mr. CRANE. Well, it is the paying a little more that I think is a part of the problem, too, at a time when there are such demands for money in so many other sectors, whether it is developing additional fuel resources, or whether it is job creation in industry, and so forth.

Let me turn to another point. On page 4 of your testimony, where you made reference to control of boiling over of demand in the fall of 1973, and you added that nearly all governments were adopting more restrictive fiscal and monetary policies, from late fall of 1973 through 1974 down to the present time, what has been the rate of expansion in the money supply?

Mr. WALLICH. The rate of expansion in the narrowly defined money supply in the United States was of the order of 7.6[6.8] [1] percent for the 6 months preceding, February through July of this year. Let us take the last 9 months, November 1973 through July 1974. Of those, the average of the last 3 months was 4.4[4.8] [1] percent, and the average of the 6 months preceding that was about 6.8[7.5] [1] percent. So, this averages 7.1[6.6] [1] percent for the 9 months.

Mr. CRANE. But most recently, it has been in the 8-percent range in the preceding 6 months.

Mr. WALLICH. The last 3 months, it has been at 4.4[4.3] [1] percent rate, and before that—in other words, the aggregate of 9 months—approximately 7.1[6.6] [1] percent.

Mr. CRANE. I see.

With respect to fiscal policy, there have been some proposals that I think are in line with other recommendations that you have made, that we might relax—or, in fact, reduce—some of the taxes on capital investments, capital gains; even some relaxation or reduction of corporation taxes as a means of trying to stimulate increased investment, because of the expectation of a higher return on investment; and it would seem to me that that coincides with some of the other recommendations in your statement. Would you recommend any specific changes in our tax laws here, to encourage more investment?

Mr. WALLICH. I have a hard time being very specific about these suggestions. I am aware of the objective and I am also aware that they are tax devices that could be useful. In that respect, may I draw your attention to an aspect of the corporate-profits picture. Due to the fact that price rises have inflated inventory profits, the true profits of business are currently very substantially overstated—in the economic sense, at least. If you take into account the fact that corporations must

[1] Figures in brackets indicate revisions made August 21, based on new data.

pay tax on these inflated inventory valuations, the rate of taxation on corporate income is really much higher than it appears to be. But that is an economic, not a legal, calculation.

Mr. CRANE. Finally, you make reference also in your statement to the need to take whatever steps we can to shift more of our economic activity from consumption into investment and I assume particularly you are concerned about return on investment and energy related fields, whether it is oil or what have you. Do you know what the return on investment at the present time is for the major oil companies in this country?

Mr. WALLICH. No. I don't. I would have to look at the figures. I would guess that because of the profits on inventory during the period when the price of oil rose, it would be necessary to take a longer period in order to get a meaningful figure. It would be very hard to put it, say, in terms of 1973 or in terms of 1974 only.

Mr. CRANE. The reason I raise that point is because unfortunately it seems to me that the oil companies have come under undue criticism. There have been very dramatic headlines advertising the percentage of profit increase over say last year or the preceding 6-month period, when, in fact, the return on investment of the major oil companies in this country during the preceding 5 years to the time of the oil embargo was, relatively speaking, lower than the return on investment in other forms of industry in this country. It just seems to me that the oil companies have taken something of an unfair and unwarranted criticism in this regard and that if we are going to stimulate that investment then it is necessary to develop a degree of self-sufficiency, that instead of talking about nationalization of American oil companies we ought instead to be applauding a return on investment that finally has exceeded a return through the prime rate, and it was below that for several years.

Mr. WALLICH. I would never accept a percentage without stating the base and without relating it to longer run data.

Mr. CRANE. Thank you, Mr. Wallich. My time has expired.

Mr. GONZALEZ. Thank you. Mr. Burgener.

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

Governor Wallich, it is a privilege to have you here. I would like to ask a few monetary policy questions and work my way through oil and end up in Eurodollars maybe. Chairman Burns suggests that monetary policy alone can certainly not solve inflation, although it is an important part. He says that fiscal restraint on the part of Government, on the part of individuals, labor, management, and everybody is essential. Higher productivity, all of this combined with monetary policy can tend to attack the problem. Is that generally how you see his views?

Governor WALLICH. Yes; that is the way I see it. Monetary policy should not be made to carry the full burden.

Mr. BURGENER. All right. Now am I correct in my assumption that if the Federal Reserve dramatically reversed its field and eased money and made it easy and it is tight at the moment, that two things would happen. I recognize that this is oversimplified. Am I correct in assuming, (a) that interest rates would come down; and (b) that prices would go up?

Mr. WALLICH. I find it difficult to generalize about monetary policy. But let me put it this way: Over a period of time inflation and the movement of prices reflect developments in the money supply. I am not speaking to the precise situation now, because there are always particular aspects that have to be taken into account. But speaking in general, if at any one time the central bank suddenly steps up the rate of growth of the money supply and the money supply eases in the sense you said, Congressman Burgener, the immediate effect would be a decline in interest rates. Subsequently, however, prices would go up. Rising prices tend to pull up interest rates in the long run. I do not know exactly what the timing would be. But the final result would be higher interest rates.

Mr. BURGENER. The Federal Reserve most recently has a slower money supply growth rate of about 4 percent as opposed to last year's 8. What do we know in general terms about the growth of money supply in foreign countries, particularly our trading partners—Japan, Europe, the Arab countries, and so on? How is their own currency growing or is it?

Mr. WALLICH. Some of those countries have in the past had very much higher rates of money growth. Some of them, however, have been quite successful in lowering the rate of growth of money. Japan, for instance, had a severe rate of increase in the money supply in 1972–73. The United Kingdom did also. They have managed to cope with that to some extent. Broadly speaking, one can trace these effects of monetary policy and price behavior. The countries I mentioned need to balance their payments. The rate of exchange of their currency also has great significance with respect to prices. In addition interest rates have an international relationship. Thus, particularly in smaller countries, rates tend to be influenced by rates abroad. All this makes it harder to follow the mechanisms, if I understand you correctly, that you are trying to examine. But, broadly speaking, I think it is validated.

Mr. BURGENER. Is it true, that without passing judgment on whether it is a good or bad idea, that Japan moves very quickly in terms of allocating credit within the nation that we do not?

Mr. WALLICH. In Japan they have had a system in which the Government has had a great deal of control over the allocation of credit. My own impression is that they feel the time has come to reduce that degree of control. They have tried to make their markets more responsive to what we would call market forces.

Mr. BURGENER. On the OPEC countries, if this large reservoir is seeking highly liquid or low-risk investments I assume that high risk brings high returns and low risk generally low returns. You state in your testimony that that would have a tendency to force the rate of return down. Is that what you are saying? If they are seeking low risk will not that bring their interest rates down?

Mr. WALLICH. That is correct. I meant to say that if more money flows into low-risk areas, such as short-term Government securities, the supply of funds there will be increased and that will necessarily tend to drive down rates.

Mr. BURGENER. Of course, I guess currently our Government securities are quite high return or is that just the short-term ones?

Mr. WALLICH. I am afraid that in considering interest rate levels one always has to consider the rate of inflation, Congressman Burgener.

Mr. BURGENER. Is 8 and 9 percent low return?

Mr. WALLICH. The nominal rate, of interest consists, economists would say, of the real rate, plus an inflation premium. I do not know what rate of inflation investors expect. But you could visualize an 8-percent interest rate that would contain a very sizable inflation premium.

Mr. BURGENER. We are paying about $20 billion more for oil and we are not getting more oil and I take it we are not getting less oil. The point is are we conserving energy or are we just talking about it, in your opinion?

Mr. WALLICH. I am not an energy expert, but my overall impression is this. There is some conservation at the consumer level. Consumer conservation of energy was better during the period of the boycott than it is now. There is a significant effort at the business level, where conservation practices are based on precise calculations. There is a longrun effect but no one knows just what that includes. There are structural factors such as a change in the size of the average car, the insulation of the average house, and the way the factories are built, which will take a long time to become effective. But effort in this area is proceeding. I think it is probably the main part of this conservation effort.

Mr. BURGENER. Would it be safe to assume that as of right now it is more of an intention than a fait accompli?

Mr. WALLICH. I would say it is certainly not a fait accompli. I would add that I think everybody has the best intentions. But, unless these intentions are backed by economic reality I do not think they are going to get us to the desired result. I do see the reality of higher prices working on people, so that regardless of intentions they are likely to be pushed in the direction of conservation.

Mr. BURGENER. All right. Finally then, I take it a Eurodollar is an American dollar in a European bank regardless of how it got there or what the source. You mentioned in your testimony that Eurodollars increased some 50 billion last year. Is that roughly correct?

Mr. WALLICH. Yes, sir.

Mr. BURGENER. Can you break down the source of that increase in any way?

Mr. WALLICH. It certainly was not in any major part the U.S. balance of payments, although that is one possible area from which the Eurodollar market can be fed. I believe there is some internal generation in the creation of funds in the Eurodollar market, proceeding in the same way as in any banking system. To look at the detail, I would have to go back to my sources, and I am sorry to say that my information about that market is not as precise as I would wish it to be, because it is an international market where many monetary systems, of many countries, come together. You can perceive events over a given interval. But it is quite difficult to go beyond that and trace the fundamental causes of the events.

Mr. BURGENER. Am I correct in my assumption that the immense buildup of Eurodollars tends to make all dollars worldwide less valuable, less desirable, devalued so to speak?

Mr. WALLICH. That is an interesting hypothesis. I could not characterize it as more than that. Giving you a very broad opinion, in one sense the Eurodollar market increases the international availability of dollars, but demand tends at the same time to press against it. The U.S. dollar is being used all over the world for trade, for reserves—privately, and by official holders. The fact that the dollar plays that great a role is of course an important element in the demand for dollars. The upshot is contradictory forces: possibly increased supply of dollars, but also an institutional underpinning of the dollar due to demand for it. I do not know in which way the net effect takes place.

Mr. BURGENER. Thank you very much, Mr. Chairman. My time has expired.

Mr. GONZALEZ. Thank you. Mr. Fauntroy?

Mr. FAUNTROY. Thank you Mr. Chairman. Mr. Wallich I just have one line of questions and it has to do with the possible use of tax reform and its effect upon the whole oil industry and upon prices. To what extent will a decrease in the oil depletion allowance affect the oil investment picture?

Mr. WALLICH. Mr. Congressman, realizing that I am not a tax man primarily, my reaction has been, with respect to depletion, that it is a device that encourages both the discovery and the production of oil. When the price of oil became high and it suddenly became very important to find more oil I think a legitimate question was raised whether we should not shift to taxes that would emphasize finding and conservation, rather than the lifting of oil above ground. That, it seems to me, would be responsive to the economic needs.

The second question is, what rate of return do the oil companies need in order to take on the admittedly high risks of exploration and additional production? Problems enter here such as: How assured are the markets? What are the chances that, after they have built refineries or drilled a well, oil will suddenly go down to a lower price and the investment will lose its value? All these things, I think, have to be considered jointly when you talk about oil taxation.

Mr. FAUNTROY. Thank you, Mr. Chairman.

Mr. GONZALEZ. Thank you. One thing has been pointed out. I think it is well for the record to clarify, Mr. Burgener in his colloquy with you defined the Eurodollar, as an American dollar in a European bank. More technically and correctly speaking, is that not really a claim on a European bank denominated in American dollars?

Mr. WALLICH. Yes, I think one could call it both. If the dollar is in a European bank, then it is a claim on a European bank. When we say it is a dollar, it is a claim denominated in dollars. There is not necessarily a dollar in the United States behind this Eurodollar. It is necessary to make that point, which I regard as a distinction.

Mr. BURGENER. If the chairman would yield I think this is important and I certainly do not pretend to understand it yet. I think it was Mr. Wright the other day who set the example of going into a London bank and opening an account and asking for the account to be in U.S. dollars for $100,000 and you give the banker a check on a New York bank for $100,000, we all understand that transaction.

A different kind of a transaction would be to say I want to open an account for 100,000 American dollars. I do not have the money, but I have collateral, so you loan me the $100,000 and will open my account and I think it was Mr. Wright who said they opened your account with nothing, with no American dollars and with no relationship to any Federal Reserve requirements in our country at all.

He alleged they just created out of thin air $100,000. Now did they, or did they not? Do they have reserve requirements? That is what we are getting at.

Mr. WALLICH. Even the experts argue about this process, because it is curiously hard to pin down. My own view is that the market can create dollars, but that by no means all of the dollars that are in it have been so created. They could have come out of the United States. Essentially it is easiest to think about the Eurodollar market as if the whole market were a single bank. Just as a bank can make a loan to you if you supply collateral and the bank will write up its liability the Eurodollar market can do likewise. There are no reserve requirements against deposits such as U.S. banks maintain. However, the "Eurodollar bank"—taking the whole Eurodollar market, for purposes of discussion, as a single bank—maintains, of course, some liquidity in the United States. It does so because it is called upon from time to time to make a dollar payment, and then it must be able to provide dollars in the United States. To do that, it must either have those dollars or must have short-term liquid assets which can be sold to obtain dollars.

Mr. BURGENER. I guess what we are finally, Mr. Chairman, getting to is that while you, the Federal Reserve, makes a real effort to restrain inflation by monetary policy, 4 percent, 8 percent, 6, and wherever you go, can you really come to grips with it with no control really over the Eurodollar? I do not know.

Mr. WALLICH. The Eurodollar market is somebody's money supply but no country's money supply—the Eurodollar does not enter into any country's statistics as money. The data appear to me to indicate that this market has been growing faster than money supplies around the world. To the extent that it has the effect of stimulating demand, this may have contributed to generating excess demand in the world. I do not think it particularly affects the United States, because the impact of the people who spend out of Eurodollar liquidity is worldwide. Thus, the impact on the United States of Eurodollar spending would at most be a small fraction of the total. But I think that on a worldwide scale it probably has been of some effect in increasing demand.

Mr. BURGENER. Thank you.

Mr. GONZALEZ. There is one final question, Mr. Wallich. It looks as if our U.S. commercial banks are going to have to recycle some of these petrodollars and loan them in turn to countries that are, or possibly can be, very bad credit risks. Is that not a dangerous situation? Isn't there anything that we should think in anticipatory action?

Mr. WALLICH. I think the banks are conscious of these risks. A well-run bank will have an idea of how much exposure it can afford in any particular country. Even so, accidents can happen, of course. The obverse of this is that countries that are not strong credit risks may not be able to get the money they need. Then a problem arises for other countries. Should they help this country? Should the international institutions enter the scene? Should the country make a desperate effort to adjust its balance of payments by some form of restriction or depreciation? All these variables enter into the matter. If the banks act prudently they will protect themselves, but they will not protect each and every country that is in need of financing, and a problem is therefore left to be dealt with.

Mr. GONZALEZ. Well, we had one gentleman witness who mentioned, and of course I am just repeating, I am not an expert on this, that we had the experience of the Franklin National Bank, and his remarks were to the effect that in some countries, and I think he mentioned England and Germany, the governments had a flat prohibition, prohibiting the banks from speculating against their own currency, and that the United States does not have this control. Is that an accurate report? Is that true? Is there such a thing as that?

Mr. WALLICH. It contains an element of truth. Some countries control the degree to which a bank may speculate and in this group each country does this to a different degree. Some countries permit no speculation against the home currency. Others impose no constraints at all. I note that for the most part restraints where they exist refer to speculation only against the home currency. This means the central bank is trying to protect the currency for which it is responsible. Such restraints do not, by any means—even when they are extensive—protect banks because it is still possible for a bank to speculate in currency B against currency C, leaving the home country out of it. Risk arising from that kind of speculation remains, and it is information on that problem that we are now trying to get.

Mr. GONZALEZ. I see. Well, thank you very much, Mr. Wallich. We are deeply grateful to you.

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

[Whereupon, at 11:55 a.m., the subcommittee recessed, subject to the call of the chair.]

[The background material on the "International Petrodollar Crisis" prepared by the staff of the subcommittee and referred to by Chairman Gonzalez on page 3, follows:]

U.S. HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON INTERNATIONAL FINANCE
OF THE
COMMITTEE ON BANKING AND CURRENCY
NINETY-THIRD CONGRESS
WASHINGTON, D.C. 20515

Background Information for Hearings on International Petrodollar Crisis

Prepared by Subcommittee St-

July 1974

Hobart Rowen

THE WASHINGTON POST June 20, 1974

The Deepening Monetary Crisis

A little more than a month ago in Basel, Switzerland, the rich nations' central bankers had one of their regular and secret sessions on the status of the world economy.

This time, the subject was the deepening financial crisis occasioned by the high price of oil set by the producers' cartel, which is causing horrendous balance of payments problems for Italy, France and Great Britain — as well as financial chaos for the hardpressed developing countries.

But the most important financial men were far from the quaint little Swiss city. They were in Vienna, preparing for a meeting of the Organization of Petroleum Exporting Countries in Quito, Ecuador, where subsequently they would decide that the oil-consuming world would get no price relief.

Last week, the IMF's Committee of Twenty met in Washington for a session which once had been targeted as the final "wrap-up" conference for international monetary reform. But as financial jitters spread, the best that the IMF could come up with was adoption of a few tentative steps attempting to ease the burdens placed on developing and developed countries alike by the high price of oil.

The plain fact is that there can be only postponement—not settlement—of the threatening international monetary crisis so long as the consuming nations must meet oppressive bills on a continuing basis.

"For the first time, international financial men speak of a world-wide recession."

For the first time, some prominent bankers and international financial men speak of a worldwide recession, with the remaining strong nations—the United States and Germany—being forced to bail out other countries.

Writing in the July issue of Foreign Affairs, oil consultant Walter J. Levy warns that we are witnessing "an erosion of the world's oil supply and financial systems, comparable in its potential for economic and political disaster to the Great Depression of the 1930s."

Italy has already been driven to the edge of bankruptcy by a deficit in her balance of payments running at an annual rate of $13 billion in the first four months of 1974. It is true that Italy has had other problems besides oil—a raging inflation, excessive imports of consumer goods, and a weak government. But it is oil that has pushed Italy to the brink, and reduced her credit-worthiness to almost zero.

France and Great Britain could be close on Italy's heels. The British balance of payments deficit just for oil this year is likely to be $7 billion, or as much as the estimated 1980 value of highly-trumpeted North Sea oil production.

The tremors are being felt, as well, in the huge, $150 billion Euro-dollar market, where major companies as well as nations have been borrowing money. This source could dry up quickly, because it has been fed by Arab "petro-dollars," placed on deposit for very short periods of time.

Recently, Chase Manhattan Bank head David Rockefeller expressed public concern about the Euro-dollar market. The best way for banks to get in trouble, he pointed out, is by borrowing for short periods of time (from the Arabs) and lending for periods up to 7 years (to European countries in deficit).

It is for this reason—in desperation—the major governments quietly got together in Washington, and over dinner at the Watergate Hotel agreed that Italy and others in the same boat should be allowed to pledge their gold reserves as loan collateral, not at the official $42.22 an ounce price, but at something "related" to the open market price of more than $150 an ounce.

This clever, stop-gap device was the brainchild of Federal Reserve Board Chairman Arthur F. Burns, who first proposed it to a surprised group of his colleagues at that meeting a month ago in Basel.

The Europeans for long have been urging that they be allowed to settle their debts with each other by the exchange of gold at real market prices. This would enable them, they held, to "unfreeze" that portion of their reserves consisting of gold—but which they obviously wouldn't part with at $42.22 an ounce.

The wily Burns reasoned that something had to be done for Italy in a hurry, but that an across-the-board inflation of total world gold reserves would not only be unnecessary, but dangerous.

The gold "collateral" compromise, a concession by the United States, may buy time for Italy and other countries fortunate enough to own a gold stockpile.

But how about the poor countries? The Trilateral Commission, a private group of American, Japanese and European citizens, speaks eloquently of the "economic disaster" that could befall the 30 poorest nations if the developed world and the suddenly wealthy OPEC nations fail to agree on a crash rescue program.

Everything done so far in the wake of the oil crisis—for the industrial or LDC countries—including the steps taken at the C-20 session, is inadequate or spineless. Untold hazards lie ahead unless there is some alteration in the vast shift of funds demanded by the OPEC nations. That requires lower oil prices.

Perils of Oil Complacency

The New York Times

June 23, 1974

By THOMAS E. MULLANEY

SOME constructive developments in the international oil and energy situation during the three months since the end of the Arab embargo—especially in recent days—have encouraged some economic analysts and seemingly eased the overwhelming pressures that last fall's oil offensive suddenly created throughout the world.

The real improvement, however, has been relatively minor and promises to be no more than a short-term palliative both for the United States and all the other nations that are so heavily dependent on the Middle East's great resource now and for some time ahead.

The real danger is that the recent abatement of the oil-supply crisis will mask for a while the potentially catastrophic financial consequences that lie ahead as a result of the sudden and explosive rise in the cost of petroleum during the final quarter of 1973.

Equally worrisome is the possibility that the oil-consuming nations will become too complacent and fail to embrace a program of austerity and cooperation to mitigate the awesome economic and political problems that the recent startling changes in oil supply-and-price conditions have created for every nation—even the most advantaged and affluent in energy and other resources.

Perhaps the best recent news—though a small comfort—was the fact that the oil-producing nations, at their meeting last weekend in Quito, Ecuador, did not push through another increase in prices and confined themselves instead to raising royalty payments from the oil companies by 2 per cent, which hopefully, will not be passed along to consumers. After a bruising intramural battle, Saudi Arabia successfully beat back the strong efforts of her producer colleagues to raise posted prices of oil at this time.

What is needed now is an actual reduction in world oil prices. That may come later on. It depends, probably, upon either the continued aggressive goodwill of the Saudis or the ability of the United States to get Iran, the most militant of the oil producers, to accept the fact that the high level of oil prices is disastrous for all.

Since mid-March, when the Persian Gulf states lifted their politically motivated embargo against certain nations, it is true that there has been some improvement in the over-all oil picture and other problems related to it, but the specter of new and even darker troubles remains ominous.

The supply situation is better because of increased production and reduced consumption. And the cost of the liquid gold, which shot from 90 cents a barrel in 1970 to $3 last October and then to $7 at the end of 1973, has since stabilized at that high and unbearable level.

Moreover, much thought and some effort have been devoted to various ways to reduce dependence on Middle East oil as well as viable solutions for recycling the vast new monetary wealth that has been flowing into the producing nations.

In addition, some steps have been taken to ease the financial burden of nations most affected by the disruptive influences created by the huge increases in their food costs, though these have been mostly pledges that still have to be redeemed—things such as promises not to engage in trade policies that would further aggravate payments positions, improvements in trade preference systems for the poorer nations and some additional monetary aid for the developing world. But not nearly enough has been done so far.

There is evidence, at the same time, that there has not been sufficient effort so far in many nations to reduce consumption of this vital resource and to push the creation of additional sources of energy.

While American industry, for instance, did achieve considerable conservation of energy in the period of greatest stringency and high prices last winter, there is a conviction among many analysts, both in Government and elsewhere, that greater opportunities in that area are still available.

To that end, the United States Federal Energy Office is planning discussions with several of the nation's largest energy consumers to seek ways to cut their consumption. Walter Sawhill, the new director of that office, has already visited some of the auto companies with a view toward exploring ways for developing cars that use less gasoline.

As any one who has motored along some of the major highways in recent weeks has noted, the public is out on the roads again in much greater volume and driving at faster speeds than they were when the gasoline shortage was so severe last winter.

Traffic has not yet returned to pre-embargo levels in most states, but there are signs that there will be more summer driving than was expected a few months ago.

Highway traffic in Michigan, for instance, came within 2 per cent of last year's volume over the Memorial Day weekend after being down 10 per cent in the early part of this year. And parkways in New Jersey and New York, which showed declines of 17 per cent or more as recently as February, have seen the drop narrow to 3 or 4 per cent in recent weeks.

The prospective increases in highway traffic and other uses of energy may soon turn demand for petroleum products sharply upward again after significant declines in the early months of 1974. Total demand was down about 7 per cent in January from a year before, off 12 per cent in February and 6 per cent in March and down less than 2 per cent in April, when the country's consumption of all petroleum products ran about 16 million barrels a day.

For the four weeks ended June 7, total demand was still around that level, but in that last week, the figure jumped to 16.7 million barrels a day, up about 10 per cent in that period from the previous one and about 3 per cent above the same week of 1973.

The greater availability of gasoline and other petroleum products, combined with the disappearance of the irritation of waiting in lines to get to gasoline pumps, may weaken the earlier public support for programs to bolster the nation's independence of foreign sources of energy. There may be a greater tendency to defer the hard choices that must be made if the nation is to commit financial resources to the necessary research and development of alternative sources of supply.

And it is clear that the United States and the rest of the world do have some hard choices to make. It is unrealistic to believe that this country can become completely independent of foreign energy by 1980, but it could sharply reduce that dependence if it pushes forward with a number of proposed high-cost programs.

The job ahead for all nations in the energy area was cogently outlined by a respected international oil economist, Walter J. Levy, in the July issue of Foreign Affairs. After setting down the grim prospects for every one of the present realities in international oil supply trends and prices, he stressed the importance of extreme austerity in consumption.

He suggests reducing the growth of consumption to a 3.3 per cent annual rate from the 5.6 per cent level that prevailed during the 1968-72 period and a "wide-ranging coordinated program among all importing countries" to achieve "some downward adjustment of foreign crude oil prices to all consumers."

In a concise sum-up of his perceptive analysis, Mr. Levy commented:

"Four elements are essential to move to a reasonable adjustment: far-reaching cooperation among the oil-importing nations; an understanding by the importing nations of the interests and aspirations of the producing countries; a clear-cut (and painful) program of energy austerity by the oil-importing countries, and a recognition by the producing countries that even in an austerity situation any attempt to hold prices high must result in worldwide dangers to which they could not be immune.

"Only with far-reaching consumer cooperation can it be expected that the producing countries will come to this necessary conclusion. At the same time, cooperation without austerity will not do the job. Both are needed, and a large new dose of political will, not yet in sight, will be required to achieve them."

In this whole effort the United States will obviously have to play a pivotal role of leadership. The world cannot afford to bear the tragic consequences that it surely faces if some dramatic steps are not taken to counteract actions by the Arab and other oil-producing states that have increased their cost of such a vital resource to the staggering total of $100-billion this year.

THE NEW YORK TIMES Business/Finance

June 17, 1974

RISING OIL PRICES CREATING DISMAY

Economies of Big Consumer Nations Are Confronted by Huge Payments Deficits

REMEDIAL PLANS HAZY

Experts Fear a World Slump May Come Before Action Is Taken on Problems

By Clyde H. Farnsworth

PARIS, June 15 -- It's happening faster even than the experts thought. The major oil consuming nations--France, Britain and Italy--are piling up huge deficits in external accounts, and the concern is mounting about how these deficits will be financed.

A banker in Frankfurt, West Germany, comments: "The monetary world has changed radically and for good as a result of the explosion in oil prices." A banker from New York speaks of higher oil prices as the "financial monkey wrench" in the world economy.

Looming in the calculations of many financial men on both sides of the Atlantic is the specter of another world economic slump. Although the first signs have appeared of more cooperative policies by the main oil importing nations, many experts are still worried that nations will act too late to stop the drain of wealth and jobs represented by higher oil payments.

Discouraging Trends

The secretariat of the Organization for Economic Cooperation and Development in Paris, the National Institute in London, the First National City Bank in New York, the Dresdner Bank in Frankfurt, Gerald A. Pollack, senior economic adviser to the Exxon Corporation, and Walter Levy, a petroleum consultant who has the ear of Secretary of State Kissinger are among those who are most discouraged by the latest trends.

The oil money is accumulated by a handful of producer governments. It does not disappear from the system. Some of the funds go into good and services from the industrial countries. Some are invested in the money markets of the West.

Accelerating rates of inflation have meant that much of the money is kept on short term deposit. So short term in fact that a banker from London snapped, "seven days nothing, we wish we could hold the money for more than 24 hours."

THE NEW YORK TIMES June 17, 1974

The question is whether these savings of the oil producers can be transferred into the capitsl that creates jobs. And as Mr. Pollack of Exxon observes, "unless governments adopt suitable reflationary politics, capital formation could actually fall."

But what is happening now is just the reverse. The governments with the biggest deficits are deflating in efforts to improve their foreign trade. The critical danger, as the O.E.C.D. secretariat points out, is on competitive deflation as countries fight for smaller and smaller export markets.

High interest rates have already slowed consumption in many countries, including the two biggest markets for the world's exports, the United States and West Germany.

Italy's Government fell last Monday when the trade unions and socialists refused to accept a stringent fiscal package on top of the severe credit squeeze imposed by the bank of Italy. They feared a sharp rise in unemployment in the fall.

Yet, Italy's desperate financial positions--caused by higher oil prices superimposed on an inflation weakened economy--made some sort of stringency a condition for the international loans it has to have to pay its bills.

"The Italian situation is bad, but it is less worse now because of the gold agreement," a banker in Zurich commented last week. He was referring to the accord in Washington that permits central banks to pledge gold at market related prices as collateral for loans.

$12-Billion in Gold

The 2,500 tons of gold in the vaults of the Bank of Italy are worth some $12-billion, when valued at near the price for gold in the free market, as opposed to the $3.5-billion when valued at the official price of gold.

This gives Italy a little time -- A "breath of air" as the Common Market's energy chief Henri Simonet puts it. But in the first four months of this year the Italian trade deficit was running at an annual rate of $13-billion. So that gold could go pretty fast.

Not only oil, but food imports have swollen the bills. Many experts on the Italian economy say the country should be producing more of its own food. But this in turn would take away markets from some of the principal suppliers such as France, Yugoslavia and the United States.

Petroleum consultant Walter Levy observed that at the present prices for oil, Italy simply cannot pay its bills and will have to be bailed out--eventually by Washington.

Mr. Levy reasons that much of the oil producers' funds will flow into the United States, and that in the long run it will be

THE NEW YORK TIMES June 17, 1974

the United States that will have to recycle money to the debtors, accepting the debtors' ever depreciating promissory notes.

So, in the end, this process will mean a loss of real resources for the United States. Will the American people accept this, Mr. Levy asked last week in an interview. He said he doubts it, especially if it would lead to more unemployment in the United States.

Yet, the alternative could be Italian bankruptcy and crashing financial markets, since if Italy cannot pay its bills the banks that have already lent it money--it has borrowed internationally some 10-billion over the last two years--will be in deep trouble.

West Germany is the big surplus country in Europe and will probably be the first to be called on to help pay Italy's bills. Although, the German accounts look good on paper, that country, too, faces enormous increases in its energy costs. And if markets are shrinking for its exports, it can also run into trouble.

Recard Trade Deficits

Last week, both France and Britain reported record trade deficits, signs that Italy may be just the first of many dominoes.

The French deficit--at 600-million in May--was even higher than that foreshadowed by Finance Minister Jean-Pierre Fourcade when he announced a series of anti-inflation measures on Wednesday.

The French action is aimed at cutting two-thirds from the 17 per cent inflation rate and getting the international accounts back into equilibrium within 18 months. The French are chiefly counting on West Germany buying of a lot more French-made cars, machine tools, farm products and perfumes. But that means some German reflation, which has yet to be seen.

THE WASHINGTON POST June 30, 1974

Joseph R. Slevin

Threat of Worldwide Recession Grows

THE THREAT of a worldwide recession is causing mounting concern among economic forecasters.

It's only a cloud on the horizon but it looms larger than it did a month or two ago.

A sampling of government and private forecasters discloses that few are willing to predict that a worldwide slump actually will occur. Many are quick to warn, however, that it is a very real possibility that must be reckoned with.

The experts see two main weaknesses in the international economic scene.

One is the serious impact that the steep Arab oil prices may have on the capacity of oil consumers to buy other goods.

The second is the restrictive effect of the increasingly rigorous anti-inflation programs that industrial nations are pursuing.

Federal Reserve Board Chairman Arthur Burns and his West German opposite number, Bundesbank President Karl Klasen, three weeks ago joined at the International Monetary Conference in flatly declaring there will be no world recession.

WHILE THE central bankers clearly were anxious to bolster public confidence and undoubtedly would take the same upper approach today, the economics of the major countries have a weaker look than they did.

"Check them out," a top federal forecaster urges. "There isn't one important country that's expanding rapidly, not one."

The government expert stresses that most countries seem to be chalking up impressive gains because their *nominal output volume* is being swollen by inflationary price increases. Real production, however, is changing little, with small increases or small declines being typical.

Germany is the envy of most other countries for it has the lowest inflation rate and best international payments performance but German industrial production is only 1 per cent above a year ago and is lower than it was during the winter.

The huge U.S. economy is struggling to grow again after having slumped sharply but the consensus judgment is that it will post only tiny gains at most during the rest of this year— and that it could sink into a deepening recession if that is the way the world is going.

TIGHT MONEY is causing even greater housing weakness than seemed likely when Burns issued his "no recession" forecast. Consumers are behaving like reluctant spenders and businessmen are showing signs of pulling in their horns, too.

French President Valery Giscard d'Estaing has announced new austerity measures to curb inflationary spending and the Bank of France recently boosted its discount rate to a record 13 per cent.

Germany is holding to its tight money policy as are the British and the inflation-ridden Japanese.

Italy has resolved its cabinet crisis with an agreement to carry out firm fiscal anti-inflation measures to bolster the Bank of Italy's restrictive credit program.

All the major Free World governments are consciously seeking sluggish economies to break their inflation spirals. It would not take much to push them over the line and into the worldwide recession that Burns and Klasen said won't happen.

THE UNDER SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

JUN 6 1974

Dear Mr. Chairman:

You wrote to Paul Volcker on May 30, following your meeting with Congressmen Reuss and Johnson, about three areas in which you desired follow-up information in connection with reconsideration of IDA replenishment legislation.

The first area concerned the Administration's position on legalization of private gold ownership, with particular reference to the Dominick Amendment. I have attached, as Appendix I, a memorandum setting forth our views on this topic.

I have also attached, as Appendix II, a memorandum on another area you mentioned, i.e., the status of negotiations concerning the valuation of SDR's, and the relation of the "basket" approach to U.S. maintenance of value obligations in the international financial institutions.

Finally, you asked what steps the OPEC countries are taking -- other than the purchase of World Bank bonds -- to help alleviate the problems of IDA client countries. I would like to point out by way of introduction that the sharp increase in revenues of the oil producers occurred only within the last eight months, a relatively brief time for the oil producing countries to realize the extent of their new wealth and then to begin to accept the international responsibilities that go with it. Viewing the matter in perspective, I believe the oil producers have made a good start -- perhaps better than we might have expected last January -- but they must be encouraged to do more, particularly, as you point out, in the area of truly concessional financing.

Some concrete actions which we are aware have been taken by the OPEC countries are as follows:

1. Six OPEC countries have pledged over $3 billion to a special facility in the IMF to provide supplementary financing for oil importing countries. Four more OPEC countries are considering contributions. It is contemplated that this facility would be somewhat below market rates, but not in the concessional area, and would help both developing countries and developed countries with balance of payments problems arising from increased oil costs.

2. Kuwait is expanding its Economic Development Fund from approximately $600 million to over $3 billion. Assistance from the Fund will no longer be confined to Arab nations, and the new funds are to be lent on a concessional basis. Expansion of operations from current levels may be relatively slow because of the Fund's shortage of qualified technical personnel, but the World Bank has offered technical assistance to overcome this staffing problem.

3. Iran is extending over $1 billion in bilateral project assistance on favorable terms to Middle East and South Asian countries in addition to providing special price and financing arrangements for certain of its oil exports. Saudi Arabia and Iraq are extending similar project and/or oil financing facilities in the region.

4. Venezuela is actively negotiating the establishment of a $500 million trust fund with the Inter-American Bank for concessional lending. Venezuela is also making a further $30 million available to the Caribbean Development Bank.

5. Negotiations were completed in May on a charter for a 24-member Islamic Development Bank, with an initial capital in excess of $1 billion. Formal approval is expected in July, with an operational target of end-1974.

6. On the basis of less definite information, Middle East OPEC countries appear to be considering special funds for Africa totalling perhaps

$500 million, including a $200 million fund, which would initially help with financing oil imports and then be recycled into longer term projects.

While we do not have complete and detailed information on all the financial initiatives, I think the preceding list amply indicates that oil producers are channelling a portion of their resources to the poorer countries, that at least a part of these resources is being made available on the favorable terms that the situation requires, and that we can anticipate still more constructive steps in the future.

Mr. Volcker will return to Washington by next Monday. I know he is looking forward to accompanying Secretary Simon for his testimony before your Subcommittee in support of IDA next Tuesday, and he hopes Committee approval and Floor action can then follow in short order.

Sincerely yours,

Jack F. Bennett

Jack F. Bennett

The Honorable
Henry B. Gonzalez
Chairman, Subcommittee on
International Finance
Committee on Banking and Currency
House of Representatives
Washington, D.C. 20515

Enclosures

New York Times 6/12/74

MONETARY FUND AGREES ON REFORM

World Financial Harmony and Aid for Poor Nations Set in Interim Agreement

By EDWIN L. DALE Jr.
Special to The New York Times

WASHINGTON, June 13 — The 20 nations negotiating world monetary reform agreed today on an eight-point package of "interim" arrangements to promote financial harmony in the world and help the less developed countries pending an eventual return to more stable currency-exchange rates.

In a major gesture that eased the way to the unanimous agreement, the United States agreed to "reconsider" its long-standing opposition to a "link" between aid for the poorer countries and future issuance of the new international reserve money called Special Drawing Rights. The less-developed countries had made this an absolute precondition for a general agreement.

Most of the elements in the package had been previously disclosed in general outline, but today's communiqué provided additional details.

Secretary of the Treasury

Monetary Accord Reached

William E. Simon hailed the results as "comprehensive" and "[illegible]." He said the negotiators had accomplished what they set out to do and called the agreement "a great international effort." The points in the agreement, he said, provide "practical steps" for "greater stability" in monetary relations among the nations.

These were the elements of the package:

¶Approval of a special new [illegible] in the International Monetary Fund, starting immediately, to make loans to nations whose balance of payments [illegible] badly into deficit [illegible] of higher oil prices. This help would be available [illegible] both industrial countries and reasonably creditworthy less-developed countries.

¶Agreement on a new valuation for Special Drawing Rights, based on a "basket" of 16 leading currencies and bearing, for the time being, an interest rate of 5 per cent. This [illegible] change will make S.D.R.'s — now linked to the obsolete official price of gold — usable again in settlements among nations [illegible] as an element in each nation's monetary reserves.

¶Agreement in principle, but [illegible] in detail, to establish still another new monetary fund [illegible] operation pegged to the needs of the poorer countries [illegible] extended fund [illegible] would make loans [illegible] terms [illegible] in the [illegible]

¶Establishment of new "guidelines" for managing floating exchange rates [illegible]. The guidelines would establish a kind of code [illegible] conduct on when central banks should or should not intervene [illegible] currency [illegible] exchange rates.

¶A new and stronger role for the I.M.F. in influencing national [illegible] in such areas as adjusting surpluses and deficits in the balance of payments and the foreign exchange reserves that nations hold.

¶A general pledge not to take measures such as import restrictions unless the I.M.F. explicitly approves them on the ground of a balance of payments need.

¶Establishment of a new 20-man committee of finance ministers, representing all the members of the monetary fund, which will meet regularly and [illegible] the work of monetary reform.

¶Agreement to set up [illegible] joint ministerial committee of the fund and the World Bank to examine the "transfer of real resources to developing countries" with special attention to those countries hardest hit by the explosion of oil, food and fertilizer prices.

Amendment of Agreement

In addition, the Committee of 20 set in motion a process aimed at amending the fund's articles of agreement, with a deadline of next February. It is in this exercise that the issue of the "link" between issues of S.D.R.'s and development [illegible] of the poorer countries will be settled, with the first signs of a compromise in the United States position emerging today.

This exercise also aims to resolve the troublesome question of the role of gold in the monetary system, though there is unanimous agreement that this role should be reduced. One possibility would be an amendment permitting the I.M.F. to sell its own gold at market prices, with the proceeds devoted to helping the less-developed countries.

Any amendment that are agreed upon would have to be submitted to Congress and other national legislatures. The amendments will be [illegible] and drafted by the permanent executive directors of the I.M.F. between now and February.

Permanent Reform Sought

Today's meeting was the last of the "Committee of 20," which was established in September, 1972, to try to negotiate permanent reform of the monetary system following the collapse of the old system when the United States ceased to convert the dollar into gold and exchange rates began to float.

The committee, though failing to reach agreement on some important issues, had made considerable progress by last September. But then the huge jump in oil prices threw the [illegible] situation in the world into disarray. The committee decided in Rome last January to abandon the search for permanent reform and instead seek the interim agreements announced today.

The outline of what has been agreed and not agreed for the shape of the permanent system will be made public tomorrow, and it will form the basis of future negotiations, though not in the Committee of 20 itself.

[illegible] stable but adjustable exchange rates for the leading [illegible]

'Floating' Guidelines

[illegible] package was the new "guidelines" [illegible]

The guidelines [illegible] rate [illegible] pressure [illegible] and [illegible]

The Wall Street Journal June 11, 1974

World's '74 Oil Costs Seem 'Manageable,' Bank for International Settlements Says

By RICHARD F. JANSSEN
Staff Reporter of THE WALL STREET JOURNAL

BASEL—The world's oil-related financial problems appear likely to be "manageable" this year, but just barely so, the Bank for International Settlements indicated in its annual report.

Although highly hedged, the finding is apt to be received in financial centers as reassuring. As the central bank for European central banks, the BIS has a reputation for silent shrewdness most of the time but for often-pessimistic candor in its annual reports.

Despite an estimated $60 billion of extra oil-import costs this year, the evidence so far suggests "that the payments problems in 1974 should generally be manageable, though individual countries are likely to encounter serious difficulties," the BIS summed up.

The world might be much less able to cope with the huge outflow of money to a few oil producer nations if an overall deep slump were developing, the bank observed. But the early 1974 worry of a "significant recession" in industrial nations has faded on "more recent indications that the setback won't be prolonged," it said.

Although there aren't any indications of a general rebound in economic output, overall activity in the quarter ending June 30 doesn't seem "much changed" from the first quarter, Rene Larre, the BIS general manager, said in a signed conclusion. And while inflation rates are generally the fastest since the end of World War II, "the extreme pessimism of some observers doesn't seem justified," Mr. Larre said.

Dousing Demand

Most countries are seeking to keep overall demand from "heating up again," and the boom in commodity prices "can reasonably be expected to taper off" so that the speed with which wage increases are granted again could become the main reason for varying rates of inflation in different countries, Mr. Larre said.

Nevertheless, the BIS view is optimistic only against the background of fears of a sharp recession or even an economic collapse akin to that of the 1930s. That catastrophic view wasn't mentioned in the report, although it was verbalized in the informal conversations of central bankers at the BIS annual meeting. Mr. Larre did warn that "problems loom ahead which may pose a real threat to the world economy and test the strength of intergovernmental cooperation."

While the oil countries' surplus "could in principle be recycled to deficit countries by private financial intermediation, the need for prudence by both financial institutions and the borrowing countries will present obstacles," Mr. Larre cautioned. In effect, this puts the BIS on the side of those who worry that even the biggest banks could be endangered if Arabs pull out the very short-term deposits on which the banks have based medium and long-term loans of Eurodollars, which are dollars held outside the U.S.

Arabs Move Funds

In response to that concern, private bankers here said, Arab countries are starting to move money into the biggest and presumably safest banks from those with deposits of under $1 billion. And to minimize the danger of overdependence on volatile deposits, they say, some large U.S. and foreign banks are starting to insist that Arab countries commit their deposits for terms longer than the one-month maturities the Arabs prefer.

Even before much Arab oil money became available, "the London-centered Eurodollar market continued growing" vigorously, the BIS said. Net loans outstanding of dollars and other currencies deposited outside their home countries rose to $170 billion at the end of March from $155 billion at the end of 1973 and from $105 billion a year before, the bank said in its yearly analysis of the Eurodollar market.

In an "I-told-you-so" tone, the BIS said the floating of currencies since March 1973 has on balance "complicated the problem of attaining and maintaining monetary stability." The breakdown of fixed exchange rates has spared countries such as West Germany from the need "to expand domestic money supply by purchasing foreign exchange at rates declared in advance to the market," it conceded, thus ending one source of inflation.

But "far from providing a policy-making nirvana," floating rates haven't freed other countries from tough decisions on supporting their currencies or lessening steep declines that worsen their inflation by making imports more costly. Currency market participants too often drove rates of some currencies sharply lower instead of stabilizing them at realistic levels, it complained, with the large swings worsening the "inflationary atmosphere" by contributing "to a lack of confidence in money."

France and Iran Sign $4-Billion Accord; Shah Will Receive Five Nuclear Reactors

Paris Payments Problem Expected to Be Eased

Special to The New York Times

PARIS, June 27—France and Iran signed a massive 10-year development agreement today, including provision for the sale to Iran of five 1,000-megawatt nuclear reactors worth $1.1-billion.

The over-all value of contracts and industrial plans was estimated at $4 billion, making France Iran's leading industrial partner.

The deal will go a long way toward easing France's acute balance-of-payments problem-provoked partly by the rise in oil prices. Far from seeking credits, as is usual in vast industrial purchases, Iran has agreed to make an advance deposit of $1-billion in the Bank of France and to pay for three-quarters of the nuclear installation cost in five years. Delivery is to be completed by 1985.

Associated Press

The Shah of Iran discussing agreement yesterday.

The agreements, signed at the conclusion of a state visit by the Shah of Iran and his Empress, represent the first vast success of the French effort to cope independently with the oil-price crisis through huge sales.

France has refused to join the cooperative approach initiated by Washington to organize joint negotiations among oil-consuming and oil-producing countries, with a view to lowering prices.

Ruler Sees Saudi Switch for Higher Oil Prices

The Shah of Iran has been pressing for still higher prices, against the resistance of King Faisal of Saudi Arabia, who has been sympathetic to American arguments that continued rises endanger the functioning of the world's economy.

Nonetheless, the Shah said at a news conference in the Grand Trianon palace at Versailles today that "Saudi Arabia will have joined our camp" when it reaches 100 per cent take-over of the foreign-owned oil companies, a result, he said he hoped current Saudi negotiations with the companies would effect.

The nuclear reactors, each on a giant scale, represent the

Continued

FRIDAY, JUNE 28, 1974

France and Iran Sign $4-Billion Pact

largest part of the French-Iranian deal. Other aspects of the deal include the electrification of Iranian railways and all railway construction, the creation of a petrochemical industry, building a subway system in Teheran and perhaps other cities and construction of a gas liquefaction plant and pipeline.

The nuclear deal includes the training of Iranian scientists and technicians and the establishment of a nuclear-research center.

There was no public mention of safeguards against using the reactors as a base for making nuclear weapons. The French Foreign Office spokesman said the agreemnt had implied safeguards.

Other Treaties Signed

The agreement provides that both parties will respect their "international obligations." France has signed the Euratom Treaty, which prohibits dissemination of weapons or weapon-making capacity to non-nuclear powers, and Iran has signed and ratified the Nuclear Nonproliferation Treaty, which calls for the safeguard system of the International Atomic Energy Agecny.

Canada, however, is believed to have imposed these safeguards when selling reactors to India and India has since conducted an underground nuclear test.

The Shah was questioned about his intentions at the news conference. He assested that for more than five years Iran had declared herself "ready to turn our area into a nonnuclear zone, that is, an area where no nuclear weapons should be used or stored. And we stick to this policy."

The French-Iranian deal also involved military sales. But the Shah said he could not give details at this time, beyond mentioning the purchase of a group of fast motor boats.

To Assure Passage

Iran's purpose, he said, was not to become policeman of the Persian Gulf, as has been charged, but to assure open passage through the Gulf and the Straits of Hormuz, which control the southern entry.

"This is a matter of life and death for us," he said, adding that Western Europe and Japan also had a vital interest in free navigation in that area.

President Valéry Giscard D'Estaing hailed the agreements as a sign that "in international affairs, Iran and France have parallel attitudes since both intend to maintain their independence and, at the same time, to cooperate in the advent of a new international order."

Finance Minister Jean-Pierre Fourcade, said the accords would mean "fabulous" earnings for French companies, notably Creuzot-Loire, which will be the prime supplier of the nuclear plants and of a steel $30-million plant.

President Giscard's spokesman said only contracts already signed or "far-advanced" in negotiation were included in estimates of the total value. Other projects are also being discussed.

According to the communiqué, the agreement pledges additional quantities of Iranian oil to France, and will make France the leader of an envisaged European consortium to develop Iranian natural gas and transport it to Europe. France will also engage in further oil exploration in Iran.

Shah Favors Nationalization

The Shah said at his news conference that he would like to see the whole oil business nationalized and then have international transactions conducted on a state-to-state basis. Since that does not seem feasible, however, he said, it is necessary to limit the companies' excessive profits.

He defended the dramatic rise in oil prices, saying it was no larger than in other commodities such as steel, cement or wheat and had been made inevitable by inflation in industrial states.

"We're trying to defend ourselves against your rampant inflation," he said. "You are going to blow up, and you're going to blow us up with you."

Paris put on a grand show for the three-day imperial visit. The highlight was a fête at Versailles, with dinner, ballet and fireworks to which, for the first time, the public was admitted.

The Shah and his Empress, who have visited two French nuclear centers, are remaining in France for two more days as "private visitors."

From the Wall Street Journal, June 17, 1974

OPEC Talks Suggest Oil-Price Postings Won't Change Much; Saudis Back a Cut

By JAMES C. TANNER
Staff Reporter of THE WALL STREET JOURNAL

QUITO, Ecuador—The Organization of Petroleum Exporting Countries will continue deliberations today in an effort to reach a compromise on petroleum prices for the next three months.

Late last night, after OPEC delegates completed a second day of deliberations, there was little indication of what those prices might be except that they aren't likely to vary much from the postings that have been frozen at current levels since Jan. 1.

Most of the 12 oil-producing countries that make up OPEC and account for more than 80% of the world's oil exports pushed for an increase in petroleum postings for the third quarter or, alternatively, higher taxes on the oil companies operating within their borders.

But while OPEC delegates attending the secret sessions denied a split had developed over prices, Saudi Arabia is known to have recommended a reduction in postings rather than an increase.

In an interview, Sheikh Ahmed Zaki Yamani, Saudi Arabia's influential oil minister, pledged: "We won't join them in increasing prices or taxes."

Posted prices aren't true market prices but are used by the producing country governments to calculate taxes paid them by the oil companies. An increase in postings means an increase in taxes. This, in turn, is passed on by the oil companies to consumers. Thus, a change in postings is directly reflected in prices paid by the world's oil consumers.

To resolve their differences over postings, the OPEC delegates continued their talks into last night. But indications were that the thorny issue soon would be settled through a compromise.

Iran's interior minister, Jamshid Amouzegar, suggested a decision was near. And Saudi Arabia's Mr. Yamani was planning to leave today before the end of the meeting. Many of the other OPEC delegates, however, plan to remain in Ecuador for the week after concluding their deliberations.

The deliberations began Saturday in Ecuador's legislative palace, little used except for international functions under the country's military government. Because Ecuador is the newest member of OPEC and host for the meeting, delegates named Ecuador's minister of natural resources, Navy Capt. Gustavo Jarrin, as president. Replacing Mr. Amouzegar of Iran, Capt. Jarrin will serve as president until the next OPEC meeting.

In other actions over the weekend, the OPEC delegates:

—Appointed a seven-member commission to study a restructuring of the OPEC secretariat and statutes.

—Listened politely to pleas of representatives of Guyana, Liberia, Sri Lanka and Nepal for more assistance to developing countries burdened by the tripling of oil prices within the past year.

—Turned down applications of the Congo and Trinidad and Tobago for membership in OPEC. The countries, however, were granted "observer" status at the Quito meeting along with Bolivia, Colombia and Peru.

After the price deliberations, the OPEC delegates will take up further discussions today of an OPEC development fund and an OPEC bank.

FROM THE CONGRESSIONAL RECORD, JUNE 24, 1974

Financial Aspects of the Energy Situation

(By David Rockefeller)

In the final quarter of last year the Organization of Petroleum Exporting Countries (OPEC) increased the price of oil fourfold. Given these prices and present levels of production, they will receive more than $100 billion yearly for their oil exports. Of this $100 billion, the oil-producing nations will spend some $40 billion for goods and services, leaving $60 billion or so of surplus to be invested. Total reserves of the oil-producing nations are likely to exceed $70 billion by the end of 1974, $140 billion by 1975, and $200 billion by the end of 1976. These huge surpluses must of necessity be offset by corresponding deficits on the part of oil consumers.

This suggests a structural disequilibrium of major proportions in the balance of payments of countries around the world—one that could have serious implications for the world economy and the international financial mechanism. Somehow, the huge surpluses of the oil producers must be recycled back to the deficit oil consumers. If recycling does not occur, the oil consumers will be forced eventually to deflate their economies, with severe worldwide consequences.

In considering this recycling problem it is helpful to distinguish between the short run—say the next year to 18 months—and the longer period. We already have some experience of recycling in the short run. The first sizable payments were made by the oil companies to the producer nations in March, April, and May, and thus far they have been recycled successfully—principally through the international banking system. The oil-producing nations have been placing their money mainly in the Eurodollar market or in sterling. The banks have been the major recycling vehicles, taking this money on deposit, usually at call or on very short maturity, and relending it to oil-consuming nations for periods of five to seven years. This process obviously creates a very unbalanced and precarious maturity structure. So far this year, $12 billion or more has been committed to industrial nations to help cover their 1974 balance-of-payments deficits. While this process can be successful for a limited period of time, there are at least four very serious shortcomings to it, especially in view of the astronomical amounts that loom ahead.

First, the banks cannot continue indefinitely to take very short-term money and lend it out for long periods. Second, and even more serious, is the likelihood that banks eventually will reach the limits of prudent credit exposure, especially with regard to countries where it is not clear how balance-of-payments problems can be solved. Third, the oil-producing countries cannot be expected to build up their bank deposits indefinitely. They, too, will soon reach prudent limits for individual banks or even for individual nations. My own view is that the process of recycling through the banking system may already be close to the end for some countries, and in general it is doubtful that this technique can bridge the gap for more than a year, or at most 18 months. Finally, this form of recycling is not even a temporary solution for lesser-developed countries in a weak financial position—countries like India, Bangladesh, and Sri Lanka which are not in a position to borrow at all in commercial markets.

Compounding these pressing short-run problems are a host of far thornier questions and obstacles down the road. Structural adjustments, of course, will gradually get under way between the economies of the oil producers and the consuming nations. Prices may decline somewhat, and the oil producers will step up their imports and increase the speed of their own internal development. But in the interim, they will be large accumulators of reserves. Moreover, countries such as Saudi Arabia, Kuwait, and the United Arab Emirates clearly lack internal absorptive capacities commensurate with the incomes they will receive. On the contrary, one of their major aims is to accumulate a body of invested wealth outside their countries which will yield an income great enough to replace their oil revenue as it runs out. Naturally they are concerned about such matters as world inflation, exchange risks, and the possibility of expropriation of their assets.

Though not yet large, long-term investments by Middle Eastern countries in the industrial nations are beginning to build up in real estate, selected securities, and some direct investments in industry. Yet the sums requiring investment are so enormous, and the institutional facilities necessary to carry this out so limited, that I question whether such investments will have much impact on the gap for some time to come. All of this clearly suggests that both the World Bank and the IMF will increasingly be called upon to play key roles in the recycling process.

Iran, for instance, has already offered to lend funds to the World Bank and IMF, and also to make some direct loans to India and others at concessionary rates to finance oil imports. Similarly, the recently announced willingness of the oil producers to establish a $2.75 billion "oil facility" to help countries with balance-of-payments problems is a positive move, at least in the shorter term. I fear, however, that this can only be seen as a modest first step when one considers the magnitude of the funds that must be redistributed. If we arrive at constructive long-range solutions, new techniques, strategies, and mechanisms will have to be devised—and devised quickly. Most importantly, a premium will have to be placed on international cooperation.

For some time, for example, the Committee of 20 in the IMF has ben considering a new central reserve asset—a revised SDR, which would represent a basket of currencies and hence neutralize the exchange risk between major currencies. Perhaps this asset could play a role in future investment plans of the oil-producing nations, and, indeed, it is assumed that it will be part of the new IMF "oil facility." It may also be possible to work out international guarantee arrangements with regard to expropriation. In this respect, we should remember that the oil producers have one important alternative to accumulating reserves and making investments abroad—they could leave the oil in the ground.

It is highly desirable that ways be found to channel surplus oil revenues into projects designed to create alternative sources of energy. This would not only help the world at large, but would also provide a source of continuing revenues for the oil-producing nations after their oil reserves are exhausted. Finally, it is imperative that the developed countries join with the oil producers to assist the less-developed countries. Unless there is a far more concerted effort in this direction, I fear that the result can only be economic and political chaos.

Underlying all of these requirements is the fact that we must come up with a means of recycling funds on a far more massive scale than now possible. Some argue that we should simply wait for the forces of supply and demand to bring prices down and thereby create a new structural equilibrium. Others feel that inflation in the oil-consuming nations will help alleviate the problem. While there is some validity to both of these positions, I believe we must also be aware of their limitations. First of all, inflation has little hope of answering the problem since the purchases of even the largest oil producers are so relatively small. Second, I fear that relying solely on supply and demand can have disastrous results for many nations—leading to disruptive unemployment and depression.

Creating a mechanism to handle recycling of this scale and to determine acceptable concessions and risks is exceedingly difficult. Perhaps the mission of the IMF could be expanded in this direction, or perhaps it would be best to create a separate vehicle so as to avoid burdening the IMF with the dual responsibility of policing monetary affairs and curbing unemployment. Whatever the means, I believe it is imperative that we develop swiftly a new way of looking at world financial needs—a perspective that emphasizes global stability as well as national creditworthiness.

There are some signs that the present high price is restricting demand for petroleum products in the consuming nations. Also, it appears that production is now running somewhat ahead of consumption. If this is the case, pressure on prices could very well develop. While oil prices may eventually come down somewhat, my own judgment is that plans and policies throughout the world should not be based on the assumption that the decline will be large enough to solve the recycling problem. Indeed, I would guess that we would need a price reduction of some 40% or 50% to produce anything close to a new structural equilibrium. Thus we have no choice but to face the recycling challenge and, in cooperation with the oil producers, to devise the institutional arrangements necessary to cope with it.

The successful creation of such mechanisms will be highly dependent on the political climate. The Middle East countries, by reason of a shift of wealth and resources, are entering a new period in which their political influence, as well as their economic weight, will loom larger on the world scene. At the same time, the new wealth of the Middle East is likely to strengthen the hands of moderate governments in that area and orient them more firmly toward the West. If sustained, this trend toward moderation may well be a highly desirable and significant political dividend. It will also be essential in assuring the stability that must underlie an orderly approach to the redistribution of international capital.

Given a clear realization of the interdependence of all the nations involved, I believe we can find ways to transform the problem of surplus capital in the hands of some nations into many positive opportunities for progress and development worldwide. But this will not happen by itself. It will demand the involvement and dedication of both the public and private sectors on a scale far exceeding that which exists now. Above all, it must involve a degree of global teamwork which we have not seen up to this point. If the nations of the world approach the energy situation sincerely and resolutely, there is reason to hope that it can be used as a catalyst and a rallying point for a new era of international cooperation.

FROM THE NEW YORK TIMES, JUNE 10, 1974

Oil Fueled U.S.-Arab Tie

But Milestone Pact Has Given Little Clue to Future for Prices or Output

By LEONARD SILK

The unmentioned word in the economic and military agreements reached this past weekend between the United States and the Saudi Arabian Governments was oil. But oil was the catalyst that precipitated this new "special relationship" between the Saudis and the Americans.

From the Arabs' standpoint, the most far-reaching result of the October war was the discovery of oil as a political weapon. Despite the shock of the economies of the United States, Western Europe and Japan, the oil weapon is leading to decisive changes in the bilateral relations between the rich industrial countries of the West and the Middle Eastern oil producers. The United States agreement with Saudi Arabia may be the key to a series of similar pacts.

From the Americans' standpoint, access to oil in adequate volume and at lower prices is regarded as crucial both to stable economic growth and to world monetary order.

Yet there was no evidence that anything tangible has yet been agreed to by the Saudis regarding the future price or volume of oil production. In an interview, Prince Fahd Ibn Abdel Aziz, Second Deputy Premier and half-brother of the king, said, "we wish the price of oil to go down." But neither the prince, who was the chief negotiator here, nor any of his ministers present would indicate just how lower oil prices might come about.

Hisham Nazer, the Minister of State for Planning, indicated that the Saudis intended only to try to persuade other member governments of the Organization of Petroleum Exporting Countries, who will meet in Quito, Ecuador this week, to lower oil prices. But Saudi Arabia, he added, would not act unilaterally to reduce its own price.

Asked why Saudi Arabia did not increase its oil production as a means of putting greater pressure on world oil prices, Mr. Nazer said his country was already producing more than it should, given long-run needs to conserve oil resources. He said that if Saudi Arabia were prepared to break with its partners—which it is not—it would simply reduce its own price.

The American Ambassador to Saudi Arabia, James Akins, who was at a party at the Saudi Embassy in Washington last Friday night, said Saudi Arabia is already producing nine million barrels of oil a day and that its full-capacity production was only 9.2 million. The American hope in the negotiations was

Continued

NEW YORK TIMES

MONDAY, JUNE 10, 1974

Oil Pact Gives Little Clue to the Future for Prices

to induce the Saudis to increase their capacity and daily output over the longer run, Mr. Akins indicated.

The atmosphere among the Arabs at the Saudi Embassy was close to euphoria last weekend. Prince Fahd, who is considered the most likely successor to the Saudi throne, said he was delighted with his trip to the United States and thought it had been "very successful." He said he found Mr. Kissinger "brilliant" and, referring t orecent changes in American policy toward the Middle East, the prince added, "Mr. Kissinger should have done it sooner."

There was a great throng of top American Government officials—virtually the whole inet—present at the Saudi top layer of the Nixon Cab-Arabian Embassy, together with many private American bankers and industrialists. Said one American banker: "Fantastic — imagine it, the great of the world coming to kowtow to the Arabs."

A Second Weapon

There was little reference to what the Arabs will do with the billions of dollars they are receiving for their oil. However, there is general recognition that the oil weapon has given birth to a second bargaining weapon that may inspire as great respect as oil among the Western officials and financiers.

Salah al-Din al-Bitar, a former Syrian Prime Minister, has suggested that the Arbs now have a second weapon, the money weapon. If billions of dollars of Arab money were to be withdrawn from European banks, he has said, this "would give rise to an unprecedented financial crisis in most Western countries."

However, the Saudis themselves appear adverse to risking any such world monetary crisis. That is why they are virtually alone among the oil-producing countries in favoring lower oil prices,

However, Western financiers and businessmen do not let them forget the power and attractiveness of their vast and rapidly-growing supply of oil dollars. The Arabs are receiving more proposals for what they should do with their money than they can quickly evaluate and process.

They appear to be in no hurry to do so. They insist their priorities are, first, to assure the security of their country; second, to promote its economic and social development and, third—apparently a poor third—to expand their long-range foreign investments.

2 Joint Commissions

The pacts they have negotiated with the Americans reflect these priorities. They have set up two joint commissions on security and economies. The security commission will be headed by Robert F. Ellsworth, who left his post as President Nixon's Ambassador to NATO to join Lazard Freres, the investment banking concren, and has now rejoined the Administration as Director of International Security Affairs at the Pentagon.

The joint economic commission, which will be headed by Secret ary of the Treasury William E. Simon, will work on programs of industrialization, manpower and education, technology, research and development, and agriculture.

The Saudi-American agreement seems more cautious in suggesting that the joint commission will seek ways to encourage cooperation in finance—the area of greatest interest to the private investment community in this country.

However, Prince Fahd, like his half-brother the king, seems far more concerned about political stability in the Middle East, the "rights" of the Palestinian Arabs, and access to the Arabs' holy shrines in Jerusalem.

Basic U.S. Policy

Yet the Saudis appear to be moving, without being willing to say so explicitly, toward some sort of accommodation with Israel.

In praising Mr. Kissinger's diplomacy, and celebrating their own success in achieving a new relationship with the United States, the Saudis appear to accept the basic United States policy line enunciated last November by Mr. Kissinger:

"We have a special relationship with Israel and we are committed to protect her security, and we believe that Israel's security can only be protected by respect for your sovereignty. If we have a special relationship with Israel, we do not regard it as incompatible with the friendship we want to promote and consolidate with you . . . what we want is that the peoples of this area should build their own system of life and security in conformity with what they see fit and in harmony with world facts."

The new Saudi-American agreement of this past weekend appears to represent real motion in that direction.

Note: This is from "International Finance" a bi-weekly publication of Chase Manhattan Bank, June 3, 1974.

World Payments Problems in 1974 and 1975

Higher oil prices have thrown a financial monkey wrench into the world economy, with an unprecedented impact on the current account of the balances of payments of both the oil-producing and the oil-consuming countries. The current account includes the basic non-capital items in a nation's balance of payments—the import and export of goods, and receipts and payments for services such as tourism, shipping, and insurance. It is generally a good indicator of the state of a nation's external financial health. Forecasts of current account deficits also give a rough idea of external borrowing requirements, since the size of any country's deficit can only be as large as the total that can be financed by capital inflows—including borrowing abroad—and the drawing down of foreign reserves.

The problem of massive oil-related current account imbalances will not last forever. As higher prices induce greater conservation in energy use and the development of alternative energy sources, oil imports will eventually put less of a strain on nations' payments accounts. But in the meanwhile, the importing countries' deficits will pose a major problem of world financial adjustment.

Clearly, this year and next are critical. According to latest estimates, the oil producers will achieve an aggregate current account surplus of roughly $60 billion in 1974 and again in 1975. This compares with a combined surplus of $4.6 billion in 1973 and only $1.6 billion in 1972. Saudi Arabia is setting the pace for the major oil producers, with its current account surplus projected to soar from $2 billion last year to $17 billion in 1974. In second place, Iran's surplus is expected to grow from $200 million last year to $11.5 billion this year. Other producers will show smaller —but still very substantial—gains in 1974.

Future surpluses will enable the oil-producing countries to increase their financial assets—their claims on foreign resources. Over time, these countries will utilize their financial assets to purchase more goods and services from the oil-consuming countries. But during the next two years, none of the oil producers can effectively absorb the huge increase in imports that would be required to balance their current accounts. Even in those countries that have the potential, the experience, and the institutional framework for undertaking import-using development projects—such as Iran and Venezuela—it will be at least two years before a substantial volume of funds can be spent effectively. It takes time to undertake feasibility studies, to select projects, to develop engineering plans, and to order and receive equipment from abroad.

Therefore, in 1974 and 1975, the main problems posed by the recent oil developments for the producing nations will be financial—in which countries or markets to place their rapidly accumulating funds, which intermediaries to use, which financial instruments to select, etc. Later, there will be the economic problem of transferring real resources from the oil-consuming to the oil-producing countries.

Of course, oil-producing nations can record current account surpluses only if the oil-consuming countries run an aggregate deficit of equal magnitude. Close to $40 billion of this deficit, or two thirds, will be borne by the developed countries, and the remaining $20 billion or so by the less developed and socialist countries. Britain will face the largest current account deficit—about $9 billion—this year, followed by $6 billion for Italy, $4 billion for France, $3.5 billion for Japan and $3 billion for the United States. Germany should post a current account surplus of some $3 billion this year, due to continuing strong foreign trade and a relatively moderate rate of inflation.

The current account deficits expected this year and next could be met, to some extent, by the drawing down of reserves. However, most countries have moderate or minimal reserve holdings. Thus, in 1974 and 1975, the main problem facing most oil-consuming countries will also be financial—how to finance their very large current account deficits. A number of these countries have already succeeded in obtaining financing from foreign private banks—the so-called balance-of-payments loans. But the more that any one country borrows, the more difficult it becomes for that country to obtain additional financing. Also, there is an overall limit to the volume of funds that private financial institutions will want to recycle—especially if the process involves converting short-term borrowings into longer-term loans.

Large current account deficits are expected to persist through 1975 and probably throughout most of this decade. This makes the world financial system highly vulnerable to disturbances. If any important financial institution becomes over-extended, or if one country is unable to repay its financial obligations, or if one key country seeks to improve its current account position at the expense of others—through trade controls or deliberately depressing the external value of its currency—then all countries and their financial institutions may be in difficulty. *Richard H. Kaufman*

Saudis Agree to Buy Large U.S. Special Securities Issues

By JOHN GERRITY

THE MONEY MANAGER

JUNE 17, 1974

WASHINGTON—Much more is riding on the success or failure of President Nixon's unprecented visit to four Arab states than the mere erasure of tarnish from Mr. Nixon's political image at home, as many of his critics have hinted or openly charged.

Perhaps the most delicate diplomatic accomplishment hanging in the balance, that will be determined in the final assessment of the President's dual journeys to the Middle East and Soviet Russia, is the new "special relationship" accord reached between the United States and Saudi Arabia, the world's largest exporter of oil.

A key feature of this accord, the "Money Manager" learned last week, is a proviso whereby the United States will play a very dominant role in the so-called "recycling" of vast amounts of new oil revenues by absorbing perhaps as much as $10 billion of the Saudis' heavy cash accumulations annually through the sale of new, possibly gold backed, "special issues" of U.S. Government securities to Saudi Arabia.

The accord, with its special proviso for a U.S. Government securities swap for excess oil revenues was reached on Saturday morning, June 8, at a formal signing ceremony at the State Department.

The principal figures in the ceremony were Secretary of State Henry Kissinger and Prince Fahd Ibn Abdul Aziz Al Saud, regarded by Middle East experts to be the second most important man in Saudi Arabia.

State Department and Treasury officials refused to discuss specific details of the securities-for-oil swap deal, such as whether the Government's "special issues" may or may not be gold-backed, rates of interest to be paid, maturities, and so forth.

Neither is there any confirmation of an absolute "fix" or "ceiling" on the total amount the United States may issue in special Government securities, to help drain off currency accumulations Saudi Arabia would acquire as a result of the 400% increase in crude petroleum prices at the peak of the fuel crisis earlier in the year.

Of the total increment in oil revenues to Middle East countries, estimated generally to be about $50 to $60 billion, approximately one half, or $25 to $30 billion, would accrue to Saudi Arabia as the largest exporter of oil in the world.

In light of other international monetary

Continued

Arab Deal

developments last week, most notably the new gold arrangement contrived by the Group of Ten Industrialized Countries to help bail Italy out of her economic troubles, the possible future use of gold-backed special U.S. Government Security issues to help soak up an over-abundance of cash concentrated in a single country, is a development that's bound to generate imaginative reactions and conjurings.

Just prior to the formal accord-signing ceremony, Prince Fahd stressed to both President Nixon and to Secretary Kissinger that long-range development of good U.S. relations with Arab world would be "contingent" upon further Israeli withdrawals from Arab-claimed lands.

Additionally, the U.S.-Saudi Arabian agreement provides for the U.S. recognition of Palestinian "national rights"—a neat diplomatic *phrase*, which means simply the ultimate establishment of a Palestinian state on the lands now occupied by Israel's forces in the west bank of the Jordan River.

The President's visit to the Middle East countries, in effect, certifies his personal involvement in the general agreement aimed at strengthening economic ties between the U.S. and the Arab world.

Too much stress has very probably been placed on the assumption that the U.S. might become "militarily involved" in the Middle East, according to one State Department official.

"This is especially so," he said, "in view of the erroneous interpretation that some attached to a $100 million 'special requirements fund' provision in the President's $5.18 billion fiscal 1975 foreign aid program."

Secretary Kissinger explained to both House and Senate Foreign Affairs Committees that, while some of this $100 million "special requirements fund" might be given to Syria to help rebuild war-damaged areas, particularly the provincial capital of Quneitra, no "hard commitment" for such aid was made as part of the peace pact ending the seven-year war between Israel and the Arab republics.

Obviously Egypt, Syria and Jordan, as well as Israel, which will share in the proposed $907.5 million aid program for the area, "welcome the prospects of U.S. aid flowing in," the State Department official said.

The United States-Saudi Arbian agreement provides for the U.S. recognition of Palestinian "national rights."

Oil-rich Saudi Arabia, which has long nurtured strong pro-U.S. sympathies, is, in a very distinct sense, "special *case* to be regarded in a special manner."

This separate-but-contingent relationship is rooted in the simple fact that Saudi Arabia wants U.S. technology and commitments for markets to help industrialize that desert kingdom.

Indeed, according to the State Department, increased American economic involvement in the Middle East was always considered to be a key component in whatever new diplomatic relations might evolve between the U.S. and the Arab states.

It may be that expectations of benefits flowing to both sides in the new compact will prove to be somewhat overblown.

But there can be no masking the fact defense pacts are not sufficient at this juncture of history. *Of* far greater importance is the economic assistance that can be made available, plus, of course, the extent to which the United States is able to fill the void left by the withdrawal of Soviet Russia support for Arab states.

In all of this delicate maneuvering, the President's role and presence is important and significant—and is not, as some have asserted, an exercise in "political barnstorming," calculated to offset political damage caused by the Watergate affair.

Certainly, the President will draw political refurbishing from his Middle East visit and his summit meeting in Soviet Russia, that begins on June 27.

But whatever personal gains Mr. Nixon makes on the home front, they are regarded as "ancillary" to the larger achievement of new and vigorous links between the United States and the Arab world.

Moreover, Mr. Nixon's direct participation in this new and highly sensitive venture into geopolitics is considered a very important element in winning the necessary Congressional support for his world-embracing diplomatic endeavors.

But the excitement provoked by any securities-for-oil agreement is subject to some serious caveats.

The U.S.-Saudi Arabia accord, no more and no less than any other agreement the United States might reach with a foreign country is, in the final analysis, a treaty, subject to ratification by the Senate.

There's no gainsaying the fact that the President's massive foreign aid program—to say nothing about such far-reaching "special arrangements" as that with Saudi Arabia—will run into some tough questioning and opposition in Congress.

"I'd like to know how far these commitments go," said Cong. H. R. Gross, R-Iowa, with respect to the overall agreements resulting from Mr. Kissinger's Cairo-to-Damascus diplomatic junketing. "I am waiting to see all of the commitments that have been made in the Middle East.

Echoing a similar belief that the President and Mr. Kissinger face a tough selling job with Congress "under the best circumstances," Peter Frelinghuysen, R-N.J., said "if experience is any guide, some severe slashing will be made" in the total dollar request.

Senator Barry Goldwater, R-Ariz., one of Mr. Nixon's most stalwart backers throughout the entire Watergate matter, was even more outspoken on his personal hostility to any aid that might be given to Syria.

Senator Goldwater sharply criticized the "Special Requirements Fund" as an aid program "inappropriate to a country we have never attacked, never been particularly friendly to, and whose aid we have never particularly sought."

The Arizona law-maker added that, in his judgement, "it was time for a long, thoughtful discussion" of U.S. foreign aid programs, which he suspects have "been largely failures from their beginning."

Besides these sorts of obstacles, there's an undefined mass of opinion, especially in the House of Representatives, that balks at the notion of the U.S. rendering economic assistance to the Arab states, which together with Venezuela, were largely responsible for the fuel crisis and inflated oil and gas prices.

"It just doesn't make sense to me to have the United States subsidizing

Continued on next page

Arab Deal

Continued from preceding page

its economic enemies," one member of the House Foreign Affairs Committee said.

Committee Chairman Thomas E. Morgan, D-Pa., a long-time backer of foreign aid programs through Republican and Democratic administrations alike, voiced some similar concerns.

After a long, closed-door session with Secretary Kissinger, chairman Morgan emerged, shaking his head thoughtfully, to say to reporters that he had some "serious reservations" about the entire aid program for the Middle East.

It was just because of such comments and fears as Mr. Morgan expressed that Secertary Kissinger went to some pains to repeat on several occasions that he would "consult closely" with Congress on all specifics such as the Saudi Arabian accord, the proposed $350 million military aid scheduled for Israel, the $207.5 million military and economic aid for Jordan and the $250 million economic aid program for Egypt.

Consequently, it can be taken for granted that, since the accord involves the issuance of new instruments of Federal Government debt, the Senate Finance Committee, as well as the Senate Foreign Relations Committee, will share in the pre-ratification process.

In that sort of environment, close questioning and fairly intense surveillance can be regarded as matters of fact, which won't be dealt with casually. ■

THE WASHINGTON POST Friday, May 3, 1974

Saudi Arabia Could Buy Into Oil Companies

Reuter

NEW YORK, May 2—Any Saudi Arabian interest in buying into four giant American oil companies faces little opposition, according to government and industry sources.

U.S. laws, designed to prevent companies from lessening competition, "never envisioned direct government purchases," a top Justice Department official said today.

Deputy assistant attorney general Keith Clearwaters pointed out that present antitrust laws apply only to corporations, not to countries, which, in theory at least, would give the Saudi government a free hand.

Two newspapers in Kuwait reported yseterday that the Saudis are interested in buying large stock interests in the four American partners of the Arabian American Oil Company (ARAMCO)—Exxon Corporation, Texaco, Mobil Oil and Standard Oil of California.

Spokesmen for the four companies declined to offer any confirmation of the reports, but an Exxon official said "Anyone who wants can buy our stock, including Saudi Arabia."

One administration official said that the government could oppose the purchases on grounds of national security, but even that seems unlikely at the moment.

"Since those companies sell fuel to the Defense Department and have other government contracts, theoretically, a foreign government in control would certainly not be in our best interests," the official said. "But since this is all so hypothetical at any rate, I can't see us doing anything about it yet."

If the Saudis actually go ahead with the stock buying plan the cost would be enormous, even for a country that could earn $20,000 million this year from selling oil.

Exxon alone has close to 250 million shares issued selling for about $80 each.

Just to buy a 5 per cent interest in Exxon—2 per cent more than the amount held by Chase Manhattan Bank, the biggest owner at present—the Arabs would have to pay in the neighborhood of $1 billion, stock market analysts estimate.

CHAIRMAN OF THE BOARD OF GOVERNORS
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

June 19, 1974

The Honorable Henry B. Gonzalez, Chairman
Subcommittee on International Finance
Committee on Banking and Currency
House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

Thank you for your letter of May 29, requesting my comments on recent developments in the petroleum market.

I share your view that the recent actions of OPEC countries in manipulating petroleum shipments and prices are harmful to the interests of the United States. Indeed, by weakening the international monetary system, OPEC countries are acting against their own best interests as well.

For the longer-run, I see no viable alternative to a reduction in the price of petroleum. The longer the present price is maintained, the more intense will become the economic forces operating to modify it. Most certainly, alternative sources of energy will be developed and conservation in energy use increasingly practiced.

An import quota scheme, such as the one Professor Adelman has suggested, has serious limitations. A quota in itself would, if set at a low enough level, reduce our energy imports. However, unless energy conservation techniques and expanded domestic energy production were already in place, cutbacks in our energy imports could subject our economy to serious strains. Furthermore, since such a quota system could be interpreted by the OPEC nations as an aggressive act on our part, it might serve as a rallying point for their cartel.

Sincerely yours,

Arthur F. Burns

New York Times June 5, 1974

Burden of Oil Money Worries Bankers

By EDWIN L. DALE Jr.
Special to The New York Times

WILLIAMSBURG, June 6—Two leading Bankers expressed deep reservations today over how long the international banking network could carry the burden of recycling the vast flows of money resulting from the huge jump in oil prices.

At issue was the channeling back to oil-consuming countries of the tens of billions of dollars that have begun to flow to a small group of oil-producing countries, particularly Arab nations with small populations.

The forum was a session today of the International Monetary Conference here, which brings together bankers and government officials from the United States, Europe and Japan.

The doubts about the ability of the international banking system, including the Eurocurrency markets, to handle the problem for more than about another year were expressed by David Rockefeller, chairman of the Chase Manhattan Bank, and Wilfred Guth, managing director of the Deutsche Bank of West Germany.


David Rockefeller

Mr. Rockefeller made public his address, although the sessions of the conference are closed to the press. Mr. Guth's remarks were summarized later.

The one Arab speaker at the conference, Edward C. Awad, technical manager of Petromin, the Saudi Arabian oil agency, told reporters that he generally agreed with the diagnosis of the bankers—that short-term recycling would only create a "false financial atmosphere" and was not a long-term solution.

But he had nothing to propose on a longer-term investment strategy for oil-exporting countries, saying only that "it is a question of education" and that general policy had not yet been established.

According to the summary of the meeting, none of the experts expressed the hope that a drop in the price of oil—even though some decline was possible—would be sufficient to solve the financial problem of the vast flows of funds to oil-producers.

Giving new estimates, Mr. Rockefeller said total monetary "reserves of the oil-producing nations are likely to exceed $70-billion by the end of 1974, $140-billion by end-1975 and $200-billion by the end of 1976."

He added that "these are staggering amounts" and said they "could have serious implications for the world economy and international financial mechanisms."

The payments to the oil countries have only just begun, Mr. Rockefeller said, and "thus far they have been recycled back successfully—principally through the international banking system." But he cited four reasons for his doubt that this could continue beyond "the next year to eighteen months":

¶"The banks cannot continue indefinitely to take very short-term money and lend it out for long periods of time." This concern was also expressed at a session of the conference here yesterday.

¶"Banks eventually will reach the limits of prudent credit exposure, especially with regard to countries where it is not clear how present balance-of-payments problems can be solved."

¶"The oil-producing countries cannot be expected to build up their bank deposits indefinitely. They, too, will soon reach prudent limits for individual banks or even for individual nations."

¶"This form of recycling is not even a temporary solution for lesser developed countries in a weak financial position." He mentioned such nations as India and Bangladesh "which are not in a position to borrow at all in commercial markets."

Mr. Rockefeller, injured in a fall in Taiwan last month, moved about with aluminum crutches, but otherwise seemed in good condition.

Emphasis on Credit

Mr. Guth also emphasized the problem of creditworthiness—that private banks could not go on making loans to governments where the prospect of repayment was dim because of a continuing deficit in national balance of payments. Payment deficits reduce monetary reserves and thus the means of repayment.

At an earlier session today on the general problem of world inflation Herbert Stein, chairman of President Nixon's Council of Economic Advisers, argued that the "fundamental" or "traditional" means for curbing inflation — control of government spending and deficits, and restraint on the growth of money and credit — had not failed in recent years but rather had not been sufficiently used.

"Our own history of accelerating inflation in the past decade," he said, "certainly is not the history of a vigorous and unsuccessful adherence to the old-time religion."

Mr. Stein cited figures on large budget deficits and large increases in various definitions of the nation's money supply over most of the period since 1965 to back up his point.

THE NEW YORK TIMES June 3, 1974

Oil and the Cash Flow

By C. Fred Bergsten

WASHINGTON—Arab oil earnings will rise by $65 billion this year, the amounts will get even bigger in following years, the balance-of-payments positions of the consuming countries will plunge into the abyss, the international monetary system will collapse, the Arabs will buy up all our companies—so goes the refrain heard frequently since the dramatic increase in oil prices in December.

There are indeed extremely serious consequences of the oil crisis:

Inflation has spiraled upward; recessions are possible if governments mistakenly cut back aggregate demand to cope with shortages of supply; countries producing other raw materials have been encouraged to emulate oil exporters; a few of the poorest countries will suffer serious deprivations, and political tensions deriving from the energy problems could intensify among countries.

But the international monetary situation adds relatively little to the problem. No industrial country will go bankrupt. The monetary system will not collapse. The prophets of financial doom simplistically compare the increase in each country's oil bill with its existing monetary reserves. They note that United States imports will rise by $15 billion and that its reserves are $12 billion, and conclude that the United States cannot pay—even for one year.

Such observations are absurd. First, they ignore that a sizable share of the increased earnings of the oil-exporting countries will be spent on imports from the industrial world. Some oil countries will spend virtually all of their increased earnings themselves; all are rapidly revising their development strategies and military plans to do so. Some will lend their money to others who will quickly spend it.

So even the trade balances of the industrial world will not decline by more than, say, half of the increase in its oil bill this year. Those trade balances will be even better in subsequent years, as any further increases in oil countries' earnings are more than offset by their increased imports. Indeed, the United States appears to have already reached its new plateau of oil imports in April at an annual rate of $27 billion), but there was a surplus in over-all trade as exports reached an annual rate of almost $100 billion.

Second, the prophets of doom confuse the balance of trade and the balance of payments. They ignore the simple but central fact that the oil exporters must invest in the industrial world any of their increased earnings that they do not spend. The Arabs will not bury the money in the ground. Thus, there can be no deficit in the balance of payments of the industrial world as a whole.

To be sure, the flow of money from the Arabs will not necessarily go to individual industrial countries in amounts that precisely match the decline in the trade balance of each. Some industrial countries may wind up with a sizable surplus; others may have deficits.

But this problem is solvable solely through action by the industrial countries themselves to recycle the money to where it is needed. Much financial recycling will take place through normal market forces. Some can be handled by government borrowing in the private capital markets.

The Eurocurrency markets—those that lend a variety of currencies from European centers—have grown as rapidly in several past years as they will have to grow now, and the United States capital market is now fully available with the abolition of controls. Together, they can handle the vast bulk of the money on their own, and are in fact doing so even as the full amount of the higher oil earnings is now being invested.

The rest of the money can move through such existing intergovernmental institutions as the swap network among central banks and the International Monetary Fund. Indeed, such backstopping will be needed for any individual borrowers whose creditworthiness comes under doubt in the private market. But Italy is the only such case to date.

In any event, no special cooperation with the oil exporters is needed in this area. It helps for the International Monetary Fund to borrow from them to help finance members' deficits, but there is no reason to give the oil exporters better terms than other lenders.

Doubts are sometimes raised about the plausibility of such smooth handling of the oil money. First, it is feared that the money, like the oil itself, will be "politicized." But it is highly doubtful that the Arabs will try to promote monetary instability by shifting their funds from place to place. Once invested, the very size of the funds will make it increasingly difficult for the Arabs to liquidate quickly without incurring substantial losses. If they were to make such shifts, the money could readily be recycled through the swap network.

Second, it is argued that some industrial countries may be unwilling to accept the needed shift in the structure of their balance-of-payments positions. It is certainly true that all of their trade balances will deteriorate and be offset by increases in capital inflows. But such a situation might well be sustainable indefinitely since the capital inflow will by definition continue as long as the trade imbalances do. And it is certainly sustainable for the interim period until energy conservation and the development of new sources of oil and alternative forms of energy are brought into play to change the energy situation to its roots.

Third, some industrial countries fear that many of their companies will be taken over by the oil producers. They need not. Most of the oil countries will soon find ways to spend most of their income on goods and services. And since they have decided to nationalize most of the foreign business concerns within their boundaries, they are quite unlikely to seek majority control of firms within the boundaries—and legal jurisdiction—of others. Even if they wanted to, they do not have the manpower to exert much effect on the operations of very many firms anyway. So the present pattern of diffused and highly liquid portfolio investment in a wide range of financial assets is likely to persist.

Finally, the proposed solution to the monetary problem requires the industrial countries to agree on at least a broad pattern of exchange-rate relationships among them, around which the financial flows can be recycled. It will be tricky to reach such agreements, which amount to taking oil out of each country's balance of payments for the purpose of determining exchange rates.

However, there was already evidence of progress toward such agreements before oil prices soared. They are a necessary component of any stable monetary system for the future, and were thus already at the top of the agenda for monetary reform. And history clearly shows that the alternative of competitive exchange-rate depreciations will not work.

It seems clear from the series of official pronouncements on the subject that all countries have recognized these facts and that this latest crisis—like most past crises—will speed rather than derail needed monetary reform. There is good reason for confidence that the mistakes of the nineteen-thirties and the nineteen-sixties can be avoided in resolving the latest international monetary crisis.

C. Fred Bergsten is a senior fellow at the Brookings Institution.

FEDERAL ENERGY OFFICE
WASHINGTON, D.C. 20461

JUN 2 0 1974

OF THE ADMINISTRATOR

Honorable Henry B. Gonzalez
House of Representatives
Washington, D.C. 20510

Dear Mr. Gonzalez:

Thank you for your letter of May 28, 1974, in which you discuss Professor Morris Adelman's proposal for an oil import quota system to curtail the cartel power of the Organization of Petroleum Exporting Countries, and his ideas on the role of oil companies.

Professor Adelman's suggestion that the US Government should re-establish oil import quotas, with quota rights to be auctioned off by direct, sealed competitive bids to oil producing nations eager to gain access to the US market, raises a number of questions.

Professor Adelman's theory that producing countries eager to get access to the US market will submit lower bids, produce more crude, and thereby force down oil prices, neglects several points. First, in a seller's market for oil, the OPEC countries are free to sell their oil to more than one prospective buyer. If the US is unwilling to purchase their oil, other countries may buy it at relatively high prices. Most, if not all, members of OPEC would probably not favor a program that would increase their own rivalries.

Because of the small number of members (11) of the oil producers' cartel, it would be difficult to protect the secrecy of the bids submitted by the producer countries. Indeed, the national oil companies of the producer countries would find it in their interests, to exercise collusion in bidding on the quota rights. Thus, the fundamental problem is to avoid collusion between producer countries and somehow neutralize the effectiveness of the OPEC cartel.

CONSERVE AMERICA'S ENERGY

Save Energy and You Serve America!

As you indicate, Professor Adelman's ideas on the future role of oil companies are interesting. However, he fails to give the companies sufficient credit for the important logistical and technological contributions that they have made. At the same time, I share your concern over the possibility of profiteering by some oil companies in their foreign operations.

The Federal Energy Office recently initiated several studies on the international oil companies. One of the studies involves a comprehensive survey of oil company cash flows and profits from domestic and international operations. Another study was referred to in my recent testimony before the Church Subcommittee on Multinational Corporations on June 5, 1974. I indicated that an in-depth study was to be undertaken on oil company government relationships around the world. Its purpose is to help policy-makers by providing the alternatives open to the US Government to have an effective voice on the terms under which oil is imported.

Unfortunately, both inquiries are presently at an early stage and, therefore, I am unable to respond fully at this time to your request for information on the role of the oil companies. The first study is tentatively scheduled to be completed in early July while the study on the relationship between oil companies and governments will be finished by next spring. When the profits study is completed, a copy will be sent to you.

Sincerely,

John C. Sawhill
Administrator

U.S. HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON INTERNATIONAL FINANCE
OF THE
COMMITTEE ON BANKING AND CURRENCY
NINETY-THIRD CONGRESS
WASHINGTON, D.C. 20515

May 28, 1974

B4a

The Honorable John Sawhill
Administrator
Federal Energy Office
Room 3400 - Post Office Building
12th & Pennsylvania Avenue, N.W.
Washington, D. C. 20044

Dear Mr. Sawhill:

As Chairman of the Subcommittee on International Finance, I am becoming increasingly concerned about the lack of action by the United States and other oil consuming nations against the price increases imposed by the Organization of Petroleum Exporting Countries. My Subcommittee has legislative responsibility in two areas seriously affected by the oil price increases: the international monetary system and the multilateral development lending institutions.

I am not sure how well the world monetary system will hold up under the strains of the approaching petrodollar glut and how it can accommodate the distinct probability of the Arab oil producers owning 70% of total world monetary reserves by 1980. While there is a number of schemes for recycling the petrodollars in the works, I question their viability.

I am sure that you are familiar with what the oil price increases will do to the economies of the less developed countries. They now face a sad fate, after so many years of economic growth aided by the United States through bilateral aid, multilateral aid and private foreign investment. Yet we seem powerless to do anything about it except beg the oil producers to give some aid to those countries which the OPEC group is in the process of bankrupting. But the aid funds being set up by the oil producers will be only a minor help to the developing countries.

The Honorable John Sawhill
Page -2- May 28, 1974

It seems that the Administration is reconciled to the oil cartel and the prices it has set and that it feels that somehow through cooperation the disastrous effects of OPEC price increases can be minimized. I am not sure that the evidence supports this position. It would appear that we are being far too weak in the face of a price gouging, international monopoly which is clearly harmful to American interests.

I am impressed with the proposal by MIT Professor M. A. Adelman that the U.S. auction import tickets for oil as a means of undermining the cartel, or at least protecting ourselves partly against it. He feels that the U.S. should impose oil import quotas to be sold by sealed competitive bid to anybody who is willing to pay cash for a selling license.

Professor Adelman also feels that high oil prices are easily maintained under the present system wherein the oil companies in effect act as agents for the oil producing nations. He feels that if it can be done in unison with other countries, the U.S. should get its oil companies out of the crude oil marketing business and leave this function to the OPEC countries.

I would like to know your opinion of Professor Adelman's proposal for an import ticket system and his ideas on the role of oil companies. Your ideas would be very much appreciated as well as most helpful.

With best regards, I am

Sincerely yours,

Henry B. Gonzalez
Member of Congress
Chairman

Enclosure

From FORBES magazine, June 1, 1974

Enlightened Self-Interest

What can the oil-rich countries do to help the poor countries? In his deal with India, the Shah of Iran is showing what can be done.

WHILE the Arab oil-billionaires preach Islamic solidarity and the brotherhood of the Third World, Muslims are starving to death in Central Africa. Perhaps out of timidity, perhaps out of greed, the Arab oil magnates have done little but talk about sharing their wealth—or even lending it out—in any but the most conventional ways.

Iran, however, is a different matter. In a shrewd mixture of self-interest and benevolence, the Shah's government last month committed over $1 billion to help India through the crisis created by swollen oil prices. In the long run, the deal will mean more to India than the atomic bomb it recently detonated.

India desperately needs the help. Its runaway inflation and food shortages are especially hard on the already suffering poorest classes. Thus India's social stability may be seriously threatened for the first time since the turbulent years when it achieved independence from Britain.

In 1972 India's oil bill was $250 million, already a heavy burden for a country that has chronic troubles making ends meet. But last year it soared to $625 million, and this year it could go as high as $1.5 billion. To put it in perspective, it is as though the U.S. spent $35 billion to import oil. And India wastes little oil: Only a tiny share goes for private motoring. The bulk is needed for India's industries and public transportation.

But where can India find the extra $1 billion-plus? India simply does not have this kind of money. And who is there to lend it?

Enter Iran. India's needs are not huge: less than 500,000 barrels a day, about what the U.S. uses every 40 minutes. India produces about a third of those needs indigenously; it imports 70% of the rest from Iran and the balance from Saudi Arabia and Iraq. Under the terms of the five-year agreement, Iran will supply all the needs of India's Madras refinery, which ran 21 million barrels last year but will be expanded, perhaps eventually to 41 million barrels. The National Iranian Oil Co. is a partner in the refinery. Iran will also provide at least 7.4 million barrels a year over the refinery's needs.

For India, the best part of the agreement involves price. Officially, India will be paying the market price. Unofficially, she will be getting a huge discount. The deal works like this: India pays $3.50 a barrel—in cash. But the balance, $6.50 or so a barrel, is deferred, with no payments for five years and with a nominal interest rate, 2.5%. The principal is payable over five years—after the five-year grace period. Looked at as a hard business deal, the discounted present value of India's deferred payments cannot be more than 60 cents on the dollar. Thus, in effect, India is getting the Iranian oil at $7.50 or so a barrel, 25% below the going market price. This is a way to cut prices without openly cutting them. And it buys India time to adjust.

Iran stands to benefit from the deal, too. It locks India in as a customer against the day when oil may be in surplus and hard to sell. It also strengthens India at a time when the Arabs, the Shah's enemies, are strengthening Pakistan, India's enemy.

The Shah of Iran

Prime Minister Gandhi of India

Beyond politics and price, however, the deal also gives Iran access to India's potentially rich but undeveloped raw materials. Iran, on a crash course to industrialization, will need all kinds of basic products. The deal between the Shah and Mrs. Indira Gandhi provides for Iran to lend over $1 billion over 20 years to expand India's basic industries: cement, sugar, steel products, paper and newsprint. India will repay the loans in the products of the expanded industries. Again, the interest rate will be a nominal 2.5% with 20 years to repay.

The products that India will supply to Iran are in short supply throughout the world and desperately short in India. "These things are needed at home also," concedes C. Subramanian, India's Minister for Industrial Development, "but we must strike a balance on how far we should starve the home market to get the fuel we need to keep our industries going."

The first two projects involve iron ore and bauxite. Iran will put up nearly $140 million for a plant to extract alumina from bauxite; Iran will get two-thirds of the expected 330,000-ton annual output. Iran has also pledged around $500 million to develop a low-grade iron ore deposit in Kudremukh, in the south Indian state of Karnataka. When the project is in full operation it will produce 8 million-plus tons of iron pellets yearly, all of it for export to Iran.

In making these deals, India has quietly abandoned the rigid socialist planning that has characterized her economic policy ever since independence. The softening of India's stand is undoubtedly made easier by the fact that Iran is not one of the traditional imperialist powers or one of the principal Cold War antagonists. The main motivation, however, is that Iran is an oil-exporting nation. "We are doing this iron-ore deal because it is Iran that wants it," says a high Indian government official. "We wouldn't do it for anyone else."

There are other signs of a loosening up in India's old policy of economic isolation. After years of waffling on whether Western oil companies would be allowed to drill offshore, the Indian government has given the Natomas Co. drilling rights on 7 million acres in the Bay of Bengal. The government is also trying to streamline the almost unbelievably bureaucratic procedures that are required of anyone wishing to invest in India. In the past a "yes" or "no" could take as long as six years; now they sometimes come in as little as 90 days. The Iranian deal, the drilling contract and the liberalized license rules suggest the Indians are finally facing reality: The Iranians offered to help India, but asked that India, in turn, bend some of its socialist dogma. India accepted. For India, the situation remains desperate, but perhaps it is not too late. ■

AMERICAN PETROLEUM INSTITUTE
1801 K STREET, NORTHWEST WASHINGTON, D.C. 20006
(202) 833-5580

Frank N. Ikard
PRESIDENT

June 14, 1974

The Honorable Henry B. Gonzalez
U.S. House of Representatives
2446 Rayburn House Office Building
Washington, D.C. 20515

Dear Congressman Gonzalez:

I appreciated receiving your letter of May 28 relating to your concerns about the impact of oil price increases upon the international monetary system and the multilateral development lending institutions.

I fully share in your appraisal of the possible impact of these abnormal prices. Up until recently, many knowledgeable people urged us to use "cheap and abundant" foreign oil and forget domestic development. I repeatedly warned of heavy reliance upon foreign oil, noting that once the U.S. became excessively dependent this oil would probably be neither cheap nor abundant. As you note, this impact is far greater upon nations almost wholly dependent upon OPEC oil than upon the U.S., and hits hardest at weak developing countries.

The API has not formulated any position with regard to the proposals of Professor Adelman. Consequently, all I can do is give you a few personal thoughts for whatever they are worth.

It is difficult for me to see how reinstating an oil import quota program could be helpful at this time. Uncertainty about supply, stemming from the old import quota program, was a factor which acted to discourage new refinery construction and contributed to our energy problems. Moreover, it could have some unforeseen and serious impacts upon crude oil supplies. This proposal would need long and serious study before adoption. I know Professor Adelman and have high respect for him as an economist. On the question of OPEC, however, his predictions about the fate of such a cartel have not, up to now, materialized. His proposal for breaking it up seems a little too simplistic.

Hon. Henry B. Gonzalez
Page -2- June 14, 1974

With regard to the role of oil companies, it is evident that a major and permanent shift is taking place in the world marketing of oil. However, I would question a blanket rule requiring U.S. firms to get out of crude oil marketing in foreign nations. Such a rule might merely result in a substitution of other foreign oil companies for U.S. firms. I question whether a simultaneous withdrawal of international oil companies could be achieved. It would seem to me in the interests of our nation to take advantage of the access to oil supplies which U.S. oil companies are able to maintain. I continue to believe that the U.S. oil industry has the technical, financial, and human resources which can permit it to continue to play an important and useful role in the development of national economies, and wonder if it is necessarily desirable to restrict the activities of oil companies any more than they will be restricted by host governments.

I recognize the importance of the issues raised in your letter. All of us are grappling with these difficult and complex problems which affect not only our industry and the nation, but could lead to world monetary instability and serious hardships for developing nations.

Sincerely,

THE WHITE HOUSE

WASHINGTON

Dear Mr. Chairman:

The President has asked me to reply to your letter of April 30, 1974, concerning the impact of oil price increases and the problem this has created for the stability of the international monetary system and, more particularly, for oil-importing less developed countries.

In response to your question as to what the United States is doing about the oil price increases, the most desirable solution to the whole problem would be, of course, a substantial softening or roll-back in petroleum prices; and I can assure you that the United States is endeavoring to promote this solution. Short of adequate movement in this direction, however, the most important thing the U.S. can do is to develop our own national energy resources in order to minimize U.S. vulnerability, increase total world energy supplies, and reduce the impact of U.S. demand on the energy market. The Congress clearly has a crucial role and an immense responsibility in advancing this "Project Independence."

In respect to the increased pressures on the international monetary system as a result of the quantum jump in oil producers' income, I believe that this is a manageable problem; although it is one that must be resolved on the basis of international cooperation. The United States is working closely with other developed nations, as well as with the oil producers, to develop and strengthen the financial mechanisms and institutional arrangements needed to permit the rechanneling of the oil funds to productive uses without disrupting the international monetary system. We have also initiated a cooperative effort among consuming nations to avoid disruptive competition in trade and monetary policies designed to manage individual balance of payments problems; and we have proposed a program to explore means for accelerating development of alternative energy resources and expanding the possibilities for energy conservation. In addition to these efforts with the major consuming nations, we are also initiating consultations with the Government of Saudi Arabia covering a range of subjects of mutual interest, including oil prices and production.

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With regard to the less developed countries, the higher cost of imported fuel and petroleum based products has created not only adjustment difficulties, but also, as your letter points out, serious balance of payments problems for those LDCs which have neither a reserve cushion nor strong export earnings from other products. There is, as you know, already a number of international schemes and proposals that have been put forward to meet the additional LDC financing requirements. The U.S. position is that the primary responsibility for resolving the oil related problem lies with the oil exporters, and that they have an obligation to ease the burden by lowering oil prices and by providing financial assistance. Within this framework, the United States is working actively through multilateral as well as bilateral channels to define the magnitude and timing of the problem for each of the hardest hit LDCs. However, the major contribution of the U.S. must be to continue the assistance levels we contemplated before the events of last Fall. The increase in oil prices makes our development assistance more -- not less -- essential. Our ability to continue development assistance at previous levels is, however, handicapped by the Congress' reluctance to meet current foreign aid funding requests, including that for the International Development Association.

Sincerely,

Peter M. Flanigan
Assistant to the President
for International Economic Affairs

The Honorable Henry B. Gonzalez
Chairman
Subcommittee on International Finance
House of Representatives
Washington, D.C. 20515

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MARY JESSIE GONZALEZ

April 30, 1974

FILE REF.: B4a

The Honorable Richard M. Nixon
President of the United States
The White House
Washington, D. C. 20500

Dear Mr. President:

As Chairman of the Subcommittee on International Finance, I am becoming increasingly concerned about: (1) the disastrous effects of the OPEC oil price increases, and (2) the potential damage to the international monetary system and the world economy as a result of the petrodollar glut.

I am sure that you are familiar with what the oil price increases will do to the economies of the less developed countries. They now face a sad fate, after so many years of economic growth aided by the United States through bilateral aid, multilateral aid and private foreign investment. Yet we seem powerless to do anything about it except beg the oil producers to give some aid to those countries which the OPEC group is in the process of bankrupting. And I seriously question the viability of the aid funds being set up by the oil producing countries.

Secondly, I am not sure how well the world monetary system will hold up under the strains of the approaching petrodollar glut and how it can accommodate the Arab oil producers' owning 60% of total world monetary reserves by 1980. While there have been some suggestions for recycling the petrodollars, I also question their viability.

The President
Page -2- April 30, 1974

In the U.S., we have worries about gasoline prices and long-term programs for development of our abundant energy resources. While solving these problems we cannot let the rest of the world sink around us. Based on the thorough information collected by my Staff, I can see few reasons for optimism. Something must be done about the cartel activity of OPEC and the resultant oil prices.

I would appreciate your advising us what the United States is doing or is going to do about the outrageous price increases by OPEC and the approaching petrodollar glut.

With best wishes, I am

Respectfully yours,

Henry B. Gonzalez
Member of Congress
Chairman

THE NEW YORK TIMES, MONDAY, MAY 13, 1974

Recycling Petrodollars

The enormous increase in oil prices and resulting transfer of purchasing power to the oil-exporting nations has confronted the world with "an over-all disequilibrium in trade accounts of unprecedented magnitude."

Behind that temperate estimate by H. Johannes Witteveen, managing director of the International Monetary Fund, lies the staggering reality that the balance-of-payments deficits of oil-importing countries this year alone may amount to $65 billion. The sum is so large that it threatens the world economy with simultaneously contractionary and inflationary forces. For the moment, the forces of inflation are most evident. But if the drain continues, many oil-importing countries will suffer a devastating blow to their real incomes and living standards. The danger affects such developed countries as Italy and Britain, but is greatest for the developing nations of South Asia and Central Africa where massive starvation and death could result.

This world payments problem will not automatically be corrected by an increase in imports by the oil-exporters or by their investment of funds in the deficit countries. The situation is analogous to the critical period after World War II, when a devastated world economy was dependent for its reconstruction on a recycling of funds by the United States—which this country carried out through the Marshall Plan and other aid and loan programs.

Will the oil-producing states, which created the present payments disequilibrium, now participate in a genuine effort to resolve it?

On the face of it, the answer would appear to be no. Obviously, the simplest method of solving the problem would be a major cut in oil prices. Yet the nature of the cartel and the politics of many of its members makes a large enough price rollback unlikely unless there develops a breakdown in the world economy—and an attendant shattering of the oil cartel.

The International Monetary Fund has taken the initiative of persuading the oil-exporting countries to recycle part of their oil money back to the importers via a new "oil facility." According to Dr. Witteveen, Arab and other oil exporters have just "indicated their willingness" to the I.M.F. to lend that facility about $2.75 billion. But even excluding the developed nations, the developing countries face extra oil deficits of at least $20 billion in 1974 alone—seven times as much as the oil producers are offering to lend.

It is far from sure that even this modest amount will be forthcoming. The Saudi Arabian oil minister, Sheik Zaki al-Yamani, has expressed coolness toward the I.M.F. plan. Since his country had initially offered Dr. Witteveen more than $1 billion, a Saudi Arabian decision to withdraw could undermine the proposal. Actually, however, the oil-exporting countries have strong reasons of their own to lend, under appropriate terms that would give them security and a reasonable rate of return. That is precisely what the I.M.F. hopes to provide.

Given the difficulties and risks of placing their enormous gains in secure foreign loans and investments —and their common stake in the viability of the world monetary system—the oil exporters have a powerful incentive to help make the I.M.F.'s "oil facility" succeed. It could help tide over for the next year or so the poorest of the developing nations. In the long run, however, lending back hundreds of billions of dollars to the deficit countries seems out of the question. The disequilibrium is too great.

THE WASHINGTON POST April 13, 1974

Oil Crisis Devastates Central America

By Bruce Handler
Special to The Washington Post

GUATEMALA CITY—The world oil crisis is threatening the economies of the Central American countries, wiping out 13 years of economic progress they had made by joining in a common market.

Central America, including Guatemala, El Salvador, Honduras, Nicaragua and Costa Rica, produces no oil.

If crude oil prices remain at current levels or go up, experts say all five of these small republics could be down to their last centavo in reserves by 1975.

A U.S. economist here put it this way: "If the international oil picture continues unchanged, it's all over for Central America."

"The oil crisis is a serious problem in places like the United States and Europe, of course," an American businessman in Guatemala City said, "But in underdeveloped countries, its effects are far, far worse.

"Central America's economy is based on agriculture," he explained. "Governments in this region have been trying to modernize farming methods and increase production, and they've made progress. But to do this, you need tractors and fertilizer. Well, half the world's fertilizers are made from petrochemicals, and tractors don't run on bananas."

Until the 1940s, Central America — slightly larger than California and with 16 million people—was a remote, backward and economically stagnant region.

Its economy depended on coffee and bananas. Power lay with a few local millionaire landowners and large foreign fruit exporters. Most others were illiterate, underfed peasants.

During World War II, the United States financed the building of a highway through Central America, to gain a strategic overland route to the Panama Canal. Panama itself is not considered part of Central America.

This road made trade among the Central American republics possible for the first time. It also allowed medium-size agricultural entrepreneurs to open the rich Pacific coastal plain to cattle ranching and growing of cotton, sugar and vegetable oil seeds.

In 1960, the five countries formed a Central American Common Market. The purpose was to eliminate trade barriers, further diversity their economies and coordinate industrial development.

Despite some rocky spots—El Salvador and Honduras fought a mini-war in 1969 and stopped trading with each other—the Central American Common Market has survived.

A new social class of businessmen, independent farmers and ranchers, and white-collar workers has started to emerge and industrial production tripled between 1960 and 1972.

The value of textile output rose from $25 million to $116 million. Production of shoes and clothing rose from $49 million to $111 million. Light machinery and home appliance maufacturing output increased from $1.4 million to $26 million.

Central America's total foreign trade rose from $1.2 billion in 1963 to $2.7 billion in 1972. Trade within Central America skyrocketed from $16 million in 1950 to $64 million in 1960 to $611 million in 1972.

Roads and communications improved greatly, and direct-distance-dial telephone link Tegucigalpa, Honduras, and Guatemala City—an impossible dream only a few years ago.

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The Common Market also made this region less dependent on the United States. In 1963, the United States bought and sold 43 per cent of the total imports and exports. By 1972, this figure had fallen to 33 per cent.

Gold and hard currency reserves climbed slowly from $130 million in 1961 to $416 million in 1972, but the oil crisis could erase the results of this decade-long struggle in less than two years.

Guatemala, the most populous country, had $213 million in its treasury at the end of 1973. But it spent $30 million on oil products last year—compared to $15 million in 1971—and its estimated oil bill for 1974 is $105 million.

Hobart Rowen

The Oil Cartel and Development Aid

Despite the noble efforts of IMF Managing Director H. Johannes Witteveen, the oil cartel countries have been willing to cough up only small amounts of money to help the oil-importing countries meet the outrageous prices that the cartel itself has set.

The defense offered by the Organization of Petroleum Exporting Countries (OPEC) is a mixture of clever rhetoric and sheer arrogance. In essence, they argue that the cartel countries have not become truly rich, like the industrialized West, but merely more "liquid"; that oil prices are still below the level that should be achieved to balance off inflation in other commodities; and that the West —notably the United States and Canada—are soaking the poor countries by extortionate prices for food.

Dr. Abderrahman Khene, the Secretary-General of OPEC, made the rounds here recently, delivering this pitch. He argues that the industrial nations have been raising the prices of their manufactured goods and food, and that the problem of the poor countries thus didn't start with OPEC.

Agriculture policy in this country, of course, has stupidly contributed to inflation. But as Dr. Khene knows, the price of wheat bears a close relationship to weather and crop yields—a matter quite different from a half-dozen oil sheikhs sitting down in Teheran, arbitrarily deciding on a price for oil that costs 10 to 30 cents a barrel to produce—a cost that hasn't varied.

If the United States decided to price wheat the way OPEC prices oil, it has enough leverage on the market to get $20 a bushel.

> *"The lack of generosity of other countries does not excuse the OPEC for the burden they placed on the rest of the world."*

But there is little doubt that the major countries of the world, especially the United States, must be faulted for lack of generosity in development aid. Far from meeting the recommended goal of 1 per cent of total Gross National Product, U.S. development aid is about one-fourth of that figure, ranking 15th in a list of 16 wealthy countries.

That does not excuse the OPEC countries for the special and sudden burden they have placed on the rest of the world, notably on the poor countries, by a four-fold increase in the price of oil within a year's time.

When Dr. Khene talks of OPEC's "moderation" and "wisdom" in "limiting" the price of oil to provide a government-take of $7 a barrel, he is talking economic nonsense. The abrupt shift of $50 to $60 billion of resources from the oil-consuming countries to OPEC (even if some of the burden is postponed by financing schemes) is beginning to raise havoc in industrial as well as less developed nations.

"In thinking about the effects of the sharply higher oil price," Federal Reserve adviser Robert Solomon said in a thoughtful speech the other day, "I have found it useful to view it as a sales tax on consumption. The imposition of this 'tax' has raised the price of petroleum products."

Solomon, vice chairman of the Committee of Twenty Deputies, points out that the OPEC countries "must lend their enlarged revenues" back to those who are paying through the nose for their oil.

But not much is coming back. Against the $52 billion increase in OPEC surpluses this year alone projected by Witteveen (to a total of $65 billion), the total amount pledged for a special IMF "facility" is some $2.8 billion.

Much has been made of some sales of oil at concessional terms to India. But the concessions don't seem overly generous—and in total, are a drop in the bucket. For example, India will get about $100 million worth of oil from Iraq and a similar amount from Iran in special deals. Against that, India's extra cost for oil this year is more than $1 billion.

The need to get cash into the hands of the hardest-hit countries is so desperate that the World Bank is scraping together about $150 million by diverting some of the International Development Agency (IDA) funds—pitifully small to begin with—to the poorest countries on the list.

International agencies calculate that higher oil, food, fertilizer, and capital goods costs to the poor nations this year will run about $6 billion more than what they will recover in higher export prices.

Assistance by the IMF and other international agencies, plus a reduction of reserves will cover $4 billion, leaving a minimum of $2 billion in new assistance needed by the poor countries. Projections are that this minimum "gap" will increase to $2.5 billion in 1975, and run to $4 or $5 billion a year from 1976 to 1980.

In the immediate and desperate period ahead, the United Nations is trying to get contributions—in any form — that would work out to roughly a 50-50 share between the industrilized world and OPEC.

But the industrialized world, even if it comes through with contributions this year equal to OPEC's, is likely to resist carrying an equal share into the future.

The strong view of the United States, as it sees new OPECs over the horizon for bauxite and other commodities, is that the biggest part of the burden ought to fall on those who create the problem.

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THE WALL STREET JOURNAL May 6, 1973
Editorial

Attracting Petrodollars

With one easy stroke, the United States can go a long way toward improving its eminence as an international capital market, with financial benefits that would exceed the $200 million the Treasury would lose in tax revenues. The necessary step is the elimination of withholding taxes on interest and dividends that flow out of the U.S. to foreigners holding U.S. securities. The program amounts to a tariff on foreign capital.

These taxes have been on the books a long time, but until the arrival of petrodollars have been of relatively little significance. The basic rate of 30% applies to all residents (other than Americans) of countries that don't have tax treaties with the United States. Most of our major trading partners do have treaties with us which lessen the impact of these taxes on investors and on capital flows. But the oil-producing nations of the Middle East and Latin America neither have nor desire such tax treaties, as long as they can invest their colossal reserves through the Eurodollar market.

What this means is that as a matter of national policy, the United States is protecting the Eurodollar and Eurobond market to the detriment of its domestic capital market. The $200 million the Treasury would forego by eliminating these taxes is admittedly a lot of money, but it is small potatoes compared to the tens of billions in petrodollar business that the U.S. is throwing away to foreign capital markets. Why should the sheiks cough up 30% of their income from investments here when they can keep it all when their investments are cycled through London?

We are not prepared to argue that this simple tax change will mean an extra $4 billion to $6 billion a year of investment in the United States, as some proponents of the change are forecasting. After all, whichever market is recycling the oil money will put it here, directly or indirectly, when that market finds superior opportunities here. The withholding taxes simply insure that London and Geneva will do the picking and choosing, not New York. If the most promising investment for a Kuwait dollar is in Niger or Bolivia, it won't be banked through New York.

This is no trivial consideration. The penny or two of banking profits on every recycled petrodollar adds up to a tidy sum when the gross amounts top $25 billion and could approach $100 billion by the end of the decade. Also, foreign exchange is earned through financial intermediation.

The process of rebuilding the U.S. capital market began earlier this year when Treasury eliminated the interest equalization tax and the direct controls on foreign investment, the two U.S. programs that more than anything spawned the Eurodollar market. The rebuilding will be further aided if U.S. tax laws invite, rather than discourage, all that oil money.

FROM THE WALL STREET JOURNAL, JUNE 19, 1974

REVIEW & OUTLOOK

Squeezing the Goose in Quito

Having acquired the golden goose, the Organization of Petroleum Exporting Countries is discovering that the bird has to be squeezed harder and harder to produce the same size eggs. Global inflation coupled with decreased demand for crude keeps nibbling away at the real incomes they'd projected for themselves.

So the cartel met in Quito, Ecuador these past few days to plan its squeeze for the next three months. While it couldn't resist hiking the royalty rate on crude by 23 cents a barrel, it wisely decided against the inclination of 11 of its 12 members to cut into the goose. All but Saudi Arabia favored another sizeable increase of the tax on the crude shipped by foreign companies.

It occurs to Saudi's Sheik Yamani, who went to school at Harvard, that OPEC's 300% price increase over the last nine months may have had something to do with both global inflation and faltering demand for crude. Although he couldn't manage to impart this wisdom to his fellows, he did get them to hold off merely by refusing to go along with them on the tax increase. He won't apply the royalty increase either, and because Saudi Arabia can by itself control the world price, this split in OPEC is bound to widen.

Mr. Yamani was turned down when he recommended a cut, rather than an increase in price postings. But give him time. The sharp drop from projected demand for crude in response to its higher price is now accelerating in reaction to a softening world economy. Treasury Secretary Simon says second quarter real GNP growth in the United States will be close to zero. If it remains flat the rest of the year, simple arithmetic suggests there will soon be more oil around than anyone wants to buy.

Already, U.S. petroleum imports have been cut to where they were a year ago against some projections that they'd be up 25% by this time. Japan has increased imports by a scant 2% to 3% from a year ago, a steep fall from last year's projection curve. Now that Western Europe has replenished inventories, demand there is falling off.

In order to maintain the current price postings, obviously some OPEC countries would have to agree to cut back production, and as fast as they cut production, and the world economy continues to soften, they'll have to cut again. With the Saudis refusing to go along, even toying with increased production, there's not much chance the other producers would commit themselves to that kind of play. And if they don't, the marketplace itself will force production cutbacks. Consumers simply won't buy all the oil the producers want to sell at the prices they insist on charging.

The strains in the cartel result because each of the OPEC nations has its own optimum timetable for selling its oil. Those who want revenues now, fast, for internal development are the most stubborn about sticking to the high cartel prices. But to do so, they have to bet against new supplies and oil substitutes coming along before they no longer need expanding oil revenues to finance development. A global recession throws all their schedules off, putting them closer by that much time to competition from Alaska and North Sea oil, as well as now unknown technological breakthroughs on the demand side. A recession of serious proportions or duration will blow OPEC apart.

Mr. Yamani understands all this. But his colleagues insist on learning the hard way. Eventually they will have to learn that while a successful cartel has its obvious advantages, it can't be insulated from the problems of the world economy it is integrated with. If it holds up the consumers, it has to be prepared to see the financial assets it accumulates depreciate through inflation; central banks cannot politically resist increasing money growth to pay the oil bills. And if the cartel insists on inflation protection, tying its oil prices to an index of its choosing, there's no way it can escape driving the world economy and petroleum demand into the ground.

At Quito, against their inclinations, the OPEC nations decided not to make this a quick and easy lesson. Increased price postings now would have had a chilling effect on the economic scene, to say the least. By the time they get together again to talk about squeezing the goose, it's highly probable they'll have an even clearer picture of how destructive and self-defeating that would be.

BUSINESS WEEK May 11, 1974

Commentary

by John Pearson

The crisis of paying for the oil

When the gasoline queues disappeared from the filling stations a few weeks ago, it may have appeared to many consumers that the worst of the energy crisis was over. Italy's abrupt restrictions on imports, aimed at stemming a sharp deterioration in its balance of payments, are a reminder that the crisis is only beginning. The problem now is not the availability of oil, but how to pay for it.

At least half of Italy's average monthly trade deficit of $1-billion in the first four months this year stemmed from the steep rise in the cost of oil imports. But the Italian trade curbs will not slow the inflow of vital oil. Instead, the measures will cut back imports of other products, from meat to automobiles, and thus shift the trade deficit to Italy's traditional trading partners. The result could be increasing pressure on countries such as France to take similar steps to shore up their balance of payments.

Thus Italy's unilateral action could set a precedent for beggar-thy-neighbor protectionism without doing anything to solve the oil crisis. The oil consuming countries, taken together, will run a deficit of $40-billion or so in trade with the oil exporters in the year ahead, and they cannot diminish it by buying less from each other or selling each other more. Such protectionism poses a real threat of a trade war.

Heavy borrowing. Even if such a conflict is averted, European bankers such as Dr. Andries Batenburg, president of the Dutch Bankers Assn., are warning that the energy crisis may reappear in the shape of an international financial crisis. That is because most oil consuming countries can finance the increased cost of energy imports only by borrowing heavily. The Italians, British, and French have already done so by tapping international financial markets for billions of dollars in loans. Ultimately, a big part of the funds for such loans will have to come from the oil exporting countries themselves.

Managing Director Johannes Witteveen of the International Monetary Fund announced this week that he has persuaded Saudi Arabia, Iran, and other nations to contribute $2.8-billion to a special fund that will make medium-term loans to member nations to help pay their oil bills. But much more will be needed, and private capital markets are the only other mechanism available for "recycling" large amounts of the oil producers' surplus money. So far, the oil-rich states have shown a marked preference for putting their money into short-term "Eurocurrency" deposits that bankers in London and other financial centers then lend out to oil users.

The trouble with this system is that the borrowers, even if they are financially respectable European governments, will eventually exhaust their credit. No banker in his right mind will keep supplying money to a client who uses it to meet current expenses, unless the borrower has a credible plan for getting his income and expenditures back into balance and paying off the loans. The oil consuming nations, unfortunately, have no such plan. Instead, they are looking desperately for financial gimmicks, including the revaluation of official gold reserves in order to create new money that could be used to pay for oil. But more than monetary wizardry is needed to deal with the energy crisis that underlies the financial threat.

Wishful thinking. Of course, the oil shortage "scare" and the rising cost of fuel have slowed the dizzy growth of energy consumption in industrial countries from 5% annually in recent years to an estimated 2% to 3% this year. But unless economic growth comes to a complete standstill, oil imports are bound to keep rising until alternate sources of energy are developed.

Faced with this bleak prospect, Administration officials are taking the official line that oil prices will have to come down. More and more, this sounds like wishful thinking.

There is, in fact, no cheap and easy solution. If a new crisis is to be avoided, it will require a combination of energy programs and financial measures, including heavy investments to develop new sources of energy; stepped-up recycling of "petrodollars" through intermediaries such as the IMF that can make loans with longer maturities than private banks; and encouragement of long-term investments by the oil producers in the U. S. and other consuming countries.

Even so, tougher energy conservation measures may be unavoidable. The Italian government is talking about reviving restrictions on automobile use and cutting back on home heating next fall. While curbs on energy use are politically unpopular, the alternative may be financial and economic turmoil that would lower oil consumption by plunging the world into a recession.

BUSINESS WEEK April 6, 1974

Oil: How the poor nations hope to pay their bills

The world's poor nations are scrambling frantically to find ways to pay their sharply higher oil bills. And while the outlook is grim, some of these efforts promise to show results. This week, Hassan Shash, Egypt's ambassador to Ghana, announced in Accra that the Arab oil states have set aside more than $800-million to help African economies. Last week, Libya's fiery leader, Mu'ammer al Qadafi, announced a three-tier price system for Libyan oil that would favor less-developed and Muslim nations. Meanwhile, a committee of the Organization of Petroleum Exporting Countries (OPEC) are discussing ways to recycle Arab oil money to the developing nations in the form of cheap loans.

Individual governments also are active. Prime Minister Zulfikar Ali Bhutto of Pakistan, whose country will benefit from Libyan price adjustments two ways—as a less developed country (LDC) and as a Muslim state—made plans to visit Iran this week for talks with the Shah.

Export earnings. Certainly the LDCs need all the help they can get. The London-based Overseas Development Institute estimates that their 1974 oil bill will soar to $12.2-billion from last year's $2.2-billion. Singapore will be nicked for an extra $517-million, while Kenya, Tanzania, and Uganda as a group must fork over $178-million more.

Tiny Jamaica will have to ante up an additional $123-million, roughly half the island's export earnings. The bite explains Prime Minister Michael Manley's widely publicized efforts to obtain higher prices for his country's bauxite exports. Manley would like to join that select group of lucky LDCs that either have their own existing or developing oil reserves—chiefly Indonesia, Nigeria, and Malaysia—or that have other valuable resource exports whose prices are strong enough to pay for expensive oil.

Thus, the Philippines had no trouble raising a $500-million loan from a group of U. S. banks led by New York's Manufacturers Hanover Trust Co. Roughly $150-million of the money will help Manila pay its oil bill. "Even though the Philippines now pays three times the price for its oil," says Tristan E. Beplat, senior vice-president of Manufacturers Hanover, "it is selling copper at $1.50 a lb. instead of 40¢ or 50¢. It will sell sugar at high prices, too. And the same goes for lumber, copra, and nickel." Nations without resource exports essential to industrial countries are in more serious trouble. Says William J. McDonough, senior vice-president of First National Bank of Chicago: "Some of the Latin American nations have pretty strong little economies. But all they produce are agricultural products. What do you do if you can't get a higher price for bananas?"

Easy terms. No country, of course, faces so gloomy an outlook as India. The oil-poor nation has a large industrial base that needs energy, and it may have to spend as much as 60% of this year's anticipated export earnings of $1.4-billion to buy oil. So New Delhi is hustling to stave off disaster. One deal calls for the purchase of Iranian oil for $3.50 per bbl. in cash and the balance in deferred payments of 2.5% interest or in barter arrangements. Last week, India arranged a similar deal with Iraq—a $10-million loan to purchase 2.8-million tons of Iraqi crude this year.

The Indian government also is hoping to roll over some of its international debt at a meeting with creditor nations this month. Yet it still may have to draw on its nearly $1-billion in reserves. Tapping reserves is a delicate matter for an LDC. Commenting on what may be the Catch-22 of international banking, Manufacturers Hanover's Beplat notes that "if these countries pay cash and get their reserves down, then everybody will be so damned scared it will become hard for them to borrow money." ■

THE WASHINGTON POST Sunday, May 19, 1974

Inadequate Plans in Payments Crisis

By C. Gordon Tether
Financial Times

For all the efforts of Managing Director H. J. Witteveen to put a brave face on it, the drive the International Monetary Fund has embarked upon to enlist the cooperation of the oil-producing countries in resolving the mammoth international payments crisis their price increases have sparked does not seem to be getting us very far.

And as the fund itself can only perform a bridging operation and the Euro-currency market is ill-suited to do more than fill the breach temporarily, the further outlook remains grim—unless that is, we can quickly think up some entirely new recycling ideas.

According to Witteveen's latest appraisal, the oil producers are going to show an overall surplus in the region of $65 billion in 1974 or about $58 billion more than they did last year. The corresponding deficit elsewhere will be distributed in a ratio of about two to one between the advanced countries and the less-developed world.

The oil producers are thus best placed to help sort out this monumental new payments mess. Yet the visits the fund's top brass have made to these countries to interest them in providing financial backing for its proposed special oil loans to oil-importing countries seem to have produced plenty of expressions of good intentions but remarkably little money. In fact, the total promised for 1974 so far amounts to a bare $3 billion.

The IMF has, of course, some money of its own it can throw into the battle. But the fact is that its total funds amount—even valuing its gold stock at the current free market price—to materially less than the oil-importing countries' 1974 deficit alone. So Witteveen is doing no more than stating the obvious when he says that his projected oil facility can only be "a bridging operation while longer-term solutions are worked out."

News Analysis

The Euro-market might appear to be a better bet, being seemingly able to generate money like water to meet each and every need, provided there is a willingness to pay the interest rates demanded. But, as Witteveen himself and other experts have been pointing out, it is an unsuitable vehicle for massive medium-term and long-term operations.

The fund's chief was certainly not exaggerating, therefore, when he concluded a recent progress report on the attempt to resolve the recycling problem with the assertion that "we cannot see with any clarity what arrangements will eventually be made to provide for an orderly investment of oil revenues in the medium term."

The fund is affecting to believe that the best hope lies in getting the oil-importing countries to open their markets to long-term foreign investment. And to this end, it is proposing to make a member's access to the proposed oil facility conditional upon it "taking measures to encourage capital inflows in the required amounts." But these things are far easier said than done.

What we really have to aim to do in the interim is to provide the surplus countries with a way of investing their money that meets their present preference for keeping it in relatively liquid form yet is not so exposed to rapid purchasing power erosion as the paper currencies they are accumulating now.

And in this connection, it is as well to recognize that the new-look Special Drawing Right, "denominated in a basket of currencies," which the fund plans to offer them in exchange for donations to its "oil facility" fund in a few months time, can have no more appeal than a typical currency. For it, too, will be losing value at the average inflation rate.

This points to a way in which the speedy remonetization of gold could do great service for the world in a double sense. For it seems more than likely that the oil-producing countries would be prepared to think in terms of accepting gold in settlement of a sizeable part of their vast surpluses for a while—always provided this was part of an international monetary stabilization program which guaranteed that the purchasing power of the metal they absorbed would itself be maintained.

Since such a plan could pave the way for all-out attack on the global inflation menace now threatening our entire planet, it would be serving the interests of the peoples of the oil-importing countries no less than those of the exporters.

FROM THE WASHINGTON POST, MAY 25, 1974

Arab Money Seen Moving Into U.S. Real Properties

Oil rich Arab nations may soon become stiff competitors with Japanese investors in the acquisition of real estate investment properties in the United States, according to a leading real estate research firm.

Middle East oil nations this year alone will accumulate $80 billion in investment capital, a study by New Orleans-based Robert L. Siegel firm reveals.

"At least $2 billion will flow into the United States, most of it for real estate," said Siegel.

The firm's study found that Arab investors are seeking the same types of investments that have attracted Japanese funds for more than two years: income producing residential housing and retail facilities, resort properties, hotels and other transient facilities and land developments.

So far, the bulk of Arab investments have been concentrated mainly in the East, Midwest and South, while most Japanese funds have been invested in Hawaii, California and other parts of the West.

One factor — the fear of nationalization — has made the Arab investor more cautious than his Japanese counterpart in placing his funds in the United States, the survey reported.

"Some Arab nations have nationalized their oil industries so they tend to be somewhate fearful that the same tactic could be used against them when they invest funds in another nation," Siegel said.

Some examples of Middle East real estate investments in the United States, the survey reveals, include:

• Financing of a major office building on New York's Fifth Avenue by the Iranian government.

• Providing $200 million in capital for the development of a mammoth apartment project in St. Louis.

• Providing $50 million in investment capital by Kuwait and Lebanese sources to a Louisville investment company for the purchase of U. S. real estate.

• Financing of the development of an island resort off the coast of South Carolina by Kuwait money.

• Purchase of raw land in California by Saudi Arabian investors for future development.

Siegel also reported that Middle East oil money has flowed into Atlanta for the financing of new retail and hotel facilities in the downtown area.

"The American motorist was the first to feel the pinch when the Arab nations raised the prices of crude oil. Now, the funds are coming back into the United States and the real estate industry is the first to feel the effect," he said.

While Siegel sees an increasing flow of Arab investment funds into the United States, he believes that few, if any, of these projects actually will be developed or managed by the Middle East nations.

"These off-shore investors need the expertise of the American developer, who can put the entire package together for the group providing the money," he said.

THE WASHINGTON POST May 14, 1974

Impact of Massive Oil Price Rises Seen Hitting Gradually

By Hobart Rowen
Washington Post Staff Writer

The real burden on the consuming world caused by massive boosts in oil prices will be gradual rather than immediate because of the inability of the oil-exporting countries to quickly increase their imports.

Thus, according to Robert Solomon, deputy chairman of the IMF's Committee of Twenty Deputies and senior adviser to the Federal Reserve Board, "the real impact on the standard of living of the rest of the world will be mitigated."

He made these *observations* in a speech prepared for delivery to a conference in New York yesterday. A copy of the text was made available here.

Solomon, who will leave the C-20 to resume full-time duties at the Fed after mid-year, was actually in Paris for the deputies' meeting prior to the full committee session here June 12-13. His speech was read for him by Edwin M. Truman of the Fed.

Solomon said that the oil-exporting countries, even those with more diversified economies, will develop large surpluses because it will take time to "increase their imports in line with their increased export earnings."

Thus, the consuming nations for the time being will be paying for their higher-priced oil with debt, rather than transferring goods and services.

But the real effect can not be delayed forever, Solomon stressed, and the deficits must be financed preferably by co-ordinated moves in which countries try to divide up the debt burden equitably, and not try to shift it to each other.

In finding ways of financing the debt—which could be in the neighborhood of $50 billion—Solomon said "it may become necessary to alter a number of conventional ways of thinking."

For example, he said it may be necessary to set aside usual fears about financial institutions that borrow "short" and lend in the long term.

He pointed out that funds placed by the oil exporters in what are usually termed short-term assets (as in Euro-currency) are likely to be held for a long time, while the exporting nations develop the capacity to absorb large imports.

At the same time, whatever form the borrowing by oil consumers takes, "the fact is that they are likely to be debtors for a long time . . .

"All this means that conventional fears about financial institutions borrowing short and lending long ought to be looked at and tempered in the light of the likely patterns over time of the balance of payments positions of oil consumers and oil exporters," Solomon said.

Conventional attitudes toward creditworthiness may have to be revised, as well, Solomon declared, "as individual oil-importing countries go into debt to finance their unavoidable trade deficits."

He pointed out that the consuming countries as a group will be able to repay their debts only when the oil exporters are in a position to buy more goods from world markets.

"Thus, we come back to the question of the real burden of the oil price increase," Solomon said. "Just as the real burden is delayed by the inability of many oil exporters to accelerate their imports, their ability to collect their debts—to accept repayment—will be delayed until they are able to generate an excess of imports over exports."

THE WALL STREET JOURNAL January 22, 1974

REVIEW *and* OUTLOOK

The Robin Hoods of OPEC

Fundamental to the oil problem is who will lose and who will gain from the seemingly imminent sudden transfer of an added $50 billion a year from oil consumers to oil producers. It can be said with some assurance that if the OPEC price boosts stick, few people in the world will not feel some effect. There can be less assurance in trying to assess specific effects.

But economics being what they are, history shows that the poor are usually the first affected by adversity. It is a reasonable bet that it will be already underprivileged places like Recife, Bombay and Mombasa, rather than Paris or Atlanta, that will feel the worst effects of the OPEC price grab. For that reason, the leaders of nations like Brazil, India and Kenya might do well to re-examine the notion that there is any real community of interest among the so-called "Third World" nations, of which both they and the OPEC countries are a part. Their best interests may well lie in joining with the industrial nations to persuade oil nations of the unwisdom of their cartel-type endeavor.

The OPEC nations, have, of course, not been unmindful of the opinion of the other Third World nations. At a meeting of the so-called "Committee of 24" Third World nations, held in Rome last week concurrently with a meeting of the International Monetary Fund "Committee of 20" industrial countries, a delegate from India voiced his fears. But an oil nation representative on the Committee of 24 is said to have offered assurances that oil nations would divide their new riches with other Third World countries through special aid and lending programs. The Committee of 20, in the rather vaguely worded communique issued after its meeting, also recognized the special problems of the oil-poor of the Third World and proposed that developed nations, the World Bank and the IMF all seek ways to help out.

As to the Committee of 24 promises, indeed it is a noble thought that the OPEC nations will play Robin Hood. But historians have ungenerously suggested that for even the real Robin Hood, helping the poor was rather secondary to the main object, which was robbing the rich.

In other words, we would suggest that the Third World not be too quick to subscribe to romantic notions about where the OPEC winnings will be reinvested. It is likely that most of them will be reinvested right back in the industrial world, where there are established capital markets, experienced bankers, political stability and any number of viable projects. For example, a Kuwaiti investment company has bought a 20% interest in an Atlanta firm that plans to finance a resort in South Carolina.

None of this is to say that the industrial world won't suffer as well from the big oil payoff. Economist Walter J. Levy, one of the soundest oil experts around, fears that the sudden movement of that much money out of the foreign exchange coffers of the industrial nations could precipitate a worldwide recession. His view may be overly pessimistic; if money managers in the industrial lands don't become too panicky and over-inflate their currencies to compensate for the loss, there might even be some beneficial effects from damping down industrial world consumption and applying some of the OPEC bank deposits to capital projects. But the large foreign exchange dislocation could indeed be disruptive to industrial economies.

Conversely, there could be some benefits to the non-oil producing Third World. Some of oil capital may well go to Niger or Zaire in search of new oil or other mineral resources. The resources they already have may prove more valuable than money in the bank in an inflationary world.

But by and large, the effects on Zaire, Niger and similar places are likely to be bad. With foreign exchange reserves crimped, there will be less money for foreign aid and development in the Third World. The U.S., having been burned by the Third World oil producers, has become more inclined to develop its domestic resources rather than seek projects abroad. Outside help for nation building might become hard to find.

We suspect that a good many Third World countries are having difficulty deciding whose side they should be on. We can offer a suggestion: Cartels are seldom good for anyone, even the nations who build them, in the long run. Taking a stand for law and order is much more realistic than expecting a handout from Robin Hood.

MASSACHUSETTS INSTITUTE OF TECHNOLOGY

DEPARTMENT OF ECONOMICS

CAMBRIDGE, MASSACHUSETTS 02139

E52-350

May 14, 1974

Honorable Henry P. Gonzalez
Subcommittee on International Finance
Committee on Banking and Currency
Washington, D. C. 20515

Dear Representative Gonzalez:

Thank you for your letter of May 9. Enclosed are (1) a letter to Honorable Henry S. Reuss, and (2) a talk given in Washington last week, (3) an article from Foreign Policy, and (4) a forthcoming paper from the American Economic Review. These summarize my suggestions about how to begin undermining or at least stopping the international oil monopoly.

I do not see any other method by which we can start to bring a little competition into the world oil market. But I think the more important task is to convince more people of your opinion, which I share, that what's bad for the cartel is good for the U.S.A.

It seems quite clear to me that the administration is not only reconciled to the cartel and the intended high prices but has actually helped them from the start and is arguing in favor of giving them what they want, so long as they "recycle" enough dollars back to the United States, and permit us to pay for oil by handing over our capital equipment. I have even seen (in today's New York Times (May 13)) a high administration official quoted as believing that security of oil supply is best achieved by being dependent on Saudi Arabia, and shipping them arms and other goods.

I think the panic about shortages will gradually subside, and more of your colleagues will share your opinion that the problem is one of a world monopoly which can be thwarted and broken up in time. The only irreparable damage would be done by the kind of a long term commodity agreement at which Mr. Kissinger seems vaguely to hint, at a "just price". I fear the loss of discretion on this country's part. So long as we remain uncommitted I think common sense will prevail before too much time has passed.

Yours sincerely,

M. A. Adelman

M. A. Adelman
Professor

MONEY

The Petrocurrency Peril

The oil-supply emergency ended this spring with the lifting of the Arab petroleum embargo, but a different kind of world oil crisis is approaching with onrushing speed. It is a potential money crisis caused by the quadrupling of oil prices orchestrated last fall and winter by the Organization of Petroleum Exporting Countries. The threat that these increases pose to world financial mechanisms absorbed much of the attention of bankers and government officials from the U.S., Europe and Japan who gathered in Williamsburg, Va., last week, but their deliberations produced no clear solution.

The dimensions of the threat are simply stated. This year the twelve OPEC countries stand to run up a trade surplus of $65 billion, *v.* a mere $7 billion last year, and the money will come out of the financial hide of the rest of the world. Underdeveloped countries that do not happen to be oil producers, such as India, Kenya and Bangladesh, could run up a combined trade deficit of $20 billion or more—if they can beg or borrow the money to pay for oil. The industrialized nations of the non-Communist world, which enjoyed a combined trade surplus of $12 billion last year, likely will swing this year to a deficit of around $40 billion.

Costly Debts. Financing such enormous deficits puts a heavy strain on the Western banking system. Already, many European nations are having to borrow at interest rates of 10% or so to pay for their oil. Though most have good credit, Italy recently had trouble raising $1.2 billion; it wound up borrowing from no fewer than 110 banks. Franz Aschinger, economic adviser of the Swiss Bank Corp., warns that over the next eight years "the accumulated debt [of the industrialized oil-burning nations] would be $400 billion with annual interest payments of $30 billion."

European bankers worry that some day one government, most likely Italy's, will default on paying interest on its loans, putting several banks under and setting off a Continent-wide banking panic. Even if that is avoided, the most strapped nations will be sorely tempted to cut their imports of non-petroleum goods so that they can save cash to pay for the oil, a strategy that could cripple world trade. Italy in April did in fact clamp restrictions on many non-oil imports, to the anger of its eight partners in the European Common Market, who fortunately did not follow suit.

The solution is to somehow "recycle" the oil money—or, more bluntly, get it back from the oil producers in the form of purchases, loans and investments. It is fairly easy in the case of four oil producers, Algeria, Indonesia, Iran and Venezuela, which have large populations and ambitious industrialization plans. They can be counted on to spend much of their wealth buying goods and services from the U.S., Europe and Japan. But the richest oil producers, Saudi Arabia, Kuwait, the United Arab Emirates and Libya, have small populations and preindustrial economies; they can spend on imports only a minor part of the $100 billion oil revenues that they will collect this year.

So far, the Arabs have been reluctant to put their excess cash into long-term investments, where it would help stabilize world finance. Western stocks and bonds, they believe, do not pay enough to be a good hedge against skyrocketing inflation, and real estate holdings could be seized by Western governments. Instead, the Arabs have been putting most of their money into the shortest-term investments possible: U.S. Treasury bills, New York and London bank certificates of deposit, and Eurodollar bank accounts—many of them "call" accounts from which the money may be withdrawn instantly without advance notice. That is a form of recycling that does little good; banks are understandably reluctant to make long-term loans out of money that may be swiftly snatched away. Indeed, the Arab strategy carries its own danger: that billions in Arab cash switching suddenly out of one currency into another could set off an international monetary crisis.

Several ways out of the bind are under consideration. H. Johannes Witteveen, managing director of the International Monetary Fund, is setting up an "oil facility" that would accept deposits from oil producers and lend the money at bargain rates of about 7% interest to nations that have trouble paying for petroleum. Unfortunately, he has collected pledges for only $3 billion in deposits, an amount far too small to be of much help.

Some European countries want to quadruple the $42.22-an-ounce "official" price of the gold stored in their central banks, putting it about in line with the free-market price of gold. That would in effect give Italy more than $10 billion, and France almost $13 billion, of new reserves to cover oil deficits. The U.S. opposes the idea, fearing that it might help restore gold to an unwarranted special position in world monetary affairs. Some highly technical compromises have been suggested that would hold the official price in theory while allowing countries in effect to pay for oil with revalued gold—a sensible idea.

The best solution of all might be for the Arabs to launch a massive program of loans and aid to poor countries that have no oil. The poor countries could then build up their economies with heavy purchases of industrial goods and machinery from the U.S., Europe and Japan. But the Arabs so far have shown little interest in helping the Third World. Perhaps that attitude will change, and the reluctance to make long-term investments in the industrialized world will diminish as the Arabs become more sophisticated in handling immense wealth. The question is whether a change in attitudes will come quickly enough to avoid bankruptcy for some of the Arabs' best customers.

WASHINGTON STAR-NEWS
Washington, D. C., Sunday, March 10, 1974

Super-Rich Arab Oil Sheiks Begin Bringing $$$ Back

By John Holusha
Star-News Staff Writer

American businessmen keep having this bad dream. It involves a dark-eyed man who steps unannounced one night from an airplane at New York's Kennedy Airport. He carries a briefcase bulging with checks bearing the imprints of companies like Exxon and Texaco.

Quietly he sets off on a series of clandestine meetings with managers of major pension and mutual funds. A few days and a few billion dollars later, the United States learns that the ruler of an obscure Arab principality has taken over General Motors. Or U.S. Steel. Or DuPont. Or all three.

Although it is the feeling of most Arab watchers that the newly super-rich sheiks don't presently plan to seize control of important U.S. companies, it is clear they will have the financial capacity.

Right now, the Arab oil producers are estimated to have $50 billion in liquid capital. All the outstanding common shares of GM could be purchased for about $15 billion at current prices.

And their wealth continues to mount. The oil producers will take in an estimated $40 billion to $60 billion this year alone. By 1980, some experts project they will have taken in as much as $750 billion.

THE QUESTION is, what are they going to do with that ocean of money?

A vast amount, of course, will be spent to develop industries in the producing countries and to improve the quality of life of Arabs in general. But some of the biggest producing states are sparsely populated. Saudi Arabia was able to absorb

only half its 1972 income of $3 billion, even with welfare state programs such as interest-free home loans. This year it may have as much as $10 billion in surplus foreign exchange.

The situation is even more acute in Kuwait which has one-fifth as big a population as Saudi Arabia (less than 1 million) and an estimated income of $9 billion to $10 billion.

The Arab leaders' problem is how to preserve that wealth against the day the oil runs out—not an easy task in an uncertain world. The lesson of Spain, which squandered its New World gold in a few generations of opulence and then sunk back into poverty, is not overlooked.

See ARABS, A-12

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FINANCIAL sophistication varies greatly from country to country, although all have progressed beyond the thinking of Abu Dhabi's Sheik Shakbut who was overthrown in 1966 for keeping the national treasury in cash under his bed. Nevertheless, according to the British magazine Economist: "The typical Arab investment strategy is still to put funds on bank deposit while waiting for the brainwave to come."

One brainwave that has struck some Arabs is U.S. real estate. The experienced and fabulously wealthy Kuwaitis have turned up in several projects.

The government-private Kuwait Investment Co. recently paid $17.3 million for Kiawah Island off Charleston, S.C. It plans to spend $100 million over the next decade developing it as a resort. The same company put up $10 million for a half interest in the new Atlanta Hilton.

A real estate company in Louisville, Ky., says it is dickering through intermediaries for $50 million in Kuwaiti money to be invested in properties such as office buildings, shopping centers and apartments.

B. M. HOLLINGSWORTH, of Enck, Hollingsworth & Reveau said there were indications the deal might eventually swell to $500 million. He said the investors don't care about income now. They want "secure positions; they aren't interested in speculation."

Richard Williamson, who represents the Kuwait Investment Co. in the United States describes its investment program as "extremely broad." He adds:

"They're not especially concerned about cash now now; they're looking for a solid investment with upside potential" Nor are their appetites confined to real estate. "There's very little we're not interested in as long as it is attractive and the people involved are ethical."

Money, he makes it plain, is not a problem. He doesn't have a budget. "We receive the money as it is required. If we find a good investment, the money is there."

WILLIAMSON estimated that the Kuwaitis, using both public and private funds, have already invested about $500 million directly in the United States. Another $3.5 billion has gone into portfolio investments — stocks, bonds, Treasury securities, etc. — he estimates.

He said the Kuwaitis aren't interested in takeovers. "We're looking for passive investments that will just leave us in a position to participate in the discussions if something goes sour. We're not the Japanese," Williamson said.

Massive Japanese purchases of propety and resorts in Hawaii and West Coast states in the last few years have prompted calls for laws restricting foreign investment in the United States. Ironically, the massive oil bills due the Arabs has taken the steam out of the Japanese buying binge.

Other reported Arab real estate investments include an office building on Fifth Avenue in New York purchased by the Shah of Iran and $1 million in California land bought by Adnan Khashoggi, a flamboyant Saudi Arabian thought to be close to the ruling family.

Last year Khashoggi bought Security National Bank of Walnut Creek, Calif. from Democratic Rep. Fortney H. Stark. At that time, Stark expressed surprise that Khashoggi was willing to pay $29 a share for the bank's stock when the open market price was in the $10-$12 range.

THERE HAVE been some reports that Arab interests favor buying into American banks or organizing their own to help control their investments here. Foreign-owned banks with head offices overseas have an advantage over domestic banks since they can branch nationwide. U.S. banks are not allowed to branch across state lines.

Rep. Wright Patman, D-Texas, the chairman of the House Banking Committee, has introduced a bill to regulate and restrict foreign branch banking in this country—a move which has sent tremors through major U.S. banks who fear retaliation against their overseas operations.

The overseas branches of U.S. banks, particularly in London and Beirut, profitably handle large amounts of Arab deposits. Over half the 70 banks operating in Beirut are reported to be partially-foreign owned.

A Commerce Department official, recently returned from a Mideast investment conference, said the Arab participants scoffed at the idea of massive takeovers of U.S. companies. "Why should we take over GM," he quoted one as saying, "What would we do with it?" He said the Arabs were aware they lack the managerial talent to run such a massive enterprise.

In Saudi Arabia, for example, there are less than 5,000 college graduates.

ONE EXCEPTION to the no-takeover policy that was discussed; the official said, was "downstream petrochemical operations." This includes everything from oil refineries to neighborhood gas stations and plants using oil/based fee-stocks.

An indication of what the future might hold is a deal made last year by Ashland Oil, Inc. In return for a half interest in a Buffalo, N.Y. refinery and a chain of service stations, the Shah of Iran agreed to supply 60,000 barrels of oil a day to the refinery.

As their experience with refining and marketing increases, it is not unreasonable to expect that the oil producers will seek to control and profit from their product from the well to the gas pump.

It appears likely that Arab purchases of real property in the United States is likely to continue. For one thing, the dollars we pay for oil have got to come home eventually. And buying something substantial is a good way to preserve the wealth represented by those dollars.

Currencies are fragile. Inflation erodes their value. If the United States has 10 percent inflation this year, an investor in a 9 percent bond actually loses 1 percent.

DEVALUATION is a constant threat. Some cynics have suggested that we pay the Arabs anything they ask for oil and then just devalue the dollar drastically.

It is improbable the U.S

government would ever adopt such a plan. Nevertheless Saudi Arabia, Lybia and Kuwait were reported hurt badly by the two recent 10 percent dollar devaluations.

"Kuwait . . . lost a half a billion dollars as a consequence of its extraordinary conservatism" in sticking with dollar securities through the devaluations, Harvard Prof. Howard Stauffer told a congressional panel last November.

Nationalization of property is always a risk, too, but the oil producers are counting on their control of crude production to prevent any retaliation for the seizure of western-owned facilities in their countries.

Moreover, it is their practice to maintain a low profile. Investments in stocks and bonds, Wall Streeters say, are made via the untra-secret Swiss through select New York banks.

PARTICIPANTS in the few real estate deals which have surfaced indicate there may be many better camouflaged investments underway.

"If anyone else is talking with the Arabs, they're doing it in secret," real estate operative Hollingsworth said. "It makes sense. Publicity about Arab money brings everybody else into your area. Its' happened here already."

Investment in the United States isn't confined to the Arabs or Japanese. In these unsettled economic times. the U.S has become a haven for nervous money. Just last week, a New York banker reported that a West German group was prepared to pour up to $100 million into U.S. real estate. They are particularly interested in shopping centers, he said.

Direct foreign investment in the United States—a category which does not include stocks and bonds—has soared from less than $500 million in 1971 to an estimated $2¼ billion last year.

The influx, which is expected to accelerate, has prompted a growing debate on its effect on the U.S. economy.

ON ONE SIDE are U.S. business interests which are fearful about the much larger U.S. investment overseas ($94 billion compared to about $16.5 billion owned by foreigners here.)

On the other is the concern of some elected officials that foreign interests could take over key sectors of the economy and that ultimately their investments could worsen the balance of payments.

Initial investment counts as an inflow, but as profits are taken back by the investor, it results in a cash outflow from the United States.

"Over the long term, foreign direct investment will have a negative effect on the balance of payments and result in a dollar outflow," a staff report for the House banking subcommittee on international finance concluded last year.

A NUMBER of bills have been introduced to control foreign investment in the United States including one by Rep. John H. Dent, D-Pa., which would bar noncitizens from buying more than 5 percent of the voting stock of any publicly-traded corporation.

A series of key hearings on the entire issue of foreign investment in the United States are planned for April and May by subcommittees headed by Reps. Henry Reuss, D-Wisc., Henry B. Gonzales, D-Texas and Rep. John E. Moss, D-Calif., himself sponsor of proposed restrictive legislation.

THE NEW YORK TIMES
6/9/74

AID TO POOR LANDS URGED BY EXPERTS

$3-Billion From Industrial and Oil Nations Asked

By EDWIN L. DALE Jr.
Special to The New York Times

WASHINGTON, June 9—A report prepared by three economic experts proposes that the industrial nations of Europe, North America and Japan join the oil-producing nations in contributing $3-billion to aid some 30 poor countries that have been hard hit by higher oil and food prices.

Under the proposal, the emergency relief would be provided in 1974 and 1975, with the oil-producing nations giving half the aid and the industrial nations the other half. The aid could be in money or food or, from the oil countries, in the form of easy credit terms for oil sales.

The proposal is the highlight of a 23-page report prepared for the Trilateral Commission, an organization established last year of leading citizens and some government officeholders from Europe, North America and Japan. The report, which was made available to The New York Times, was written by Richard N. Gardner of the United States, Saburo Okita of Japan and B. J. Udink of the Netherlands. All have held government positions and have otherwise been involved in international economic affairs.

'Fourth World'

The report says: "The plight of the 'fourth world' countries cannot wait for a general restructuring of the international economic order—a task that may take years. Without emergency measures in the next few months, the shortage of food, energy and other essential supplies will bring mass starvation, unemployment and increased hardship for millions already at the economic margin."

The report refers to the industrial countries of Europe, North America and Japan as the "trilateral world" and says: "We must not allow the plight of the non-oil-producing developing countries to worsen while the trilateral world and the [oil-producing] countries argue about who is to blame for the present crisis, nor will anything be gained by controversies about what is a 'fair' price for oil."

Urging an "extraordinary act of cooperation" that would not strain the finances of either the trilateral world or the oil countries, the report says:

"Time is now of the essence. The full impact of the plight of the developing countries has not registered so far because financial settlements for oil are made quarterly and bills for oil shipped at the new high prices are only just coming due.

'Crunch' This Summer

"The 'crunch' will come this summer when accounts for the second quarter of the year have to be settled," the report says.

The report suggests that the industrial countries divide their $1.5-billion contribution according to the formula of their shares in the World Bank's International Development Association. This would mean one-third for the United States, or $500-million. No specific suggestion was made as to how the oil-producing countries should share their $1.5-billion contribution.

The 50-50 sharing of responsibility "should be accepted as an ad hoc measure appropriate only to the present emergency and without prejudice to burden-sharing arrangements for the longer term, the report says.

Washington Star-News

SATURDAY, MAY 11, 1974

Plan for Petroleum

A sense of utmost urgency is reflected in a new British proposal for getting some kind of control over oil prices and putting some order into the anarchic conditions that prevail today in the world oil and money markets.

The problem, as the British government sees it, must be dealt with immediately if the world is to avoid a possible collapse of the West's financial system before the end of the year on the same proportions as that which followed the stock market crash in 1928. Especially among the developing poorer countries such as India, it is believed that bankruptcy is a real possibility in a matter of weeks. And the industrialized nations would feel the crunch soon thereafter

The British plan — still not formally approved by the Wilson government — is being outlined to administration officials here by Harold Lever, a minister without portfolio and financial adviser in the Labor cabinet. It is being billed as the first European response to Secretary of State Henry Kissinger's plea for cooperation between oil producers and consumers in meeting the crisis precipitated by the skyrocketing price of crude.

It proposes a collective effort by the major oil consuming states in dealing with the producers. The six major consumers (the United States, Britain, France, West Germany, Italy and Japan) would bargain collectively with the major producers for most of the world's oil production. They would then resell the oil to consuming countries at cost, plus a small surcharge.

The main idea is not to force down the price of crude by hard collective bargaining, but rather to put an end to unrestrained competition among consumers for oil and credits that promises to force prices even higher. The surcharge on the huge cash turnover would be used to offset the price increases by loans or outright gifts to the poorer countries. The producers, furthermore, would be encouraged to take in cash only what they can usefully use to buy commodities and increase their reserves — perhaps about $15 billion. The balance — about $50 billion — would be deposited with the six-nation agency to be loaned out as needed to cover deficits among consuming nations, rich and poor. All payments and deposits would be tied to the export commodities index, insuring against devaluation through inflation.

It is a bold and imaginative scheme and it just might work. The objections, of course, are largely political — the suspicion of the producers that the West is ganging up on them in forming a consumers' cartel — the tendency of some countries, notably France, to go it alone in such matters — the fact that the scheme is certain to require an enormous amount of American dollars, a preferred currency.

Still, if the situation is anything like as critical as it appears to be, with all that is implied in terms of economic and social dislocation among the oil consuming nations, there is no time to be lost. Certainly the British proposal deserves the most prompt, careful and sympathetic consideration by administration experts.

THE WASHINGTON POST April 8, 1974

Expert Urges U.S. to Adopt New Oil Import Quota Setup

By Daniel Q. Haney
Associated Press

CAMBRIDGE, Mass., April 7—The United States should start a new oil import quota system to make it easy for members of the international oil monopoly to cheat on each other, says a world oil expert.

Such a policy could lead to the downfall of the Organization of Petroleum Exporting Countries, the cartel that has quadrupled the price of foreign oil in the past year, says Maurice A. Adelman, an economist at Massachusetts Institute of Technology.

But before this can happen, American foreign policy makers must acknowledge that the oil cartel is bad for American interests, says Adelman, whose views on OPEC often run opposite to fellow oil economists and Nixon administration policy.

OPEC is made up of 11 of the 12 biggest oil exporting countries in the world and controls more than two-thirds of the world's known oil reserves. The most important members are the Persian Gulf countries which include Saudi Arabia, the world's largest producer of oil after the United States. Also included in the membership are all the major Arab oil-producing states which only recently lifted an embargo on oil shipments to the United States. Canada is not a member of OPEC.

The OPEC countries decide among themselves how much oil they will sell and how much they will charge for it. Their goal is to sell as much oil as possible without creating a surplus that would drive down prices, Adelman says.

"There is no question that oil imports into the United States are going to be limited" as the nation moves toward its goal of energy independence, says Adelman,

M. A. ADELMAN
... a way to cheat.

a controversial, but widely respected authority on the international oil market.

"My suggestion is that we put this limit in the form of a quota and that we put parts of the quota up for sale by direct, sealed competitive bids," he says. "The higher the price, the more profitable it is to export oil into the United States.

"Anyone with potential oil knows he can find a home for it in the U.S.A. All you require of a bidder is that he plunk down some good, hard cash" for oil-selling licenses.

This system would magnify the tensions that already exist among OPEC countries, he says. Some of them want to sell as much oil as possible now so that they can invest the profits, while others want to hang onto their oil to keep prices up.

This way, any government that wants to do some chiseling has a perfect vehicle for it," Adelman says. No country would know how much its colleagues were selling to the Americans, he says.

"This mould shake the cartel," he says. "It means you cannot make any kind of agreement to keep the price at a certain level, because you can't control the people who are going to cheat.

"If it works well in the United States, other countries will try it, and that will be the end of the cartel. This would bring oil prices back down. How far, I don't know, but there's lots of room to go down."

The price of oil produced by the cartel now hovers around $8 a barrel, and OPEC says this price will be maintained until June when it will meet again to consider adjustments.

There is no worldwide oil shortage, only a market artificially controlled by the cartel, Adelman says.

Iran, Iraq, Saudi Arabia, Kuwait and Abu Dhabi "have a huge excess of potential production capacity which can be made into actual capacity in a relatively short time.

"Always the problem has been how do you keep up the price by containing this potential and not letting it become actual?"

And herein lie the seeds of disagreement that could lead to the cartel's downfall, Adelman says.

"There are some countries —Iran is the most important —with fairly sizable populations, water and natural resources who can put to very profitable use all of the revenues they can get, building the infrastructure of a civilized society," he says. "For every dollar they invest, they can probably get a return of 20 per cent a year if it's done sensibly.

"Other countries, such as Abu Dhabi, have to invest in the international financial market. They cannot hope to get any such high rate of return. Between those countries who want to make money as fast as possible and those who don't, there is a big difference of opinion."

The cartel is bad for American interests, because it vastly enriches the Arab nations and makes it easier for them to impose future embargoes, he says. It also makes a scramble for oil that creates hard feelings between the United States and its allies in Europe and Asia.

Adelman maintains that U.S. foreign policy is partially to blame for the current strength of OPEC. He says that because of fears in the 1950s that the Soviet Union would gain too much influence with Arab oil-producing states, the United States embarked on a policy of Arab appeasement. One of the results of this policy was the development of a system whereby American oil companies can deduct from their U.S. income tax royalties paid on oil from OPEC countries. OPEC was founded in 1960 with the encouragement of the U.S. government, Adelman says.

Adelman's view that OPEC should be actively opposed by the United States and other oil-consuming countries has been heavily criticized by some of his fellow economists. The Nixon administration itself seems disinclined to take an adversary posture against OPEC. The U.S. oil import quota law, in effect since the Eisenhower administration, was lifted last year by the President as oil shortages began to appear. There have been no indications that the quotas will be reinstated in the near future.

The Nixon administration has called for consuming-country unity in the face of OPEC price increases, but with little success. The American government has repeatedly warned its European allies not to make country-to-country deals for oil. But several European countries are in the midst of negotiating separate deals for oil with OPEC countries.

THE WALL STREET JOURNAL,
Wednesday, May 8, 1974

Britain Leaning to Oil Purchases, Sales By IMF to Attack World Monetary Woes

By RICHARD F. JANSSEN
Staff Reporter of THE WALL STREET JOURNAL

Fear that the world's banking system will break down by year-end is impelling British government officials to broach a drastic new approach to the oil money problem.

The idea surfacing in the Labor Party government's highest circles is that the International Monetary Fund should swiftly be empowered to buy oil from producer nations and resell it to consumer countries to assure that both oil prices and currency flows are kept under orderly multilateral control.

Top U.S. officials are sure to be sounded out on the British thinking this week when Harold Lever, special economic and financial adviser to Prime Minister Harold Wilson, is on a mission to Washington. In London, it is hoped he may find some supporters in incoming Treasury Secretary William Simon and in Chairman Arthur Burns of the Federal Reserve Board.

Earlier this week, the IMF's managing director, Johannes Witteveen, described a plan for his agency to borrow funds to relend to oil-consuming countries. The British idea, being described as a brainchild of Mr. Lever rather than official government policy, goes further by suggesting that the IMF purchase the oil outright. The two ideas, in the British view, aren't incompatible.

British officials privy to the plan concede it sounds incredibly ambitious, but some of them, at least, contend that continuation of current uncertainties about currency movements and values poses the gravest risk to the Western world's financial stability since World War II, and with economic consequences that could be comparable to the depression that followed the 1929 financial crash.

Basically, the worriers reason that nearly all the extra $50 billion that oil-producing nations are apt to receive this year due to higher prices will be placed in the commercial banks of the U.S., Britain and other industrial countries. The deposits, and the need to find lending opportunities for them quickly, will increase far faster than the underlying capital of the banks, they figure. This is a concern that some other sources separately attribute to the Fed, as well.

The banking system's soundness could succumb more swiftly, the reasoning goes, if some of the non-oil poor countries and some of the hardest-hit industrial countries, such as Italy, launch dollar borrowings outside the U.S. that flop. Attempts by major banks to call existing debts of such countries for immediate repayment would fail, too, it's figured, possibly triggering a panicky chain reaction of financial collapses of governments and banks alike.

Cooperation by the U.S. would be crucial to preventing or arresting such a process, British strategists say, if the idea spreads that dollars aren't safe to hold outside the U.S. They could imagine a drain from the London-centered market in Eurodollars (dollars on deposit in banks anywhere outside the U.S.) and back to New York. That would mean that the countries in direct need of Eurodollar credits to offset their enlarged oil bills wouldn't be getting them.

The consequences, sources who couldn't be quoted directly say, would be akin to those afflicting the secondary or fringe banks in Britain, which have suffered runs by major creditors. The rescue operations that central banks and governments would have to mount on a global scale would be so vast and so sensitive, they warn, that mishandling could easily cause results ranging from a major mishap to catastrophic economic slumps in major nations.

Whether the IMF's Committee of 20 deputies will discuss the British ideas during their meeting this week in Paris remains to be seen. The deputies already are being diverted from their once-ambitious long-range planning for a new monetary system to doing some interim patching up and to preparing standby plans that may need a shelf life of some years before conditions become calm enough to try putting stabler exchange rates into being.

It is conceivable, though, some Paris participants say, that the desire of Common Market finance ministers to make use of gold reserves at something closer to the market price, currently $163 an ounce, than to the nominal official price of $42.22 an ounce, could lead to a breakthrough on the long-standing demand of the poorer countries for an extra share of the IMF's "paper gold," or Special Drawing Rights.

Should it appear that the richer ones are about to hand themselves a windfall by roughly quadrupling the worth of their gold reserves to market levels, planners worry, the poorer or developing nations may block agreement on anything else unless they get their long-sought "link" between SDRs and foreign aid. The U.S. and West Germany in particular are against using SDRs as aid, preferring to limit them to a reserve asset function.

The rich countries will be watching the poor ones for clues during the deputy-level sessions, so they'll have an idea whether a ministerial meeting June 12-13 in Washington may get bogged down on the link issue. If the Europeans feel strongly enough on making use of their gold, though, some insiders figure it is possible that a grand-slam compromise could be worked out, giving the rich what amounts to a richer hoard of gold and giving the poor an extra ration of SDRs.

MARCH 21, 1974

The Washington Post

AN INDEPENDENT NEWSPAPER

Pavlovian Politics and Arab Oil

PRESIDENT NIXON was evidently caught between two opposite impulses at his Houston press conference when he talked about the end of the Arab oil embargo. There was the strong temptation to play up the good news and tell the country that its oil troubles are over. But Mr. Nixon knew, of course, that our oil troubles are anything but over; the Arabs mean to keep the shipments lower than this country had expected. As it turned out, Mr. Nixon chose his words skillfully and managed to harvest several rounds of applause from his audience without giving away any substantial part of his position. He announced, for example, that he was rescinding his "order" to close gas stations on Sundays. But the order was never anything more than a request for voluntary compliance, and it was being increasingly ignored. The important parts of the oil conservation program all stay in place—the allocations, the low speed limits, the mandatory savings in industry. Prices will continue to rise, the strongest force of all for conservation. It is unpleasant but absolutely necessary to hold down oil consumption. In view of the Arabs' public statements, this country has no reason whatever to rely on the continuity of their future oil shipments to us.

The Arab oil producers now say that they are going to end their embargo against the United States temporarily, depending upon our good behavior. Dr. Pavlov rings the bell, and the dog salivates. In order to keep the dog salivating on signal, it is necessary to give him a morsel from time to time. In the same orderly and scientific spirit, the Arabs evidently intend to train us to identify our interests with their purposes. When we are obedient, the oil will flow. When we are refractory, the oil will stop. But if the oil is stopped too long, there is a danger—from the Arabs' point of view—that Americans will learn to live without the embargoed oil. It follows that the canny Arabs do not intend to leave the oil turned off indefinitely, even though progress toward a firm peace in the Mideast continues to be very slow. But to underline their intention, the ministers mean to meet again on June 1, less than three months from now, to "review" the decision on the embargo.

The Pavlovian politics of oil requires not only continuous uncertainty regarding the embargo but, much more important, a lower flow of oil than the world was expecting. Saudi Arabia has said that it will ship 1 million barrels a day to the United States, an amount not quite sufficient to bring our oil imports back up to the level of last fall. Until last fall, American oil policy assumed relatively low prices and a massive increase in oil consumption. Most of that increase was to come from abroad and, specifically, from Saudi Arabia. The Arab exporters are now offering us the opportunity to end our present discomfort by re-establishing our dependence on them.

Everything comes down to Saudi Arabia and its position. The Saudis command vastly the largest and most accessible oil reserves in the world. It is not really a matter of a cartel, because very little depends on what the other Arab producers choose to do. Saudi Arabia is by itself a large enough element in world oil trade that when it holds down production there is a worldwide shortage, and if it pumps to capacity there will be a worldwide glut. A lot of oil exporting countries are going to be pressing the Saudis to restrict shipments in order to keep up the prices for everybody else. More dangerous, every setback in the Arabs' negotiations with Israel will immediately bring an outcry from other Arab governments and political movements to invoke the oil weapon again. With every rise in their level of frustration, and with every rebuff to the Palestinian cause, the more militant and radical Arabs will begin to lean on the Saudis to turn off the oil. Saudi Arabia, a small country in terms of population and military strength, is in no position to stand up to unlimited pressure from its neighbors. That truth needs to be kept very much in mind by Americans as they consider the stability of our future oil supplies.

Now that the Saudis are going to ship to us again, for the time being, what ought we do? First of all, we need to keep the present conservation rules in force. If we drop these precautions, after having been plainly warned that the Arab oil ministers are taking up the embargo question again in June, we are foolish to the point of negligence. Next, we ought to store at least some proportion of the new imports. Building oil storage capacity is expensive, but it is not as expensive as the anxieties and uncertainties of recent months.

The oil weapon has been a great success in terms of raising prices, dismaying consumers and disrupting economies in the industrial countries. But it has had no visible effect on the pace or direction of the peace negotiations between Israel and its Arab neighbors. The United States is trying earnestly to assist the negotiations and speed both sides toward a stable peace agreement. But it has been slow work, and it will continue to be slow work. The oil weapon has been effective for everything except the one purpose for which it was evoked. The United States can readily agree to continue to deal with both sides in good faith, but it cannot promise rapid or dramatic results. We must assume that the oil embargo may flicker on and off over the months to come. If it catches us unprepared a second time, we shall have no one to blame but ourselves.

Address to National Press Club, Washington, D. C., Thursday May 9th, 1 P.M.

COPING WITH THE OIL CARTEL

M. A. Adelman
M.I.T.

I am honored to address the National Press Club, also grateful. The press has created the public record of the world oil market, directly and indirectly, often interacting with Congress. If it were not for you, academic industry study would be impossible, which some people think would not be a bad idea.

1974 may be the year of returning sanity. There seems at least the beginning of understanding that surging demand pushing us against limited resources is a fantasy. World oil remains in huge potential surplus, as it has been for at least 50 years. The problem for the industry has always been how to contain that surplus. Before the great turbulence began in 1970-71, the Persian Gulf price was about $1.20 per barrel. There was a chronic surplus, with more oil available than demanded, because at that price it was enormously profitable to expand production by drilling new wells. Now that the price has been multiplied by a factor of 7 or 8, there is a far bigger potential surplus, but also a much stronger barrier to hold it back, namely, the cartel of the producing nations, the members of OPEC.

A good picture of the market five years ago is the memorandum released by Senator Church's subcommittee, written in December 1968 for the top management of the Standard Oil Company of California, which for some obscure reason is trying to belittle it and shove it under the rug. It confirms other evidence, of people doing their best to contain the surplus but unable to practice collusion with the other companies. From 1947 to 1969 the Persian Gulf price came down, in real terms, by about 65 percent. The oil companies were beating a slow but long retreat. The current furor against the oil industry distracts our attention while the cartel nations lift $100 billion every year.

The big change since 1969 is that a group of governments have taken over from the companies the job of containing the surplus. This is something really new. A private monopoly can restrict output and raise prices, but only within limits permitted by the coercive power of government. Monopolists may lose their monopoly, or go to jail. But a group of sovereign states can do as they please. There is nobody to stop them from charging what the traffic will bear, which is the cost of the cheapest alternative.
When somebody says - in defense, in accusation, or as a simple fact - that oil producers set a price equal to the "real value" of their product, as set by competing products, he is saying that they are monopolists. If the farmers could maintain a monopoly, they would charge us whatever we were willing to pay for the privilege of eating. The principle is: what's it worth to you? The man who points a gun and says "Your money or your life" is also giving us a lesson in monopoly pricing.

Right now the governments at the Persian Gulf are taking between $7 to $11, and prices range from $8 to $12. I will not waste your time in trying to distinguish between taxes and royalties and buybacks and direct sales, nor about ownership and participation and just compensation. The governments are completely in charge, but they have not yet settled the price at which they convey the oil to the companies who do the actual work of finding, developing, and producing. The average will probably settle out closer to $7 than $11.

Today producing capacity at the Persian Gulf is already 20 percent above production. As for the years to 1980, a number of people are now doing a few sums. They use various methods, and come out with various answers. But estimates of consumption and production in consuming countries suggest that the demand for oil from the OPEC countries will not be much larger in 1980 than it was last year. Among the OPEC nations some are driving as hard as they can for greater output. In prudence, count only the announced production plans, nearly all for 1976, which have not been criticized as impractical. This assumes no increase at all for Algeria; and it assumes that Iran, Indonesia, and Nigeria, will take seven years to expand as much as they have in the past three. Venezuela, Libya, Kuwait, and Abu Dhabi are assumed unchanged. What's left for Saudi Arabia is less than what they actually produced last year. There is even a good chance that if all the OPEC nations but Saudi Arabia produced at rates which they can easily reach before 1980, that country could shut down completely, and yet the amount supplied would equal the amount demanded at current or less than current prices.

Of course, Saudi Arabia is not going to shut down. Nor will they be content with 5 million barrels daily when their capacity is already twice that and growing. Of course, we have heard from Americans and Saudis that Saudi Arabia is producing far more than is in their economic interest - that they are sacrificing, producing for sweet charity. Some people will believe anything. The point is, Saudi Arabia cannot by itself contain the surplus by relatively small and manageable cutbacks. Therefore other OPEC nations must share the burden of restraint. The nations must negotiate, and compose their differences. The only argument any will heed is the threat of damage. The best way to make threats credible is to build excess capacity in case of a fight.

I will not guess how much excess capacity will actually accumulate by 1976 or 1980. But assume the investment needed for one barrel per day added capacity stays around 1972 levels. For a Persian Gulf country which enjoys average costs - not the lowest level - one daily barrel of oil sold at $8 a barrel pays back the investment in 16 days. (This is 23,000 percent per year profit on investment.) If the price has dropped to $5, it takes 32 days (only 14,000 percent.) If there is any chance of ever finding a market, the excess capacity is well worth building and sitting on.

The cartel will therefore build a lot of actual excess capacity. The sooner the governments reaaly nationalize and take over the investment decisions, the faster the buildup of excess capacity. But the cartel will probably not collapse by itself. The gains are too enormous to give up easily. One must in common prudence assume the OPEC nations will hold together; if they quarrel they can reconstitute the scheme.

What the surplus does promise is a great temptation on each of them to chisel and cheat, to make incremental sales at lower prices to get additional profit. This is the traditional nemesis of cartels. When producing nations build refineries and buy tankers, there will be many more opportunities to shade prices. And the impulse is irresistible when fear reinforces hope - the fear that others are profiting by your scruples. Distrust melts the glue that holds the monopolists together; each can reflect: When you have a friend tried and true, do him quick before he does you.

The temptation to chisel and cheat is all the stronger when there exists a very large market which any producing nation can hope to penetrate, to get large blocks of additional business by rebates which do not affect prices elsewhere. This is the traditional role of the large buyer, which the United States can play if it so desires.

Zero imports for the United States are a mirage. There will be imports, and those imports must be limited for the sake of national security. A tariff will not do because one cannot predict in advance how much it will reduce imports. Domestic producers will have no firm idea of how much they can sell. Hence there must be an absolute import limit. The total of permitted imports must be divided up and allocated somehow.

Consider a ticket which permits the holder to import a given amount of oil. The value of the ticket is the difference between the United States price of oil, on the one hand, and the cost of obtaining and transporting oil on the other. Producing governments can bid several dollars per barrel, in fact their limit is their take.

Import quota tickets are exactly like other valuable rights, like leases to produce. They should be awarded in exactly the same way: for flexibility they should be sold in assortments, from 3 months to perhaps three years. Anybody at all ought to be permitted to bid, the only requirement being a cashier's check for the amount bid. Nobody need know who was putting up the money. Resale of quota tickets should be permitted. In this way, any government which wanted sales in the United States could have them, by rebating part of its gains to the United States Treasury. They would have to furnish tickets to the producing companies who otherwise could not import here. We could offer a home for oil all over the world, and an incentive to expand output. Since our imports would be a minor fraction of world production, it would take only a small minority, under cover of anonymity, to bid for all the tickets offered. Those who put profits higher than loyalty to the cartel would get the business.

This scheme would not affect the domestic price of oil, which will for the foreseeable future be far above production costs all over the world, and much higher than at any time since World War II. The sooner we face this, the better; but it is an issue separate from our appropriating a slice of the monopoly gains. The consumer is neither helped nor hurt - as a consumer - because this scheme has no effect on the domestic price. The consumer benefits as a taxpayer.

The immediate reward to this country of a quota ticket system would be a large reduction in the economic burden of oil imports. Also, we would start the war of all against all and put the cartel on the slippery slope. Once it begins, the slide can accelerate.

Those OPEC nations which curtail production can only afford to do so because of the high prices they receive. Hence a reduction in prices is twice blessed for us and other consuming countries. It reduces the burden and it also makes the producers willing or anxious to expand output.

This idea is practical but that does not necessarily make it good. Do we want the cartel to flourish or fade? My own opinion is that what's bad for the cartel is good for the United States. The burden of paying for oil imports has been much exaggerated but is still very great. For most of the underdeveloped countries, it is ruinous. There is no way they can pay, and we will need to bail them out. We are embroiled with our friends and trading partners in attempts to shove the burden of higher price on each other. Our government denounces the bilateral deals of armaments or other goods for oil, while we ourselves negotiate the biggest bilateral deal of all.

The cartel is also making the world a much more dangerous place. A vast arms buildup is just beginning at the Persian Gulf. Every little patch of barren ground is worth fighting over because of its potential wealth. The Arabs will be out of the control of either the Soviet Union or the United States because they can buy arms from all the world. When Saudi Arabian revenues were only $4.5 billion per year, in 1973, we got one shooting war and one economic war. Imagine what we will get when their revenues are multiplied. Unlimited arms, plus the "oil weapon" which made the consuming countries shake like jelly, do not add up to peace.

Oil supply is very insecure because the producing nations are saving so much money that they can afford to cut back production and pass up the revenues for a time, in order to inflict damage on consuming nations.

All of these dangers and burdens are simply unneccessary. High prices of oil do not result from scarcity, imposed by nature. Men have made them and other men can un-make them.

It will not be easy or quick work to remove this threat. It will be years before the cartel can be pronounced well and truly dead, because the OPEC nations have learned the enormous rewards of a successful monopoly. They will not soon give up, and they are encouraged today as they have been for years by consuming country governments' talk of "cooperation".

The producing countries are amused not impressed by American warnings that they may go too far. nheir experience has been that they can go as far as they please and they will get nothing but meek déference from the United States whose policy is to see, hear and speak no evil of them.

Any move to inject competition into the world market will of course stir bitter complaints: What a vicious animal! When attacked, he defends himself!

Our government seems to have in mind some vague grand design for a world commodity agreement to fix what Mr. Kissinger calls "a just price," whatever that means. Such an agreement would be a floor but not a ceiling, a one way street. The Persian Gulf nations have a clean record; they have never yet failed to violate an agreement on oil. If they can rig the price higher, up it will go; the agreement will merely keep us from taking defensive action.

In 1971, the State Department rightly claimed credit for the Tripoli and Tehran so-called "agreements", which they told us would bring "stability" and "durability". Those wonderful people who brought you the first Tehran are now preparing a super-Tehran which will freeze a dismal present into the indefinite future.

I think we can do much better; it's hard to see how we can do any worse.

Thank you.

The Washington Post
May 3, 1974

Stephen S. Rosenfeld

Aiding Developing Nations

The special session of the United Nations General Assembly on the world economy has dealt a heavy blow to the enlightened "liberal" notion of economic interdependence—the notion that we're all in the same basket and that we therefore must cooperate for our common good.

For what the session seems to have demonstrated is that some nations, especially poor ones, are more in that basket than other nations; that what economic interdependence there is is not matched by a corresponding recognition of political interdependence; and that the organized international community is not likely to act significantly to ease the critical condition brought to some 40 of the poorest countries by, principally, the massive price increases laid down last winter by the oil cartel.

A member of that cartel, Algeria, took the lead in calling the special session, apparently for the purpose of diverting opprobrium and responsibility for the new misery from the oil cartel to the good old "imperialists."

It is not yet clear who will be blamed for the limp and inadequate steps actually taken at the special session but it is clear that very little benefit has been gained by what the United Nations calls the "MSA" countries, those "most seriously affected" by the higher energy costs. Something like a billion people live in those countries.

To some goodwilled observers, the result—indeed, the general reluctance of old rich and new rich alike to do much more than make speeches for the poor—reflects a shortfall not only of moral values but of an understanding of the close link between the economic and political fortunes of rich and poor. This is the interdependence argument: the rich, needing the resources, markets and investment opportunities of the poor, should help them. Thus is self-interest hitched to internationalism and human dignity.

Indeed, after New York it becomes a real question whether there is much advantage for the poor in coming together in a big political forum such as the United Nations and trying to get the rich to agree to come across on development financing, trade, food, energy, emergency aid, and so on. Nothing useful can happen in a political forum on such issues unless there is a consensus, and there is no consensus.

Algeria's President Boumediene, opening the session, cited the postwar Marshall Plan for Europe as a hopeful model. But, as Secretary of State Kissinger replied, "then the driving force was a shared sense of purpose, of values and of destination. As yet, we lack a comparable sense of purpose with respect to development."

He could have added that the stirrings of detente have rendered anti-communism inoperative as a source of

"Partisans of interdependence warn that the alternative is confrontation. The warning is fair."

such a sense of purpose. Oil inflation, turning publics and governments inward, has nipped even more cruelly that common sense. So has the Western public's keen awareness that the Mideast oil states have billions of dollars rattling around in their bank accounts that they have no conceivable way to put to rational use now at home.

These are the political realities which crush worthy appeals to interdependence.

Partisans of interdependence warn that the alternative is confrontation. The warning is fair. No one can say just who will be the target but it seems to me inconceivable that countries like India, Pakistan or Bangladesh, to cite three of those worst hit, will sink meekly into deep public catastrophe without blaming someone and perhaps wildly casting about.

A second alternative to recognition of interdependence will surely be mass suffering on a scale heretofore unimagined. It becomes even more difficult to see how millions of people are going to avoid dying by starvation and associated causes, soon.

The best available answer is simple. The newly rich oil states should take their excess billions and apply them immediately to the relief of the world's poor. Then and only then will it be possible for all nations to apply the moral and political dictates for interdependence and to move forward on real development.

BUSINESS WEEK: May 11, 1974

An Arab bank shops for a New York office

One of the Arab world's newest and most aggressive banking groups, the Union des Banques Arabes et Francaises (UBAF), is wrapping up negotiations this month to open its first New York operation—a joint venture with at least two U. S. banks.

Significantly, the Paris-based bank is 60% owned by Arab governments and banks, many of which are scrambling to find places to invest the flow of new oil money into their coffers. The new office would give them a window into the U. S. capital and money markets.

"There's a great deal of enthusiasm on the Arab side, and the Americans seem quite receptive, too," says Mohamed Abushadi, the Egyptian chairman of UBAF. "We expect to file for a New York license in June." Six months later the bank could be in business.

Explaining the New York penetration, Abushadi says: "There has recently been great improvement in relations between Arab countries and the United States. So the flow of trade justifies it." Abushadi says the New York financial market is best suited to the Arabs' needs "in the sense that it can cope with the huge funds we will have." UBAF is expected to attract a substantial share of the $50-billion in annual Arab oil earnings that will result from oil price hikes last October and December.

A cool billion. The UBAF group, established in 1970, is 40% owned by the French banks Credit Lyonnais and Banque Francaise du Commerce Exterieur. The rest is held by 25 Arab banks and governments, of which the main shareholders are the Arab Bank (Jordan), the Banque Exterieur d'Algerie, the Commercial Bank of Syria, the Libyan Arab Foreign Bank, the Rafidain Bank (Iraq), the Central Bank of Egypt, and the Arab African Bank (mainly Kuwaiti and Egyptian interests). Total deposits, mostly in short and medium-term funds, are about $1-billion.

Abushadi: The New York market 'can cope with the huge funds we will have'

Abushadi, former chairman of the National Bank of Egypt, says he has already launched a search for New York office space on Fifth Avenue and in the Wall Street area. He is also looking into salary levels and personnel availability. And while he declines to name the U. S. banks he is negotiating with, banking sources in Paris say Bankers Trust, Irving Trust, and First National Bank of Chicago are among them.

"We need qualified Arabs to share in the management of our operations," he says. "They are very hard to get. And we don't want to operate under a false Arab image, with Arabs playing no effective role in management."

Fast expansion. Abushadi plans UBAF affiliates in India, Latin America, Greece, and Spain. "We will go wherever there is a great need for credit and project financing," he says. UBAF has a joint venture in Germany with Commerzbank and Bayerische Vereinsbank, in Britain with Midland Bank, Ltd., and in Rome with Banco di Roma and Banca Nazionale del Lavoro. Total deposited funds of all three ventures come to about $730-million.

Some recent UBAF major deals range from co-management of a $1.5-billion Eurodollar loan to the Italian government, to a $200-million loan to Algeria's national shipping company for building liquefied natural gas tankers.

The UBAF-American venture also will keep its activities diversified. Besides recycling Arab dollars back to the Middle East and Europe, it will probably invest in U. S. securities and real estate. "It's in both our interests to go ahead with our New York operation," says Abushadi. "It is essential to attract Arab funds to the U. S." ■

OIL MONEY AND THE POOR

HON. HENRY B. GONZALEZ

OF TEXAS

IN THE HOUSE OF REPRESENTATIVES

Wednesday, May 8, 1974

Mr. GONZALEZ. Mr. Speaker, everyone in this country realizes the awesome impact of oil price increases imposed by the Organization of Petroleum Exporting Countries on our own economy. Less well recognized is how much the poor countries have been and will be affected by the oil price hikes. We hear much about what the exporting countries might do in behalf of the poor, but one litmus test of their real intentions is what the Arab nations are doing for their truly desperate Moslem brothers in the sub-Sahara regions of Africa where mass starvation is not merely a threat but a daily fact. Here is a region where the wealthy Moslem countries might well show their concern for the fate of the poor and helpless.

But as a recent article in the New York Times points out, little or nothing has been forthcoming from the oil wealthy states to relieve the extraordinary and terrifying disaster that has overtaken the Sahel area of Africa. If the Arab nations have done so little for their Moslem brothers, I can only wonder how sincere they are in their proclamations of willingness to help other poor countries meet the extraordinary demands placed on them by the OPEC increases in petroleum prices.

The article follows:

[From the New York Times, Apr. 3, 1974]

OIL BILLIONS FOR THE FEW—SAND FOR THE STARVING

(By Chester L. Cooper)

WASHINGTON.—By the grace of Allah, a few Middle Eastern nations have become rich beyond even the wildest dreams of the fabled potentates of ancient Araby. Through little effort of their own, 55 million people—or, more accurately, their leaders—of Saudi Arabia, Kuwait, Iran, Iraq, Abu Dhabi, Qatar and Libya "earned" '$16 billion in 1973 and are expected to "earn" almost $65 billion this year. The spice trade was but salt and pepper compared with commerce in black gold.

The roll of the dice and the leaders' greed have combined to raise havoc with the energy-intensive, interdependent economies of Western Europe, Japan and the United States and to jeopardize the development prospects of scores of countries in Africa, Latin America and Asia. Because of quantum jumps in oil prices, worldwide inflation is sharply accelerating. International monetary arrangements, chronically fragile in the most stable of times, are under severe stress. The specter of a worldwide depression is becoming all too real.

Meanwhile, life goes on, at least for some—the lucky ones whose only urgent need is oil. But millions of Africans are facing another, more terrifying crisis. They are dying of thirst and hunger. Unknown thousands have perished over the last year and scores of thousands have fled from baked fields and destroyed herds to rot slowly away in unfamiliar, frightening cities.

On his return recently from the sub-Sahara region of Africa, Secretary-General Waldheim of the United Nations was aghast at what he had witnessed. "Peoples and countries could disappear from the face of the map," he said. "This region has not seen such a disaster in two centuries."

The international community, or rather a part of it has not remained unconcerned. Approximately $350 million in aid—food, money and services (not including airlifts)—have been contributed to the stricken countries of Senegal, Mali, Mauritania, Chad, Niger and Upper Volta. Of this, the United States, despite domestic problems, has contributed more than a third. The European Economic Community, racked by balance-of-payment problems and inflation, has contributed slightly less than a third.

The United Nations and its subsidiaries, not including the Food and Agriculture Organization, has given approximately 7 per cent. The F.A.O. has provided separate assistance, largely from American and European contributions. France, West Germany, Canada, China, Nigeria and the Soviet Union have made up the remainder.

On rereading the roster of contributors, one has the feeling that it must be incomplete. Are there not some countries missing? Some of the very rich perhaps? Some Moslem countries, since most of the stricken people south of the Sahara are also Moslems? Some fellow African countries, possibly? We had better review the official data.

Strictly speaking, three countries were overlooked: Libya contributed $760,000—from the $2.2 billion it collected in oil revenues last year. Kuwait contributed $300,000—from the $2.130 billion of its oil earnings in 1973. But what of Saudi Arabia, which earned twice as much as Libya? Not a dollar in 1973, and only $2 million so far this year.

And Iraq, which earned as much as Kuwait? Not a penny. Abu Dhabi, which earned over $7 billion, or about $23,000 for every one of its inhabitants? Nothing. And Qatar, which earned almost $400 million, or about $2,600 per capita? Zero. Bahrain? Zero. Algeria? Another zero And what of Iran, with almost $4 billion in oil revenues in 1973 and $15 billion projected for this year? A further zero.

Altogether, then, the Middle Eastern oil-exporting nations have contributed less than 1 per cent of the total aid to the starving people south of the Sahara.

This is not to say that they remained entirely aloof. Not at all. They raised the price of oil, not only for the rich industrial countries but for the desperately poor ones as well. As a consequence, virtually all of the American financial assistance to the stricken countries of sub-Sahara Africa will be absorbed by the increased cost of their oil imports—a "contribution" by the oil exporters to the needy that should not go unnoticed.

To be sure, the Arab League, with all deliberate speed, has been discussing easing the borrowing terms and doubling to about $400 million, the capital of the Arab Bank for Economic Development in Africa. And there has been talk of preferential oil prices for some of the developing countries and some desultory discussion of eventually doing something about the famine. But, meanwhile, by the grace of Allah, the oil flows out and the billions flow in. And life goes on, for some.

THE WALL STREET JOURNAL
Monday, May 6, 1974

Oil-Rich Nations Slate $2.76 Billion For IMF Aid Fund

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON — Oil-producing nations have offered to lend $2.76 billion to a special International Monetary Fund pool of currencies to be lent to nations that need help in paying their increased oil-import bills, the IMF disclosed.

Ever since the skyrocketing of world oil prices began to threaten international financial trouble for many oil-importing nations, IMF Managing Director H. J. Witteveen has been trying to drum up support for a special oil fund that would lend money to nations in need. He has sought funds from five oil-rich Middle East and African nations and this week will travel to Venezuela on a similar mission.

Reporting results of the effort so far, the IMF said the oil-exporting nations have offered to lend to the IMF the equivalent of $2.76 billion for the oil fund. It said Saudi Arabia offered the equivalent of $1.2 billion, Iran $720 million and other unidentified nations a total of $840 million. "Additional amounts may be forthcoming from other oil-exporting countries," the 126-nation organization said.

The IMF chief called the results of the fund-raising effort "satisfactory and encouraging." Member nations would be entitled to borrow from the special fund an amount about equal to the increase in the oil-import bill resulting from the quadrupling of world oil prices since last fall. The special oil fund is expected to begin lending after midyear.

THE WASHINGTON POST May 5, 1974

Courting The Arabs

Inter-American Development Bank Seeks New Investors, Changes

By Lewis H. Duiguid
Washington Post Staff Writer

This hemisphere's principal development lending insitution is seeking to attract Arab investors and thereby reduce the influence of its main source of funds until now, the United States.

Successful attraction of the Arab funds would accelerate a drastic transformation of the institution, the Inter-American Development Bank, which began with a decision by Venezuela to underwrite major bank programs.

Venezuela has teamed its commitment of a reputed $1 billion in oil export earnings with a call for reducing US. influence in the bank. The United States is frequently accused of dominating the institution, which has its headquarters in Washington.

Mexican Antonio Ortiz Mena, president of the 24-nation bank, announced to the staff that Arab funds will be welcomed on the same terms as those of Venezuela and will be used to finance giant industrial projects.

Ortiz Mena had just returned from exploratory talks at the Beirut meeting of the Arab Economic and Social Development Fund. He also visited Tehran to sound out Iran on possible investment of oil profits in the bank.

Praising the Venezuelan commitment, Ortiz Mena said the conditions that make investment in the bank desirable for this hemisphere's main oil producer are equally valid for the Arabs. He did not specify any Arab commitments, but his words to the bank staff implied confidence that such investments would be orthcoming.

Ortiz Mena indicated that bank would borrow from the oil producers at commercial rates, offering them a return more than offsetting inflation. The bank's role, he said, was to offer "assurance to the investor of the quality of the projects." billion

The bank has lent $6 million over its 14-year history, but is often accused of approaching Latin America's development too timidly. "We are now in a moment when the size of our projects should not frighten us," he said.

The onetime finance minister of Mexico said the bank must help Latin America to be in the forefront of nuclear energy exploitation and to develop "the world's biggest food production reserves." But his main emphasis was on industry, and he described a project for "the first Latin American trans-national corporation."

As explained by Ortiz Mena, the bank would oversee creation of a huge cellulose and paper industry in Honduras, with Venezuela lending 50 per cent of the capital to Honduras and the four other countries of the Central American common market.

Ecuador, another oil exporter, along with Argentina and Mexico would lend the other 50 per cent and assure the Hondurans of markets for the paper. From Honduras's earnings, it would pay back Venezuela, which would thus receive a return far into the future on its present sales of the non-renewable petroleum. Honduras, he said, would gain the biggest paper industry in Latin America, capable of exporting elsewhere as well.

The Honduran government recently decreed nationalization of foreign (largely American) lumbering interests in preparation for state takeover of forest industry.

Venezuela's offer to help finance bank programs was made last month at the bank's annual meeting in Santiago, Chile. Details of the proposed trust fund are yet to be negotiated, but Venezuela made clear that some of the funds would be provided at concessional interest rates.

The Venezuelans have also indicated that they will not accept more than a token U.S. role in administration of these funds. They have urged "Latinization" of the bank and have hinted that its headquarters might better be located in Caracas than in Washington.

The main accusation of U.S. dominance turns on the pressures successfully mounted against loans by the bank to the government of the late Chilean President Salvador Allende.

Critics say the failure to lend to Chile, a member in good standing, made the bank a tool of U.S. foreign policy. Since Allende was ousted by a military coup last September, the bank has lent almost $100 million for two Chilean projects.

According to sources within the bank critical of its response to U.S. pressures, the failure to lend to Allende cost the bank another non-hemispheric source of funds—Europe.

The bank had proposed to bring European Common Market members into the bank on the pattern of the recent recruitment of Canada. They were to pledge $500 million in development funds for the bank, again with an unstated purpose of diluting U.S. influence.

However, these sources allege, West Germany backed off from its key commitment on the basis that the Allende experience indicated excessive U.S. control over the bank. With that, European membership was put off if not precluded altogether.

Some isolated European and Japanese investments have been negotiated, and the proposed Common Market memberships remain a goal of the bank, but Ortiz Mena indicates that the Arabs' booming oil profits are now looked upon as a more effective route to diversifying the bank's lending portfolio.

In his talk, Ortiz Mena made no criticism of the U.S. role in the bank or in hemispheric development. Indeed, he said, despite all of the talk of failure surrounding the Alliance for Progress, "the '60s saw substantial change in Latin America."

THE MONEY MANAGER May 6, 1974

Swiss Central Bank President Sees Oil Deficits As the Biggest Obstacle to Monetary Reform

The efforts toward international monetary reform will be complicated by a problem far more serious than the once-chronic United States balance of payments deficits, according to Edwin Stopper, the president of the Swiss National Bank.

This problem is the massive balance of payments deficits resulting from the massive escalation in the price of crude oil by the oil-producing and exporting nations last year, he said.

Mr. Stopper, who retired at the end of April, told the recent anual meeting of the Swiss central bank that it is assumed that oil-exporting nations will accumulate balance of payments surpluses during the next five-to-ten years at a rate starting at $50 billion annually.

Only a few countries would be able to finance their balance of payments deficits arising from crude oil purchases for some years through the depletion of their foreign exchange reserves. One of these countries, Mr. Stopper said, was probably Switzerland.

The other nations would be forced, as many are now, to borrow heavily to finance payment of their balance of payments deficits. Among these nations are now the United Kingdom, France, Italy and others. In later years the interest payments on these debts will represent another outflow, and thus burden, on these nations' balance of payments.

Mr. Stopper urged international cooperation which would also help oil-producing countries. This cooperation could justify a reduction in petroleum prices, which has been requested by the United States. A price cut has also been favored by Saudi Arabia; however, it is opposed by other members of the Organization of Petroleum Exporting Countries.

However, some oil analysts fear that a lowering of imported oil prices may not be desireable over the long-term for national security reasons. A lower imported oil price would increase consumption of imported oil and discourage investment to develop domestic petroleum and non-petroleum sources of energy they contend. Lulled into a false sense of security, the United States, Western Europe and Japan would be even more vulnerable to an Arab oil embargo such as the one embarked on last October.

As for the world's financial system, Mr. Stopper said that the United States' warning that the balance of payments problems could become unmanageable should be taken very seriously.

Furthermore, the developments unleashed by the crude oil price increases make an early restoration of fixed exchange rates 'doubtful,' he added. But private industry needs, at least in the intermediate-term, more exchange rate stability than the floating rate system has brought, Mr. Stopper asserted.

A restoration of the fixed rate system could only be achieved by international cooperation to fight inflation, which he called Switzerland's greatest problem, and by reductions of sudden and substantial exchange rates fluctuations, he said. Mr. Stopper added that the hopes placed on the systems of floating currency rates had not at all, or only partly been realized.

Mr. Stopper also urged careful examination into the possibility of commercial banks voluntarily aligning the credit policies and techniques to the system of credit growth limits.

The alternative to this cooperation would be for the central banks to obtain authority to institute restrictions on bank credit expansion, he contended.

Mr. Stopper added that he hopes that gold will again one day resume its place as basis for a new international monetary system. He added while raising the official price of gold would not solve the problem of inflation it would solve a lot of other problems.

Energy and Money *Oil Price Rises Hit International Monetary System*

The shock from rising oil prices has been felt in the economies of the entire world. The International Monetary Fund (IMF) has calculated that the "western" industrialized countries will have to pay $50-60 billion more for their oil imports in 1974. For the nine EC countries, the figure is estimated at $23 billion.

Such a large capital hemorrhage will further aggravate the economic problems already facing the Community. Taking into account the price rises in manufactured and agricultural goods due to the petroleum product price rises, inflation will exceed 8 per cent annually. In addition, the dearth of supply will probably accentuate the slowdown of economic activity and will raise unemployment.

Finally, the accrued cost of oil will probably cause a deficit in the European balance of payments and seriously threaten the still embryonic system of the Community "snake." The French decision to float the franc is a concrete consequence of the oil crisis' influence on monetary affairs [see page17].

DISASTER FOR THE THIRD WORLD

Even if the developed countries' strong economies can weather the crisis without long-term catastrophic consequences, the "Third World" countries present a different case. Many developing countries are threatened with economic disaster by the oil price rises. The present increase in prices has already neutralized United Nations (UN) aid given to these countries. (UN aid equals one-fourth of the total aid they receive.)

The developing countries import less than one-fifth of the total oil imported by the industrialized countries. But the majority of the developing countries' imports are used in vital sectors, which leaves a narrow margin of maneuver in efforts to economize energy consumption. In addition, the general price rise on the international scale will make developing countries' other imports more expensive. Most other imported products are as vital to these countries as oil.

Some developing countries could compensate for these difficulties by increasing prices of their raw material exports. But the slowdown of world industrial activity will reduce the demand for raw materials, leading to a decline rather than an increase in prices.

Other Third World countries which lack raw materials are on the edge of ruin. India, for example, strongly depends on advanced technological industries, especially the petro-chemical industry. But, with its international credits already pushed to the limit, India cannot pay for the crude oil for its refineries. The world cannot ignore this crisis which affects hundreds of millions of people.

HOW TO USE THE NEW MONETARY SURPLUS

The Arab world's new position presents the international monetary system with problems it is not equipped to face. In the last 20 years, monetary disequilibrium (payments deficits in certain countries, excesses in others) was corrected by the system of Special Drawing Rights (SDR's) or by bilateral loans between central banks.

The Arab oil weapon has turned the situation around. In the last three years, Saudi Arabia has seen its reserves rise from $670 million to $3.7 billion. The World Bank estimates that, by 1980, the Persian Gulf oil-producing states will have reserves of $280 billion, 70 per cent of world reserves.

What is to be done with all this money? The economies of these countries, primitive and concentrated on one product, can only absorb a small part of their revenues.

It is here that a ray of hope for monetary stability resides. These monetary surpluses could be reemployed in the economies of developed and developing oil-consuming countries. [For an example of such reemployment, see page 18.]
The IMF and the World Bank could perfect a system to channel the money toward the developing countries and to the Western markets. At the same time, a short-term stability could be assured by financing national purchases of oil through the sale of gold reserves at market price.

These two plans were proposed at the meeting of the finance ministers of the IMF in Rome in January. There is no evidence, however, that the Arab states would approve these proposals, especially since they have had nothing to do with IMF affairs in the past.

A WORLD-SCALE CRISIS

In any event, the EC member countries should prepare for serious monetary problems.

Some EC countries will be able to balance the political capital exit caused by oil price increases—Great Britain, for example, can attract considerable investments and thus find itself in a paradoxical situation of a record commercial balance deficit on one hand and a pound reinforced by monetary reserve increases on the other. Thus, Great Britain may be able to support itself until it has developed its own oil resources (North Sea) in about 10 years.

Other Community countries, like Belgium or France, which do not have this capital market capacity, will be worse off. Their balance of payments could feel a chronic deficit that they could not resolve alone. In fact, it appears that even the most favored nations cannot expect to find individual solutions. The monetary crisis is the last in a long list of common problems that demands common policies and international solutions.

THE WASHINGTON POST May 10, 1974

Saudis to Keep Oil Money

Yamani Rejects IMF Plan

By Bernard D. Nossiter
Washington Post Foreign Service

LONDON, May 9—Saudi Arabian minister, Sheikh Zaki Yamani, has rejected—at least for now—a plan by the International Monetary Fund to protect the world's economy from currency disorders.

Since the fund scheme depends heavily on the cooperation of Saudi Arabia and other oil states with huge revenue surpluses, Yamani's cool response at a press conference here today has placed the plan in jeopardy. The IMF plan would recycle some of this surplus to developing and industrialized countries hard hit by the nearly fourfold increase in oil prices.

The Arab minister told reporters that Western experts were exaggerating the problem, that oil states would have "much less" than the estimated $50 billion in extra revenues this year. Later, he said he thought oil state surpluses would not reach $25 billion.

In addition, he said, he did not like the idea of the oil states losing control over their surplus revenues by lending them to an international agency controlled by the West. Iran, however, has come out strongly in support of the IMF plan.

Above all, Yamani expressed concern over the erosion that Arab loans to the IMF might suffer because of the rapid rate of inflation in the West.

"For the time being," he said, "you do not need" the IMF plan. "We will absorb a large part of the surplus we realize," he said.

"We won't be amenable to letting that money recycle to the Western economy for the sake of the Western economy as such," he said. However, he added, "That does not mean we will never do it."

Yamani's position is in sharp contrast to the optimism voiced just last Monday in Detroit by Johannes Witteveen, IMF managing director. Witteveen said that oil exporting states "have taken a very positive attitude to my initiative" and that he was "hopeful" that the fund scheme would be set up before June 30.

Yamani did leave the door open, however, to a modified version of the Witteveen plan. If the IMF would tie loans from oil states to the consumer price index in the United States, Saudi Arabia might be interested, he said.

The Saudi oil minister dismissed out of hand the more ambitious proposal for monetary and oil price stability now being discussed in Washington by Harold Lever, the British Cabinet minister and financial advisor to Prime Minister Harold Wilson.

Lever proposes that the United States and five other industrial nations collectively buy and distribute oil and then serve as a lending agency financed by the surplus of producer states.

"I have had a chance to look at the inside story" Yamani said, "and I don't think the consumers will adopt this plan."

He declined to explain further. But he apparently meant that American opposition has already killed the Lever plan even before it got off the ground.

The one cheerful piece of news that the Harvard-trained oil minister offered was his view that crude prices are too high. The Saudis, the world's largest oil producers outside the United States, had already brought the price of oil down from $17 a barrel to about $10, he claimed.

SHEIKH ZAKI YAMANI
... problem exaggerated

"It should be a bit lower," he said. "I think it will go further down." But he declined to spell out how this would be achieved.

Here Yamani runs into opposition from the shah of Iran, who has sought to push oil prices. The Saudis, however, could force prices down by opening their taps and increasing sharply their current output of about 8.5 million barrels daily.

Yamani said his country would not increase production to the 10 million barrel-a-day level planned before the October war until the Arab-Israel conflict is settled. But he did hint at an increase above current production as one means of further reducing the price.

Yamani was talking about the "realized" or actual selling price of oil in the Persian Gulf as opposed to the "posted price" used for fixing royalties and taxes. It is now around $11.65 for Persian Gulf low-sulphur crude.

Yamani has been in London primarily to see financial and industrial leaders whom he hopes to enlist for the rapid industrialization of Saudi Arabia. At a closed meeting of about 50 persons yesterday, he also voiced his coolness toward the IMF plan.

The meeting was proposed to deal with the currency dislocations threatened by the surpluses the Arabs and other oil states are now earning because of the leap in oil prices. Western officials have estimated that the oil states this year will earn $50 billion more than they can invest in their own countries or use to buy arms, goods and services from the West.

Witteveen has proposed creating a "special facility" or temporary loan agency in the IMF. It would make seven-year loans to Italy, Britain and other countries now running big payments deficits because of sharply increased oil costs.

Funds for this "facility" would, under Witteveen's plan, come in part from the oil states with big surpluses. Thus the IMF would recycle money that Arabs and others can't absorb to countries with emergency needs.

The Saudis, Yamani said, would find outlets for their surplus by lending to the World Bank, a new Arab-African bank and financing an even newer Saudi development loan program.

Apart from losing political control over oil money loaned to an IMF facility, Yamani fears that the purchasing power of such credits would be eroded by price inflation in the West.

That is why he said he might be more "amenable" to an IMF scheme linking oil state credits to the American price index. In other words, the Saudis might lend the IMF facility $5 billion if every 10 per cent rise in U.S. prices increased the Saudi investment by $500 million.

The oil minister, whose trim goatee and mustache are now internationally known trademarks, said he expected to negotiate a new deal this summer with the four American companies exploiting Saudi Arabia's oil. They are Exxon, Mobil, Standard of California and Texaco. Their joint Saudi concern is Aramco in which the Saudis already have 25 per cent interest.

Yamani said that the existing deal is "out of date" and that the Saudis need "completely different arrangements." Oil industry executives think he will seek anywhere from 75 to 100 per cent of Aramco in the next few years.

Venezuela Pledges Money to IMF Plan

Reuter

CARACAS, May 9—Venezuela has pledged $540 million to the IMF to help countries whose balance of payments have been seriously affected by the higher price of oil, central bank governor Alfredo Laffee said today.

Laffee said at a news conference that Venezuela's contribution to the IMF's oil-loan fund was made on the condition that it be used preferentially to help developing countries, especially in Latin America.

The offer was made during a meeting here with IMF managing director Johannes Witteveen who was present at the press conference.

Hobart Rowen THE WASHINGTON POST Sunday, March 31, 1974

Global Oil Austerity?

THE END of the Arab oil embargo still leaves the industrial world with a terrible dilemma and the poor countries facing a disaster of unmanageable proportions.

Although it has become fashionable in banking circles to suggest that financial gimmicks of one sort or another can "solve" the problem, it is important for the public to keep in mind that loans and investments—while great for the banking business—solve neither the difficulty of growing trade deficits nor the loss of purchasing power due to the higher price of oil.

There are two facts that should be remembered when anyone tells you that the energy crisis is over because the Arab oil embargo has been lifted:

First, despite some easing in the auction price for oil in the Persian Gulf, the "mainstream" of supplies, as oil consultant Walter Levy points out, still ranges upward of $7 a barrel, compared to $3 as recently as October 1973, $1.25 in 1971 and 90 cents before that. Thus, the world oil bill for 1974 is something like $65 to $75 billion higher than last year's.

Moreover, the secretary general of the Organization of Petroleum Exporting Countries, Dr. Abderramman Khene, forecast on Wednesday that the cartel will boost prices after the current freeze expires in July. Oil prices are "artificially low," Dr. Khene alleges. The OPEC governments, watching the rate of inflation around the world climb, are talking of a "take" in taxes and royalties that will yield them about $12 a barrel instead of the present average of $7.50.

Second, as George W. Ball cautions, the end of the embargo "must still be regarded as provisional—for the embargo cannon will continue to be loaded and ready for firing until the Arab-Israeli dispute is finally settled which—even if we are lucky—is not likely to occur for another two to three years."

SO, EVEN with the oil embargo lifted, the oil problem remains. For the less-developed countries which last year had a combined trade deficit of $11 billion, the staggering oil price increase means that they will wind up with a deficit of $20 to $25 billion in 1974.

For the industrial nations, as West German central banker Otmar Emmminger pointed out here the other day, the situation varies. But even the supposedly wealthy United States faces an Arab oil "tax" which will cut consumer purchasing power by perhaps $15 billion this year. And if prices go up, the situation will be worse.

Europe and Japan are feeling pressure to boost exports to earn more foreign exchange. Former Commerce Secretary Peter Peterson, now head of Lehman Brothers, says that this "may wipe out the advantage the United States increasingly enjoyed during 1973 from an under value dollar and restore roughly the same condtions that existed prior to Aug. 15, 1971, when American goods encountered serious problems of price competition in world markets."

Emminger, it should be said, thinks that the major nations will not engage in a cutthroat competition for export markets typified by exchange-rate wars or "beggar-thy-neighbor" policies.

But Japan—which must import virtually 100 per cent of its oil—already has indicated that it will junk the plans once made to improve the standard of living at home and return to the old emphasis of an export economy to improve its foreign exchange earnings. That can only mean a return to the bitter fights among Japanese, American and European manufacturers to obtain and secure outlets for their goods.

Where does all of this leave us? First of all, we must ignore the advice of such as Roy Ash, head of the Office of Management and Budget, that all allocation controls should be dropped once imports reach last August's levels. That would be stupid and short-sighted. We must accept as reality that the Arb oil weapon has not been discarded, only temporarily suspended.

Second, we have to make Project Independence believable, rather than something—as Peterson says—"which currently suffers from a credibility gap."

Economic Impact

The United States government, if it truly believes that price is the real problem, can bring pressure on the Arab monopolists only by setting specific production schedules and goals for oil shale, tar sands, offshore oil, solar energy, and so on, that will diminish our dependence on Arab oil.

If we yield to the temptation suggested by Ash to believe that the energy crisis is over, all necessary effors to achieve major conservation in the use of oil will go down the drain.

IN A NEW analysis called "Implications of World Oil Austerity" which is gaining wide attention in Washington circles, Levy comes to the conclusion that there must be a substantial cut in world oil consumption until the latter part of he 1970s, with the burden of reduced production falling on Saudi Arabia, Kuwait and Abu Dhabi.

Those are the countries in the cartel which are

Hobart Rowen

Will Worldwide Oil Austerity Continue?

under the least pressure to generate increased revenue and also the ones least able—because of their small populations—to absorb added goods and services from the Western World in exchange for their oil.

Whether these countries would agree to reduce output while Iran, Iraq and others are expanding is an unanswered question. But high oil prices unquestionably will force some kind of austerity in oil consumption on the West.

Economic Council Chairman Herbert Stein, in a thoughtful speech on Project Independence, said this past week that "we will find it prudent to hold oil imports to a lower level than a free market would bring about and to try to avoid an increase in the import share of our energy supply."

This is necessary not only because we no longer can afford all of the oil we would like to use, but because the cartel has demonstrated it is an unreliable source.

This will require some new disciplines. It means smaller and more economical cars—by legislative order if necessary—and a conservation program to cut energy wastage of the same order of urgency that once was the accepted ethic in wartime.

PETROLEUM PRICES

	Imports* (Dollars per barrel)				Consumer prices† (Cents per gallon)	
	Crude	Gasoline	Distillate	Residual	Gasoline	Distillate
1973-Jan.	2.75	3.92	2.46	2.58	36.6	20.0
Feb.	2.73	6.16	2.76	2.75	36.8	21.2
March	2.82	5.53	2.98	2.70	37.0	21.3
April	2.84	6.25	2.84	2.77	37.6	21.4
May	2.90	7.05	2.77	2.85	38.3	21.5
June	3.05	7.64	2.90	2.75	39.1	22.1
July	3.15	7.32	3.39	2.75	39.2	22.1
Aug.	3.25	6.87	3.39	3.00	39.2	22.3
Sept.	3.38	7.58	3.52	2.95	38.9	22.4
Oct.	3.54	8.39	4.21	3.10	40.2	23.7
Nov.	3.81	8.52	6.80	3.60	41.8	26.1
Dec.	5.28	11.84	7.76	5.34	43.7	29.1
1974-Jan.	6.71	13.23	11.95	7.30	46.5	32.9
Feb.	9.09	17.02	9.35	9.55	49.1	34.2
March	11.08	17.99	13.76	9.99	52.8	34.1

* Unit values were calculated from Department of Commerce data. Prices are on F.O.B. basis.

† Distillate prices are a 31-city average for #2 heating oil published by BLS. Gasoline prices for October-March are a 56-city average for regular gasoline published by BLS. The gasoline prices prior to October were computed by chaining the BLS index for retail premium and regular gasoline. Retail prices include all applicable taxes.

The

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MAY 1974

Those oil deficits—pick a number

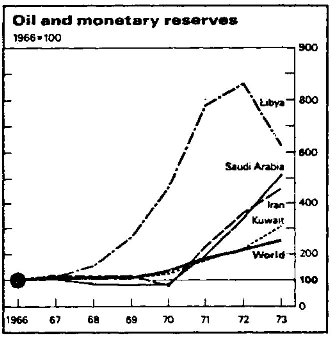
M. S. Mendelsohn

Latest official and semi-official calculations on just how the oil deficit will be shared out are, if anything, even more frightening than the total numbers involved. Here is a framework for readers to make their own calculations.

Trying to forecast this year's oil deficits has become all the rage, and the Bank of England streaked in with its contribution on 15 March, when it published its latest *Quarterly Bulletin*.

An attraction of this game is that the guesses can be amended from month to month to keep speculation on the boil. But although there is nothing certain about the numbers (except that they are going to be very large), there have been very important changes recently in the underlying assumptions that are being made. One of them is the official recognition that developing countries will be unable to secure the financing they would need to maintain investment, output and employment; and another is that the industrial countries will therefore face deficits even bigger than those previously predicted.

The details of the way that official estimates have changed and some of the ways in which they differ from each other are summarized in the tables at the end of this article. It will be seen that the finance ministers of the IMF accepted as a basis for discussion, in Rome in January, an OECD guesstimate that OPEC might run a current surplus of about $55 billion this year offset by current deficits of about $32 billion for OECD and about $23 billion for the oil-importing developing countries.



Oil and monetary reserves

However, these and subsequent official estimates are not forecasts in the ordinary way. They are simply suggestions of what might happen in given circumstances, and these assumptions include a good deal of polite diplomatic fiction. One such assumption is that it may prove possible to maintain January's oil price levels throughout the year while at the same time maintaining the growth of real output in the industrial world at between 3 and 4%. It is improbable that both these conditions can be satisfied at the same time, and if one of them is not, then the size of OPEC's suggested current surplus would shrink.

Impact on the LDCs

Another polite fiction was that oil-importing developing countries might somehow be able to find around $23 billion to finance their projected current deficit this year, but that fiction, at least, was dropped by the time that OECD's Working Party III met in Paris in mid-February. Dr Otmar Emminger, the chairman of the OECD group, disclosed merely that the industrial countries' anticipated deficit was expected to be about $40 billion rather than about $32 billion, but he declined to go into the embarrassing details of what this implied.

What it implied, first, was the official acceptance that the oil-importing LDCs would probably be unable to secure more than about $15 billion for the financing of their current deficits this year, and that they therefore face a considerable risk of recession and political instability.

The second implication was not merely that the industrial countries faced an even bigger deficit than originally guessed, but that most of them face larger deficits even than is being officially conceded now. This is because the February estimates retained, among other diplomatic fictions, the one that the US might be running a current deficit of around $4 billion this year.

But if the US current account ends in approximate balance, as seems more likely, then the other industrial countries would face between them a combined current deficit of close to $45 billion, or about 50% more than the combined current deficit being predicted for them

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only a month earlier in Rome. No wonder that the details were not emphasized, and no wonder either that France, Italy and the UK have been so quick to rush into the front of the queue for large Eurocurrency borrowings (not to mention lesser fry like Greece, which secured $250 million in March, equivalent, on foreign exchange earnings, to a single $2·5 billion borrowing by a country like the UK).

The forecasts of oil deficits will no doubt be changed again, or several times, over the course of this year, and it will be interesting to compare the results when they are known with the guesses that were made. But some assumptions seem reasonably safe:

1. That there may either be some fall in oil prices or else a greater fall in oil imports than now being estimated, and that OPEC's current surplus may therefore prove somewhat less than the $60 billion being suggested by the Bank of England or even the $55 billion suggested by OECD, although that surplus will still be very big;
2. That oil importing developing countries may go short of oil, or finance, or both; and
3. That the brunt of whatever the world's oil deficit turns out to be will probably fall on the industrial countries other than the US and Canada even more heavily than most public statements have so far suggested.

The tables below allow readers to join the game with their own guesstimates:

Current payments, 1974
$ billion

	at Sept. 1973 prices	at Jan. 1974 prices*	at Jan. 1974 prices
US	6¾	–1½	balance
Canada	– ¼	balance	balance
Japan	1¾	–6	–8
France	¾	–3¾	–3½
Germany	2¼	–2½	–1
Italy	balance	–3½	–6
UK	–3¼	–7½	–8/9
OECD	10	–32	–40†
non-oil LDCs	–15	–23	–15
OPEC	5	55	55†

*Official Rome estimates, January.
†Official Paris estimates, February.

Possible impact of higher oil prices, 1974
(rise in cost of oil imports at 1973 volumes)
$ billion

	OECD	Bank of England
US	8½	9·4
UK	4¼	4·3
Japan	7½	8·3
Germany	4¾	5·4
France	4¼	4·6
Italy	3½	4·7
OPEC surplus	55	60

NEW YORK TIMES

April 3, 1974

OIL BILLIONS FOR THE FEW - SAND FOR THE STARVING

By: Chester L. Cooper

WASHINGTON -- By the grace of Allah, a few Middle Eastern nations have become rich beyond even the wildest dreams of the fabled potentates of ancient Araby. Through little effort of their own, 55 million people -- or, more accurately, their leaders -- of Saudi Arabia, Kuwait, Iran, Iraq, Abu Dhabi, Qatar and Libya "earned" $16 billion in 1973 and are expected to "earn" almost $65 billion this year. The spice trade was but salt and pepper compared with commerce in black gold.

The roll of the dice and the leaders' greed have combined to raise havoc with the energy-intensive, interdependent economies of Western Europe, Japan and the United States and to jeopardize the development prospects of scores of countries in Africa, Latin America and Asia. Because of quantum jumps in oil prices, worldwide inflation is sharply accelerating. International monetary arrangements, chronically fragile in the most stable of times, are under severe stress. The specter of a worldwide depression is becoming all too real.

Meanwhile, life goes on, at least for some -- the lucky ones whose only urgent need is oil. But millions of Africans are facing another, more terrifying crisis. They are dying of thirst and hunger. Unknown thousands have perished over the last year and scores of thousands have fled from baked fields and destroyed herds to rot slowly away in unfamiliar, frightening cities.

On his return recently from the sub-Sahara region of Africa, Secretary-General Waldheim of the United Nations was aghast at what he had witnessed. "Peoples and countries could disappear from the face of the map," he said. "This region has not seen such a disaster in two centuries."

The international community, or rather a part of it, has not remained unconcerned. Approximately $350 million in aid -- food, money and services (not including airlifts) -- have been contributed to the stricken countries of Senegal, Mali, Mauritania, Chad, Niger and Upper Volta. Of this, the United States, despite domestic problems, has contributed more than a third. The European Economic Community, racked by balance-of-payment problems and inflation, has contributed slightly less than a third.

The United Nations and its subsidiaries, not including the Food and Agriculture Organization, has given approximately 7 per cent. The F.A.O. has provided separate assistance, largely from American and European contributions. France, West Germany, Canada, China, Nigeria and the Soviet Union have made up the remainder.

On rereading the roster of contributors, one has the feeling that it must be incomplete. Are there not some countries missing? Some of the very rich, perhaps? Some Moslem countries, since most of the stricken people south of the Sahara are also Moslems? Some fellow African countries, possibly? We had better review the official data.

Strictly speaking, three countries were overlooked: Libya contributed $760,000 -- from the $2.2 billion it collected in oil revenues last year. Kuwait contributed $300,000 -- from the $2.130 billion of its oil earnings in 1973. But what of Saudi Arabia, which earned twice as much as Libya? Not a dollar in 1973, and only $2 million so far this year.

And Iraq, which earned as much as Kuwait? Not a penny. Abu Dhabi, which earned over $7 billion, or about $23,000 for every one of its inhabitants? Nothing. And Qatar, which earned almost $400 million, or about $2,600 per capita? Zero. Bahrain? Zero. Algeria? Another zero. And what of Iran, with almost $4 billion in oil revenues in 1973 and $15 billion projected for this year? A further zero.

Altogether, then, the Middle Eastern oil-exporting nations have contributed less than 1 per cent of the total aid to the starving people south of the Sahara.

This is not to say that they remained entirely aloof. Not at all. They raised the price of oil, not only for the rich industrial countries but for the desperately poor ones as well. As a consequence, virtually all of the American financial assistance to the stricken countries of sub-Sahara Africa will be absorbed by the increased cost of their oil imports -- a "contribution" by the oil exporters to the needy that should not go unnoticed.

To be sure, the Arab League, with all deliberate speed, has been discussing easing the borrowing terms and doubling to about $400 million, the capital of the Arab Bank for Economic Development in Africa. And there has been talk of preferential oil prices for some of the developing countries and some desultory discussion of eventually doing something about the famine. But, meanwhile, by the grace of Allah, the oil flows out and the billions flow in. And life goes on, for some.

THE WASHINGTON POST

April 3, 1974

VENEZUELA PLEDGES DEVELOPMENT AID

Venezuela, whose coffers have been swelling because of higher oil prices, yesterday told the Inter-American Development Bank meeting in Santiago that it would give at least $1.2 billion to be used to set up a trust fund to finance development projects in Latin America.

At the same time, Venezuela and Peru criticized the United States' dominant role in the bank's affairs, Agence France Presse reported.

Venezuelan Finance Minister Hector Hurtado told the bank meeting that when Latin American countries contribute more of the bank's capital, "no country is going to be able to claim for itself the role of leader or overseer." The United States controls more than 40 per cent of the bank's

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board of governors, with the remaining votes shared by 22 Latin American countries and Canada.

U.S. Treasury Secretary George P. Shultz told the meeting that the United States welcomed "the initial positive response of the oil producers of this hemisphere -- and in particular Venezuela -- who have announced their intentions to provide major help to sister nations."

Shultz said that because of higher energy prices, the Inter-American Development Bank, which makes development loans to Latin America, must "husband the scarce concessionary funds . . . for the poorest." The IDB also should put greater emphasis in its lending on energy projects and member countries also should allocate more of their own internal investment funds toward energy, he said.

Shultz also voiced concern that the world's raw materials producers might form cartels to artificially raise the prices of their exports. He also cited "export taxes and other restrictions aimed at insulating domestic markets from the general upward trend of primary-product prices."

He noted that rising food prices in the United States have triggered strong sentiments toward isolating the U.S. economy from the rest of the world.

THE WASHINGTON POST

March 14, 1974

By: James L. Rowe, Jr.

MORE DEVELOPMENT AID ASKED OF OIL COUNTRIES

The heads of the five major international financial organizations yesterday said their organizations need some of the "increased financial assets of the oil-exporting countries" to help developing countries pay their higher energy bills.

The heads of the organizations, including the International Monetary Fund and the World Bank, noted that the higher energy bills not only threaten the balance of payments situations of the developing countries, but also jeopardize "the orderly execution of development programs and the growth prospects of their economies."

Last month, Iran announced that it would make available $1 billion of its surplus oil revenues to a special IMF-World Bank fund which would help countries pay their higher oil bills. However, reports from Tehran said the Iranian investment would be made at a commercial return of 7 to 8 per cent.

The agency chiefs said yesterday that a considerable portion of both the long-term and short-term aid the developing countries will need "should be made available on concessional terms."

They emphasized that "advanced countries have a continuing responsibility for providing aid resources." They pointed out that "the oil-exporting countries now have a greater capability to share the burden of the additional international aid effort, both through their own channels and through cooperation with existing institutions."

Besides IMF director Johannes Witteveen and World Bank President Robert S. McNamara, Antonio Ortiz Mena of the Inter-American Development Bank, Abdelwahab Labidi of the African Development Bank and Shiro Inoue of the Asian Development Bank met March 12 "to assess the impact of the current international energy situation on the developing member countries of those institutions."

The Inter-American Development Bank issued a statement on that meeting yesterday.

The five executives agreed that "in the light of the expertise and experience of their respective institutions in effectively channeling resources to the developing world, they have the capacity to play an important and timely role in the international aid effort.

"To perform this function, additional funds are required by these institutions and a special effort should be made to mobilize such resources from the increased financial assets of the oil-exporting countries," it said.

Financing the oil deficits

H. Johannes Witteveen
Managing director, International Monetary Fund, Washington D.C.

The enormous deficits of the western industrial world could lead to savagely nationalistic reactions. It is to help try and avoid these that the managing director of the Fund has devised the new special drawing facility to help countries through this period. Here he describes the plan and its aims, and he sounds a warning.

Uncertainty and change, it is a truism to say, are no strangers to the international monetary system. In recent years, however, and more particularly in recent months, the pace of change has accelerated. There have been large movements in the relative value of major currencies and a general departure from the system of fixed exchange rates that has prevailed since the war. Gold has ceased to be bought and sold at its official price, and gold prices in the free market have reached levels that would have seemed unthinkable even two years ago. Now the dramatic developments in the energy situation have introduced new elements of uncertainty and the prospect of substantial changes in economic relationships.

The enormous increase in oil prices presents countries with many difficult decisions, both in their domestic and in their external policies. Besides imparting an additional push in the direction of cost inflation, increased energy costs will have a deflationary effect on real demand.

Externally they will give rise to a substantial disequilibrium in the global balance of payments. This combination of circumstances will place strains on the monetary system far in excess of any that have been experienced since the war. To withstand these strains with a minimum adverse impact on economic trade and growth requires close co-operation between governments and a willingness to subordinate short-term national interests to the longer-term general good. To help achieve this the International Monetary Fund must provide its member countries with guidance and support —to help ensure that appropriate policies are adopted and, where necessary, to assist in financing structural adjustment.

Undoubtedly, inflation will continue to be a major problem in the year ahead. Even before the increase in oil prices, inflation was running at an unacceptably high level in the developed countries. Now the prospect is for rates of price increase in double figures for many, perhaps most, of them. In the developing world the situation is similar and for some countries worse. Even in those countries which have pursued reasonably sound domestic policies imported inflation has pushed the price level up at historically high rates. There has thus been a dangerous acceleration of inflation throughout the world, which at the present time shows no signs of abating.

How much deflation?

It is, of course, much easier to inveigh against inflation than to suggest effective and workable policies to control it. At the present time policy choice is particularly difficult because of the deflationary effect on real demand of the new oil prices. These prices will bring about a substantial transfer of purchasing power from oil-importing countries to oil exporters. Since the spending capacity of the latter is much less than that of the former, at least in the short term, the result will be marked contraction in real demand. In its economic effect, therefore, the oil-price increase is similar to a tax increase or a sudden growth in savings. How large this deflationary effect will be depends on a number of factors: the extent to which the labour force seeks and obtains compensating increases in wages; the size of the consequential change in business profits; the scope for reduction in consumers' savings; the speed with which oil-producing countries expand their imports; the extent to which increased saving in the oil-producing countries can be channelled into higher investment in the consuming countries and so on.

Within limits, a measure of deflation may be welcome in reducing excess demand; but where the deflationary impact of high oil prices is more than is needed to remove existing pressures on resources governments may need to take some offsetting action. The task of domestic management will be, as always, to strike the right balance between stimulation and restraint. Policy choice is even more difficult at the present time because of the considerable uncertainty concerning the magnitude of the 'oil factor' on demand. Furthermore, since rates of inflation are already high, and confidence is brittle, the penalties for miscalculation are probably greater than usual.

Apart from posing difficult domestic policy choices, the oil-price increases also create a need for balance-of-payments adjustment, an area which is a particular concern of the Fund. If oil prices remain at the levels established last December, the combined current surpluses of the oil-exporting countries could, in 1974, be as high as $65 billion. These surpluses will have to be matched by deficits of equivalent amounts for the oil-importing countries taken as a group. The developing countries alone face an additional import bill approaching $10 billion, a figure roughly equivalent to their total

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receipts of official development assistance.

Faced with these deficits, there is a danger that the external policies of the oil-importing countries may come into conflict with each other. It would be inappropriate for the oil-importing countries to use deflationary demand policies to try to eliminate the additional current deficit caused by the rise in oil prices. Such policies would only shift the balance-of-payments problem from one oil-importing country to another and might have cumulative depressing effects on the world economy. Equally unfortunate would be an attempt to solve balance-of-payments problems by import restrictions. This would not only, again, shift the problem from one oil-importing country to another, but would also give rise to serious trade conflicts and reduce the flow of international trade in a most harmful manner. Of course, the present flexibility of exchange rates should be used to facilitate adjustment. But if a number of large countries were to try by this means to reduce their current account deficits to an extent that was inconsistent with the unavoidable total deficit of oil-importing countries, the outcome might be a return to beggar-my-neighbour policies. It is gratifying that the Committee of Twenty at its Rome meeting showed itself to be fully aware of these dangers.

In the present situation floating has several advantages and is probably unavoidable. But given the volatility of exchange markets, and the need for many countries to accept large deficits on current account, there is a clear need for constructive management of the floating regime. Whatever happens, there are bound to be strains on the mechanisms whereby offsetting capital flows are induced to finance the enormous current account in balances to be expected this year. The Eurocurrency market will have an extremely important role to play in attracting surplus funds from oil-producing countries and lending them to countries in deficit. However, in view of the preference of oil-producing countries for short-term deposits, and the need of deficit countries for at least medium-term loans, there will be a very heavy burden on this market, about which there is already some concern. It seems improbable, therefore, that all deficit countries will find it possible to borrow from the market to the required extent and on reasonable terms. It is to meet these unfilled needs that I have proposed a special new facility, limited in time, and related to the higher costs of imported oil.

Avoiding economic nationalism

The facility would be designed to deal with an emergency situation and would not be a permanent feature of the Fund. It is proposed that the facility should be related to higher oil costs incurred in 1974 and 1975, taking into account the relative ability of countries to finance their current account deficits by net capital imports, or by reducing the level of their net international reserves. The maximum amounts drawable in the first year would constitute, within limits related to quotas, an important proportion of the impact effect of oil-price increases, but this proportion would decline in 1975.

The conditions for use of the facility would be specific to the drawings under it. Countries would be expected to undertake the following policies, for example, in regard to the exchange rate and incentives for capital inflows that would facilitate the appropriate adjustment. It should be possible to use the text of the Committee of Twenty communiqué as a basis for reaching agreement on conditions to be applied to drawings. The relevant part of this reads as follows:

'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'.

To an important extent the fund will be able to finance drawings under a new facility from its existing resources. However, if there is a heavy demand to draw, the Fund will need to supplement these by borrowing. Although one would naturally think in this connection of borrowing from the oil-exporting countries, funds could also be obtained from those oil-importing countries which receive a large capital flow and which are relatively less affected by oil price increases.

A breathing space

The purpose of the new facility is not to obviate the need for adjustment, but to provide a breathing space which will enable countries to avoid inappropriate adjustment policies. This breathing space should be used for consultations on the nature of the needed long-run adjustment and to cover the transitional period during which the necessary policies are put into effect. To the extent that the current account deficit should be financed, the Fund should encourage its members to adopt policies that will help attract the necessary capital inflows. To the extent that some improvement in the current account is necessary, the Fund should endeavour to see that this is not achieved through excessive currency depreciation or unjustified exchange restrictions.

There will, of course, be difficult policy decisions involved in the adjustment process—not only concerning the nature of the policies that are applied, but also concerning the extent. Both under-adjustment and over-adjustment carry their different dangers. The task of the Fund must be to try and help its member countries to chart this difficult middle course. The dangers of a failure to chart such a course are recession on the one hand and a worsening of inflation on the other. The dangers are the perpetual Scylla and Charybdis of economic policy; but on this occasion the whirlpool and the rock seem to be uncomfortably close together.

THE WASHINGTON POST April 12, 1974

Joseph Alsop

From Energy Crisis to Dollar Crisis

NEW YORK—Maybe it is a bad mistake to come up here to ask the insiders on the money market about the future effects of the miscalled "energy crisis." It makes you feel that the Watergate-besotted political community in Washington resembles nothing so much as a party of drunkards in a graveyard, boozing away among the corpses.

The reason for this dire, perhaps extreme sensation is really pretty simple. The wisest and most conservative men in the economic and financial communities have begun to talk helplessly about the threat of an onrushing, worldwide financial calamity in many respects as serious as the Great Depression of the '30s.

If these apprehensions have any foundation, the leaders of both political parties and all other members of the political community ought to begin worrying, too, along with the insiders on the money market. The worst of it is that by any logical test, the apprehensions of threatened calamity appear to be well founded.

Here one must begin by noting that the "energy crisis" is miscalled, because it is a money crisis rather than an energy crisis. It results exclusively from the enormous increase in the price of crude oil in recent months. This has created an entirely new situation for all of the world's leading financial-industrial powers, including the U.S., since these are also the big oil-importing powers.

By the best estimates of the leading expert in the field, Walter J. Levy, the oil-importing countries will end this year owing the oil-producing countries no less than $50 billion. This will be net debt, please remember, after subtracting the costs of everything the oil importing countries can persuade the oil producers to buy from them, all the way from perfumes to bomber planes.

As stated in the previous report in this space, all the signs further suggest this net debt will be in the nature of a recurring deficit. In other words, the $50 billion in debt piled up in 1974 will then have another $50 billion of debt added to it in 1975—and so on indefinitely, unless something gives way somewhere with a rending crash.

On this matter of something giving way somewhere, there is a division of opinion. Among the great American banks, whose deposits may be vastly and profitably swollen by the ever-mounting funds owed to the oil producing countries, there is a rather general tendency to argue that "the system can take it."

In this respect, David Rockefeller, head of the Chase Manhattan Bank, stands almost alone. This is because he has been saying forthrightly, albeit privately, that he cannot see how the existing financial system can possibly stand the double strain ahead.

The first part of the double strain will be inability to pay their bills, and therefore the continuously increasing indebtedness of the U.S., Japan and the other leading financial-industrial nations in Western Europe. The second part of the double strain will be the immensity of the sums owed to the oil producing countries—tens of billions upon tens of billions, in fact, all sluicing about in search of investments.

The optimists suggest that a way out will be found by selling the oil producing countries large chunks of the economies of the big oil importing countries. This raises an interesting policy question, to begin with. For do we really want great numbers of the principal financial and industrial enterprises in the U.S. to be owned by Arabs and Iranians?

But aside from the policy question, the optimists' way out also raises a practical question. On their system, the oil producing countries will make overseas investments in just two years, 1974 and 1975, in amounts about $10 billion higher than the present value of all the overseas investments accumulated by the U.S. since 19[illegible]. The oil producers' foreign holdings by the end of 1975 will reach about $100 billion, in other words.

But no one makes investments overseas or elsewhere without expecting a reasonable return. Such a return is now thought to be around 10 per cent per annum. At the beginning of 1976, therefore, the oil importing countries will have to face another year of going into debt for energy to the amount of $50 billion. And they will also owe the oil producers something like $10 billion in interest and/or dividends.

The year following, the sum of interest and/or dividends will then rise to $15 billion. And so it will merrily continue, at least in theory. But in practice, it cannot possibly continue in this manner. Unless oil prices come down drastically, something really will give way somewhere.

FROM FINANCE MAGAZINE, JUNE 1974

Arab Lands Awash in Cash

Quadrupling of price of oil begins to flood Middle East with Incredible Riches. The recipients' initial reaction has been to seek refuge in traditional short-term money markets, juicy real estate deals in New York and Paris. But the sheiks will wind up holding so many chips, the world financial system could be ruined unless they unbend and lend at longer term, meeting maturity needs of deficit oil-consuming lands. In due course, the Arabs might even develop an appetite for common stocks, but that could still be a long time off.

By H. LEE SILBERMAN

"ONE THING you can be sure about the Saudi Arabians. They have no intention of being a patsy for anybody, aimlessly sloshing money around the world."

Speaking is a Wall Street financial executive, recently returned from a trip to Jeddah, the financial center of the huge Moslem land. He might just as well have been speaking for all of the soon-to-be incredibly wealthy Middle Eastern oil producing countries.

Since the Arab oil producing countries quadrupled the price of oil last fall, the annual cash flow to that part of the world has swelled by over \$100 billion. Of that, the countries are expected to wind up with an estimated \$60 billion after paying all of their bills this year, up from a \$4 billion surplus by the same lands in 1973.

By 1975, however—just one year later—total monetary reserves of oil producing nations, including such other oil-rich Arab lands as Iran, Kuwait, Iraq, United Arab Emirates and Libya, are likely to exceed \$145 billion—and \$210 billion by the end of 1976. These are mind-boggling amounts, expected to materialize in only three years. Saudi Arabia alone is likely to accumulate at least \$50 billion over the three years.

With oil-payment checks reflecting the higher prices recently starting to pour into Arab coffers in some volume, the Middle Eastern countries are now having to make increasingly difficult decisions concerning the disposition of their embarrassment of riches. "Arab oil money historically has been invested at short term in Treasury bills in the U.S., in sterling or in the Eurodollar and Eurocurrency in markets abroad," says the Wall Street financial man. "That was no sweat because the amounts were modest—on the order of \$10 billion or so. But now with their cash flow starting to pile up," he continued, "concentrations in the short end could be self-limiting, forcing down rates. That means we can expect some lengthening of maturities, though they will still probably stay relatively short, at least for starters."

The maturity preferences of Arab investors are actually a matter of considerable concern to international bankers and monetary officials. The reason is that as countries that buy the oil began to run up sizable balance-of-payment deficits because of the higher oil prices and funding most of these bills through the international banking system, that mechanism itself is in jeopardy of a breakdown. The problem, David Rockefeller, chairman of Chase Manhattan Corp., and its subsidiary Chase Manhattan Bank recently explained, is that "banks have been taking this short maturity money and relending it to oil-consuming nations for periods of five to seven years." Such a process "obviously makes a very unbalanced and precarious maturity structure," Mr. Rockefeller warned in a recent address to the Spring meeting of the prestigious U.S. Business Council. The Chase chief executive emphasized the need to develop mechanisms whereby the "huge surpluses of the oil producers can be recycled back to deficit oil consumers." He expressed the hope that "countries in the Middle East, as they become more familiar with the recycling process, will at least agree to place funds at longer maturity."

Other solutions for resolving the problems outside the banking system have been proposed. Johannes Witteveen, managing director of the International Monetary Fund, for example, has called on the oil-producing countries to advance some $2.7 billion to a special new "oil window" at the IMF which in turn would lend the funds to the deficit ridden oil-importing lands.

Chase Manhattan itself has become increasingly involved in the Middle East. The global banking organization is setting up a merchant bank to manage securities underwritings in Saudi Arabia and a commercial bank in Iran — both jointly owned with local participants; Chase has also established branches in Egypt, the United Arab Emirates and elsewhere. It has a long way to go, however, to catch up with its New York archrival, First National City Bank, which has long operated branches both in Jeddah and Riyadh, capital of Saudi Arabia as well as in Abu Dhabi. Bahrain and Qatar among other places in the Middle East.

The more recent inundation of the area with a rising tide of oil money has triggered a rush to those Arab lands by major banks from the U.S., France, Japan and elsewhere. In recent months, First National Bank of Chicago announced opening a branch in Dubai while its hometown competitor, Continental Bank of Illinois, was buying into a Bahrain Bank. But the most concerted activity is taking place in Beirut, the Arab world's traditional financial center. Prominent U.S. banks that now hold important interests in Beirut banks are New York's Chemical Bank and Fidelity Bank of Philadelphia. The Lebanese capital is also the center for the creation of merchant banks, in which Western banks are playing a role as partners or advisors. One such bank is Arab Finance Corp., which while 56% Arab owned, also has New York's Manufacturers Hanover Trust Co. and banks in Tokyo and Paris as partners.

It is only a matter of time in the view of U.S. investment experts, before many of the Arab countries direct a significant portion of their newly gained oil billions into medium and longer term investments. Recent experience in Saudi Arabia shows that such direct investments are initially made at home — for schools, government buildings, roads, hotels, office buildings, apartment houses and the like. But because countries like Saudi, Kuwait and Iran are underdeveloped industrially, there is a limit as to the long-term financing they can absorb. The ultimate aim of each country's planners, according to a well posted New

York banker, is to accumulate enough profitable investments outside its borders that will yield sufficient income to replace its oil revenues as they run out.

While still on a modest scale, long-term foreign investments by Middle Eastern countries are beginning to build up, in real estate, selected securities and some direct investments in industry. Newspaper financial pages in recent months have headlined such developments as the purchase of a large office building on Fifth Avenue, New York, by Shah Mohammed Riza Pahlevi of Iran; a $27 million investment by a group of Kuwaitis in a planned luxury office and bank building on the Champs Elysees in Paris, to be called the House of Kuwait; and the acquisition of about $1 million in raw land for development in California by Adnan M. Kashoggi, a Beirut-based Saudi Arabian, who also purchased two California banks.

Other major deals involving pooling investments and businesses are in the works. It is reported, for example, that the Saudi Arabian Government has talked to Chase Manhattan about the possibility of Chase managing a pool of $200 million in Saudi Government funds for investment in Saudi business and in joint ventures with foreign partners whom Chase would find. Earlier this year the Kuwait Investment Co., one of several owned jointly by the Kuwait Government and individual Kuwait investors, bought Kiawak Island off Charleston, S.C., for a reputed $17 million in cash; the company plans to spend more than $100 million developing it as a residential resort over the next 15 years.

The Arabs' emphasis on real estate is understandable because it is visible and tangible, attributes cautious investors can readily appreciate. Arab investors, moreover, have been realizing a fabulous return on real estate investments at home: real estate in the center of Jeddah is said to have trebled in value over the past 12 months alone.

As a result of this kind of appreciation, a lot of oil money is being sunk right into the land at home. A Saudi student, temporarily in the U.S. relates, admiringly, a personal encounter in a surburban area on the outskirts of Jeddah. "I had long known the section to be sparsely settled and consisting of older scattered residences, but I had not been out that way for six months or so. Imagine my surprise to discover the area completely transformed into a modern planned neighborhood, with wide paved streets, shops and homes. I frankly didn't recognize the place, in a city where I have lived all my life!"

Experiences like these buoy the sense of pride and mission of the Saudis and add to their zeal to put their newly earned billions to good use. "When I see something like this," the Saudi continues, "I am overcome by the conviction that we will play a catalytic role not only in the Arab world but in the world of finance as well. There are many things we will want to do as our planning evolves; a few years from now, I look for considerable emphasis in joint ventures abroad — many of them, I expect, in the United States. We will approach these opportunities, I am sure, with the concept of having a benevolent and stabilizing effect on world finance.

> ***. . . we will see Arab money move into quality stocks, when conditions in the U.S. economy and markets become more promising.***

For the time being, the major focus of Saudi investment planners is on the country's infra-structure as well as that of the Middle East in general. The emphasis thus is on such fundamentals as roads, power generation and transmission, schools and the like. The government at the same time has begun to lay the groundwork for the development of industry that, it is believed, will benefit the country most. This is the building of a full-fledged petrochemical industry to refine the crude after it is brought to the surface, thereby enabling the country to expand its export earnings even more significantly through the shipment of the more valuable finished products instead of just the oil itself.

Next to its own infra-structure, the Saudis are increasingly involved in strengthening the basic economic underpinnings of its Arab neighbors. Toward this end the government is setting up its own Islamic Bank with no less than $1 billion capital for aid to the Arab world. It is also sponsoring a Cairo-headquartered Arab African Bank, which will channel Arab funds to African countries. In these efforts Saudi Arabia and Egypt have drawn closer together in a combination harnessing Saudi's financial resources and pioneering zest and Egypt's more mature economic and social structure; Egypt itself produces no oil. The relationship is made even more secure because of Saudi's reliance on the fertile Egyptian Sudan as the country's breadbasket, a tie it recently knotted with the guarantee of a $2.5 billion loan to Cairo.

As the Arab world begins to flex its new-found oil wealth, major international banks have come conspicuously to the fore to join with Arab banking interests, to help smooth their path in the world. Investment banking houses based in the U.S. and elsewhere are not quite as much in evidence in this process, at least at the time being, probably because of the Arab countries' predeliction at this stage in their financial evolution to invest their surplus oil funds mainly through the banking system. There seems to be little doubt, however, that the securities industry, both in New York and London, will bulk larger in the picture as the Arab investors grow more comfortable with longer-term debt and equity investments.

"I am quite confident that we will see Arab money move into quality stocks, when conditions in the U.S. economy and markets become more promising," says the Wall Street financial executive. "Right now, the tendency is for Arab investors to carefully assess equity opportunities and the market process, while their general approach toward the stock market is one of considerable caution."

Then again, whose isn't? ■

THE WASHINGTON POST March 31, 1974

Hobart Rowen

'The Oil Crisis Will Continue'

The Arab oil weapon has temporarily been laid on the shelf, within easy reach by the managers of the exporters' cartel. It has not been abandoned, and it would be a mistake for the American public to delude itself into thinking that the Vienna announcement of the lifted embargo has more than marginal meaning.

So long as prices for oil remain sky-high—triple what they were prior to the embargo—and so long as production levels are carefully controlled by the oil-producing states, the oil crisis will continue.

Of course, it will be difficult to sustain public concern about the oil crisis if gasoline becomes somewhat more readily available—albeit at prices nudging 70 cents a gallon in the East.

But the most difficult problem created by high oil prices—the potential for economic recession in the industrialized world—remains unsolved.

As much as $50 billion to $60 billion must be transferred from the oil-consuming nations to the oil cartel this year to pay for the increased costs of oil—a sum which threatens vast dislocations here and abroad.

No one has yet figured out how the consuming nations will pay the bill—or how the exporting nations will use or invest the vast sums they receive—once they're paid over.

But the terms of the lifted embargo, as made public in Vienna, carefully eschew any guarantee of increased production which would tend to assure a softening in price. Iran and Algeria, to the contrary, have been arguing loudly for yet another increase in price.

The remaining potency of the oil weapon, moreover, should be seen from the Arab statement which warns that "Israel alone" will bear the responsibility for "more severe oil measures, in addition to the other various resources which the Arab world can master in order to join the battle of destiny."

Plainly, this is a threat to use not only oil itself, but oil money, as it piles up, as a bludgeon over the West. By moving large blocks of capital in and out of money markets, for example, a concerted drive by the oil cartel countries could shake Western currency markets. Demand for payment in gold, from those who have limited supplies of gold, could also weaken the financial underpinnings of the West. And large-scale industrial and commercial investments in industrialized countries could provide the Arab nations with a degree of leverage over economic prospects and job opportunities.

It is not at all far-fetched to visualize a scenario in which the embargo might be threatened again unless the industrialized countries step up their aid programs for the hard-pressed African countries who have given the Arabs political support.

Faced with the Arab nations' clear-cut success in the initial round of the oil war, it is disconcerting to see the potential for joint action by the consuming nations fade away in a welter of acrimonious debate between President Nixon and Europe.

Europe—dominated by France—seems determined to pursue bilateral deals with the Arab nations. If the United States were to sacrifice principle to be assured of a steady flow of Arab oil, it could elbow the French and British or anyone else out of the way, especially with Iran and Saudi Arabia, offering them as much money and technology and certainly more security than any combination of European nations.

Because it has not succumbed to blackmail, the United States has so far not chosen this course. Hopefully, the Nixon administration will not be panicked by the new harsh language in the cartel's Vienna announcement, or by a political need for some new diplomatic "success" to offset Watergate troubles.

We can anticipate a flood of fairly optimistic assessments from the major banks and the big oil companies who are heavily engaged with the producing countries in oil and money matters. It isn't reasonable to look to bankers or oil presidents for a re-statement of the need for independence from Arab oil.

But if that crucial drive gets lost in a misplaced euphoria over a slight jiggle in the use of the Arab oil weapon, it will be a shame. They have the ability to turn the oil supply valves on and off at will. They make no pretense of their willingness to use their oil and new found wealth as political blackmail. A policy that doesn't recognize this as a fact is suicidal.

We hardly needed to be told that the embargo will be "reviewed" June 1. Only a year ago, Saudi Arabian Minister Zaki Yamani was saying that oil would never be used as a political weapon. Now, we know (or should know) that no assurance from the Mideast exporting countries means anything.

The oil cartel has created a vast uncertainty over a vital supply, with the combination of oil and money forged into a devastating weapon. So far, the Western World has evolved no effective response.

Oil-Cash Recycling Plans Vary

By CLYDE H. FARNSWORTH
Special to The New York Times

PARIS—The quadrupling of oil prices at the end of last year has caused economic and financial upheaval in the world. The petroleum-exporting nations are accumulating money at a rate that has been put at $6-billion a month.

A number of plans have been offered to "recycle" surplus funds of the oil-exporting nations into productive uses to avoid reductions in consumption and even a world recession.

The two plans most widely discussed have been formulated by H. J. Witteveen, managing director of the International Monetary Fund, and Harold Lever, a Cabinet Minister and financial adviser to Prime Minister Wilson of Britain. Another has been advanced by David T. Kleinman, professor of finance at Fordham University.

Discussions Planned

Some of the plans for recycling money will be discussed in Washington next Tuesday at a meeting of the Group of Ten, a forum of the 10 leading industrial powers that has been resurrected to deal with the oil-financing crisis. The Group of Ten was disbanded in March, 1973, when the world monetary system went into a pattern of floating rates.

The proposal by Mr. Witteveen, a former Dutch Finance Minister, seeks to persuade Middle East states to lend some of their oil earnings directly to his institution, the International Monetary Fund, which would relend to countries in need.

On a recent tour of the oil states he was able to get subscriptions for only $2.8-million, a minor amount in relation to the magnitude of the oil countries' income.

American officials are convinced that given the right interest rates and the right exchange rate guarantees, the Witteveen plan could become an important recycling vehicle in the future.

Mr. Lever proposed a mechanism for collective purchases of Middle East oil by the industrialized nations of the West. His plan envisages an agency that would buy the oil at a negotiated price and sell just about at cost to the main consuming nations. Revenues from a surcharge on these resales would b lent or given to developing countris.

The mechanism was described in British circles as an alternative to the Witteveen plan. The British think it might prove more acceptable because of certain technical features having to do with the role of the monetary asset known as Special Drawing Rights.

However, Sheik Ahmed Zaki al-Yamani, Oil Minister of Saudi Arabia, has warned that any efforts to purchase oil collectively could result in further increases in prices. The oil states have been cool to both the Witteveen and Lever ideas because they involve a loss of control over the countries' money.

While some of the oil nations' new wealth is used to buy goods in the West and for investment in Europe and the United States, most goes into the money markets, which means that it is placed in short-term securities at relatively high interest rates. It is highly volatile money.

Until now commercial banks have been the chief recyclers, borrowing the short-term funds and lending them out at longer term for productive use by business. The volatility of the money, however, creates unusual risks. David Rockefeller, for one, chairman of the Chase Manhattan Bank, warns that commercial banks were not equipped to handle the recycling job.

Plan by Kleinman

The latest plan was offered by Professor Kleinman, who presented his ideas in Paris last month at a meeting of the Young Presidents Organization.

Professor Kleinman, who as a consultant to the United States Agency for International Development worked out a plan for restructuring Brazil's capital market in 1967, believes the problems can be solved by giving free rein to market forces. He proposes to create capital markets in developing countries to attract surplus funds of oil-producing states, stimulate more rapid economic growth of the poor countries and increase exports of industrial nations.

Mr. Kleinman claims the plan would promote the rapid economic development of the Third World, establish a new monetary equilibrium and generate enormous demand for capital and other goods from the industrialized world.

He envisages development of financial institutions such as those created in Brazil in the late nineteen-sixties. Credits on liberal terms would be provided for underwriters and market makers in each country, as well as for entire regions.

Monetary Correction System

Debt securities providing a "real" interest rate after cost-of-living increases are taken into account would be offered. This monetary correction system, which was included in Professor Kleinman's program for Brazil in 1967, is the key to attracting surplus oil funds.

Oil money that is now being invested may get what is known as a negative interest rate if market rates are less than inflation rates. So with a higher rate of return, there would be an incentive for oil states to shift their funds to the developing countries' financial centers.

The securities that are issued—both debt and equity—would finance newly organized public and private enterprises in participating countries and would be traded on local and regional stock exchanges.

FROM THE NEW YORK TIMES, MARCH 20, 1974

Arab Oil Strategy

Economics, Business and Politics Mixed in Aiming at Embargo Goals

By LEONARD SILK

Economic Analysis

Some day the Arab oil embargo, which now has been largely suspended against the United States, will make a great case at the Harvard Business School. It could break new ground in that largely unexplored no - man's - land where economics, business and politics meet. The essence of the case was stated by an Arab oil sheik to Peter G. Peterson, the former Secretary of Commerce who is now chairman of Lehman Brothers, the big New York investment banking house. "You taught us in your business schools," said the Arab sheik, "that we should maximize our profits. Do you want us now to repeal the laws of supply demand? If we are to do this, you should have to give us some powerful incentives."

Although the embargo case is far from complete, here is a preliminary version of how it looks.

Situation: You are a leading Arab oil-producing state and a member of the international cartel, the Organization of Petroleum Exporting Countries.

With your fellow Arabs, you have been embargoing oil shipments to the United States, the Netherlands and other countries that, you assert, have aided Israel against the Arabs.

With your fellow members of the Organization of Petroleum Exporting Countries you have quadrupled oil prices. To make the embargo and price increase stick, you had cut oil production back by about 15 per cent. Now, in response to American efforts to work out peace terms with Israel, you have lifted the embargo against the United States. You must now think through your broad future strategy.

Lasting Development

Objectives: Your major objectives are: to maximize profits, maximize capital accumulation, recapture territory from the Israelis, and to maintain your security against internal and external Arab radicals, against Western imperialists, against Soviet Communists. Finally, you want to achieve lasting economic development of your country.

Customers: Your principal customers are the United States Western Europe, Japan and a crowd of energy-poor, less developed countries.

The United States has enormous military power, Europe not much, the less developed countries still less. But the Soviet Union also has military power — air force, missiles, tank — not to mention their ships and submarines in the Indian Ocean.

The United States has a good relations with Israel, the Soviets bad. The United States has Henry Kissinger. The United States is freer to wheel and deal between Arabs and Israelis than the Russians are.

Problem: How much oil should you produce and how much should you charge for it? These are interdependent questions. If you go back to producing as much oil as you did before the October war, you could break the present oil price, and maybe break up the cartel.

As it is, the price of crude

oil has been softening. The posted price is $11.65. At the peak of the oil scare, prices in the Middle East got up to $22 a barrel. Until recently, light Arabian crude had been going for $9 to $11. Now some independent oil importers say they are able to buy at $8. How can you keep prices from falling too much?

Proposal: Restrict production below the October level. Do this by maintaining your embargo against the Netherlands, Denmark, Portugal, South Africa and Rhodesia, charging that they are all unfriendly to the Arab cause against Israel. This will justify the hold-down on total production and help maintain the price of crude. It may also yield political benefits, since the industrialized countries seem to put economic needs above all else.

Problem; What if your fellow cartel members increase production in order to maximize profits, letting you carry the burden of cutbacks?

Proposal: Threaten to increase your own production, which would break the price. Alternatively, threaten to make a political deal with the United States at the expense of your colleagues.

Problem: The industrialized countries claim they can't pay the huge oil bills. They assert that high oil prices are worsening their inflation, which reduces your real gain.

Proposal: Warn them that you will raise the price of oil still higher unless they get inflation under control. Tell them that they can't cheat you out of your just price.

Problem: But they may be unable to control inflation, and if inflation gets out of hand, the money they owe yo will be worthless.

Proposal: Buy gold.

Will Gold Really Help?

Problem: But what if you get all the gold? Actually, you can afford it. The artel's oil revenues will go up by $65-billion to $75-billion just this year, and keep on climbing.

But does it make any sense just to bid up the price of gold higher and higher? Will that really help your economic development?

Your gross national product is growing fast. The combined G.N.P. of all the Arab countries is going up from $36-billion in 1973 to $74-billion in 1974. In Qatar, per-capital G.N.P. will soar from $5,800 last year to $17,400 this year. In Abu Dhabi, it will hit $45,000 per person this year — compared to a mere $6,127 in the United States. But what happens to your G.N.P. when the oil runs out?

Proposal: Invest your petrodollars in income-earning assets You can absorb only so much breed galloping inflation and corrupt or ruin the working class. Invest more money abroad.

Problem: What if foreigners nationalize your investments?

Proposal: As one wise old sheik said, "The most illiquid investment is a demand deposit at the Bank of America."

Your dollar holdings can not only be blocked but the purchasing value of the dollar will surely decline over time.

Therefore, consider a range of alternatives: Diffusing your money through Arab-controlled banks in the West, recycling petrodollars through an "International Petrorevenue Fund," financing economic development in the poor countries of Africa or Asia through an oil exporters' International Bank for Development. You don't need to use the Western world's International Monetary Fund or World Bank.

Problem: But recycling or running an aid program sounds terribly complicated and risky. The West never did it very well. Why should we now carry the burdens and risks of soft aid? Isn't there a safer way to stay rich and further our own development?

Proposal: Improve relations with the United States and other industrialized countries. Relax the embargo. Set up joint Government and business development programs in such areas as food, education, housing, desalinization, as Peter Peterson and George Ball, the former United States Under Secretary of State, have proposed.

Negotiate tax treaties, mutual investment guarantees. Build programs for long-term development of energy, shale, solar power, etc., for the time when your petroleum runs out.

Work out pricing and production policies that will serve the interests of both oil-exporting and oil-importing countries. World inflation and world recession or depression, combined with breakdown of trade and hostility among nations, won't do the West or you any good.

Problem: You sound too rational. But if we had been rational, we would never have got where we are today. How can we trust the West, those neocolonialists who never did anything for anybody but themselves?

Proposal: Hang on to the oil weapon. Threaten to reimpose the embargo if necessary, and use it ad lib for either economic or politcial purposes, or both. Keep the oil price high enough to keep profits flowing in, but not so high as to accelerate shifting to other energy sources.

Hold the cartel together at all cost. If the industrialized countries show serious signs of conserving on oil and substituting other high-cost technologies too soon, step up your oil production and cut the price.

Make them come across politically. Insist on military protection.

Keep cool. Remember what you have achieved so far. And remember what the great German strategist, Karl von Klausewitz, virtually said:

"War and business are not merely political acts, but also political instruments, a continuation of political relations, a striving for the same ends by other means."

THE NEW YORK TIMES April 8, 1974

OIL NATIONS FAIL TO AGREE ON AID

Exporters Decide to Set Up Fund for Poorer Countries but Differ on Donations

By JUAN de ONIS
Special to The New York Times

GENEVA, April 7—The oil exporting countries decided today to set up a special fund to help poorer developing countries, but they failed to agree on how much money to put [illegible] program.

[illegible] reflected a political split [illegible] 12-nation Organization of Petroleum Exporting Countries. Iran, Venezuela and Algeria firmly sponsored the fund, but Saudi Arabia, Kuwait and other Arab members resisted a firm decision.

Jamshid Amouzgar, Iran's Minister of Finance, said that his country was ready to give the fund $150-million as an initial contribution, but he said that the organization's ministerial meeting here today had left all contributions voluntary.

No Specific Aid Offer

An official statement said that the fund would not go into operation until seven member countries had ratified the articles governing its establishment and operation.

Conference sources said that only Iran, Venezuela, Algeria and Libya had clearly indicated that they were ready to ratify the agreement. As a result, the oil exporting countries will be going to the special session of the United Nations General Assembly that opens Tuesday in New York to discuss raw material and industrial inflation without a concrete offer of aid for the developing nations.

President Houari Boumediene of Algeria, who has been the principal sponsor of the special session, had been interested in strengthening the third world by spreading some of the wealth of the oil exporters among the poorer members.

Large developing countries such as India, Bangladesh, Zaire and Brazil, and many other smaller countries that do not have oil, have been hurt financially by the sharp increase in oil prices that is the source of new wealth for the oil exporters.

The Arab producers of the Persian Gulf region are the major recipients of increased income, particularly Saudi Arabia, the world's largest oil exporter.

But Saudi Arabian sources said that Sheik Ahmed Zaki al-Yamani, Saudi Arabia's Minister of Petroleum, had made no commitment on any contribution to the new fund during today's four-hour meeting.

There is a strong rivalry between Saudi Arabia and Iran, whose ruler, Shah Mohammed Riza Pahlevi, initially proposed the establishment of a special fund for the developing countries.

The dispute between Saudi Arabia and Iran shows up in policy debates over oil pricing. The Saudi Arabian position is that prices now are too high and that the best contribution the producers could make to the welfare of developing and industrial countries would be to reduce prices.

Iran has been among the majority of oil exporters that opposes any lowering of prices. These countries note that Saudi Arabia has not taken any individual steps to lower the prices for her oil.

Among the non-Arab members of the Organization of Oil Exporting Countries, little enthusiasm for the fund was shown by Indonesia, a country of 120 million people, as many as the total of all the Arab members. Indonesia exports 1.4 million barrels a day compared with Saudi Arabia's 8.5 million barrels, and members of the Indonesian delegation said that all the earnings from Indonesian oil exports could be utilized within the country.

BUSINESS WEEK: March 16, 1974

Middle East: The banking scramble for Arab dollars

The flood of oil dollars into the Middle East is bringing with it a matching influx of Western bankers, financial advisers, and just plain promoters—all eager to help the Arabs invest and manage their Croesus-like wealth.

U. S. bankers are combing the area so intensively for business that they are practically bumping into each other. A few weeks ago, when a senior vice-president of New York's Chemical Bank took a swing through Middle East capitals, he reportedly found prospects waiting for Chase Manhattan's Chairman David Rockefeller, who was just a few days behind him on the same circuit.

U. S. banks are opening new branches in the area and buying into local commercial banks, and they are setting up joint-venture merchant banks with Arab partners as well.

Bank bids. Beirut, the Arab world's traditional financial center, is attracting much of the attention. Philadelphia's Fidelity Bank recently bought 80% of Banque de la Mediteranée, Beirut's largest, and is selling off all but 20% to Arab investors. Chemical Bank last year bought 80% of Beirut's Rubiya Bank, and Irving Trust is negotiating to take over a bank there.

The banking boom is also spilling over to Persian Gulf sheikdoms that were little more than sleepy sandpiles a few years ago. First National City Bank of New York has branches in Bahrain, Dubai, Abu Dhabi, and Qatar, and two in Saudi Arabia—the only U. S. bank branches allowed in that country so far. Continental Bank of Illinois is about to buy into a Bahrain bank, and First National Bank of Chicago will soon open a branch in Dubai—as will France's Paribas, and a flock of Japanese banks. Kuwait bars foreign-controlled banking operations, but is getting a merchant bank with minority American and European shareholdings (page 61). Even Egypt, which nationalized its banking system years ago, is allowing Chase Manhattan to set up a representative office and eventually, branches.

Bank of America, which has had a branch in Beirut for years, is expanding in the Middle East mainly through its 30% share in the Bank of Credit & Commerce International, which it set up in Luxembourg two years ago with Arab partners. The venture has 10 branches in the Persian Gulf emirates, owns an interest in the national bank of Oman, and recently bought 80% of Lebanon's Bank Chartouni.

These and other banks in the area are bracing for the huge surge of payments for oil that is about to hit the Middle East, reflecting last December's sharp increase in oil prices. At the outset, most of the money will bypass Middle East banks, both locally owned and foreign, which operate mainly in local currencies. Instead, Arab governments are expected to "recycle" the bulk of their dollar earnings directly into deposits and short-term investments in London, Zurich, New York, and markets (page 42).

Fueling a boom. Gradually, though, local economies will feel the effects of stepped-up spending by Arab governments. That, in turn, will fuel the biggest business boom the Middle East has ever seen, and local commercial banks will reap a bonanza of deposits and loan business with Arab individuals, importers, contractors, government agencies, and other customers.

Although Lebanon has no oil, Beirut will get its share. Says Bankers Trust representative Muhammed Saleem: "Beirut bankers have a saying: The flow of money to Beirut will be like opening a can of beer. We will get only the foam, but the foam will be enough to keep us working full time."

The Lebanese capital is a center for the latest development on the Middle East financial scene—the creation of merchant banks designed to tap Arab funds for medium- and long-term lending and equity investments, with Western banks playing a role as partners or advisors. Several such banks are sprouting in Beirut:

- Arab Finance Corp., 56% Arab-owned. It will have as partners Kuwait Investment Co.; Credit Libonaise, a Lebanese bank; the Beirut-Riyadh Bank, with mixed Lebanese-Saudi ownership; the Bank of Tokyo; France's Banque de l'Union Europeene; and Manufacturers Hanover Trust Co., with an 18% share.
- Investment & Finance Bank, owned by Britain's Hambros Bank, France's Renault, and Japan's Mitsui Bank and Nomura Securities.
- American Express Middle East Development Co., set up by American Express Co. six months ago. It has already helped a British insurance broker, Bland, Welch & Co., buy a stake in a Middle East insurance company owned by Saudi Arabian construction tycoon Suliman Olayan, and aided in the financing of construction equipment for Saudi Arabian operations of San Francisco constructor Bechtel Corp.

Now, American Express and two other banks—one American and one Japanese—are joining with Olayan in trying to set up a merchant bank in Saudi Arabia to concentrate primarily on financing business ventures and "infrastructure" projects, such as petrochemical plants.

Still another vehicle for mobilizing Arab investment money—this one entirely Arab-owned—is First Arabian Corp., incorporated in Luxembourg with a $10-million initial capital by a group of Arab banks. New York's Kidder, Peabody Co. has played an advisory role at the outset.

Finding projects. The Beirut-based Arab Finance Corp. will be headed by Dr. Chafic Akhras, a Syrian who worked with the United Nations and set up his own consulting firm staffed with economists, engineers, and technicians. Part of that staff will move over to the new merchant bank to help in identifying investment projects. The bank's first venture, according to Michael C. Bouteneff, Manufacturers Hanover vice-president, will be a syndicated medium-term financing for a project in an Arab country. But the bank also expects to channel Arab money into ventures outside the area. "There are not too many opportunities in the Arab world," explains Bouteneff. "There are plenty in other developing countries, but at present the Arabs are not ready to take the risks. So initially most of the money will go to the industrial world. But the return there is relatively low, so gradually they will move into developing areas as they gain more experience, in order to gain a much higher return."

Despite the Middle East's big potential as a source of investment capital, the new financial institutions will have to move cautiously in testing the capacity of fledgling markets. A warning occurred last year when Renault floated a bond issue, denominated in Lebanese pounds, in Beirut and soaked up all the available funds. Recalls Mehli Mistri, manager of the Beirut branch of First National City Bank of New York: "The interbank rate shot up to 33% almost overnight, and only now is it settling down to 11% or 12%." ■

TIME March 4, 1974

INVESTMENT

The Arabs Are Coming

An embargo may still be keeping Arab oil out of the U.S.—but not the gigantic amounts of investment capital that the Arab countries are accumulating by selling that oil elsewhere. Over the years, the Arabs have piled up American holdings estimated to be $10 billion to $15 billion. Now such thinly populated countries as Kuwait, Saudi Arabia and the Persian Gulf sheikdoms are pulling in more money through oil-price boosts than they can possibly absorb at home, and are channeling still more cash into the U.S.

The money is being placed discreetly, without publicity, in outlets that draw little attention—chiefly bank deposits and blue-chip real estate. There are two reasons. One is simply that Arabs tend to be ultra-conservative investors who are fearful of being cheated if they venture into anything the least bit speculative. Also, the Arabs are well aware of the political climate in the U.S., and so the Arabs are determined to maintain a low investment profile.

Still, the pickup in Arab investment has been noticeable. "Every day we get offered vast sums, like $200 million at a time, to be invested in things like Treasury bills," says a California banker. Adnan Kahsoggi, a Saudi, has moved beyond U.S. bank deposits to buy U.S. banks. Over the past two years, he has purchased controlling interests in two headquartered in Walnut Creek, Calif.: Security National, which has assets of $115 million, and the Bank of Contra Costa, with assets of $22.8 million.

In the real estate field, the mixed public-private Kuwait Investment Co. last year committed itself to put up $10 million, half the equity of a $100 million urban complex in downtown Atlanta, two blocks from Peachtree Street. The project will include a Hilton hotel, offices and a shopping mall. Kuwait Investment reportedly has also bought a South Carolina island intending to build a luxury resort.

Best Addresses. Kuwaitis and Saudis are also buying feed lots, agricultural land and New York City office buildings, almost all at the best addresses in town, such as Wall Street and Fifth Avenue. Raymond Jallow, chief economist of the United California Bank and himself an Iraqi, says he knows of several shopping centers and office buildings that Arabs have bought in California, ranging in price from $1 million to $10 million. Dr. Jallow expects such investment to increase "twentyfold in the next two years."

Most experts are convinced that the Arabs will eventually move beyond such cautious investments to ones that have more political clout. One reason: they genuinely, though wrongly, believe that U.S. support for Israel stems partly from a Zionist hammerlock on U.S. business, and are eager to break it. One industrial area that the Arabs are certain to aim at is so-called "downstream" oil activity—refining and marketing in consuming nations. Kuwait is already considering buying a large chunk of Gulf Oil stock (from whom is not clear).

The pacesetter for Arab investment is likely to be the "First Arabian Corp.," an Arab version of First Boston Corp. that was organized by Roger Tamraz, Middle East representative of the U.S. investment firm of Kidder, Peabody. First Arabian will soon open offices on Park Avenue expressly to channel Arab funds into the U.S. Tamraz says that he plans to take over an American bank (one just below the big ten) on behalf of his clients, then bid for an industrial firm that he will not identify beyond saying that its brand name is a household word. He sees these moves as test cases that he will stage-manage carefully, probably clearing every step with Secretary of State Henry Kissinger and Treasury Secretary George Shultz.

The Arabs will get further help in locating U.S. investments from American banks that are setting up throughout the Middle East. In the past six months, Americans have bought controlling interest in three banks, and bought into three others in Beirut alone. The U.S. bankers believe, in the words of one, that "the only thing worse than the Arabs investing in America is the Arabs deciding not to." His point: a vast mass of Arab capital pitching aimlessly from country to country and industry to industry could disrupt economies and financial markets throughout the West. In order to avoid that, stable, long-term investments must be found for the Arabs, and the best are in the U.S.

THE WASHINGTON POST April 10, 1974

Joseph Alsop

A 'River of Money'

NEW YORK—In March-April, the insiders on the money market tell you that $10 billion of oil-producing governments' profits will be looking for investment opportunities around the world.

The people who are searching for places to put this vast amount of money are the major oil companies, like Exxon in this country and Royal Dutch Shell abroad. Initially, most probably, they will select short-term obligations. Eventually, something a bit more solid and more permanent will be wanted.

Rudyard Kipling once wrote an entire poem about the unseen, worldwide flows of money as an underground river more powerful than the Amazon, the Mississippi or the Nile. What we are now seeing, in Kipling's terms, is the first great flood of high water on the underground river, resulting from the miscalled "energy crisis."

To give an idea of the extent of the high water, you have to bear in mind that the value of all the overseas investments of the United States is currently estimated at about $90 billion. In just two months, therefore, a small number of oil-producing governments will invest one-ninth of the amount that thousands of immensely rich American individuals and corporations have invested abroad over a period of about three-quarters of a century.

The comparison is almost ludicrous with the British overseas investments at the beginning of World War II, when the British so desperately needed American money to finance their courageous effort to withstand Adolf Hitler alone. In short, insiders on the money market, pale-faced and confused, are mumbling about a wholly new situation.

"The oil producers' total profits for the first 12 months of the new higher prices are estimated at about $100 billion."

The figures already cited, moreover, are only a beginning. By the best estimates available, the oil-producing countries will need to find places to invest about $50 billion before 12 months have passed.

In other words, the high water on the underground river is going to continue. The $50 billion is net, too. It is the amount, in fact, that the Persian Gulf countries and other oil producers will have *left over* after they've spent every cent they can think of spending, on everything from private luxury to national defense.

The oil producers' total profits for the first 12 months of the new higher oil prices are estimated at about $100 billion. Given their small average populations and their real needs, it is probably optimistic to suppose that they can find ways of spending half this amount on goods and services provided by the big oil importers like the United States, the Western Europeans and Japan. But suppose the hopeful forecast is correct. The current value of the Mellon-controlled Gulf Oil Co., for instance, is no more than $5 to $6 billion. That means, for instance, that every one of the major U.S. oil companies can be legitimately purchased by just one year of the oil producers' new-style profits. Or look at it another way, on the simple assumption that the oil producers will want their profits to earn a currently normal return.

On this assumption, the big oil consumers like the United States will have to find $4.5 billion—additional to what they will need to pay for new oil —in order to give the oil producers the money that their first year's investments ought to earn. And next year's net profits for the oil producers are again forecast to be around $50 billion, since there is no foreseeable end to the high water on the underground river.

No wonder, therefore, that the older insiders on the money market have begun to whisper the name "Kreditanstalt." The Kreditanstalt was the great Austrian bank whose failure lead to the collapse of the old world monetary system and thus to the second and worst phase of the Great Depression nearly 50 years ago. Besides Watergate, in short, we have some other things to worry about!

Introduction

The huge size of oil revenues has led to increased interest in the institutional arrangements available to channel oil revenues into development. The present paper reviews available information about aid efforts of some oil producers and describes the institutions which exist or have been proposed to channel flows of oil money into the developing world.

In considering this question, it may be worthwhile recalling that the oil producing countries represent rather small economies in spite of the large oil revenues. Even if they all were to provide financial flows to developing countries of 1 per cent of their GNP in 1974, this would amount to the relatively modest amount of $1.5 billion.

Another point to be kept in mind is that some of these countries are rapidly exhausting their only known natural resources. It is therefore imperative for them to invest the oil revenues in such a way that they will provide income when oil is no longer available. One may therefore expect flows at commercial terms, i.e. OOF-like flows or private investment to play a substantial role in the financial flows from some oil producers to the developing countries.

The present paper deals with the subject under the following headings:

1. Actual financial flows
2. Funds and other ODA-type institutions
3. OOF-type financial institutions
4. Private financial institutions.

1. Actual financial flows

The aid programmes of Egypt, Kuwait, Libya and Saudi Arabia have been described in the "Flows of Resources to Developing Countries, 1973". The present note is, therefore, limited to additional, most recent information.

(i) Kuwait

In October 1973 Kuwait decided to resume its financial aid to Jordan which had been interrupted in September 1970. This has amounted in the past to £16 million ($40m.) annually and is expected to continue at this level.

It is recalled that following the decision taken at the Arab Summit Meeting in Khartoum in Autumn 1967 Kuwait has undertaken to provide annually KD47.5 million ($160 million at the 1973 exchange rate) to Arab countries which had suffered from the war with Israel. Already before that date Kuwait had been providing substantial amounts to other Arab countries in the form of direct government loans (independent of the loans through the Kuwait Fund). These loans amounted to KD120 million ($405 m.) by the end of 1968. But no such loan was extended in 1969 and 1970 and there is no evidence that any has been made in recent years. In 1973 Kuwait has provided some relief assistance to Niger ($0.35 m.). At the end of 1973 the IBRD raised another KD25 million ($85 m.) in Kuwait in the form of a public bond issue. The bonds have a life of 15 years and an interest rate of 7¼ per cent. It was the 6th bond issue by the IBRD in Kuwait which increases the total amount raised in that country by the IBRD to $439 million. Kuwait thus remained the fifth largest purchaser of World Bank bonds.

(ii) Lebanon

Beirut is playing an increasing role as an international financial centre. The Lebanese authorities have encouraged bond issues by foreign borrowers in Lebanese currency. In 1973 foreign bond issues reached at least LL 250 million ($100 m.) of which LL 50 million ($20 m.) were raised by the European Investment Bank, Algeria being another borrower. World Bank bonds in Lebanese pounds have reached the value of $30 million.

(iii) Libya

With a capital subscription of 15 million units of account ($18 m.) Libya is together with Egypt the largest contributor to the African Development Bank. In 1973 it provided a $8 million grant for various projects in Chad (improvement of a slaughterhouse in Sahr, construction of a hospital in Fort Lamy and another one in Mao, colleges in the capital and in Largeau) and close to $2 million for famine-stricken countries in Africa (Upper Volta $0.7 m., Chad, Mali and Mauritania $0.35m. each). Libya has recently agreed to participate in the construction of a number of factories and an oil refinery in Togo.

Libya has participated in the creation of the Malta Development Corporation through its National Investment Company. Algeria was authorised in 1973 to raise $51 million in the form of Libyan Dinar bonds.

(iv) Saudi Arabia

With foreign exchange reserves in 1973 amounting to some $5 billion and expected foreign currency earnings in 1974 in the neighbourhood of $20 billion Saudi Arabia is becoming a major financial power. Since 1967 Saudi Arabia has provided annually an amount of riyals 662 million (at present exchange rates $186m.) to Egypt, Jordan and Syria. The same amount is included in the 1973/74 budget. However, according to the press, King Faisal is believed to have decided to provide $1 billion as reconstruction aid to Egypt and Syria.(1)

(v) Iran

Following earlier proposals the Shah of Iran in February 1974 pledged about $1 billion to relieve balance-of-payments problems of developing oil-importers. His proposal contains three elements:

- a $2-3 billion fund with participation of oil exporters and major industrialised countries to be managed in close co-operation with IBRD and IMF. This proposal will be discussed at the OPEC meeting in June;
- purchase by Iran of IBRD bonds;
- a loan to IMF's proposed new lending facility.

In addition Iran has agreed to sell oil to India on credit and to invest in joint ventures in India.

2. Funds and other ODA-type institutions

Several oil producers have established or are in the process of establishing financial institutions aimed at providing concessional aid to developing countries. They are described in the following paragraphs.

A. Bilateral aid institutions

(i) Kuwait Fund for Arab Economic Development (KFAED)

The Kuwait Fund, the first development fund in the Arab World, was created in December 1961 as an autonomous agency of the Kuwait Government. Its purpose is to assist Arab states to develop their economies by providing financial and, to a lesser extent, technical assistance. The Fund's policy is to provide loans at concessional terms to specific projects which are likely to have a favourable impact on the borrower's economic development and promise a satisfactory rate of financial return.

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(1) Saudi Arabia and other oil producing countries also supported the Egyptian war effort with substantial amounts. Alone in the first half of October 1973 $920 million was made available of which Saudi Arabia provided $300 million, Kuwait 250 m., Libya 170 m., Qatar and Abu Dhabi 100 million each. In February 1974 Saudi Arabia also provided a $16 million grant for military assistance to Uganda.

The statutory capital of the Fund is Kuwait Dinar 200 million ($676 m. at the 1973 exchange rate) of which 101 million has been paid in. By March 1973, i.e. at the end of its eleventh financial year, the KFAED had committed 39 loans amounting to KD103 million ($348 m.) to 12 recipient countries and 10 grants totalling KD0.76 million ($2.6 m.). Cumulative loan disbursements had reached KD74.7 million ($252 m.) by that time and repayments KD18.9 million ($64 m.). The main recipients of loans have been Sudan (15%), Tunisia (14%), Egypt (13%), Morocco, Jordan and Algeria with about 10% each. The distribution by sectors shows a strong concentration on transportation and storage (39%), followed by agriculture (28%), power (20%) and industry (13%). The grant element of loans (calculated with a 10% discount rate) varies according to the recipient and the sector. It is highest in agriculture with a weighted average of 48 per cent and lowest in industry (29% grant element). Some projects have been jointly financed with the World Bank Group.

Since 1963 the Director-General of the Kuwait Fund has been Mr. Abdelatif Y. Al-Hamad. Mr. Al-Hamad is also Managing Director of the Kuwait Investment Company (see below), Chairman of the Compagnie Arabe et Internationale d'Investissement (see below), and on the Board of Directors of the Arab Fund (see below). During 1971/72, the Kuwait Fund managed the administrative and financial affairs of the newly created Arab Fund.

(ii) <u>Kuwait Development Fund for non-aligned countries</u>

According to an official announcement of 1st October 1973 the Kuwait Government has decided to set up a Development Fund for the non-aligned countries. No further details have been made public.

(iii) <u>Abu Dhabi Fund</u>

In early 1973 Abu Dhabi started to set up a Fund with an initial amount of Dinar 8 million ($27 m.). Total authorised capital is Dinar 50 million ($169 m.). Yemen (A.R.), Syria, Tunisia and Sudan will be the first recipients. In the beginning loans shall be extended for 7 to 10 years at an interest rate of 3.5 to 4.5 per cent. The Fund is interested in joint operations with the World Bank Group.

Managing Director is Mr. Hassan Abbas Zaki, a former Egyptian Minister of Economics, who has been principal financial advisor to Shaikh Zayed, ruler of Abu Dhabi, since 1970.

B. Multilateral institutions

(i) Arab Fund for Economic and Social Development

The agreement establishing this Fund was reached in May 1968 but the first meeting of the board took place only in November 1972. The Fund is a joint Arab financial institution with headquarters in Kuwait. Managing Director is Mr. Saeb Jaroudi, former Minister of Economic Development in the Lebanon and before that chief economist of the Kuwait Fund. The Membership of the Fund is composed of Arab League countries(*).

The Arab Fund has a capital of KD100 million ($338 m.) and a borrowing authority of KD200 million ($678 m.). The main contributors are Kuwait ($101 m.) and Libya ($41 m.). Saudi Arabia has stated its intention to join but has not yet contributed. The Fund is intended to operate in Member countries of the Arab League only and in particular to (a) finance productive investment on soft terms (which may vary according to the project and the risk involved); (b) encourage private and public investment and (c) provide technical assistance and expertise. As of January 1974, KD20 million ($68 m.) had been committed. In particular, the Fund has recently agreed to lend Algeria $50 million (at 2.5 per cent interest over 30 years) to build an oil-loading terminal at Arzew. This project is also supported by Germany and the World Bank.

(ii) Special Arab Fund for Africa

In January 1974 the Arab countries decided to create a $200 million Special Fund for Africa. The Fund is to be established in March 1974 to support the purchase of oil by African countries and to develop oil resources in Africa. Another stated purpose of the Fund is to compensate African countries for the economic loss they have suffered from breaking off relations with Israel. The main contributors to the Special Fund will be Saudi Arabia ($25 million), Kuwait (**) and Algeria ($20 million each). The United Arab Emirates and Qatar will pay $10 million each, Lebanon plans to contribute $1.5 m., and Egypt, Syria and Bahrein $1 m. each. The Libyan contribution, if any, is not known. Loans out of the Special Fund are to have the following conditions: 1% interest rate, 3 years grace, 5 years repayment. Loan recipients will be selected by the OUA in consultation with the Arab League. The Fund might be ultimately linked to the Arab Bank for Africa (see below).

(*) Algeria, Bahrein, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, United Arab Emirates (incl. Abu Dhabi), Yemen A.R., Yemen P.D.R.

(**) In February 1974 Kuwait announced that it would increase its contribution to the Special Fund from $20 m. to $30 m.

(iii) Arab Technical Assistance Fund for Africa

At the same meeting in January 1974, the Arab countries decided to set up a $15 million Technical Assistance Fund.

In addition to the above funds which are clearly intended to provide ODA-type flows, a number of development banks are at various stages of creation. It is not known to what extent these institutions will concentrate on lending at market rates (IBRD style) as opposed to concessional lending (IDA style). Somewhat arbitrarily they have been included in this section rather than under OOF-type institutions below.

(iv) Arab Bank for Industrial and Agricultural Development in Africa

The creation of this Bank was decided upon at the 6th Arab Summit Meeting in Algiers in 1973 on the initiative of Kuwait. According to an announcement capital subscriptions have already begun although the statutes of the Bank have not yet been drawn up. The capital of the Bank which had been variously stated as $125 m., $195 m. and $500 m. was finally fixed at $206 m. at the Cairo Meeting of Arab Finance Ministers in Mid-February 1974. According to the Iraq News Agency, Iraq had decided to make the largest contribution with $30 m. followed by Saudi Arabia with $25 million, Kuwait(*), Algeria, and the United Arab Emirates each with $20 million. Other Arab states are participating with sums ranging from $2 million to $10 million.

(v) Arab Bank for Development in Asia

A proposal to establish a similar bank for Asia is reportedly under consideration.

(vi) Islamic Development Bank

In December 1973, 25 Islamic states signed an agreement to establish an Islamic Development Bank with a capital of $1 billion. The creation of the Bank whose head office will be Jedda was largely due to Saudi Arabian initiative and a special committee has been formed for this purpose under the Secretary-General of the Saudi Arabian based Islamic Congress, Mr. Tanku Abdul Rahman. Subscriptions have been announced so far by Qatar ($20 m.), Lebanon ($5 m.) and Jordan ($1.2 m.).

(*) In February 1974 Kuwait announced that it would increase its contribution to the Arab Bank from $20 m. to $50 m.

(vii) OPEC Development Bank

A proposal to establish an OPEC Development Bank will be discussed at Quito, Ecuador, on June 10, 1974. The capital of the proposed bank has been reported as $1 or 2 billion. Members would be the OPEC members: Iran, Kuwait, Saudi Arabia, Libya, Abu Dhabi, Algeria, Indonesia, Venezuela, Nigeria, Iraq, Qatar, Ecuador, Gabon.

3. OOF-type financial institutions

A number of institutions have been created to invest public funds from the oil-producing countries abroad at commercial terms and largely using the methods of private investment flows. A list of such institutions which have come to the attention of the Directorate is given below.

(a) Arab African Bank

Head Office: Cairo (Egypt)

Established: 1964

Capital : £10,000,000 ($25 m.)

Share-holders :

Kuwait Ministry of Finance and Industry	34%
Egyptian Public Organisation of Banks	33%
Public and private interests from other Arab and African countries	33%

Special Egyptian legislation gives this bank the status of an international organisation.

(b) Libyan Arab Foreign Bank

Head Office: Tripoli

Established: ?

Capital : LD 20 million ($68 million)

Share-holders : Libyan Government

This bank participates in financial institutions in Uganda, Chad, Mauritania, Lebanon and Egypt.

(c) Kuwait Investment Company Group

(i) Kuwait Investment Company

Head Office: Kuwait

Established: ?

Capital : KD 7.5 million ($25 million)

Share-holders :

Kuwait Government	50%
Other Kuwait interests	50%

Apparently this company has entered into a co-operation agreement with American Express.

(ii) Banque Sénégalo Kuwaitienne d'Investissement

Head Office: Dakar

Established: 1974

Capital : 1 billion F CFA ($4 million)

Share-holders :	Kuwait Investment Company	50%
	Government of Senegal	25%
	Private Senegal interests	25%

(d) Arab Investment Company
(Société Arabe d'Investissements)

Head Office: ?

Established: decision December 1973

Capital : £100 million ($250 m.)

Share-holders : Egypt
Saudi Arabia
Kuwait
Abu Dhabi
Qatar
Sudan

Investments to be concentrated on agriculture and Shipping; the company will be open to private Arab investors wishing to repatriate capital.

(e) Arab International Bank Group

(i) International Arab Bank previously the Egyptian International Bank for Foreign Trade and Development

Head Office: Cairo

Established: 1973

Capital : £30 million ($75 m.)

Share-holders : Egyptian interests
Libyan interests

(ii) Joint Company between Lonrho and Arab International Bank

Head office: ?

Established: 1973

Capital : ?

Share-holders : Lonrho
International Arab Bank

(f) Banque Libano Brésilienne SAL

Head office: Beirut

Established: ?

Capital : ?

Share-holders : ?

Private financial institutions

The following (incomplete) list describes a number of private joint financial institutions which have been established largely to channel oil money into productive investments in both developed and developing countries.

1. UBAF Group

(a) Union de Banques Arabes et Françaises (UBAF)

Head Office: Paris

Established: 1970

Capital : FF.100,000.000

Share-holders :

Credit Lyonnais	31.98%
Banque Française du Commerce Extérieur	8.00%
Private French interests	0.02%
Sub-total European interests	40.00%
Arab Bank (Jordan)	6.8%
Banque Extérieure d'Algérie	"
Commercial Bank of Syria	"
Libyan Arab Foreign Bank	"
Rafidain Bank (Iraq)	"
Central Bank of Egypt	"
Arab African Bank (Arab multi-national)	6.2%
Banque du Maroc	3.8%
Alahli Bank of Kuwait	1.9%
Riyad Bank (Saudi Arabia)	1.9%
Bank of Jordan	1.1%
Sudan Commercial Bank	0.8%
Banque Nationale de Tunisie	0.6%
Jordan National Bank	0.6%
Société Tunisienne de Banque	0.6%
Banque Audi S.A.L. (Lebanon)	0.5%
Banque G. Trad (Crédit Lyonnais) (Lebanon)	0.5%
Alahli Bank Limited (Dubai)	0.1%
Bank of Bahrein and Kuwait	0.1%
Central Bank of Yemen (Sanaa/Yemen Arab Republic	0.1%
National Bank of Yemen (People's Democratic Republic of Yemen)	0.1%

Yemen Bank for Reconstruction and Development (Sanaa/Yemen Arab Republic)	0.1%
Banque Arabe Libyenne Mauritanienne pour le Commerce Extérieur et le Développement (Mauritania)	0.1%
Private Arab Interests	0.001%
Sub-total Arab interests	60%

(b) Union de banques arabes et Françaises - UBAF Limited

Head office: London

Established: 1972

Capital : £2,000,000 (to be raised to £5,000,000)

Shareholders :

UBAF Paris	50%
Libyan Arab Foreign Bank	25%
Midland Bank	25%

(c) Unione di Banche Arabe ed Europee - UBAE

Head office: Rome

Established: 1972

Capital : L.15 billions

Shareholders :

Union de Banques Arabes et Françaises - U.B.A.F.	51%
Banco di Roma	9.5%
Banca Nazionale del Lavoro	9.5%
Societa Finanziaria Telefonica per Azioni - STET	6%
Istituto Ligure Interessenze Industriali e Commerciali SpA (Finsider)	6%
Societa Italiana per Condotte d'Acqua	6%
Istituto di Credito per le Imprese di Pubblica Utilita - I.C.I.P.U.	6%

(d) Union de Banques Arabes et Européennes UBAE

Head office: Luxembourg (branch in Franfurt)

Establsshed: 1973

Capital : DM.30,000,000

Shareholders :

Arab Bank Limited Arab Bank Overseas Ltd.	33 1/3%
Bayerische Vereinsbank Commerzbank A.G. Commerzbank International S.A. Westdeutsche Landesbank Girozentrale	33 1/3%
Union de Banques Arabes et Françaises - U.B.A.F.	33 1/3%

(e) Union de Banques Arabes et Nippones - UBAN

Head office	:	Tokyo and Hong Kong	
Established	:	1973-1974	
Capital	:	$25,000,000	
Share-holders	:	Bank of Tokyo	8%
		Long Term Credit Bank of Japan	8%
		Mitsui Bank	8%
		Nomura Securities	8%
		Sanwa Bank	8%
		UBAF Paris	20%
		5 Arab Banks	40%

2. FRAB Group

(a) French-Arab Bank for International Investments (Banque Franco Arabe d'Investissements Internationaux) (FRAB Bank International)

Head office	:	Paris	
Established	:	1970	
Capital	:	FF.50,000,000 (to be raised to FF.100,000,000)	
Share-holders	:	Société Générale (France)	36%
		Société Générale de Banque (Belgium)	7%
		Swiss Bank Corporation (Société de Banque Suisse)	6%
		Banco Urqinjo (Spain)	1%
		Sub-total European Shareholders	50%
		FRAB-Trading and Contracting Company	7.7%
		Kuwait Investment Company	4%
		Kuwait Foreign Trading Contracting and Investment Company	4%
		National Bank of Kuwait	1.5%
		Al Sagar and Bros.	1.14%
		Private Interests, Al Sagar Group	3.30%
		Other Kuwait Financial Institutions (incl. Kuwait Insurance Company Commercial Bank of Kuwait)	2.60%
		Other private Kuwait interests	12.16%
		Sub-total Kuwait Interests	36.40%

	Bahrein	2.2%
	Abu Dhabi	1.2%
	Dubai	1.8%
	Sharjah	1.0%
	Sub-Total other Arab Gulf Interests	6.2%
	Libya (Sahara Bank, Libya Insurance Company)	5%
	Bank of Tunisia	1%
	Société Nationale d'Investissements (Tunisia)	1.4%

(b) European Arab Holding

<u>Head office</u>: Luxembourg

Established: 1972

Capital : L.Frs. 1 billion

Shareholders : Amsterdam-Rotterdam Bank N.V. Amsterdam;
Creditenstalt Bankverein, Vienna;
Deutsche Bank A.G., Frankfurt-am-Main;
Midland Bank Limited, London;
Société Générale de Banque, Brussels;
Société Générale, Paris;

Sub-total European Bank International Company	45%

Egyptian National Bank of Foreign Trade and Development
Abu Dhabi Fund for Arab Economic Development,
Banque Nationale d'Algérie,
National Bank of Egypt;
National Bank of Kuwait,
Banque Libanaise pour le Commerce,
Banque Misr, Lebanon;
Crédit Libanais, Lebanon;
National Commercial Bank, Libya;
Banque Marocaine du Commerce Extérieur,
National Commercial Bank, Saudi Arabia,
Central Bank of Syria

Sub-total Arab Shareholders	45%
FRAB-Bank International	10%

(c) European Arab Bank

<u>Head office</u>: Brussels

Established: ?

Capital : ?

Share-holders :	European Arab Holding	?
	Others	?

(d) Europäische Arabische Bank

<u>Head office</u>: Frankfurt

Established: ?

Capital : ?

Share-holders :	European Arab Holding	?
	Others	?

3. <u>CAII Group</u>

(a) Compagnie Arabe et Internationale d'Investissements Société Holding

<u>Head office</u>: Luxembourg

Established: ?

Capital : US$30,000,000

Share-holders :
Dresdner Bank A.G. (W. Germany)
Osterreichische Länderbank (Austria)
Banque de Bruxelles (Belgium)
Banco do Brasil (Brazil)
Canadian Imperial Bank of Commerce
Banco Central (Spain)
Bank of America (USA)
Banque Nationale de Paris (France)
Banque Nationale de Paris Inter-continentale (France)
Algemene Bank Nederland EV
Banca Nazionale del Lavoro (Italy)
Sumitomo Bank (Japan)
Société Financière Européenne (Luxembourg)
Barclays Bank LTD.
Union de Banques Suisses

Government of Abu Dhabi
National Commercial Bank (Saudi Arabia)
Bank of Kuwait and the Middle East (Kuwait)
Gulf Bank (Kuwait)
Kuwait Investment Company

Banque du Liban et d'outremer
National Investment Company (Libya)
Banque Centrale Populaire (Maroc)
Banque Marocaine pour le Commerce
l'Industrie
Banque Nationale pour le Developpement
economique (Maroc)
Qatar National Bank
Banque Nationale de Tunisie
Union Bancaire pour le Commerce et
l'Industrie (Tunisie)

(b) Banque Arabe d'Investissements Internationaux BAII

Head office: Paris

Established: 1973

Capital : FF.50,000,000

Share-holders :	CAII	99.9%
	Banco Central (Spain)	
	Banque du Liban et d'outremer (Lebanon)	
	Banque Nationale de Paris (France)	
	Banque Nationale de Paris inter-continentale	
	Banque Nationale de Tunisie	
	Banco de Brasil	
	Bank of Kuwait and the Middle East KSG	
	Canadian Imperial Bank of Commerce	
	Société Financière Européenne	
	State of Abu Dhabi	
	Kuwait Investment Company	
	Saudi National Commercial Bank	
	National Investment Company	
	Osterreichische Länderbank	
	Union Bancaire pour le Commerce et l'Industrie	
	Union de Banques Suisses	
	Intéréts privés particuliers	

It is intended to obtain more participations by Arab financial Institutions.

4. Investment and Finance Bank (INFI)
(Banque d'Investissement et de financement SAL)

Head office: Beirut

Established: 1974

Capital : £Lib 1,500,000

Share-holders :	Banque Audi SAL	35%
	Caisse Centrale de Banques Populaires	8%
	Hambros Bank Limited	8%
	Mitsui Bank Limited	8%
	Nomura Securities Co. Limited	8%
	Groupe Renault	8%
	Private Arab interests	25%

THE NEW YORK TIMES March 13, 1974

The Petrodollar Flow

If the Theory of Panglossian Economics Is Right—and It's Not—All Is Well

By LEONARD SILK

Economic Analysis

There is a school of economics whose fundamental tenet is that everything happens for the best. Among the historic claims for this principle are the following:

¶If the taxes of the rich are cut, the benefits will trickle down to the poor. Similarly, if the rich or the middle class build more new houses, this will benefit the poor, because the standing stock of existing houses will trickle down to the poor. (The trickle-down theory is one of the major contributions of this school of Panglossian economics.)

¶A fall in output, income and employment is good because it will restore the economy to a sound basis.

¶For every seller of stock, there is a buyer. Strong hands will take over the assets once held by the week.

¶Equilibrium is the law of economic life. If people spend more money for food, they will have less to spend for other things, so inflation will not result. If one nation loses monetary reserves, another nation will gain them, so the world monetary system will not suffer from either inflation or deflation.

To those principles of symmetry, balance and divine automaticity, the contemporary followers of Dr. Pangloss (Voltaire named him "Professor of Metaphysico - Theologio - Cosmolonigology") have added the following doctrines:

¶It doesn't matter how much money the oil-consuming countries pay out to the oil-producing countries, because the money will flow back to the oil-consuming countries as investments or to pay for goods.

¶It doesn't matter if the outflow of money to pay for oil causes a temporary cut in consumption in the oil-consuming countries, because this will constitute a form of saving, and the "petrodollars" will then increase the world's stock of capital, furthering growth and damping down inflation.

Volume to Be Great

However, the volume of petrodollars may be too great for the world monetary system to handle. The whole system could break down.

J. Carlin Englert of New York University has made fresh estimates of the money flows from 11 major industrialized nations to defray the costs of higher-priced petroleum and petroleum products this year. He found that the United States, Canada, Japan, West Germany, France, Britain and five other European countries would see their oil bills increase from $42.6-billion in 1973 to $108.7-billion in 1974.

What will the Arab oil states do with their money? Much of it will indeed flow west.

Ibrahim M. Oweiss, a native of Egypt who is an associate professor at Georgetown University in Washington, notes that the Arabs have already set up four major financial consortia in collaboration with American and European interests.

One is the Union des Banques et Française (U.B.A.F.), established in Paris in 19709 with more than $700-million in assets. This is 40 per cent owned by Crédit Lyonnais the big French bank, but it is controlled by 14 Arab banks. U.B.A.F. has subsidiaries in London, Rome, Frankfurt, Luxembourg and Tokyo; partners of these subsidiaries include several big European banks and the Bank of Tokyo.

The three other consortia are:

¶The Banque Franc-Arabe d'Investissement Internationaux (E.R.A.B.), chartered in Paris in 1969 by the Kuwait Investment Company in partnership with the French Société Générale and the Société de Banque Suisse;

¶The European Arab Bank, started in 1972, with headquarters in Luxembourg, which is made up of 16 Arab financial institutions (including E.R.A.B.) and seven European banks;

¶And la Compagnie Arabe et Internationale d'Investissement, incorporated in Luxembourg in January, 1973, which is owned by 24 Arab and other banks, including the Bank of America, West German, Italian, Japanese and French institutions.

Arab Business Sought

In addition to these major Arab combines, many Western banks and brokers are competing for Arab business, led by the First National City Bank of New York, with branches in Beirut, Saudi Arabia, Bahrain and Dubai, and the Chase Manhattan Bank, with branches in Beirut and Bahrain. Chase Manhattan and the Morgan Guaranty Trust Company of New York are the largest holders of Saudi Arabian Government deposits.

But the flow of capital from the oil-consuming to the oil-producing countries is so huge as to threaten hyperinflation in the Western economies.

The more moderate Arab countries, such as Saudi Arabia, Kuwait and Abu Dhabi, appear to recognize this.

Professor Oweiss noted that Saudi Arabia has proposed to reduce the current price of Persian Gulf oil "once justifiable political and economic demands of Arab countries are met and once rich oil-consuming countries pursue a policy of genuine cooperation with the developing countries."

He added that "it is not in the economic interest of oil-exporting countries to push the price of oil beyond the interval in which demand is inelastic."

The sharp increases in oil prices will mean a huge transfer of real income and wealth from the West—a real lowering of living standards.

As economists of the First National City Bank put it, "The discomfort of facing up to this harsh truth has engendered illusions—notably that, for consuming countries, the adjustment can be eased by more rapid inflation or by government intervention in the marketplace."

But the real transfers of income and the potential disruption of the world economy threaten to exacerbate both global inflation and recession.

Hopes for Price Cuts

It is the belated recognition of the gravity of these dangers—not only to the industrialized nations but to the oil-producing states as well—that has given rise to hopes that the Arab states meeting in Tripoli today may be ready to lift the oil embargo and expand production. The Western nations and Japan are also hoping for some price cuts.

The United States has pressed hard for such concessions to the Western nations, while France has been following a go-it-alone line, seeking to make her own deals with the Arabs.

Even if the Arabs end the embargo, however, the threat to the world economy will not evaporate over night. Inflation is raging, and the Western political and economic alliance is severely strained — possibly shattered.

The deciples of Dr. Pangloss should remember that their master barely missed losing his head in the Inquisition and wound up living humbly on the farm of Candide.

The Journal of Commerce

APR 4 1974

Euromarket Challenge: Recycling Arab Funds

By ALENA WELS
Journal of Commerce Staff
(First of a Series)

LONDON — Johannes Witteveen, the managing director of the International Monetary Fund, is currently touring the Middle East oil producing countries with the hope of enlisting their support in helping the world deal with sharply higher energy costs. The Shah of Iran has already pledged some support.

But officials and bankers here are well aware that the main job of recycling the $35 billion to $60 billion in excess oil revenues this year will fall on the banking community.

The opportunities for profit to the "City," London's financial district, are huge and banks here are carefully cultivating their already extensive ties with the Arab world. There are, however, serious pitfalls for financial institutions of which even the most euphoric and confident bankers are acutely aware.

A. T. Mitchell and P. C. Day, assistant general managers of Barclays Bank, expressed their serious concern in an interview that the banking system just wasn't geared to handle the influx of Arab money. A lot of banks with balance sheets under pressure will face the exposure of borrowing short-term Arab funds to lend on longer and longer terms. These funds, they cautioned, could be pulled out and, if the worst came to the worst, the Arabs could bypass the banking system altogether.

Britain, France, Italy, Denmark, Austria and various other countries are already tapping the Eurodollar market for billions of dollars at a time when Arab oil revenues are only beginning to flow. Heaven knows where interest rates would be, bankers here say, if very considerable funds weren't coming into the market, primarily to the three largest U. S. banks.

City Delighted

The City is delighted with the speed and secrecy with which the $2.5 billion clearing bank loan to the British Government was carried off. It epitomizes to bankers here the strength and flexibility of the London money market, supported as it is by a flexible Treasury and a cooperative central bank. There was tremendous interest, they said, from Japanese as well as American banks. What's more, they insisted, broken arms weren't as nearly in evidence in London as they were in Paris after the $1.5 billion loan to the French Government.

Be that as it may, the Barclays spokesmen believe that the nationalized French banks could be in a better position in the future than the private British institutions when the crunch comes.

They say, however, that resistance to taking deposits on short-term will grow and will force a lot of money into longer term. It could be that the Arabs in time will have to deposit their funds for as much as seven years in order to get a quote at all.

David Montagu, chairman and chief executive officer of the consortium bank Orion, which participated in the British government loan through its ties with National Westminister, conceded that the banking system will have a lot of adapting to do to meet the "unbelievable" demand for long-term funds. If exchange rates continue to float, raising substantial risks in individual currencies, there will be tremendous room for multicurrency financing.

Other bankers predicted that simplified multicurrency units will be developed that could be a great inducement to Arab investors and could be a sizable factor in reducing uncertainty and, as a result, inflation. They view the Rothschild composite unit, known as Eurca, as far too complicated. Two Eurco bond issues were launched last year with very disappointing results. The unit is composed of nine currencies weighted by gross national product and adjustable daily.

Questioned as to what would happen if the Arabs were to withdraw their funds from London at some future date, Mr. Montagu said that there are very few places where such sums can be invested and that they are bound to return to the "melting pot" in some form or fashion.

It is his impression that the bulk of the Arab funds will be going into the Eurocurrency markets and that the oil producers will be coming to the consortia for longer-term financing.

David Benson, the director in charge of corporate finance for Kleinwort, Benson Ltd. points out that the banking end of the Euromarket has been operating well in the face of a very large demand for funds.

The Arabs are handling themselves "in a mature way," he indicated, and are aware that they must insure themselves against being victims of their own success.

They are particularly concerned to form relationships with banking institutions of "undoubted quality" and aren't in any particular hurry to consolidate relationships. This leaves room for every kind of tie with the Arab world, he said.

Orion, like everyone else, is looking closely at the Arab countries. A "personal" tie doesn't seem necessary, Mr. Montagu explained, because most of Orion's shareholders have their own presence in the Arab countries.

THE WASHINGTON POST January 20, 1974

Hobart Rowen

Oil, Gold, the Dollar

IN THE LAST 10 weeks, the major European currencies have plummeted about 13 per cent in value against the dollar, which now is within hailing distance of the foreign exchange levels set by the Smithsonian Agreement of December 1971.

Excluding the British pound (which is in a seriously weakened condition), the dollar is within about 5 per cent of the levels set at the Smithsonian for major currencies. (Including Britain, the dollar is within 1.65 per cent of the Smithsonian averages.)

Or, to put it another way: the dollar has totally recovered from what Georges Pompidou called the "third devaluation"—the panicky erosion of last spring and summer—and about half of the 10 per cent devaluation of February 1973.

Meanwhile, the price of gold has skyrocketed to a record $136 an ounce, and it would surprise no one if it goes even higher.

In both cases, we are witnessing a dramatic response to the energy crisis, which threatens the oil-importing world with a financial upheaval. The United States, as the Chase Manhattan Bank points out, looks like such a "safe haven" compared with Europe and Japan that the dollar has gained in value even faster than it dropped during the crisis in confidence in 1973.

Moreover, European bankers who who were worrying about a massive "dollar overhang" around $90 billion last year have just quit talking about it: they will need every one of those dollars—and more—to pay the massive oil bill that the cartel of producing nations has laid on their doorsteps.

The dollar problem, in effect, has taken a 180-degree turn: there is no longer a deadly surplus, but a prospective shortage. Central bankers, meeting for the past few days in Rome, are arguing not about propping up the dollar—but how most efficiently to keep it from going too high.

These same forces explain the stunning advances in the gold market. Once upon a time, when gold was going up, the dollar would be going down, and vice versa.

But the dimensions of oil price escalation forced on the consuming countries by the producer cartel could point to a new role for gold in providing additional resources necessary to foot the oil bill.

IN THE SPACE of just two years—from 1972 to 1974, the world is faced with an oil bill rising from $21.6 billion to something just short of $100 billion. Of the latter figure, Europe, Japan and the United States would have to shell out $87 billion at current prices, assuming consumption at 1972 levels.

As Treasury Secretary George Shultz said in Rome on Thursday, it is impossible for such a "staggering" result to take place. At current prices, oil imports and consumption will fall. New sources of energy will be developed. But there will remain, nevertheless, a huge bill to pay, and serious secondary effects, Shultz warned, on the supply of products ordinarily derived from petroleum, such as fertilizer. Beyond that, there lies great uncertainty about what happens to trade, money flows and balance of payments positions.

"We must be realistic," Shultz said, "and recognize that the present problem is literally unmanageable for many countries."

Unless the problem is made manageable—and that means a rollback of the cartel-ordained prices—the world could encounter a wave of devaluations in an effort to cope with the enormous oil costs.

As former Federal Reserve Board economist Daniel

Economic Impact

H. Brill put it, "If major oil-importing countries try to cover their soaring fuel bills by competitive devaluations to get a little larger share of a diminishing world trade market, we could be in for a repetition of the Thirties."

WHERE DOES GOLD come in? If major currencies are devalued, the oil cartel countries might respond by insisting on exchange rate guarantees, or payment in gold. Already, Europe is full of talk of an official $150 gold price as part of a "package" plan to expand world liquidity.

Since the present, theoeretical official price is only $42.22 an ounce, those countries with substantial gold reserves would triple the resources available to pay their future bills for imported energy.

The American dollar, of course, had been enjoying steady gains before the energy crisis broke into full view as a result of great improvement in the U.S. balance of trade and balance of payments accounts.

In turn, that improvement was due to the better competitive edge given to American exports by the double devaluation of the dollar, plus a much better

See IMPACT,

Hobart Rowen

Oil, Gold, Dollar

IMPACT,-

score on inflation at home than recorded in most other industrialized countries.

The oil crisis—although it causes discomfort and higher prices here—simply underscores the strength of the U.S. economy relative to the rest of the world. Since we are dependent on imported oil for only a fraction of our needs, higher oil costs will worsen our balance of trade to a lesser degree than Japan's or that of any country in Europe.

Beyond that, while the real growth of the U.S. economy may be sliced to a small figure (or even to zero), the degree of recession here is likely to be much less severe than in Japan and Europe. The contrast with the catastrophe in Britain is stark.

THEREFORE, the prospect—how ironic for Arab policy-makers!—is that surplus revenues built up by the oil-producing nations will flow mostly back to the United States, seeking safe investment, directly or through the Eurodollar market.

There is not a little bitterness in Europe over the way things seem to be working out. A few have wondered, seeng the relatively insulated American position, whether the U.S. government is not secretly content with a situation which shows Europe helpless and distraught, the Common Market a shambles, while the U.S. dollar regains its former prestige.

It is certainly true that the United States stands to come off best of any major country, regardless of the future Arab squeeze and what it may portend. But officials here know that the United States can not prosper in the midst of a world depression.

They take seriously IMF Managing Director H. Johannes Witteveen's warning, like Brill's, that failure to find common approaches could bring the world to the kind of disaster that befell it in the 1930s, with the less developed countries suffering the most.

It would be illusory for anyone to think that because the dollar is strong in exchange markets, the U.S. will be home free. It won't.

THE WALL STREET JOURNAL February 11, 1974

Arab Oil and the Currency Crisis

By WILLIAM C. CATES

When a Secretary of the United States Treasury finds it necessary to characterize an international monetary development as "literally unmanageable" for many countries, as Secretary Shultz did in Rome on Jan. 17, things must be pretty bad. They are.

By most estimates the gap between exports and imports of Saudi Arabia, Kuwait and the other Persian Gulf sheikdoms alone, which had already swelled to some $10 billion last year, will shoot up to $50 billion in 1974, against a trade deficit of about the same amount facing Western Europe and Japan. If left unchecked, or uncompensated by a counterflow of loans or investments, this transfer of over $4 billion a month could clean out all of the monetary reserves of Europe and Japan within 23 months. Even if the gold component of these reserves were re-priced at $120 an ounce, they would last for but 33 months.

The crisis that looms so directly ahead differs from those of the past three years in more than just direction and degree. So long as the United States was running the deficit and others the surpluses, we could in a pinch, and we did, stop paying out reserves and simply let other countries accumulate dollars or revalue their currencies or both. Looking back, despite hard feelings among finance ministers, remarkably little harm was done to world trade. In other words, because the U.S. dollar was both a reserve currency and the standard denominator for world trade, we could cover our sins or misfortunes by supplying more dollars.

This is not the case when the shoe is on the other foot. With European and Japanese currencies weakening, exporters to those countries, including oil exporters, will demand and receive dollars, for which the suppliers of last resort are the European and Japanese central banks. Since these dollars come from finite reserves, the present crisis is unique not only for its magnitude but also for the fact that it cannot be papered over. It is unique as well for its suddenness. Given time, economies, like people, can adjust to almost anything, and had the oil price increase come upon us in 50 cents a barrel increments over the past decade, national economies as well as the world's trade and payments system could have taken it in stride. As is, automatic market forces will not have time to perform their function, and agonizing decisions will have to be made rapidly.

Reality and Illusion

For this reason it is worthwhile to try to sort illusion from reality in the proposals and prognostications that have already been put forth.

ILLUSION: An international body, be it the IMF, the OECD, the Common Market or a meeting of oil-consuming nations, later joined by oil-producing nations in Washington can set up a nice system to handle the problem.

REALITY: While it is sometimes easy to organize a grand coalition of nations to fight fascism, communism, capitalism, papism or Zionism, when it comes to jobs and money, international agreement is well nigh impossible. A modern day exception was the Smithsonian Agreement on new currency parities reached in December 1971, and there, not only were the nations represented manageable in number and the sacrifices required marginal, but we had the benefit of Secretary Connally, whose "tough" tactics have ever since been lambasted by well meaning people.

ILLUSION: Floating exchange rates will take care of the problem, providing they do not constitute competitive devaluation. (The distinction is becoming hard to discern, but we know the first is good and the second is bad.)

REALITY: Floating rates, the New Testament of the free market economists, can cope very nicely with modest marginal changes in a nation's trading position, but not with a deluge. For one thing, the favorable trade effects of devaluation can take as long as two years to become evident. For another, as Arthur Laffer pointed out on these pages Jan. 10, any benefits of devaluation are largely offset by inflation in the devaluing country.

The Western world together with Japan face a trade and monetary crisis of serious proportions within a matter of months. No assemblage of nations will find, let alone agree upon a solution.

ILLUSION: The oil crisis demonstrates and enhances the need for meaningful trade negotiations.

REALITY: The administration first proposed trade negotiations when the U.S. balance of trade was in terrible shape, allegedly due to Japanese aggressiveness and European protectionism. Now it is the Europeans and Japanese who face bankruptcy. Is now the time to tell the former to dismantle their Common Agricultural Policy and regional preferences and the latter not to invade our markets but pick on the Europeans instead? Apparently it is, and in addition, according to our trade negotiators, it is time to start working on rules which would prevent nations, including presumably the U.S. and Canada, from limiting their exports of oil, wheat, soybeans, or whatever else gets scarce. In today's crisis atmosphere such an ambitious round of trade negotiations would at best be a failure and at worst result in the hardening of national positions to the ultimate detriment of free trade.

To summarize: The Western world together with Japan face a trade and monetary crisis of serious proportions within a matter of months. No assemblage of nations will find, let alone agree upon, a solution. Nor can we expect the "market mechanism" to cope with an adjustment of this velocity and magnitude. In such a climate the free trade platitudes of yesteryear will provoke at best derision, at worst reaction.

But no crisis arises without providing the opportunity for leadership, and this opportunity is knocking, however quietly, at the door of the U.S. government. Logically the problem would resolve itself if the Arab governments were willing to hold and then use European and Japanese currencies in payment for their oil. However, this is unlikely, given the immediate prospects for these currencies on the exchange markets, and it would be foolhardy to ask any favors from the Arabs.

What is needed, therefore, is a financial intermediary. The U.S. alone can fulfill this function. If our government declares itself willing to accumulate substantial amounts of European and Japanese currencies, thus stabilizing their values at levels which, before the oil crisis, we regarded as quite reasonable, the Arabs would receive dollars, the Europeans and Japanese would be spared loss of their reserves and ultimate bankruptcy, and world trade could continue to function smoothly.

Though this sounds simple, if not simplistic, such a policy is fraught with technical and political difficulties; for example, does the U.S. support the pound or lire on the eve of a British or Italian election which may result in a Socialist or Communist government? The difficulties being endless, an intervention policy will not be popular with those who have to administer it (although our currency "swap" network with other central banks already totals $18.98 billion). But, at present levels, the yen and most European currencies are a businessman's risk, and even if we sustained book losses on a few, much as other countries lost for a time on their holdings of our dollars, the effect on the American taxpayer would not be noticeable, certainly not in comparison with the consequences of the rapid shrinkage of world trade which faces us today.

In return we can insist on a few important quid pro quos, among them no arms deals with the Arabs and no imposition of quotas or other serious trade restraints.

Careful Explanation Needed

Obviously such a course of action can be undertaken only after the most careful explanation to Congress, as the opportunity for demagogic attack in this complex area is unlimited. One can almost hear the epithet "Marshall Plan" reverberating in the Senate chamber. At the same time steps must be taken, including removal of withholding taxes and provision of ironclad guarantees against expropriation of foreign investors, to ensure that the American capital market can play its essential role in the overall financial intermediation.

Assumption by the United States of positive leadership and specifically a financial intermediary role would not only avoid or mitigate an immediate currency crisis, it would expedite the necessary adjustment to a new pattern of trade and investment flows. Such a pattern will entail vastly increased investment in countries which can in turn purchase products made in the U.S., Europe and Japan. This probably means Eastern Europe and Russia, plus any developing countries viable and stable enough to absorb and utilize substantial outside investment. Thus, the reduction in consumption by the wealthy industrialized nations, brought about through the oil price increases, can become investable funds which, properly handled, will be a boon to all concerned.

While the execution is far more complex than the recipe, failure by the United States to grasp this nettle of economic, and with it strategic, leadership could indeed result in "unmanageable" consequences for the trading world, including ourselves.

Mr. Cates, an economic consultant, was Deputy Assistant Secretary of the Treasury during the first Nixon administration. An editorial related to this subject appears today.

FROM THE NEW YORK TIMES, MARCH 7, 1974

Kuwait to Invest Riches in Arab Channels

By JUAN de ONIS
Special to The New York Times

KUWAIT, March 6—Kuwait intends to deploy her oil riches primarily through channels under Arab control and will not contribute to special funds proposed by the Shah of Iran and the International Monetary Fund to meet the world's oil payments crisis.

"We will make our own contribution to the world, big or small, through our own institutions," said Abdel-Rahman Salem al-Atiki, Kuwait's Minister of Finance and Oil, in an interview.

Last month, the Shah of Iran proposed that the 12 major oil exporting countries and 12 large industrial countries, including the United States, set up a special development fund, receiving $2-billion to $3-billion a year, to make loans on "soft" terms to poorer countries.

The proposal was hailed by Robert S. McNamara, president of the World Bank, and H. Johannes Witteveen, managing director of the International Monetary Fund, as a proposal of "great vision." Both institutions offered to manage the fund.

Camera Press
Abdel-rahman Salem al-Atiki

The shah said Iran was prepared to provide $1-billion, part of which would go to the proposed fund, while the rest would be used to buy World Bank development bonds and make a $700-million loan to the I.M.F., which could be used to ease balance of payments deficits arising from higher oil prices.

Neither the Special Development Fund nor the financing by the I.M.F. of oil deficits from oil-producer loans was viewed with favor by Mr. Atiki, whose country is a major financial power in the Arab world.

He said that Kuwait was participating in discussions among member countries of the Organization of Petroleum Exporting Countries on the creation of a bank to make development loans, and he said Kuwait was prepared to join in a four-point, $5-billion replenishment of the funds of the International Development Association, an affiliate of the World Bank.

But the major part of Kuwait's international financial aid will be put at the service of Arab countries, and to assist other Moslem countries, particularly in Africa, Mr. Atiki said.

"Nobody looked at the Arabs before," Mr. Atiki said "why does everybody expect us now to be the godfather?

Continued

Kuwait to Invest Her Oil Wealth In Channels Under Arab Control

We will not accept instructions from anybody on how we use our money."

"This part of the world has been neglected for centuries and its wealth has been carried away by foreigners without giving it a hand for development," he said. Mr. Atiki added:

"If there seems to be a capital surplus now, it is not because we have more than we need, but it is because we lack the ability to consume these amounts so quickly in a very short period."

Kuwait's estimated oil revenues this year, at current oil prices, are $9-billion to $10-billion for a country of 850,000 people, with oil as the only large domestic resource.

This massive revenue, reflecting an increase of more than 300 per cent in oil prices, may rise further when Kuwait acquires, as is planned, a 60 per cent equity in the Kuwait Oil Company, now owned jointly by Gulf Oil and British Petroleum.

Mr. Atiki said that he considered the present level of government take from taxes and royalties of $6.96 a barrel for Kuwaiti crude oil as "still too low."

He said that Kuwait is prepared to market directly her 60 per cent share of oil production from the Kuwait Oil Company, which was three million barrels a day until production was cut back after the October Middle East war, if the foreign partners do not meet Kuwait's terms for "buy back" prices.

These demands were believed to be in the vicinity of $10 a barrel. The companies have offered $8.50.

"I think oil prices on the world market should go even higher," said Mr. Atiki.

"I pay $21 for a Swiss-made shirt and $90 a sack for imported rice. So why is my barrel of oil the only thing supposed to be too highly priced?" he asked.

"Oil is a commodity affected by the law of supply and demand, and its prices should be equitably matched with the cost of equivalent commodities that produce energy," he said.

Earlier than most other oil exporting countries, Kuwait faced in the early nineteen-sixties the build-up of oil income to levels above domestic development and welfare needs, which are budgeted at about $1.5-billion.

With an outward looking policy, Kuwait has been a leader among the Arab countries in establishing investment institutions designed to put Kuwaiti funds to work abroad.

These institutions, both profit making and for development lending, include the Kuwait Fund for Arab Economic Development, the Kuwait Investment Company, and the Kuwait Foreign Trading, Contracting and Investment Company. They have made loans and investments of more than $500-million abroad.

Kuwait has been the moving force in the establishment of the Arab Fund for Economic and Social Development, a sort of regional development bank, which made its first three loans last year, totaling $30-million. New loans to Egypt and Algeria totaling $200-million will be announced this month.

Kuwait has pushed the creation of an Arab-African Bank that was set up with a $200-million capital in Cairo in January, and is planning to join in major investments in Egypt and the Sudan for projects ranging from oil pipelines to highways and major agricultural and livestock development.

"It is going to take a lot of money to get this part of the world to stand on its feet," said Mr. Atiki, whose combined role as Finance and Oil Minister puts him at the center of Kuwait's financial management.

BUSINESS WEEK, February 16, 1974

Money: Where the Arabs will invest their new oil wealth

"It's going to be a helluva task but an interesting one, if you are in international banking," says Richard Vokey, vice-chairman of London merchant banker Hill Samuel & Co., Ltd.

Hill Samuel's "task" is the awesome but potentially lucrative one of helping recycle an estimated $50-billion a year of surplus Arab oil revenues back through the world's capital markets to the nations that consume oil. Not surprisingly, Hill Samuel will have considerable competition. Commercial and merchant banks from the U.S., Britain, the Continent, and Japan are rushing to get a piece of the action.

There will be plenty of it. The oil-exporting countries will be able to spend less than half of their fabulous earnings, expected to total around $90-billion this year, for imports of capital equipment and consumer goods. Libya, Saudi Arabia, and the Persian Gulf sheikdoms, which will pile up the biggest surpluses, have not even decided what to do with the remaining unspent funds, according to Beirut bankers.

But for lack of other profitable alternatives, it is virtually certain that they will have to deposit, lend, or invest a good part of the money in the major Western capital markets. Says banker Vokey: "They will put their money where they get the best deal."

Oil consumers, in their turn, will have to borrow in these very capital markets to help finance their purchases of Arab oil. Thus, France is swinging a $1.5-billion medium-term credit line in the Eurodollar market via a consortium of banks headed by France's Societé Générale. The French will draw on the money when needed to offset a projected $3.7-billion balance-of-trade deficit that will be created largely by soaring oil-import costs.

The Arabs will supply some of the money that the French need. Says an official of the Paris-based Union des Banques Arabes et Francaises (UBAF), jointly owned by Arab and French banks: "We are bound to subscribe to this loan, and thus we will serve as a conduit for Arab funds finding their way back into European hands."

Via New York. In addition to the Eurodollar market, some Arab funds will flow to national money markets on the Continent and in Britain through the purchase of such securities as British Treasury bonds. Eventually, a big share probably will surge into the New York money market because the U.S. economy, less affected by the energy crisis than most, looks like the safest haven for investors.

To keep the Arab dollars circulating—and give American bankers a larger role in handling them—Washington last month lifted U.S. restrictions on capital outflows.

The French already are tapping New York. The French national telecommunications agency plans to float a $75-million bond issue in the U.S. In the next few months, says a French Finance Ministry official: "I think you will see a whole lot of French companies making loans of this kind." The Arabs also are expected to step up the real-estate investments they have been making in the industrialized nations, and some Arab money will probably go into corporate stocks.

Economic effect. The reverse flows of money from the Arabs to the world's capital markets will go a long way toward offsetting the deflationary impact that the oil-payment deficits would otherwise have on the economies of the consuming countries. Still, the sloshing of huge amounts of Arab money through financial markets may make the job of managing the world's economies a rough one. Explains a top economist of the Organization for Economic Cooperation & Development: "If Italy and France don't attract Arab funds to compensate for their oil bills, they are going to have to mount an expansionary monetary and fiscal policy. And if the U.S. attracts more than its share, it will have to adopt a restrictive policy." To ease such problems, French Foreign Minister Michel Jobert reportedly proposed to Arab governments that part of the payments they receive for oil be left on deposit in banks of consuming countries.

Tragically, the developing countries, with gloomy economic prospects and thin capital markets, have little hope of attracting Arab funds. And they lack the credit to borrow in the major capital markets or the ability to pay commercial interest rates. Managing Director Johannes Witteveen of the International Monetary Fund (IMF) proposes to help them with an expanded credit facility that would be financed mainly by Arab funds.

Meantime, Saudi Arabia is setting up its own Islamic Bank with $1-billion capital for aid to the Arab world, and a Cairo-headquartered Arab African Bank will channel Arab funds to African countries.

Actually, the recycling of Arab funds is not yet into top gear because there is a two-month lag between the loading of tankers in the Persian Gulf and the flow of tax and royalty revenues into Arab coffers. The big bulge of revenues from the Dec. 23 oil-price hike will start pouring into Arab treasuries next month.

Lots to learn. Investing huge chunks of that money will be no easy task. "The Arabs are terribly worried about their money and what they can do with it," says Burhan Dhajani, who heads the Beirut-based Union of Arab Chambers of Commerce.

Traditionally, the Arabs have been very cautious with their funds—investing heavily in short-term instruments. Their natural caution has been buttressed by a number of sobering financial experiences, including heavy losses in the debacle of U.S. offshore mutual funds. Arab investors "have been had in the past," notes William Higman, a director of a newly-formed London bank, the Arab & Morgan Grenfell Finance Co., which is jointly owned by Jordan's Arab Bank and London's Morgan Grenfell & Co. But, notes Higman, "they have learned a lot."

With the assistance of countless eager financiers, they will learn a lot more. Vokey of Hill, Samuel notes that the Arabs generally have bought Eurobonds in the relatively safe secondary market. Now, he says, "a lot of bankers are hoping they will get active in the primary market" as original lenders—an activity that involves considerably more sophistication. Indeed, the Kuwait Investment Co., owned by the Kuwaiti government and private shareholders, already is active as a comanager of new Eurobond issues.

A lot of bankers are hoping the Arabs will get active in the primary market

New partners. Europeans and Americans are setting up merchant banks in Beirut to tap Arab money nearer its source, while Western and Japanese commercial banks are flocking into the gulf states. And bankers from all parts of the world also are jostling each other in their rush to set up joint-venture financial houses with the Arabs, headquartered in such European money centers as Paris and Brussels.

The Union des Banques Arabes et Francaises, which opened its doors on Rue Ancelle in the Paris suburb of Neuilly in 1970, has assets of more than $1-billion. Arab participants, including banks from Kuwait, Bahrain, Oman, Libya, and Tunisia, own 60% of the shares, and France's Credit Lyonnaise and Banque Francaise de Commerce Exterieur hold the rest. UBAF operates branches in London, Frankfurt, and Rome, is opening another in Hong Kong with Japanese banks, and is considering yet another in New York.

Other such joint ventures include Frabank International in Paris, European Arab Bank in Brussels, and Cie. Arabe et International de Investissement in Luxembourg, in which Bank of America has a holding.

Says an UBAF official: "At the summit meeting in Algiers last December, the Economic Council of the Arab League called for Arabs to withdraw funds gradually from Western banks. This won't happen overnight, but in a year I think you will see a change in the flow of funds to Arab affiliated banks." And Suliman Olayan, a Saudi Arabian entrepreneur with interests in construction and oilfield contracting, explains why such joint ventures will also attract private Arab business. "When I go to see these people, they speak my language, they know who I am. I can get in to see the president." ■

THE WALL STREET JOURNAL March 5, 1974

Arab Investors

As Oil Money Pours in, Mideast Lands Search For Places to Put It

While Much Is Still Banked, States Now Seek to Invest In Real Estate, Businesses

Exit Gnomes, Enter Sheikhs

By PRISCILLA S. MEYER
Staff Reporter of THE WALL STREET JOURNAL

The flow of oil money into Arab lands is becoming a flood as the oil-producing nations collect their windfall profits from the most recent doubling, on Jan. 1, of the price they charge for oil.

Last year, Middle East oil revenues ran about $22 billion. Much of the profit was invested domestically. This year, with revenues running anywhere between $85 billion and $110 billion, an estimated $40 billion to $50 billion should spill into the international money markets. Over the longer term—by 1980, according to an estimate by Chase Manhattan Bank—Arab foreign reserves should swell to more than $400 billion from a meager $5 billion, as estimated by the World Bank, in 1970. That compares with total foreign investments of U.S. corporations of $145 billion at the end of 1972.

The big question is how the Arabs will invest all this money. For the immediate future, it appears, most of it will continue to go into bank deposits and in government securities like U.S. Treasury bills. But the potential demand for such funds is limited. And already there are solid indications that the Arabs are starting to change their traditionally ultraconservative investment policy to take the plunge into more profitable ventures. Arab institutions are buying real estate in the U.S. and elsewhere—hotels, apartments and office buildings. Arab institutions and private investors are buying and attempting to buy interests in U.S. banks. And negotiations are starting for joint ventures, mainly in oil, petrochemical and other energy-related projects, in the U.S.

An Arab Landlord on Fifth Avenue

Partly for political reasons, and also because they haven't yet developed a big force of investment professionals and business managers, the Arab nations are unlikely to make a run on the U.S. stock market or acquire big publicly held companies anytime soon. Iran, it is true, has indicated that it plans eventually to invest heavily in "blue chip" U.S. securities, and it already has agreed to a joint venture with Ashland Oil in the U.S. Individuals in the Middle East, too, may be buying U.S. securities. "Don't be surprised if Arab interests already have a significant participation in American companies," Joseph A. El-Khoury, director general of the Banque de la Mediterranee of Lebanon, said during a recent visit to New York.

But these kinds of developments now seem more typical:

—Shah Mohammed Riza Pahlevi of Iran has bought, through his Pahlevi Foundation, a large office building, which he's remodeling, at 642 Fifth Avenue in New York.

—A group of Kuwaitis recently paid about $27 million for property along the Champs Elysees in Paris for a luxury office and bank building to be called the House of Kuwait.

—A group of Arab banks is setting up First Arabian Bank and First Arabian Corp. as vehicles for pumping funds—including money to buy ownership interests in U.S. banks—into the U.S.

Sudanese in California

—Adnan M. Khashoggi, a Beirut-based Saudi Arabian who acquired 50% of the stock of Security Capital Corp. last September, and who has purchased two California banks, also has acquired about $1 million in raw land for development in California. He plans to bring some 40 young business trainees from the Sudan to California to learn how to use venture capital and develop real estate.

—The Saudi Arabian government has talked to Chase Manhattan bank about the possibility of Chase managing a pool of $200 million in Saudi government funds for investment in Saudi business and in joint ventures with foreign partners whom Chase would find.

—Libya has established an investment bank in Buenos Aires. Abu Dhabi and Saudi Arabia are discussing building a large oil refinery, in partnership with a New York-based firm, in Puerto Rico. And the Saudi Arabians are investigating the possibility of a refinery and petrochemical complex in the Philippines.

—Kuwait, a small nation with inordinately large oil revenues and relatively solid experience in investment, also is buying U.S. real estate. The Kuwait Investment Co., one of several owned jointly by the Kuwait government and individual Kuwait investors, this month bought Kiawah Island off Charleston, S.C., for $17.4 million in cash. The company plans to spend more than $100 million developing it as a residential resort over the next 15 years. The same company put up $10 million, or half the equity funds, for a project in downtown Atlanta that includes the new Atlanta Hilton hotel.

Once Stung, Doubly Cautious

—An executive with a major U.S. bank estimates that in the past few months up to $400 million has been lent directly to U.S. borrowers by Arab investors. Enck, Hollingsworth & Reveau, a Louisville real estate firm, says it has agreed in principle to borrow $150 million from Persian Gulf investors for the purchase of U.S. real estate. Wooten & Associates, a Dallas builder and developer, says it has got about $200 million in Middle East financing for an apartment development in St. Louis.

—Najeeb Halaby, former chairman of Pan American World Airways, has assembled $100 million in real estate he hopes to sell to private Saudi Arabian investors.

Arabs like real estate because it's "tangible," Mr. Halaby says. "They've seen prices of their own real estate rise faster than other investments," he adds. David Toufic Mizrahi, editor of a New York-based newsletter called the MidEast Report, says some land in the Hara district of Beirut has doubled in six months.

Even so, some bankers say, the Arabs appear to have rejected most of the deals offered them by the flocks of investment men who have been giving them pitches in recent

Arab Investors: as Wealth Pours in, Mideast Lands Seek Places to Put It

Continued From Page One

months. This may partly reflect some unhappy past experiences. Arab investors were hurt by the collapse of Bernard Cornfeld's I.O.S. Ltd., which sold many mutual-fund shares in the Middle East. Some Arab investors still haven't received full repayment from the collapse of a major Mideast bank, Intra-Bank, eight years ago.

That kind of experience explains the Arab desire to enter joint ventures with experienced, reputable partners, says Benjamin V. Lambert, president of Eastdil Realty Inc., an affiliate of Blyth Eastman Dillon & Co. that is planning a mixed pool of Arab and other investors' funds. The Arabs, he says, have been "stung and double-stung."

Mr. Lambert thinks the Middle East oil nations will invest around $1 billion in U.S. real estate in the next two years. Other observers think it might amount to five or 10 times that. Mr. Lambert is conservative because, he thinks, investment may be limited by the supply of "good" investment property and by political considerations. The Saudi Arabians, for example, apparently fear that a worsening in relations with the U.S. might persuade the U.S. to freeze Arab funds in U.S. banks. The Arabs are aware that Congress has been making fretful noises over the prospect of massive Arab investment in the U.S., and they are aware of the controversy in Hawaii over Japanese investment in the tourist industry.

Some bankers, however, see a massive flow of Arab money into foreign real estate and industrial development as a near-inevitable development over the long term. Derick Richardson, Chase Manhattan's group executive for the Middle East and Africa, doubts that money markets alone can absorb all the new Arab wealth. "Looking at the capacity of markets to cope with the accumulating dollars," he says, "unless there are structural changes in the nature of institutional markets there will be severe difficulties two years out." Specifically, he says, the market for Eurodollars, or dollar deposits held outside the U.S., will become "saturated."

Alternative Energy Sources

Other big U.S. banks have discussed alternatives to money-market investment at considerable length with Arab financial officials. Chase seems more willing to talk about these discussions than its competitors. Chase says for example, that Chairman David Rockefeller and Mr. Richardson have encouraged Saudi Arabian officials to establish a large pool of Arab money for investment in energy research and development—partly because Arab oil eventually will run out.

Many international banks and brokerage houses are buying into Arab institutions and forming new ones in the Middle East to influence and exploit the Arab desire for new investment. Most of these efforts are thinly veiled attempts to import surplus Arab dollars and shore up financial markets here and in Europe, though the financial men usually describe their efforts as "harnessing Arab funds for Arab investment."

Though internal investment has top priority in most Arab countries, even ambitious projects, given the relatively small populations and capital needs, aren't likely to drain off much of the cash flowing into Arab treasuries. Not even the $3 billion fund for loans to underdeveloped countries proposed by the shah of Iran amounts to more than a tiny fraction of Arab funds that will become available for investment over the next six years or so.

A Place in Financial Folklore

Their vastly increased wealth has earned Arab investors a certain notoriety in some financial markets—and the Arabs are displeased. " 'Arab sheikhs' have now replaced in financial folklore the notorious 'gnomes of Zurich' of the '60s," Abdlatif Y. Al-Hamad, director general of the Kuwait Fund for Arab Economic Development, complained recently at a meeting in Luxembourg. Arabs, he says, have "played virtually no role" in recent foreign-exchange and commodities-market gyrations, he says.

Some international bankers say that although Arab governments may not be very active in those markets, private Arab institutions and investors are. The oil-generated profits of Arab contractors, business consultants, private banks and others on the fringes of the oil business are financing foreign-exchange and commodities speculation, they say.

At the same time, some Western "money brokers" are trying to exploit awareness of the Arabs' new riches by collecting fees from U.S. firms for arranging loans from Arab investors, and then disappearing. Offers to arrange such loans have proliferated since last fall. Mr. Halaby, proprietor of his own investment company, says he has checked out many of these brokers and found them to be "phonies."

Opening the Arab well to money-dry nations

BUSINESS WEEK March 30 1974

The oil-producing countries have the money and the oil-consuming countries need it—most of all the developing lands with only limited access to the world's capital markets.

So World Bank President Robert S. McNamara was in Algeria this week, Treasury Secretary George T. Shultz was in Caracas, and Managing Director Hendrikus Johannes Witteveen of the International Monetary Fund leaves Tuesday on a six-week swing through oil-producing nations from Iraq to Venezuela. Each man hopes to open a conduit through which the billions of dollars being paid for oil today will flow to nations that face bankruptcy because of soaring fuel bills.

The financing of oil costs through borrowings in international markets has worked well enough for some—Britain this week announced a $2.5-billion commercial bank standby facility—but countries with doubtful credit ratings need more foreign exchange than the market will give them.

So far, oil-producing countries talk in generalities about plans for officially recycling funds to the hardship cases the markets turn down. But they are not plunking down much hard money. Says McNamara, whose agency so far has had only $200-million from Iran and $27-million in commitments from Venezuela: "No doubt other funds will come forward. The question is whether they will be soon enough, and in the proper amounts."

Eurodollars. The pinch would be worse if the Eurodollar market were not so fertile in providing financing. Britain, France, and Italy have put their state-owned companies to work borrowing at a great rate. Japan has directed its private banks and corporations to seek out Eurodollar resources.

Even Britain and Italy would like to supplement what the market is willing to lend them with official credits, provided they could be had without the strings the IMF attaches to all the ordinary credits it gives. Among the poorer countries, India was able to borrow $62-million from the IMF a few weeks ago, but the increase in its oil bill this year over 1973 is estimated at $900-million—which it cannot pay. Meanwhile, the schemes for using the oil money are focusing on development of the oil regions first. This leaves little for other less developed countries.

Already in the Arab world, there are no fewer than five local development funds—the Kuwait Fund for Arab Economic Development, the Abu Dhabi Fund for Arab Economic Development, the Islamic Bank, the African Fund for Agricultural & Industrial Development, and the Arab-African Bank. The latest talk is that the Islamic Bank, set up to help Islamic nations with the important patronage of Saudi Arabia, will see its resources doubled to $2.8-billion.

Venezuela seems likely to dispense oil money in a similar regional pattern. It is negotiating with the Inter-American Development Bank to set up a $250-million fiduciary fund. And a national investment fund, which will collect an estimated $5-billion in oil revenues, will be used partly to finance Latin American development projects. One project is for an oil refinery in Costa Rica to supply Central America.

Gaps to fill. With the increase in the world's total oil bill estimated at $50-billion and up, this leaves a lot of financing gaps for McNamara and Witteveen to fill. Witteveen's contacts with the oil countries will make or break his proposal to set up a special "oil window" at the IMF where governments can borrow with relative ease. Says a fund official: "Without oil money, the window would have to be so severely scaled down, there is doubt it would be possible."

It does not help that the Arabs are apathetic and the U.S. hostile to the Witteveen proposal. No oil money has been committed since Witteveen first proposed it in January, except for $700-million that Iran may place with the fund. Says University of Colorado Professor Ragaei El Mallakh, who does consulting work for the oil governments: "He doesn't really have much of a chance to get Arab countries to subscribe heavily to the IMF. They want to invest unilaterally."

As for the U.S. viewpoint, a Treasury official says: "With the embargo off, the oil price must come down. Why institutionalize high money costs and give the oil countries guarantees? If you go to them on bended knees and ask for money, the terms will not be very generous." For this year, at least, the U.S. feels the market can do the job for developed countries that can afford to borrow at all. By next year, though, financial officialdom may find itself giving guarantees to commercial bank loan officers if the oil financing problem does not wane.

Still, Witteveen in the 127-member IMF has a wider constituency than the industrialized nations. Furthermore, aides say preliminary contacts with the oil countries about putting money into the IMF are not so negative as to keep the managing director from making the trip. And, they add, not only does the IMF chief expect to bring back some commitments, but he also feels there is a "good chance" to get them at interest rates below going market yields. ■

THE WASHINGTON POST March 1, 1974

Iran's Proposals for the World Economy

IRAN HAS MADE a far-reaching proposal to cope with some of the acute dislocations caused in the world economy by the oil cartel's quadrupling of prices two months ago. To help poor countries hit by the increases to maintain the momentum of development, Iran would have 12 oil exporters and 12 industrialized countries put up $150 million each a year (a total of $3 billion) in a new soft-loan fund, to be run by donors and recipients on "non-political" lines and to be serviced by the World Bank and the International Monetary Fund. To help oil importers absorb the severe balance-of-payments impact of the new prices, Iran will lend perhaps $700 million (at commercial rates) to the IMF, to be recycled to importers. Iran also will buy (at commercial rates) some $200 million in ordinary World Bank bonds. The Shah has committed his country to put up $1 billion for these three uses this year. He hopes his initiative will be joined and supported by other states.

The Shah's proposal is, first, a major political move reflecting an Iranian bid for global political stature. It goes well beyond the bilateral oil arrangements which the Shah is quietly and simultaneously making with countries of his region. It makes Iran the first member of OPEC, the oil cartel, to offer a comprehensive adjustment plan for the world economy. It puts Iran in the prestigious position of using the great international financial institutions, the World Bank and IMF, as instruments of Iranian policy to a considerable extent. Indeed, these institutions, by accepting the Shah's initiative, have in effect endorsed his grand strategy of reshaping the world economy to pay the new high prices of the oil cartel; it is the American grand strategy, of course, to lower the prices. And no matter what comes of the proposed new soft-loan fund, the Shah will make a good return on funds invested in the IMF and the World Bank's hard-loan branch.

The soft-loan fund idea is especially interesting because of the poor countries' desperation. The oil exporters have sound moral and political reason to come to the aid of their price-stricken third-world brothers. To be candid, however, $150 million a year per donor is not much; for Iran, it's only one per cent of the *increment* of its oil revenues. Then, there are differences between Iran's aid proposal and the evident aid proclivities of OPEC's Arab members. Iran and Saudi Arabia are political rivals; whether the Saudis will wish to support an Iranian proposal, one which they were not invited to help shape, remains to be seen. Iran wants aid to be nonpolitical but the Arabs avowedly want to use oil as a political weapon. The Arabs may not be as ready as Iran to use the services of the World Bank and IMF. So far only Venezuela, another non-Arab OPEC member, has indicated support for the Iranian proposal. There is always the prospect, however, that if the Arabs do not choose to join Iran on this fund, they will create their own separate and larger one. The need is there.

The $700 million which Iran plans to loan to the IMF will help it serve better the swollen liquidity requirements of the oil-importing nations. There is no particular political reason why the Arabs in OPEC should not follow suit, and there is good economic reason why they should: the IMF is a good safe place to invest some of their surplus funds. Recycling oil revenues to consumers should quiet their nerves, at least in the short run. Just how consumers are to earn the money to pay back the IMF, and their other creditors, is necessarily a longer-term problem running beyond the writ of the IMF.

Needless to say, the Shah's initiative is not the last word, or perhaps even his last word. But he has put into circulation serious proposals to deal with some of the basic new conditions of the world economy. Moreover, he is treating the world economy as the integrated interdependent entity which it is. If there is a tight strand of Iranian self-interest in what the Shah of Iran suggests, then the rest of us should not be put off. We should test his ideas to see which of them may work.

BUSINESS WEEK March 2, 1974

FINANCE

How to handle $50-billion in Arab oil money

Investors look for guidance in the new, vast international market

Surplus Arab oil money, the strengthening of the dollar, and the end of U.S. and foreign capital controls are combining to create a vast, integrated international capital market. But just how the government will permit private institutions to operate in the new environment has regulators' phones ringing all over Washington.

The Eurodollar market is as notoriously unregulated as domestic U.S. financial markets are tightly controlled. Yet both are expected to share in the extra $50-billion that oil producing countries will have for investment this year.

The U.S. wants its markets free enough to recycle capital inflows of oil money in excess of what it needs to balance its own international books. And it wants a freer capital market to encourage inflows, too.

The trouble is that the capital controls that ended on Jan. 29 were only one of the many governmental regimens ruling U.S. markets, from registration of securities to reserve requirements on banks. One of the hottest issues concerned the big-loan business that U.S. banks had done in the London Eurodollar market during the era of the controls.

Reserve rule. In 1969 the Federal Reserve imposed special reserve requirements on any loans by the Eurodollar branch of a U.S. bank to corporations resident in this country. The idea was to close a loophole in the credit crunch then prevailing by stopping U.S. banks from siphoning Eurodollar market funds. To oblige the capital controls program, however, the Fed had exempted loans to Americans by the foreign branches of U.S. banks if the American borrowers pledged to use that money to pay for the factories they bought or built overseas.

The sudden end of capital controls in January made bankers fear that the exemption from Eurodollar reserve requirements would be cut off. And it was, at least on new loans, even though Fed governor Andrew F. Brimmer heard their protests that this was unfair in the new integrated market.

Says David Devlin, vice-president of First National City Bank: "The problem is that foreign-owned Eurodollar banks can lend to U.S. firms here and

Brimmer: "If the problem is foreign banks, the Fed will not stand by helpless."

they are not subject to reserve requirements. Subjecting our London branch to reserve requirements for the same loan," he argues, would increase their costs and make their loan rates to prospective borrowers uncompetitive.

So far, foreign banks are not lending to U.S. companies on any scale. "In the future," says Brimmer, "if the problem is foreign banks, the Fed would not stand by and be helpless." Although

One Presidential plan would repatriate the Eurodollar operations of U. S. banks

the Fed has no way to put reserve requirements on foreign banks abroad, with a change in law, it might do what Germany did in 1972. To keep Eurodollar market borrowings from ballooning the domestic money supply, German authorities put reserve requirements directly on German corporations when they borrowed abroad in defiance of anti-inflation restraints.

Nixon's proposal. The Fed also is not responding too warmly to a Nixon Administration proposal that it felt had similar implications. The international economic report of the President urged that Eurodollar market operations of U.S. banks be brought home. If domestic banks kept a separate set of books, they could be exempted from domestic reserve requirements as well as normal U.S. ceilings on deposit yields, so long as they were using only Eurodollar money.

But the implementation would have to be done by the Fed. And central bank officials are very skittish about their capacity to police banks here to prevent them from using their unregulated Eurodollar funds for making domestic loans contrary to monetary policy. "You'd need exchange controls to insulate that Eurodollar window," one official observes.

SEC problem. The Securities & Exchange Commission faces a different dilemma. A year ago, the SEC to help the balance of payments by getting U.S. business to finance overseas investments with overseas money ruled that securities sold abroad do not have to be registered with the commission.

The SEC was aware of the danger that a company might nominally sell its capital issues to foreign buyers and arrange for the distribution to be rerouted back to retail customers inside the U.S. a violation of registration requirements. However, so long as the interest equalization tax (IET) was in effect, the extra cost it imposed on Americans purchasing securities from foreigners gave effective insurance that this danger would not materialize. Now that the IET is gone and American corporations are no longer required to employ foreign money to finance overseas capital spending, the SEC says that "we have to work up a set of guidelines that will keep the stuff from coming back."

Similarly, the Treasury Dept. had been, in effect, waiving U.S. withholding tax on American-source interest and dividend income paid to foreigners so long as the securities in question came under the IET. Like the Fed and the SEC, it did so to get U.S. corporations to finance abroad.

The Treasury now says it would like to get rid of the withholding tax altogether. The argument for abolishing it, however, goes straight back to the dilemma of the new integrated capital market. The people overseas who are potential buyers of American securities, including the Arabian oil sheiks, are not apt to touch any issue with a withholding tax. There are plenty of investments around without it. And some investors fear they risk exposure at home for tax evasion if U.S. tax collectors get data on their incomes. ■

THE NEW YORK TIMES, THURSDAY, APRIL 25, 1974

Arabs Starting to Invest New Oil Money in West

By LEONARD SILK

A large amount of Arab oil revenues has begun to flow West, including about $1-billion to the United States—a small but significant part of the vastly increased revenues the Persian Gulf states are obtaining for their oil.

Only limited amounts have surfaced as direct investments in the West, so far. Some of it is going into real estate—raw land, hotels, apartment houses, office buildings, including one on Fifth Avenue and one on the Champs Elysees in Paris.

An unknown amount is flowing indirectly to Moscow, in payment for arms, and may be flowing back to the United States in payment for wheat. But the truly massive flows are yet to come.

Among the projects that have come to light so far are these:

¶A Louisville, Ky., real estate and finance company, Enck, Hollingsworth & Reveaux, will invest an initial $50-million of Kuwaiti and Lebanese money in American real estate, backed by a $200-million line of credit. Ultimately, the company claims, the investment will reach $250-million.

¶Wooten & Associates, Dallas builders and developers, say they have $200-million of Middle East financing for apartment house development in St. Louis.

¶The Shah of Iran, through his Pahlevi Foundation, has

Continued

bought 642 Fifth Avenue in New York City. The Pahlevi Foundation purchased the former DePinna Building on the southwest corner of Fifth Avenue and 52d Street last August for $8.6-million from Sam Minskoff & Sons, the building organization, Lehman Brothers and the Custom Shop Shirtmakers. The foundation is based in Iran and is named after the Shah, Mohammed Riza Pahlevi. Demolition of the buildingn was recently begun to clear the site for the construction of a 34-story multi-use tower that will include an Iranian cultural and commercial center. The tower project had been originally planned by the former owners who had abandoned it when the office space market in the city became glutted.

¶Several Kuwaitis paid $27-million for a large property on the Champs Elysees in Paris, where they will build a large luxury office and bank building to be called the House of Kuwait.

¶In early March, 1974, in one of the moves that has most caught public attention, the Kuwait Investment Company bought Kiawah Island, 15 miles south of Charleston, S.C., for $17.4-million in cash and are planning to develop a $100-million residential resort there. The same company put up $10-million, half the equity, for a downtown Atlanta center that will include a Hilton Hotel and a shopping mall.

¶Many other real estate concerns are looking for Arab money. Benjamin V. Lambert, president of Easdil Realty, an affiliate of Wall Street's Blyth, Eastman Dillon, says he thinks Middle East oil states will put about $1-billion into American properties in the next two years. But he disputes claims that the Arabs may invest five to ten times as much, asserting that they are nervous about exposing themselves too much and having their assets frozen by the United States Government, if relations with the Arab world deteriorate.

¶Adnan M. Khashoggi, a rich Saudi Arabian based in Beirut, has bought raw land in California for development. He has also acquired controlling interest in the Security Capital Corporation with assets of $115-million, and in the Bank of Contra Costa, Calif., with assets of $22.8-million.

Fall-Out Still Evident

Six months after the Arabs deployed their "oil weapon" against the West, in the course of the October war against Israel, the fall-out from the induced energy crisis is still striking the world economy.

The quadrupling of oil prices by the Organization of Petroleum Exporting Countries has hurt a broad range of industries from autos to air lines to public utilities.

Worldwide inflation has been intensified. An enormous transfer of wealth to the Middle East has begun—the equivalent of a massive tax increase on the rest of the world. Interest rates have been forced to record levels, everywhere, squeezing stock brokers and investors, and threatening the solvency of many businesses dependent on ready credit.

The combination of soaring oil bills, inflation and huge shifts of funds jeopardizes the balance of payments and currency of many countries—including some of the poorest, such as India and Pakistan—of many countries and endangers the stability of the entire world monetary system.

The quest is on for monetary security—in the oil-producing states as well as among the oil consumers. The use of the oil weapon by the Arabs, far from causing a counterattack by the Western powers, has set off a race in business, financial and government circles for access to the billions of "petrodollars" flowing to the Middle East. That flow has been estimated as likely to exceed $80-billion in 1974 alone and to reach a cumulative total by 1980 of half a trillion dollars in investible funds.

Yet one of the critical mysteries of the moment is where is all the Arab oil money going? For the fact is that most of it seems remarkably invisible. Rudyard Kipling wrote a poem about hte unseen flow of money as an underground river more powerful than the Amazon. But the Arabs and Iranians are sending forth their money not in a mighty river but in hundreds and thousands of rivulets.

American bankers and financial advisers are in ardent pursuit of Arab money. David Rockefeller, chairman of the Chase Manhattan Bank, has concluded a deal with the Saudis in which Chase will manage $200-million in Government funds for investment. The Philadelphia Fidelity Bank has bought 80 per cent of Lebanon's largest bank, the Banque de la Mediterranée; Irving Trust is taking over another.

The First National City Bank of Chicago is opening a branch in Dubai, and the Continental Bank of Illinois reportedly is about to buy a Bahraini institution.

The First National City Bank of New York — which ranks with Chase Manhattan and Morgan Guaranty as the biggest American holders of Arab Government funds — already has branches in Bahrain, Dubai, Abu Dhabi and Quatar, and is the only foreign bank in Saudi Arabia. Chase is setting up a branch in Egypt—in Aswan, of all places—despite the country's nationalized banking system. Manufacturers Hanover Trust of New York has an 18 per cent interest in Beirut's Arab Finance Company, which is 56 per cent Arab owned.

The Bank of America is expanding in the Middle East, with a 30 per cent share in the Bank of Credit and Commerce International, set up in Luxembourg in 1972 with Arab partners.

The American Express Middle East Development Company which helped a large British insurance brokerage company buy into a Saudi Arabian insurance company, is joining with Japanese and other American institutions to set up a merchant bank to invest in construction and development projects in Saudi Arabia, including petrochemical plants.

Lehman Brothers, the big New York investment banking house, with former Commerce Secretary Peter G. Peterson and former Under Secretary of State George Ball leading the way, is seeking to interest the Arabs in a broad range of development projects and to get the United States Government to support the joint development of the Middle East in such areas as food, education, housing, and desalinization.

On their side, the Arabs have set up their own banks and joint ventures, especially with the French, and are using them as a vehicle to move part of their funds West.

Hundreds of foreign banking, brokerage and investment institutions in financial centers all over the world are waiting for the truly massive flows of petrodollars to come, but so far the flows of Arab money have been less than expected.

A Lag in Payments

One reason for this is that the payments for oil from the big international oil companies have not yet been reaching the Middle Eastern oil-producing states in sizable amounts. Major oil companies such as Exxon, Mobil and Gulf normally pay their bills with lags of three to six months. The Persian Gulf producers have not been pressing for early payment. For the moment, therefore, their funds are still piling up in the oil-companies' own accounts. Bigger transfers will come within the next few months.

A second reason for the limited visibility of the Arabs' new wealth so far is that a great deal of Arab money has been flowing to the Soviet Union, in payment for armament furnished to Egypt and Syria for the war against Israel. The Arabs — especially the Saudis — bankrolled the Egyptians and Syrians, and are still paying off their arms bills. The Russians have been eager to get dollars to meet their own external obligations—especially to the Americans for the huge

1973 wheat deal.

Thus, Soviet supplies of weapons to Egypt and Syria were essentially paid for by higher oil prices charged in the West by the Arabs. The Saudis, Kuwaitis, and Libyans have been shipping money to the Soviet, who transhipped some of it back to the United States. European sources estimate that the Arab payments to the Russians have amounted to nearly $5-billion.

Middle Eastern money is also being used in growing amounts to increase imports from Western Europe and Japan. In Europe, West Germany appears to be reaping the biggest gains in trade with the Arabs.

Much oil money is likely to go for increasing imports of armament.

Iran has spent about $4-billion in the last half dozen years, especially on American aircraft and British tanks. British tanks have also been going to Saudi Arabia, Iraq and the Gulf States. The French have been selling aircraft and surface-to-air missiles to Libya and Kuwait, and have reportedly just agreed to sell $150-million worth of missiles, mortars, ammunition and other equipment to seven Arab countries. The Soviet Union has been the big supplier of military goods to Egypt and Syria, but the Egyptians are in process of switching to United States and other Western sources.

Thus far, the Arabs are taking their time in making long-range investment commitments. Prof. Ibrahim M. Oweiss of Georgetown University says that they "are studying all prospects, and seeking to find on their own what investment demands are open to them." Somee outsiders criticize them for having no "system" for evaluating investment projects; they are short of expert analysts, economists and planners.

Professor Oweiss, a native of Egypt, feels that the Arabs are in no hurry because of the lag in collecting the oil funds due them; he suggests that the lag will last another six or seven months, stretching into 1975. Meanwhile, they are eagerly trying to screen the vast number of projects, at home as well as abroad, open to them.

The greatest single share of Arab money seems to be going into the Eurodollar market — dollar deposits in banks abroad —and into foreign exchange, especially West German marks, which helps to account for the superstrength of the mark.

For the time being, the Arabs are staying liquid. Such long-term investing as they have done in Europe has gone into gilt-edged securities in London and into West German bonds and they have reportedly been buyers of gold. They have also parked millions in longer-term time deposits, ranging from three to 10 years. New York sources say they have stayed out of United States Treasury bills. However, Venezuela—a beneficiary of the quadrupled oil price —has been a heavy buyer of United States Treasuries.

The Arabs, American observers agree, are nervous about putting too much of their holdings into dollars. They have been asking Washington for guarantees against further devaluations, but the Treasury h refused to give such guarantees. Some critics feel that the Unite States should be prepared to sell bonds to the Arabs, denominated in riyals or othe Middle Eastern currencies, which would assure repayment without loss of value. This has been done in the past, but only with major currencies.

Dollars Still Dominant

Even without guarantees, much of the Arab money going into the Eurodollar market is likely to find its way to the United States anyway — directly from the Middle East or indirectly via Europe — given the still dominant international role of the dollar and the size of the American capital market.

All countries that purchase oil are strapped for funds to pay the bill this year. The oil squeeze is intensifying the demand for Eurodollars on the part of nations threatened with unpayable balance-of-payments deficits.

Financial experts estimate that total borrowings by governments in the Eurodollar market this year will reach about $30-billion. Britain has announced that it intends to borrow $2.5-billion to help cover its oil deficits. Italy will be after $2.2-billion—if lenders are willing to give the shaky Italy Government that much. France is expected to borrow $2.3-billion. The Philippines, Spain, and Denmark are expected to borrow nearly half a billion dollars each, and a sizable group of other countries will seek smaller amounts.

Including both private and public borrowings, Eurodollar loans this year are forecast to total $40-billion—about double last year.

The resource-poor developing countries, such as India, Bangladesh and Pakistan, have been thrown into desperate straits by the increased oil price, and regard increased loans or aid from abroad as a life-and-death matter.

Economists of the World Bank have estimated that, on the basis of an $8.65 price per barrel of oil, the poor developing countries will require an additional $9.4-billion in capital to cover their external payments gap. The Arabs and Iranians have indicated that they will cover some fraction of this but are ambiguous on how much.

And, overwhelmingly, it is Arab money that these borrowers will be taking. As one New York banker puts it, "all the longer-term money in the Eurodollar market is from the Middle East."

Immediately, given the relatively moderate flow of Arab oil money into capital markets, the heavy demands of governments, caught in a balance-of-payments bind, and of private borrowers, hit by inflation and urgent cash needs, interest rates are being forced up to 10 per cent and higher, here and in Europe, although a bigger flow of Arab money into the capital markets in coming months is expected to ease interest rates next summer and prvent the situation from becoming critically tight.

However, not all money-market experts are confident that a timely adjustment will take place.

economists as Prof. Richard Cooper of Yale and Prof. Sidney Rolfe of Long Island University feel, the world needs an international central bank to serve as a lender of last resort, should some major national financial institution crack. The danger is that, if there is no prompt bail-out, there could be an extinguishment of money and credit that would bring depression in its wake.

Others believe that such fears are exaggerated, and that the highly developed international money markets will automatically take care of the recycling of excess funds flowing to the Middle Eastern states back into the normal channels of the world monetary system.

If these moves are not enough to bring the extraordinary new situation down to manageable proportions, there are also the possibilities that the Arabs will make matters easier themselves — by lowering prices, or increasing their imports and their foreign aid — or the countries that consume oil will move to buy less, especially from producing countries that will not use the money productively.

Or the West might seek accommodation with the Arab oil producers on their own political terms. Says Professor Oweiss: "The United States should take another look at its foreign policy and at the right of Arabs in the area. It should also take another look at its true economic interests. If the United States and the Arabs can build up cooperation and mutual respect, then Arab money will flow into the United States for investment."

Some observers feel this is a more subtle and dangerous form of blackmail than the oil embargo, one that poses serious danger for the survival of Israel. Others think, however, that in the long run improved relations between the Arab world and the United States are a precondition both of world political and economic stability.

EUROMONEY April 1974

Oil money and the markets

Last month the markets started to see the first early signs of what the new oil surpluses might mean. We don't know whether it was a switch of oil funds out of the dollar that triggered off the currency's weakness towards the end of the month; but we can be pretty sure that it was a flow of oil funds into sterling that brought the rate from $2·16 to $2·36 between mid-January and late March. Certainly it was not confidence in the economy that did this.

There is some debate whether the flow of funds into sterling was mainly oil companies buying the currency in order to pay their royalties (much Middle East oil is still invoiced in sterling), with these funds not being switched out of sterling by the new holders; or whether the flow was more a straightforward placement of royalties previously earned. It must be a bit of both; the question is one of degree.

But we do know that there has been steady buying of gilts since mid-January by Middle Eastern interests, sometimes on a very big scale. On two days towards the end of last month £80 million was bought, while total purchases of UK Government securities by oil producers this year may already have reached £500 million. The gilt purchases are the main example seen in London of the producers investing medium-term—in this instance mainly in five- to seven-year maturities. Elsewhere shorter maturities seem to have been favoured, with some funds (apparently from private Middle Eastern investors) being placed in CDs.

Evidently, too, substantial funds have been placed in US Treasury bills by the New York Fed, acting for Middle Eastern government agencies like the Saudi Arabian Monetary Agency.

Aside from some publicized property purchases—for example, by Kuwait on the Champs-Élysées—that is about all that is known. There has not been much long-term placement of funds, there has been virtually no investment in equities, hardly any direct investment. The Arab funds coming into the Euromarket have been largely from Arab banks (in the medium-term market) and private individuals (in the Eurobond market), not from official sources.

So it means the pressure is still on the producers to do something other than pile up short-term paper, which offers them no real return at current inflation rates.

What does it mean?

This is pretty thin evidence to start drawing conclusions about the implications for the financial world of the oil revenues, but it does seem worth making a few points, if only because of the scale of the funds in question and the fact that these will be a major (if not *the* major) influence on exchange and interest rates for several years. Besides, no better guideline of what will happen exists.

First the parochial part. As far as Britain is concerned there are, in fact, very clear lessons. The breadth of the London market gives the country a real advantage in attracting Arab funds to tide her over until she becomes a major oil producer herself. London, New York and perhaps Paris are the only markets where funds on the scale accruing to the oil producers can be placed without sending the market through the roof. Secondly, the guarantees now given to official holders of sterling make sterling, in effect, a secure currency. The fact that this country may see a steady (and perhaps embarrassing) rise in the currency coinciding with a continued awful current account deficit has been pointed out already. It may even be that Britain will be able to cover the non-oil—as well as the oil—deficit from capital inflows without needing the official $2·5 billion borrowings now negotiated and the others in the pipeline.

For the world as a whole the lessons are less obvious. Certainly the influence on exchange rates will be massive if the impact on sterling is anything to go by. There is no evidence that the oil producers will use their currency holdings as a potential weapon; nor even is there any evidence that they will pursue an active foreign exchange policy, switching between currencies to try to maximize their return. Not only do they not need to play this game; they probably could not, as there would be no one playing against them on the other side. Since central banks can sit out the dance by floating their currencies the days of the one-way bet on the exchanges are now over.

But even the oil producers' straightforward investment policies are bound to distort currencies. It would be extraordinary if their investments tallied precisely—currency by currency—with their earnings. For this to happen, countries which were more successful at exporting to the oil producers would have to take a smaller share of the producers' investment funds. This seems most unlikely. If anything, the reverse will happen, with countries with close political ties with the producers, or which are particularly successful at exporting, getting more than their share of investment funds. We have just seen how one currency—sterling—can move in quite the opposite direction to what might be expected on economic and political grounds. Such movements are bound to be repeated by other currencies, with the French franc as an obvious candidate.

If this is correct, the idea of centrally planned distribution of the oil revenues, via the IMF, takes on further attractions. The cynical view of the Fund's plan is that it puts the Fund back in business after floating rates had reduced the need for its services. This is true enough, if unkind. But the Fund's plan does provide the much-needed mechanism through which the distortions of the market's redistribution of oil revenues can be counterbalanced. This job has to be done; and no one has yet come up with a better way of doing it.

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Politics, Economics, and World Oil

By M. A. Adelman*

Zen Buddhist monks used to torment novices by asking: "What is the sound of one hand clapping?" That sound has become deafening in recent years: the official predictions that because world oil consumption will increase, oil must grow more scarce and the price must increase. But scarcity is the pressure of *demand* upon *supply*. To omit either element is nonsense. They are united in the true measure of scarcity, long-run marginal cost. The only relevant question is whether, as consumption grows, society must keep putting more or less into the ground to get out another barrel.

Long-run marginal cost is mostly the return on the investment needed to develop additional capacity. Failure to discover new flush reservoirs means ever more intensive development of old fields, hence rising development investment and cost per unit, and rising prices. Anticipated price-cost increases delay development of some deposits, forcing more intensive work on the remaining ones, hence higher costs. Thereby a development cost increase serves as a distant early warning signal of future scarcity, bringing it into the present. Conversely, a stable (or declining) marginal cost means no greater scarcity, and this is the actual case. For the Persian Gulf, or even for the whole world outside North America, real costs have been sharply declining, and even if they were now to reverse course and climb, as is always possible, they would be a negligible fraction of price. The current flood of projections from here to eternity is a pitiful and futile attempt to replace the price-cost thermometer-thermostat, but they are official truth. One projects "needs" and "amounts available" to find a "surplus" or "deficit" regardless of elasticities of demand or supply.[1]

A Royal Dutch Shell executive sums up the world oil market: "The underlying situation of supply and demand remains one of potential surplus. Yet the producing countries manage to reap the rewards of a sellers' market by creating a producer's monopoly" (Geoffrey Chandler).

I. Monopoly

The multinational oil companies are not junior partners but rather agents of that monopoly, the members of the Organization of Petroleum Exporting Countries (*OPEC*) (but not *OPEC* itself). Aside from short-term flights, the price is now around $8 and (probably) close to the long-run profit-maximizing level set by the competition of substitute energy sources, as the Shah of Iran has stated (*New York Times* [*NYT*], Dec. 24, 1973). The official truth stated by Secretary of State Henry Kissinger, that prices have risen because of a surge of demand against inelastic supply (*NYT*, Dec. 12, 1973), is in utter conflict with the fact of enormous supply elasticity at cost of at most one-fortieth of the current price.

The popular slogan "avoid overbidding" suggests that oil prices have been bid up by demand exceeding supply, which is untrue, and also betrays a misunderstanding

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[1] Elementary economics is ignored in grain as in oil: the Department of Agriculture's Economic Research Service was never consulted on the notorious 1972 wheat sale to Soviet Russia (*NYT*, Oct. 7, 1973).

of what has been happening in 1972–73. Current supply-demand fluctuated, with occasional excess capacity. But the demand for crude for *later* delivery was insatiable because buyers knew prices were going to be raised. Buyers had little downside risk. If the producing countries delivered at the contract price, buyers would make a speculative gain; if they delivered at the expected higher prices little would be lost. Whereupon the *OPEC* countries turned around and cited the rising contract prices as a reason for raising their taxes—thereby putting a firm tax floor under the higher prices and validating the expectations. "Reasons" are as plentiful as blackberries; what matters is the power to raise the price of oil close to the cost of (expensive) substitutes.

Monopoly means control of supply, hence power to stop it, hence dependence and insecurity. Food is more essential than fuel, yet nobody is "dependent" on any farmer or on all farmers together, because farmers cannot act together to control and if need be withhold their production. Our "dependence" on imports exists only because of the cartel and (in the short run) the Arab majority bloc. Its history is extremely important: "those who ignore the past are condemned to repeat it," and we have already repeated it once. The key words in that history are *threats* by the producers, and *collaboration* by the consuming nations, especially the United States. The threat of an embargo gave the cartel its first triumph: the Tehran "agreements" of February 1971, whose expected and actual effect was to raise prices at a time of slack demand. The documented record of the 1970–71 events shows that only *after* American-sponsored capitulation to producing country demands in January did anyone dare voice public threats. The American policy maker did not blush to tell a Senate committee that threats had been made *before* the capitulation—and ceased upon his request; see M. A. Adelman (1973). He later explained that the threats had been made privately (James Akins). This evades the issue; threats are made in private so that they may be denied, reinterpreted, or repudiated. And to say that the threats ceased is completely false in the light of the numerous public statements which culminated in a formal *OPEC* resolution, issued just before the Tehran agreements, threatening "total embargo"—and equally numerous threats since.

The first triumph of blackmail announced more to come—as some were then denounced for saying. Our government "expected the previously turbulent world oil situation to calm down following the new agreement." In fact, the five-year Tehran agreement lasted four months, and after several "revisions" was pronounced "dead" last fall when the Persian Gulf nations unilaterally raised prices. Perhaps they were bored with what an oilman called "the charade of negotiations." (*NYT*, Oct. 19, 1973.) But the American policy maker may be right in claiming that the Tehran agreements "worked well" (Akins)—from his point of view. So also with the proposal for preferential entry into the United States for Saudi Arabian oil—the most insecure source conceivable. The State Department was "enthusiastic" (*Oil and Gas Journal* [*OGJ*], Oct. 9, 1972), for reasons not explained. Nobody can doubt that its "exaggerated talk of an energy crisis greatly strengthened the bargaining power of the Arab states" (Petroleum Press Service [PPS] Nov. 1973).

II. Shooting War and Economic War

Middle East politics, specifically the Arab-Israel tension, have had no effect on the price, and a Middle East settlement will do nothing at all to keep the price from increasing to the monopoly level. The producing nations will take what they can get. The monopoly revenues make peace unlikely. (See below.)

The shooting war and economic war waged by a subgroup of the cartel—the Arab oil producers—were invited by repeated American statements, of which the public record is probably only the tip of the iceberg, and whose complete exploration would richly repay a Congressional inquiry. The Saudis were told they were the last best hope of civilization, we had to have their oil, and would they not please produce it, even though it was not (we said) in their economic interest to do so? No revenues were high enough to induce the Saudi government to agree to big production increases; something extra must be done for them. (*Wall Street Journal* [*WSJ*], Aug. 15, 1973; *OGJ*, Sept. 10, 1973.) This was a self-fulfilling prophecy. For if we believe it and are willing to do something extra for the Saudis, they are glad to demand it.

The buyer is asking to be had who tells a seller, "I know you don't want any more business but please just to do me a favor won't you sell me something?" There are few such buyers because they don't stay in business very long. Not so in government.

Sheik Yamani, the Saudi Arabian petroleum minister, recently asserted that before the recent cutbacks, when Saudi Arabia was producing eight million barrels per day (*MBD*), "we were producing at a much higher rate than what we should for our economy (*Meet the Press* [*MP*], Dec. 9, 1973). And that was a sacrifice on our part." It amounted to "losing money." Sheik Yamani says, without a smile, that his government has been producing not for its benefit but for sweet charity. He speaks as a man who expects to be believed. But that's no wonder, for the United States Government was saying this publicly before he was.

But if eight *MBD* is a production rate "much" too high for Saudi Arabia's good, twenty *MBD* is catastrophically too high, and we will owe them three times as much or more in 1980 than we do now. To keep the oil flowing, we will impose a just peace in the Middle East this year. Next year it will have to be even more just, and the year after that . . . and so on.

This official truth about needing to do something for Saudi Arabia, because it is not worth their while to expand output, is all implicit, never set down for analysis. But it appears to rest on two assumptions. (a) "Oil in the ground appreciates faster than money in the bank," abbreviated *OGMB*. It is often embellished by saying that the dollar has depreciated, and prices on the New York Stock Exchange have gone to pot, ergo, there is no place to invest. In fact the dollar may be an undervalued currency, or payment may be in another, and in any case the annual volume of capital formation in the developed world (not to mention the total stock of existing purchasable assets) is many times the future revenues of even Saudi Arabia. But let that go: *OGMB* is at best meaningless without specific numbers. The current price of Persian Gulf oil is about $8. If 8 percent is a safe interest rate, then a barrel is worth holding, instead of a corporate bond, for four years for an expected price rise to $11, and for nine years for an expected price of $16. The price is not going to appreciate indefinitely at 8 percent per year: it is not going to $32 in eighteen years, nor to $64 in twenty-seven years. But Saudi Arabian crude reserves are fifty times current output, and can be greatly increased at negligible cost. They are held back in order not to wreck prices. *OGMB* is an irrelevance in a noncompetitive market.

(b) Saudi Arabia (and others) will limit their oil revenues to what they "need." This means—if it means anything—that they will hold back output short of the monopoly optimum, i.e., the point where it maximizes the present worth of their assets. It is an odd assumption, to say the least, and quite unsupported. If King Faisal acts like a true dynast to serve his successors, family, retainers, friends, etc., the best way to insure this is to maximize present worth.

We are better off with less talk of "need" and a little thought about economics. Saudi Arabia, like the U.S. Steel Corporation or the Texas Railroad Commission in other days, has the usual problem of Mr. Big in a cartel: find the combination of price and quantity which will maximize group profits—or more generally, best serve the economic interests of the producers. They can fix the price and let the price determine quantity; or fix the quantity and let it determine price, but these are only two routes to the same goal. No blandishments will make them expand output; anyone who thinks he can persuade them is merely stroking his ego and reminding us how right was a Scottish professor of moral philosophy who warned against the "overweening conceit" of men "in their own abilities." Repeated assurances of how badly we need them are simply taken as evidence of inelastic demand and signal the monopolist that there is greater profit in even greater restriction.

The drift of American policy was visible in these statements that we owed Saudi Arabia, to whom we sent as ambassador the principal architect and defender of the Tehran "agreements." His earlier statement that "a seller's market arrived in June 1967" disregards three years' price decline but reveals his belief that the Six-Day War was a calamity to be reversed. He "think(s) the *OPEC* countries should be granted substantial increases," in order to induce alternative energy sources needed "to avoid an energy crisis in the 1980's, or 1990's," a "crisis" again assumed, never explained. Also, "price increases will hurt America's commercial competitors Europe and Japan," and Saudi Arabian revenues would mostly be invested in the United States (*Economist* [*Ec.*], Nov. 26, 1973).

Saudi Arabia "planned the Arab strategy for the [*1973*] Middle East War," both shooting war and economic war (*LeMonde* [*LM*], Oct. 9, 1973; *NYT News of the Week in Review* [*NWR*], Oct. 14, 1973; *OGJ*, Oct. 15, 1973; *NYT*, Nov. 10, 1973; see also *NYT Mag.*, Nov. 18, 1973). King Faisal and Prince Saud al-Faisal had stated they needed to put pressure on the United States. But "the *U.S.* can get along without Arab oil until the end of the decade" (*OGJ*, Sept. 12, 1973). Therefore it was necessary to reduce total production deeply and deprive others of more oil in order to deprive the United States of less. A selective embargo was taken seriously by our principal policy maker but by nobody else (Akins 1973).

III. Surrender Without a Fight

The cutbacks have been a great political success. We are right back to the 1930's, when European nations looked for a deal with the aggressor in the hope he would go jump on somebody else, and when German generals opposed to aggression were discredited by the willingness of the Western powers to give away other people's lands and lives; so too the moderates among the Arabs. For, confronted with the cutbacks, the Europeans and Japanese stood clear of the Americans, however dangerous that was for them. More important, in my opinion, was their inaction at home: oil stocks were not spread over time by rationing, i.e., not used as a defensive weapon to gain time wherein to carry out a plan, but as a means of putting off the unpopular decisions to curtail demand. Most important was European eagerness to collaborate with the Arabs rather than each other. "Arabs don't have to police their own boycotts. Sycophant nations are doing it for them" (*WSJ*, Nov. 6, 1973). The Common Market countries refused to ship or pool oil resources, as requested by the Dutch who had been picked out as a special victim. Apparently the Dutch are getting some covert help—but only after they threatened to cut off natural gas deliveries to France and other nearby countries.

Japan had been more pro-Arab than any large country but France, and had stood aloof from other consuming nations, lest they offend (Petroleum Intelligence Weekly [*PIW*], May 14, 1973), only to find itself accused of "odious neutrality" (*NYT*, Oct. 18, 1973). Saudi Arabia was ready to make new demands "because of their success in recent years in enforcing a boycott . . ." (*WSJ*, Nov. 7, 1973; *NYT*, Nov. 9, 1973).

A cut in British deliveries ". . . is clearly causing embarrassment to the government, which . . . had received assurances [sic] from Arab countries . . . " (Platt's Oilgram [*POPS*], Nov. 20, 1973). The French government is embarrassed over reduced supplies (*NYT*, Nov. 20, 1973). Such governments are especially reluctant to begin rationing because it would be an "admission of failure," i.e., groveling did not insure oil supply (*PIW*, Nov. 19, 1973; *LM*, Nov. 23, 1973).

The servility of consuming governments, playing the Abbe Alberoni to the Arabs' Duc de Vendôme (see Luigi Barzini), has made the original Arab demands of no importance. A weapon which makes consumer nations shake like jelly cannot be contained by a scrap of paper enumerating Israeli security or Palestinians' rights, etc.—there are far bigger objectives now to be considered. Moreover, Saudi money, to be multiplied many fold, can procure more arms from many sources, freeing the Arabs from whatever control the Soviet Union might exercise. This makes fresh wars likely if not inevitable, especially when the Saudis begin shopping for the nuclear weapons they can well afford. Already there is a semiofficial Egyptian call for nuclear weapons, which would cost only an estimated $1 billion, stimulated by "a high-level Washington visitor" to Cairo (*NYT*, Nov. 24, 1973).

IV. Economic Failure, Political Success

Yet the cutback failed badly to reduce American supply. At its maximum (as of December) it amounted to 4.7 *MBD*, about 14 percent of all oil moving in international trade. Hence had there been just enough leakage and diversion to put us as well off as oil importers generally, our import loss would have been about 14 percent. Now, for the four weeks ending November 16, our combined imports of crude and products averaged 6.55 *MBD*. Since the boycott date was October 17, and Persian Gulf—U. S. transit time is about a month, this amount measures the preboycott level of shipments. For the next four weeks, through December 14, the average was 6.10 *MBD*, indicating a loss of about 450 thousand barrels daily, 7 percent of imports, about 2.4 percent of total supply. The truly vulnerable place was the East Coast's heavy reliance on residual fuel oil, much from Caribbean and Canadian refineries which also ran some Arab crude oil and might therefore be forced to stop all shipments to this country in order not to lose some supply. An Arab resolution of November 26 to cut off the Caribbean and other transshipment centers (*OGJ*, Dec. 10, 1973) shows that by mid-November the Arabs realized their failure and their resolve to damage this country where they could. Yet on November 8 our ambassador to Saudi Arabia had warned that the plight of the East Coast would be "critical" if Arab oil supplies were not increased "in a matter of days" (sic) (*NYT*, Nov. 10, 1973). This was wildly untrue.

The Arabs' 25 percent cutback in their production was scheduled originally to keep increasing 5 percent per month until Israel withdrew to her 1967 boundaries and "the legal rights of the Palestinian people" were restored. But the Arab oil exporters' meeting of December 26 reduced the cutback to 15 percent, ignored the two conditions, and let it be understood that the cutback would be cancelled upon Israeli withdrawal from the west bank of the Suez Canal (*NYT*, Nov. 26, 1973). Furthermore, the "friendly" nations (Britain, France) were guaranteed Arab oil even in excess of the base amount (September 1973), which means that their previous imports of non-Arab oil are completely freed for the not-so-friendly (Japan) or the unfriendly nations (United States, Netherlands).

To what extent this failure of the production cutback to reduce *U.S.* supply is due to cheating by the Arab producers and to diversion of non-Arab oil is as yet impossible to say.

V. Monopoly Harmful to Consuming Nations

Relief at this failure should not obscure the fact that the oil cartel is very harmful to American interests. (a) In 1974 customers, including us, will be paying out well over $100 billion, and over 1972–80 cumulative the transfer to the producing countries will be several times that. The richer these nations are, the better they can maintain an embargo to make supply yet more insecure—as the Arab production cutbacks remind us. (b) The world monetary system will be harmed by huge amounts of liquid funds ready to move at a moment's notice, not to serve the holders' malice (the usual straw man) but for self-protection. Controls on capital movements to prevent this danger will in themselves be harmful. (c) Restrictions on American imports, because of the expected oil deficit, have already embroiled us with our main trading partners in Europe and Asia, not only because of John Connally's bluster and bullying but also over the substance of our demand to get more than we give (*NYT*, May 10, 1973).

(d) The risk of mineral exploitation in less-developed countries is much greater; concessions and contracts are now worthless. (e) The hope of a rule of law for the world's oceans has gone by the board because of the hugely inflated artificial value of any possibility of oil. (f) A vast arms buildup is just beginning in the Persian Gulf. Producers have billions available and every little patch of barren ground or barren seawater is actually or potentially worth fighting over.

The arms buildup reminds us that although the oil monopoly will cost us dear, there will be gains for exporters and for contractors for construction, investment management, public relations, etc. There will be plums for many in the industrialised nations and crumbs for less-developed countries. Those "working for the petrodollar," paid or enriched by the monopoly, are highly influential. Moreover, each industrialized nation can hope that the burden will be borne by them in proportion to their oil consumption, but that they will get a disproportionate share of export and investment business. M. Pompidou appears to have talked to King Faisal of little else but French exports during their May 1973 meeting (*LM*, May 15, 1973); he is now "shocked" that anyone thinks exports have much to do with his Middle East policy (*LM*, Nov. 19, 1973).

VI. Implications for Policy

Only in the long run can we get the cartel off our backs, and it will not be easy, quick, or cheap. It is necessary but no longer sufficient to stop the oil producing companies from being the vehicle for the price-fixing agreement of the producing governments. (1) Expelling the companies and losing their know-how would be a huge waste of resources, harmful to all. But if they simply produced (and developed and explored) and were paid in money or a modest share of the oil, the producing countries would have to do their own selling and monitor thousands of transactions all over the world. The companies have managed the difficult task of determining output shares because they have sold the bulk of the final product; the producer nations would inherit the task without the means. Nothing in the history of the trade suggests they would succeed; even the tight cartel of the 1930's was eroded, and it never faced an independent refining industry.

A managing director of Royal Dutch Shell has well said that in buying from producing countries the multinational oil companies "have formidable advantages." (See G. A. Wagner and A. Glimmerveen.) Once they become "formidable" buyers of crude oil rather than tax collecting agents, the market will look considerably different from what it does today. The oil companies are a big gun pointing toward the consuming countries, which ought to be pointed the other way. Hence real nationalization is greatly to the advantage of the consuming countries.

The producing countries may yet oblige us, as did Algeria and Iraq, by first expelling the companies and then inviting them back as contractors or by doing their own selling of most of their oil as "participation." This is good for the individual country in the short run and bad for the group in the longer run—the classic cartel dilemma. It is imprudent to assume they will be so helpful, but the chances of this happening look better in late 1973 than I expected a year earlier; see Adelman (1973). Perhaps such prophecies will be realized as those of Thomas R. Stauffer in 1970: "We conclude . . . that prices will probably sink below the $1.15 level and that . . . non-concessionary oil will drive out concessionary oil." The price-undermining effect of direct sale by the producing countries' national companies ("nonconcessionary oil") remains a key variable if the consuming countries want to make it one.

The American government ought not to force American companies into being contractors, since they would merely be displaced by European or Asian companies. It must be done in unison or not at all.

By the time most consuming nations see their interests a bit more clearly, some will have taken another step: put oil imports under quota, to sell the tickets on sealed competitive bids. Any country which wished to expand or even retain its market in the United States would have to share its gains with the Treasury. This would not reduce the price of oil to the consumer. There would be in effect a tax on imported oil which would keep the domestic price level high also. (In my opinion a high energy price is desirable to reduce pollution and congestion. Those who disagree with this policy judgment may yet prefer to have the money go to the American not the Saudi government.)

If the producing countries succeeded in collusively fixing quota ticket prices, we would be no worse off, but chances of success are small because it would not take much cheating to fill the quota. Detection of cheating would be difficult and might be made impossible by Theodore Moran's suggestion that prices in any given bid be kept permanently secret. There would be no way of knowing whether any country's higher exports were due to its cheating.

The current price level is so much higher than the cost of producing oil, *even in high-cost deposits*—see Adelman (1972)—that trickles, then streams of new supply in the 1970's are a foregone conclusion, and they have been the bane of all cartels. Given supertankers and superports, a barrel of oil anywhere in the world is a barrel everywhere, at a transport cost of a dollar, which is little compared to the producing nation's profit. Only the shortage of men and materials keeps this potential from becoming actual. But even now the producing countries are not deceived about the "world oil shortage." Saudi Arabia, as mentioned earlier, tried for preferential entry into the United States, which only makes sense when more people are trying to enter than there are places to set them. Venezuela keeps proposing worldwide prorationing. Iraq expelled the Iraq Petroleum Corporation from the largest oilfield because they refused to expand output, which under the new regime will have doubled or tripled from 1972 to 1975. When the consuming countries want to get rid of the burden they can; but at present there is no will, hence no way.

This brings us back to the dismal present and decisions to be made soon. The Arabs have failed to cripple us; the Administration is trying to snatch defeat from the jaws of victory to serve some grand design not yet revealed to us. Our greatest immediate danger lies in a super-Tehran agreement for "cooperation" of producing and consuming states, announced by a flourish of trumpets on a TV spectacular, with the same promise made by the same people who brought us the first Tehran that *this time* "the previously turbulent world oil situation" will *really* "quiet down." The ambassador to Saudi Arabia, who in 1972 told the Arabs that it was in their interest to curtail output, told us that for lack of oil our condition would be "desperate" by 1976, (Adelman 1973) and thought the Tehran agreement had worked well, etc., has suggested a world commodity agreement to set oil prices and ensure availability (*NYT*, Apr. 16, 1973). It would be a one-way street, preventing independent action by consumer states to promote price reductions. But if the monopoly holds and the price can be rigged higher, up it will go. A few weeks ago, in proclaiming the Tehran agreements dead, Sheik Yamani supplied a classic formula: "We in Saudi Arabia would have liked to honor and abide by the Tehran agreements, but . . . " circumstances had changed (Middle East Economic Survey (*MEES*) Sept. 7, 1973). Sheik Yamani may one day say that he and his colleagues would have *dearly loved* to honor and abide by the Kissinger agreements, but . . . circumstances, etc. The super-subtle diplomat is no match for the fellow who grabs what is in his reach, then asks if you want to fight to get it back. But it may not even be necessary. For in waving proudly an "understanding" with Saudi Arabia to let output increase to 20 *MBD* or whatever, our government will not realize that there is no meaning whatever to an agreement which does not specify both quantity and price. For if Saudi Arabia's interests are better served by producing less, it raises price to where there is less demanded.

As regards supply outside this country, a sound world oil policy for the short run is to do and say nothing. There are some virtues in necessity. Without a world agreement, each producing nation will seek to maximize its own profit. If Saudi Arabia will for years play the statesman and hold back on output expansion, we are no worse off; if they retaliate against any rivals, we have gained enormously. Similarly with the consuming countries: some of them will recover from their panic and will begin inviting producers to make some special deals for disguised low prices, to put the cartel on the slippery slope. This country needs not *ordnung* but disarray in the cartel. But we cannot by statesmanlike action cure the nonexistent world oil shortage.

However, there are some matters where action may help. Sheik Yamani warned in early 1973 that any attempt at consumers' self-defense meant "war," and "their [i.e., our] industries and civilization would collapse" (Platt's Oilgram News Service [*PONS*], Feb. 22, 1973). By November 9, he and his colleagues "are letting the word out that the present cutbacks in oil output are the limit." The reasons mentioned are possible Western responses: food, manufactures (including armaments), and military action (*NYT*, Nov. 10, 1973). They who had talked of "war" and suited the action to the word understand the language. We had better learn it quickly.

There is as yet no weakening in our infatuation with Saudi Arabia, to whom we seem resolved to return bounty for evil done to us. In late November "a very high official in the Nixon Administration who is a policy maker in this area" told a reporter "he feels King Faisal . . . at the last minute would prevent any serious economic harm from being done to this country because he is at heart a friend of the United States" (*MP*, Nov. 25, 1973). Meanwhile, King Faisal is "angry with Mr. Sadat" of Egypt for being too cooperative with the Americans (*Ec.*, Nov. 24, 1973). Without doubt the Saudis feel they have every right to be hostile to the United States, and it is not for an American to say they are wrong. But our safety demands that we recognize which way is down.

The Saudi connection, which our government values so highly, is no asset but a heavy liability. The profits of Aramco, whose protection is a perfectly legitimate national objective, will be kept at a level needed to secure incremental investment, and can scarcely amount to a billion dollars annually even if Aramco reaches 20 *MBD*. If the Saudi investment portfolio reaches $100 billion, a 0.1 percent per year management fee is the most the management company can reasonably expect. This is less than the extraordinary expenditures already forced upon us this year by King Faisal's shooting war, and it is insignificant compared with the losses of national product here and throughout the world, due to the oil embargo: 1 percent of *GNP* lost is $13 billion per year.

In war one seeks not to be strong everywhere, but only at the strategic points. For the non-Communist world the decisive point is the United States. This country should immediately take steps to separate itself completely from Arab oil sources. Once we are beyond the reach of oil cutoffs, they can no longer pressure us. Then there is no profit in tormenting Europe and Asia, and risking retaliation, as an indirect means of pressuring the United States.

Our overseas imports before the cutback were about six *MBD*. Future imports will for a time be larger, but will come nowhere near the ten or more *MBD* freely predicted a short time ago, because of the drive for greater self-sufficiency. The four largest non-Arab oil exporters—Iran, Venezuela, Nigeria, and Indonesia—already produce thirteen *MBD*, and their production will grow substantially, Iran alone being a good bet for 10 million *MBD* in a few years, especially if we act. (Our current ambassador to Saudi Arabia insisted in September 1972 that Iran *had been* interested in production increases, but no longer (*OGJ*, Sept. 25, 1973), which was contradicted by previous public evidence (*OGJ*, Aug. 14, 1973, Sept. 4, 1973, Sept. 13, 1973), and also the expansion program decided early in 1973.)

Two routes ought to be examined. One is to bar or penalize imports from countries declaring embargoes against us or pressuring third parties to embargo us (see above). Or the United States could make contracts with any countries desiring preferential entry, in return for which they would guarantee certain minimum amounts. We would of course have to promise—and keep our promise—to pay the very high world prices. But as shown earlier, this price will likely be in the neighborhood of what it would cost us anyway to produce at home from substitute sources. Richard Gardner has embarrassed our government by pointing out that Saudi Arabia has violated their treaty with us providing for mutual most-favored-nation treatment (*NYT*, Dec. 19, 1973). We need only tell the Saudis their embargo on shipments to us is henceforth permanent, their status having been cancelled by their own act.

As George F. Kennan, a respected scholar and ex-diplomat, has well shown, in saving ourselves, we save our friends abroad, by making boycotts against them unrewarding and therefore unlikely.

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IMF Survey

March 18, 1974

Aid from Oil Producers Asked for Poor Nations

Fund Managing Director H. Johannes Witteveen and World Bank President Robert S. McNamara met on March 12 with Inter-American Development Bank (IDB) President Antonio Ortiz Mena, African Development Bank President Abdelwahab Labidi, and Asian Development Bank President Shiro Inoue. The meeting was held at IDB headquarters in Washington to assess the impact of the current international energy situation on the economies of developing countries and to encourage a flow of funds from the oil producing countries to the developing world.

The participants recognized that sharply higher oil costs represent not only a heavy drain on the external payments of the developing countries, but also a threat to the orderly execution of their development programs and to their economic growth.

The developing countries urgently require additional external aid, both short-term assistance to avoid harmful adjustment measures and long-term financing to sustain their development efforts, and a considerable part of this assistance should be made available on concessional terms, the participants agreed. They re-emphasized that the advanced countries have a continuing responsibility for providing aid resources. At the same time they pointed out that the oil exporting countries now have a greater capability to share the burden of the additional aid effort, both through their own channels and through cooperation with existing international institutions.

The participants indicated that the expertise and experience of their institutions in channeling resources to the developing world give them the capacity to play an important role in the international aid effort. However, to perform this function, additional funds are required, and a special effort is needed to mobilize such resources from the increased financial assets of the oil exporting countries. The heads of the five organizations agreed to continue to coordinate their actions in light of the new financial requirements.

IMF Survey April 8, 1974

A financial agency to supervise the flow of Arab funds among the various Arab countries has been suggested by El Sayed Hassan Abbas Zaky, Economic Advisor to the United Arab Emirates. The agency could help Arab countries cover the deficit in their balance of payments and could also give long-term facilities to Arab banks so that they might give medium-term loans to finance local Arab schemes. In addition, the agency would reinforce the potentialities of existing development funds in Abu Dhabi and Kuwait as well as the Arab Development Fund by granting loans to these funds. The Egyptian official said that in spite of the current large increase in oil revenues, Arab countries suffered unique problems, foremost among them being the absence of machinery for channeling Arab funds to Arab countries in need of them. He advocated the establishment of a market for Arab capital and the early institution of the Arab Payments Union to serve as a nucleus for an Arab monetary market. He added that the idea of issuing an Arab dinar should be revived, and suggested the dinar be issued initially in Arab countries on the Persian Gulf, and then introduced gradually in other Arab markets.

Egyptian Gazette, Cairo, March 22

THE OECD OBSERVER February 1974

CONSEQUENCES OF THE OIL PRICE RISE:

The Need for International Action

Highlights from the speech of OECD's Secretary General, Emile van Lennep, to the Consultative Assembly of the Council of Europe 23rd January 1974.

For the OECD countries three main types of problem result from the very sharp increase in oil prices. One problem is that a new twist is given to the *price-wage spiral.* There is the likelihood that, in the immediate future, the price increase will rise beyond last year's 10 per cent rate into the 'teens. The longer that anything like a double-figure price rise is continued, the greater the danger that inflationary expectations will become engrained in our thinking and in our economic behaviour.

This means that a renewed attack on the problem of inflation, using all the available weapons, must be made by OECD countries acting simultaneously, for when inflation is so widespread a phenomenon as today, the efforts of individual countries are bound to be frustrated unless they are matched by equal efforts on the part of all.

Another problem is the danger of an unwanted *contractionary effect on the general level of economic activity and of employment.* Income which would have been spent by OECD residents is being transferred to oil-producing countries. If they spent the whole of their increased income on purchases of goods and services, there could be no threat of recession. But for a number of them it is certain that, in the short-run, they will not be able to step up their expenditure in line with their incomes. Moreover, sharply rising oil prices may cause a general climate of uncertainty in OECD business circles.

These potential contractionary effects on activity and employment may, at least in part, be offset by other expansionary elements. The appropriate inter-governmental bodies in OECD keep the prospects for demand and employment under continuous review, and discussions in the early weeks of 1974 suggest that governments are alert to the possible depressive effects of the energy price rise and to the importance of taking action to support demand if and when appropriate.

A third problem area concerns the *balance-of-payments.* Higher oil prices will raise the import bill of OECD countries: a figure of around $50 billion—which already allows for some economies in the use of oil—is an approximation of the higher bill for the first year. In normal cases, a rise in the bill which an OECD country has to pay for its imports could be expected, rather quickly, to be followed by an equivalent rise in export possibilities. But because the oil-producing countries cannot in the short run be expected to use more than a small fraction of their additional earnings for stepping-up their own purchases, OECD countries will be unable, as a group, to raise their exports in step with their import bills. For this reason, OECD countries, taken as a whole, are going to have to see their balances of payments swing from a normal sizeable surplus on current account to large deficit. For illustrative purposes only, instead of earning a current account surplus of around $10 billion in 1974, OECD countries taken as a whole could go into deficit to the tune of $30 billion. If individual countries seek to escape this swing, it will only mean that the balances of other OECD countries have to swing further into deficit.

This swing does not, of course, mean that the area will have an *overall* deficit on the balance of payments and a net loss of reserves. The oil-producing countries will certainly in one form or another, invest their unspent earnings in the money and capital markets of the OECD area. Nonetheless, a change of this order of magnitude in the *structure of the* OECD's balance of payments can only be digested if governments take a highly rational and sophisticated view of the position, and convince markets that this is going to be so. If countries struggle to offset the impact which higher oil bills have on their current balances, we could witness a spiral of competitive—and mutually-frustrating—devaluation, deflation and trade restrictions—the disastrous spiral which we witnessed between the two World Wars. Governments could take this path through a simple failure to accept that, for some time to come, current account deficits will have to be the order of the day.

More likely, perhaps, will be a fear by individual governments that they may be unable to attract, to their own shores, a sufficient part of the return flow of capital from oil-producing countries to offset their current account deficits. A further danger may be that OECD countries, in the attempt to ensure that they attract a sufficient share of the return flow of capital, will engage in a competitive escalation of interest rates that would raise the cost of credit to levels inappropriate from the point of view of the general expansion of activity.

To avoid these dangers emanating from the changed balance of payments situation will require an important measure of agreement, inside the OECD, as to the aims which each country should now set itself on current account. Only thus shall we escape the danger of seeing OECD countries scrambling, individually, to preserve or create for themselves current account surpluses which the area as a whole cannot, over the next few years, achieve. The task of seeking agreement on individual balance of payments aims is not new to OECD. We went through a very similar experience in 1971, and without the understanding reached between countries on that occasion, largely through OECD's Working Party No. 3, I do not think that the Smithsonian exchange rate agreement, and the further devaluation of the US dollar in 1973, would have been possible.

But the adjustments that now have to be accepted, are far bigger than the ones we had to negotiate at the time of the Smithsonian realignment. And in the present case, questions of aims on current account cannot be discussed without, at the same time, discussing what is going to happen to the capital which will be flowing back from the oil-producing countries. For we cannot expect an individual OECD country to resign itself to a rather sizeable current account deficit unless it is reasonably confident that it can obtain a sufficient capital inflow to finance it.

An urgent task is, therefore, to consider what steps need to be taken to enable the very large amounts of capital that will henceforth be flowing out of oil-producing countries to be made available in the geographical locations—and in the forms—that will most facilitate the continued expansion of world trade and employment. Stable conditions in the international monetary system—which are in the essential interest of all countries—are unlikely to prevail unless the vast capital sums flowing from oil to non-oil countries are invested in a reasonably stable form and unless they are channelled directly or indirectly—through the markets or by other means—to recipient countries in rough proportion to their external financing needs. It is encouraging that discussions on this problem have already begun.

Immediate Problems for the Developing Countries

One obviously important group of countries to whom part of these funds should be channelled are the less-developed countries who are not, themselves, producers of oil. The facts speak for themselves—and in an alarming fashion.

These poorer countries are likely, in 1974, to find their oil bills put up by something near $10 billion as a result of the recent price rises. This would just about wipe out the whole of the official development assistance that the OECD area makes available each year to these countries. For some developing countries, the higher oil bill will amount to about half their existing earnings from exports.

The new conditions faced by developing countries call for three major policy imperatives:

- *First,* existing official development assistance programmes must not be slowed down or reduced. This would worsen the difficulties of developing countries and would only add to our own problems.
- *Secondly,* the developing countries that are worst hit will need special help, largely in the form of cheap loans, to enable them to adjust their economies and balance of payments to the additional burden.
- *Thirdly,* the new problems also present new opportunities. There is going to be a substantial rise in world savings since the oil producers will not be able to spend all their extra revenue. It should be possible to find ways by which part of these savings can be mobilised to accelerate economic progress throughout the developing world.

Thus in the present situation, there are clear dangers of uncoordinated policies which would lead to over-reaction both to the inflationary and to the recession threats; of isolated moves to compensate the impact on foreign trade of higher oil prices; of cutting on development assistance thus aggravating the situation of non-oil producing developing countries; of going to a sterile confrontation between oil-consuming and oil-producing countries. Such policies would be both inadequate and self defeating. What is required, on the contrary, is increased co-operation at all levels to solve problems common not only to the industrialised countries but to the international community as a whole, including in particular the oil producing nations.

Longer-Term Problems of World Energy Supply

The suddenness of the price change over the last few months should not obscure the fact that both oil producers and oil consumers have a common interest in a price for oil which correctly reflects the longer-run supply and demand for oil and alternative sources of energy.

Looking first at this question from the point of view of the *oil-producing* countries, we should recognise that they themselves face difficult problems in the pricing of their oil. In particular, it would be wrong to describe recent decisions by the oil producers as simply the actions of strong monopoly producers who can fix the level of output or prices of their product without concern for the future.

- *First,* the oil producers are having to exploit a depletable asset. How fast, at any given rate of consumption, their oil reserves will be depleted varies from country to country—and this, in itself, may be a source of difficulty for the producers when they seek a common approach to their problems. The task of government in any traditional oil-producing country is to ensure that its oil is traded on optimal terms. On the price at which they sell their oil will depend their ability to raise the living standards of their own populations, and diversify their economies against the day when their oil runs out or is in less demand. If the price is set too low, their incomes may prove insufficient for their future needs—and some of them will see their oil resources disappearing at an alarming rate. If the price is set too high, they will enjoy great prosperity for a short while —but the higher the price the shorter the period, because the faster will be the action which their customers take to economise on traditional oil sources and to develop alternative energy supplies.

- A *second* very real problem for the oil-producing countries is to find suitable forms in which to hold their earnings until such time as they wish to use them. It is both in their interest and that of the rest of the world that these investments should as far as possible go to increase the productive potential of the world economy. But at the rate at which these assets seem now likely to accumulate, this may not be easy to achieve.

Now let us look at these same problems from the point of view of the *industrialised* countries. It should first be noted that OECD countries are important producers of energy. Indeed, in 1971 about two-thirds of the energy consumed in the OECD area was produced from indigenous sources. Moreover, there is much potential for future development. Although OECD countries account for only some 10-20 per cent of estimated world reserves of crude oil, their reserves of all fossil fuels, including coal, shale oil and tar-sands, probably account for the major part of the world total, sufficient—at a cost—to meet foreseeable needs.

The main question now before these countries is how fast they should, in fact, develop alternative sources of energy. This is where any rational person should see that the interests of the OPEC countries and the OECD countries really coincide. *First,* because investment in alternative forms of energy is extremely costly, and can have extremely damaging effects on the environment. Therefore, it is in the interest of OECD countries not to move faster in this direction than they have to. *Second,* because it is not in the interests of the OPEC countries if the industrialised countries were to embark on costly programmes for energy diversification which might, in time, seriously reduce the earning power of the OPEC countries before they have had time sufficiently to diversify their own economies.

The speed with which OECD countries build up alternative energy supplies will depend, essentially, on the cost of imported oil in relation to the cost of the alternatives. If the cost, in OECD countries, of imported oil is well above the cost of comparable alternative sources of energy (in economic parlance, if the substitution price is exceeded), a wild and wasteful scramble for national independence through the exploitation of indigenous energy resources will be set in motion with all the attendant disadvantages to OECD countries and oil-producing countries alike. If, on the other hand, the price of oil is too low, there will be a wasteful use of the oil producers' valuable but exhaustible asset, while in OECD countries the incentive to invest in alternative energy sources will be insufficient to prevent at some stage, an energy crisis of far more serious proportions than today.

This is why I think that the price of oil in the next few years is going to be a matter of common interest to all countries, an area in which international consultation can yield important longer-term benefits for all. The issues concerned cannot be limited simply to the question of oil prices. They cover a wide range of associated economic questions concerning supply, the development problems of the OPEC countries, investment outlets for OPEC countries' savings, and (urgently I trust) those developing countries which are not producers of oil.

All these are questions which can now profitably begin to be discussed in appropriate broad intergovernmental forums. And, when they get under way, the discussions will benefit from the work which, in many of the important areas, has recently been done inside the OECD, including, in particular, the Organisation's comprehensive assessment of long-term energy trends. I hope we can now carry these discussions forward into the wider intergovernmental arena.

THE MONEY MANAGER

MARCH 4, 1974

Money Surges Out To Meet Oil Costs, But Only a Trickle Finds Its Way Back

By ROGER LOVE

A surge of oil payments money from western countries is flooding into the Middle East—and apparently staying there. Reports indicate that thus far this tidal wave of money, which may reach $50 billion this year because of the sharp increases in oil prices decreed by Middle East producers last year, is not reflowing significantly into western markets or western corporations, with the possible exception of the Swiss franc.

Observers note the following recent development:

• Apparently less than $21 million of a recent $1.5 billion French Treasury international bond issue was taken up by Arab banks, despite France's efforts to cultivate a special relationship with Arab states. This cultivation included a refusal to join with other industrial countries at this month's Washington energy conference in forming some kind of "united front" of consumers to deal with producers' claim.

In fact, the bulk of the French bond issue appeared to be subscribed to by banks in the industrial countries which France had refused to support. Barring $500 million taken up by Government-influenced French banks, the other big subscribers were U.S. banks, with some $370 million, Canadian banks with some $117 million and British banks with some $98 million, according to reports from Paris.

• Iran, which triggered the recent oil crisis through unilateral price increases, has now agreed to make $1 billion available through international organizations and special development funds to help ease the balance-of-payments impact of higher oil prices on industrial and underdeveloped countries.

This is about 6% of the anticipated rise in all revenues this year and would be split three ways, between the World Bank, the International Monetary Fund (IMF), and a special development fund which would be operated in some fashion jointly by the two Washington-based institutions.

• Islamic countries, meeting in Lahore, Pakistan, rejected proposals that Arab oil money should be used to help all developing countries. Instead, the meeting called for restrictions on aid from Arab countries to Moslem countries and also refused to set aside a specific amount of money for aid.

• Arab oil countries earlier turned down a request from African countries for preferential oil prices. The Arabs argued inter alia that any attempt to run a two-tier international oil market would be unworkable. This caused bitterness in Africa where many countries had gone out of their way to break diplomatic relations with Israel

Arab interest in Switzerland may have been fanned by last month's decision of the Swiss Authorities to remove many of the restrictions on non-resident use of the Swiss franc in making deposits.

ahead of and in the aftermath of the Middle East war in October last year, in sympathy with the Arab cause.

• Iran refused to roll back oil prices, while pledging some unspecified help to developing countries. The Shah did proclaim that the United States was getting "more oil than any time in the past" in spite of the Arab embargo, a remark which drew furious denials from U.S. energy officials. Iran, in turn, issued a harsh attack against the United States and other oil consumers for using the energy crisis as a "scapegoat" for reducing aid to developing countries.

• The United States indicated that it would like to see Arab and other oil producers pick up the tab for the estimated increase of some $10 billion in oil import bills of developing countries. The Arabs and others showed little inclination even to pick up the tab for the higher import bills of developed and industrialized countries which in their eyes are much better credit risks.

• Various national Governments, including that of Germany, indicated that the impact of the oil crisis, on top of other imponderables like higher domestic wage rates, already raging inflation and a clouded export outlook, made economic policy decisions increasingly difficult.

Reports that Arab cash to the extent of perhaps $1 billion had gone into the Swiss franc in the last few days were particularly interesting.

The Swiss currency is a traditional refuge in times of international capital and currency upheavals, even though the interest rate structure of the Swiss money market offers little incentive to investors as compared with other European countries or New York.

Arab interest in Switzerland may have been fanned by last month's decision of the Swiss authorities to remove many of the restrictions on non-resident use of the Swiss franc in making deposits, investments or purchasing for instance real estate. The presence of such restrictions over the last year or so did succeed in turning away some inflationary money inflows, while the lifting of the restrictions has now returned the Swiss franc to its traditional role, that of a currency one can get into or out of without too many questions being asked.

However, the apparent Arab opting for low Swiss returns and a high degree of guarantee of exchange rate risks raises some disturbing questions on the willingness of oil producers to play the part sketched in for them by western nations in saving what is left of the world's monetary system and economy from total collapse.

The Lahore conference decision is perhaps the most disappointing blow to efforts to get oil producers to accept a role in helping developing countries, most of whom are excluded from western capital markets by the shaky conditions of their economies and by their low credit ratings.

The number of poor Moslem countries which would benefit from the largesse of oil producers under the Lahore decision is sizable enough. It would include Egypt, Syria, Jordan, Tunisia, Morocco, Sudan, Mauritania, Mali, Niger, Somalia, both Yemen republics, Pakistan and Afghanistan.

It would, however, exclude India, Ceylon, Burma, Thailand, Kenya, Tanzania, most of southern Black Africa and all of Latin America, barring a mass conversion of these countries to Islam.

If the Lahore conference decision is sustained, it would leave a large number of non-Moslem countries directing their aid attempts even more clamorously to the non-Moslem world, at a time when the industrial and developed countries are beginning seriously to feel the pinch of Arab and Iranian oil price hikes and supply cutbacks.

Two African countries are a particularly poignant example. The most heavily populated are not overwhelmingly or even in majority Moslem, and these countries supported the Arab cause without stint in last year's confrontation with Israel, losing in the process considerable Israeli development aid and technical assistance.

If friends of the Arabs can expect such treatment why should 'enemies' expect to do any better?

The African countries as a group paid about $350 million on oil imports last year at $8.50 a barrel, according to estimates of the Organization of African Unity, headquartered in Addis Ababa, Ethiopia, but this bill is likely to rise to at least $1 billion this year. This compares with total African reserves of some $2.9 billion held by Libya and some $600 million held by Nigeria—both oil producers.

The Arab countries told African states recently that no concessionary prices could be granted to Africa or indeed to other developing countries. The Arabs did make proposals for the establishment of an Arab development bank for Africa, with a capital of some $500 million and on the establishment of a separate $200 million fund which African countries could draw from to help defray the costs of increased oil.

But African countries were cautious in the face of these proposals. Some of them, Kenya for instance, estimated that the rise in oil prices had made its entire current development plan unrealistic and estimated that annual economic growth, currently running at about 7.5%, could fall to zero within the next 12 to 18 months. The African nations, as noted above, had generally wholeheartedly supported the Arab cause last October and since.

But if friends of the Arabs can expect such treatment, why would "enemies" expect to do any better? The "enemies" are the industrial countries who seem to be relying on massive injections of Arab cash into western money markets, to permit industrial countries to borrow to cover their balance of payments deficits, in effect paying western cash to Arab and other producers for oil, then borrowing the cash back to cover the gap caused by the oil payments, then paying more cash for oil, then borrowing more back to close the gap.

The great problem with this scenario is that none of the oil producing countries has as yet indicated any eagerness whatsoever to play its part, whether through normal channels of the International Monetary Fund (mainly for industrial countries) or through the World Bank (for underdeveloped countries).

Meanwhile, the lines in front of ticket windows in the international money markets are getting longer and longer. France which has already borrowed $1.5 billion in the medium-area of the Eurodollar market, is seeking at least another $1.5 billion to $2 billion through state-owned and state-controlled corporations. Italy seems bent on raising as much as possible, perhaps $4 billion, before its credit resources run dry. Britain has indicated that it may be seeking as much as $7 billion internationally this year. And Japan is seen as a likely candidate either for direct official borrowing, or for government-sponsored corporate borrowing.

The total of demand in the first half this year could easily reach $15 billion with little end in sight if other industrial countries start to join the scramble. Where the funds to finance this demand are coming from is unclear, but at the moment it appears unlikely that it will be from the Arabs and others. ■

London Letter

BY JOE ROEBER JUNE 1974

Arab Oil Money and the City of London

A year ago the only people you would expect to find in the offices of a London merchant bank at 7 AM in the morning would be the char-ladies. These days it is not uncommon to find a banker at his desk. In Bahrain it is 10 AM and the working day, which starts at 7 AM, is half over. London's bankers are only too aware that a few sacrifices have to be made if they are going to profit from the Arab's new found wealth.

Britain has always had close ties with the Arab world. Kuwait, Oman, Qatar and the United Arab Emirates are all in the Overseas Sterling Area. London, along with other continental centres such as Paris, Zurich and Geneva, have been havens for Arab funds for many years. But only recently these funds were modest. Total oil revenues of the major Arab oil-producers and Iran in 1972, amounted to a mere $10 billion. The recent sharp rise in oil prices has changed all that. At the end of this year oil revenues could be running at an annual rate of close to $70 billion.

Saudi Arabia's oil revenues this year will probably be 8 times as high as in 1972. In a 7-month period it can earn enough, at present oil prices, to cover the entire cost of its 1970-75 development plan. A similar situation faces Libya, Kuwait, Abu Dhabi, and Qatar. All are wondering what to do with their new funds.

Petrodollar Tidal Wave

M. Jean Parrey, president of Arab Bank International, estimated recently that around 60% of these surplus funds would find its way into international money markets. If true this would amount to more than $30 billion this year alone. How large this inflow is, can be gauged from the fact that publicized medium-term credits on the euromarkets amounted to only $21.6 billion in 1973.

Even before the latest surge in oil revenues London was attracting a large amount of Arab money both in sterling and foreign currency. The latest Bank of England statistics, which refer to December 1973, show that non-sterling liabilities of UK banks to Middle Eastern countries, not members of the sterling area (such as Saudi Arabia, Libya and Iran), had risen from $1.7 billion in 1972 to $4.2 billion. The sterling holdings of Kuwait, Bahrain, Qatar, the UAE and Oman had risen rather more slowly from $1.3 billion to $1.8 billion.

Until the Bank of England releases fresh statistics in June it is impossible to gauge the inflow of Arab money this year. Nevertheless there are signs that it has been substantial. In the first three months of 1974 sterling rose 20% against the dollar, a large part of which City experts ascribe to the inflow of Arab funds.

The inflow has been patchy. Little interest has been shown in the equity market and, even more suprisingly, in the gold market. Considerable sums, however, have been invested in UK Government bonds. According to C. P. Lunn, a general manager of Barclays Bank International, up to £500 million has gone into gilts this year (on two days alone £80 million is thought to have been so invested). The bulk of it has gone into 5 to 7 year maturities. Others pitch their estimates somewhat lower — but it is generally agreed that the reason why the 1980 Tap stock ran out so quickly was due primarily to Saudi Arabian demand.

Diversification

A certain amount of money (primarily Kuwaiti) has been channelled into the UK property market, which is currently in desperate need of funds, following the collapse of its primary deposit reservoir, the beleaguered secondary-banking sector. One merchant bank, which has been busily arranging loans in Kuwaiti dinars for UK property companies, estimated that up to £70 million might have been invested in this sector. But despite their shortage of funds many UK companies still shy away from the exchange risks involved in taking foreign-currency loans.

The bulk of the surplus oil funds, however, are being deposited in the eurocurrency market — a large chunk of which is based in London. Once again estimates of the Middle East involvement vary considerably. The Bank for International Settlements estimated almost 12 month ago that $8 billion of Arab money was deposited in the euromarkets. Since then the market has grown substantially — Morgan Guaranty estimate that its size in April 1974 was $16 billion. Arab and Iranian deposits may now amount to $25 billion.

As in the past, much of the money is placed very short-term and handled by the big American banks, such as Chase Manhattan, Morgan Guaranty and First National City Bank, all of which have close links with the Middle East. Whereas in New York considerable sums of Saudi Arabian money have been channelled into Treasury bills, most of the funds moving into London and the euromarkets are from Arab banks and private individuals.

Just how these funds are managed varies considerably, depending on the expertise of the Arab countries concerned. Kuwait is probably the most sophisticated. In London, apart from the United Bank of Kuwait, the state-run Kuwaiti Investment Office places substantial official funds in the overnight-market. Another state-owned vehicle, the Kuwait Foreign Trading and Contracting Company, has also been aggressively developing its business. In February it surprised the London

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financial community by appearing as co-manager of a $34 million loan to the City of Bristol—a novel and welcome departure for an Arab institution. More recently still it has notched up another first, acting as co-manager of an Arab-currency-related eurobond issue, in partnership with First Chicago Ltd, European Banking Company, and Kredietbank Luxembourgeoise.

Short-Term Preferred

KFTC's aggressive approach is exceptional. So far Arab banks have been noted for their absence in medium-term lending syndicates — contenting themselves with placing money short-term on the euromarkets, much to the consternation of loan managers fearful of a liquidity squeeze. Their absence probably reflects lack of expertise rather than unwillingness to join in. This is being partially solved by Arab participation in a growing number of consortium banks being established both here and in the Middle East. (UBAF, based in London, is a prime example). Another drawback is that a substantial proportion of Arab funds is controlled by Arab central banks, which are unable to participate in syndicated loans. The government-owned Libyan Arab Foreign Bank was formed to get round this obstacle.

Iranian banks have been more visible — there are 4 in London in addition to a new consortium bank, the Iran Overseas Investment Bank. Bank Melli Iran, which has been in London since 1967, and Bank Saderat Iran, have underwritten a $200 million loan to the City of Glasgow and a $500 million loan to the Electricity Council. With the exception of the Kuwaiti banks, Arab banks have tended to deal in London at arm's length.

Preferential Prejudices

A considerable amount of business is being put through a few London merchant banks; most notably Morgan Grenfell, Kleinwort Benson, Hambros, and to a lesser extent Robert Fleming. Morgan Grenfell, one of the most traditional of the Acceptance houses, and a breeding ground for future governors of the Bank of England, is typical. Lord Catto, its chairman, stresses that the bank is particularly strong in the Gulf states because "we are effectively a non-Jewish bank" and has emphasized this aspect. At the time of the Yom Kippur War the bank aroused widespread criticism by going ahead with a $180 million loan to Abu Dhabi. Political—or rather religious—considerations rule out a large number of London's merchant banking elite.

Much of their work is straightforward — dealing in the foreign exchange market, buying and selling gilts and equities, and generally advising their Arab customers. Even if the funds are not deposited in London, the merchant banks often earn commissions for their advice. With an eye on the day when the Middle East may control two-thirds of the world's monetary reserves (one source predicted this will happen by 1980) the banks are consolidating their Middle Eastern ties. Morgan Grenfell recently took a 50% stake in the Arab and Morgan Grenfell Finance Company and Hambros has taken a 20% stake in UBAF Financial Services Ltd. New York may still attract the bulk of the Arabs' funds but London is certainly in the running.

The Eurobond Situation

If the one place the Arabs have not been putting their money is into eurobonds, then who has? In contrast to New York, where, despite rising interest rates, new issues have been sold in bigger volume than ever before, this year, issuing activity in the eurobond market has run to a virtual standstill. In the first four months of this year less than $700 million has been raised, compared to $1.64 billion in the same period of last year. With even tiny issues of $10-$15 million being slow to get away, issuing houses have had to plumb the depths of inventiveness to interest investors, and one or two novel issues have been appearing — for instance, one denominated in Canadian instead of US dollars and another offering an Arab currency option. Mostly, however, underwriting has become such a hazardous affair that issuing houses are simply telling their clients to stay away or to turn to the rapidly expanding medium-term eurodollar bank lending market.

"FLOATING ON OIL - A WORLD MONEY SURVEY"
THE ECONOMIST March 23, 1974

Without precedent

There will be no agreement between governments on a grand new monetary system by this summer as had been scheduled. Instead, the formal debate on it is about to be wound up. It would probably have never really made the winning post, anyway. But the decisive point has been that the very framework of the debate has been torn apart: every variant of the system which finance ministers have been considering—and squabbling over—assumed that the major industrial countries would strive to keep their overseas accounts roughly in balance over a reasonable length of time. That is now neither practical nor desirable.

The sudden, sharp rise in the cost of imported oil has made it impossible for the world to maintain a balanced pattern of payments. Even if oil prices fall a little, as seems likely, the sums involved are huge. Whether it turns out to be $30 billion or $50 billion, the increase in trade payments to a handful of countries this year will be without precedent. Only America and Germany among the big industrialised countries have any hope of seeing their current overseas account anywhere near the black this year. At a stroke, the oil problem has altered the whole international industrial and trading scene. It follows that it has also altered the monetary system needed behind it.

But in what way? *The Economist* has long been on the side of the floaters and is more than ever convinced that a system of floating currencies is the only one for today's uncharted waters and beyond them. But do finance ministers and bankers agree with us? At the same time, we feel there are parts of the reform under consideration before the oil crisis that should still be brought in piecemeal, while others should be adapted to the new energy situation. But, again, what do the politicians and practitioners think?

We have interviewed some of the key politicians and advisers who have been leading the official debate in the Committee of Twenty and some private bankers too, questioning them on the solutions they would like or expect, and are grateful for their co-operation. Their replies are on pages 12–53, preceded by our summary of the main points they make. The rest of this survey reports on the various plans being hatched in national treasuries and banking parlours to capture the new Arab oil money and, more specifically, how bankers rate the chances of individual financial centres in the competition for the most sought-after funds of all times.

Every banker naturally thinks he has the edge over the next one, and stands, therefore, to be disappointed. But it is encouraging that the oil problem is now widely recognised as one of recycling funds through either private or institutional channels and not one to be taken by exchange rates or by domestic deflations designed to make room for exports. The flexibility provided by floating exchange rates can help industrialised countries adjust among themselves to the differential impact of higher oil prices, but not eliminate it. However cheap industrial goods became, there is a physical limit to how much of them the Arab countries could absorb in the short run. Indeed, the upshot of competitive depreciations would probably be to shift the bulk of the aggregate deficit on to the United States, since payments for imported oil are largely made in dollars and therefore countries trying to depreciate their currencies would appear in the exchange markets as buyers of dollars and sellers of their own currencies. That sort of beggar-my-neighbour policy could all too easily precipitate a world slump in a year when the American economy promises at best to stand still and only France, Italy and Canada, among the industrialised nations, hold out any prospect of decent economic growth of 4 or 5 per cent.

The problem has been put elegantly by Mr Robert Solomon, a vice-chairman of the deputies of the Committee of Twenty; he points out that it is useful to visualise the oil price increase as a large sales tax on the use of petroleum products. Internally, that tax has a deflationary effect on demand which is likely to require offsetting action to avoid unemployment. But the proceeds of the tax are transferred unilaterally to the oil-producing countries who, unable to increase their imports in the short run, cannot avoid lending their receipts back to the rest of the world. So the effect of the higher oil prices in terms of absorption of real resources will only be felt in the long run when oil producers are in a position to receive repayment, with interest, of their loans to the industrialised world.

If only the oil producers were to lend back to each country exactly what they have levied in the oil tax, there would be no effect on a country's total balance of payments in the short run. But, of course, they will not. This survey emphasises that the United States can expect to get more than its fair share; the International Monetary Fund could counter the effect in part simply by making more liquidity available all round, through special issues of SDRs. (For definition of those unsexy bits of paper, see glossary, page 16.) However, clearly some redistribution or recycling of funds among oil consumers will be essential.

The money may come back from the oil producers in all sorts of ways: direct investment in industry or in property, bank deposits, purchases of equity, fixed-interest securities or Treasury bills, gold or commodity purchases, development loans (such as World Bank bonds) or loans to a central international clearing-house. All that can really be argued about as yet is whether most of the recycling will, or should, be done through the Eurocurrency market or through the IMF.

But since the IMF was not set up to deal with something like the oil crisis, it can only play a central role if a special oil facility is set up, as its managing director, Mr Johannes Witteveen, is urging (again, see glossary, page 16). Countries would be able to draw on this facility in amounts related to their oil-induced deficits, to the size of their reserves, and to their quotas in the IMF; it would be supplementary to their other access to Fund resources. But, of course, the scheme depends on the oil-producing countries supplying the funds, preferably directly. Iran has indicated it would play—at market-related rates. But some exchange rate guarantee will have to be given, and will the Arabs like the idea of that being related to the "basket of currencies", in which SDRs are to be defined, as seems to be the idea? Bankers are dubious; the Arabs have shown no interest in such abstract concepts in the past. Only Mr Witteveen, who will tour the Middle East next month, can hope to discover the answer. Unfortunately it looks as if he will not go with the full blessing of Washington. The Nixon Administration has reservations about the plan, both tactical and technical.

But at least some constructive proposals are being made and in the face of a huge upheaval the monetary system is holding up well. No one should mourn the demise of the Committee of Twenty; if truth were told, the finance ministers were glad of an excuse to wind it up. The writing was on the wall when *The Economist* wrote in September, 1972, more than a year before the oil crisis broke:

> If the committee does spin out its job, its efforts will be in danger of being overtaken by one of two events. There may be another currency crisis which will reintroduce floating generally . . . But even if there is no such crisis, the Committee of Twenty could nevertheless find that its reform, if not introduced for another three or four years, is out of date. The distribution of power will go on changing: significantly, Japan and the Middle East now have 16 per cent of the free world's reserves, compared with 8½ per cent only two years ago.

But it is now essential to set up a top-level decision-making forum for dealing with international money problems. The movements of funds round the world this year will be of a size that will make the operations of the multinationals look mini. If a chaotic slip into world recession is to be avoided, an unprecedented degree of international co-operation will be needed.

The deputies of the Committee of Twenty will at least have something to get their teeth into when they meet in Washington next week. Not only will there be the new oil facility to discuss, but a paper from the IMF which puts the emphasis on getting an "interim" agreement on managed floating—and you can interpret "interim" as you like. The proposals are basically two: a hefty guidebook of rules which, funnily enough, would in some ways give the IMF more powers than it ever had under the old Bretton Woods system; and, by implication, the notion of target values for exchange rates. Also, a definition of SDRs in terms of a standard basket of major currencies is spelt out. The question is whether in the end the politicians will be able to swallow it whole.

Figuring out the oil crisis

On top of all the usual uncertainties plaguing payments forecasts, especially in a floating world, there are the new questionmarks about consumers' ability to economise on oil, producers' readiness to supply it and whether, or for how long, present oil price levels will be held. Nevertheless, the debate about appropriate policy responses cannot get far in a vacuum. The world's policymakers have been getting most of the key statistical work—as well as early warnings about the dangerous implications of the arithmetic for world growth and trade if countries react without regard to the consequences for others—from the Organisation for Economic Co-operation and Development in Paris. Normally very little of the OECD's work is made public—although the Bundesbank's Dr Otmar Emminger last month admitted that the latest estimates put the likely current account deficit of the industrial countries in 1974 closer to $40 billion than the $32 billion that was being bandied about in January, and more details have since become available.

The Economist has attempted its own exercise. The key assumptions underlying the data in our table are:

(1) Oil prices will remain at the levels implied by today's posted prices throughout 1974. If you disagree, make your own corrections; a rough rule of thumb is that every change of $1 a barrel in the price adds (or subtracts) $10 billion from the total oil bill of the OECD countries.

(2) Actual oil supplies will not fall short of "normal" demand at current prices; that is, straight political rationing will cease, as now looks on the cards. Column 3 of our table does imply that the volume of oil consumed by importing countries will be less than it would have been in the days of cheap energy, but only to the extent that higher prices themselves induce economies.

(3) Oil producers will step up their imports from oil consuming countries, more particularly the industrial countries, this year—but not by very much. The usual range of guesstimates here varies from a cautious $5 billion to an optimistic $10 billion. The best compromise guess is, perhaps, that the OECD countries will enjoy a $7 billion boost to their exports. However, against that must be set what they will have to pay out in interest on increased Arab investment funds placed in their markets—a sum that will probably amount to about $2 billion this year (and rise to closer to $5 billion next year).

One reason for thinking that the combined deficit for the industrial countries as a group will be at the higher, rather than the lower, end of the range in our table is quite simply the unhappy likelihood that the less-developed countries will not be able to finance a current account deficit of much over $15 billion (see page 73). If they are enabled to do so, by increased aid flows or by special oil-financing schemes, that will help countries like America, Britain and Japan to improve their own current account performances. If they are not, the burden of oil financing, superimposed on existing payments imbalances, looks frighteningly large and lop-sided. Just three countries—Japan (especially vulnerable to the oil crisis itself), Britain and Italy (both of which have had the bad luck to be hit by the oil crisis just when their payments were anyway weak)—could be left carrying well over half of the total current account deficit of the industrialised world.

The current account arithmetic

$ billion	1973 outturn (est.)	1974 guesstimates: Pre-oil crisis forecast	Additional oil bills (inc. = −)	Post-oil crisis forecast*	Reserve holdings end-'73
United States	+1.5	+7	−10½	−½ to −3	14.4
Canada	−0.6	−½	—	—	5.8
Japan	—	+1½	−9¼	−7½	12.2
Britain	−3.7	−3½	−4½	−7½ to −9	6.5
France	+0.4	+1	−5	−3½	8.5
Germany	+3.8	+4	−5¼	nil to −1	33.1
Italy	−2.2	−1	−4¾	−5 to −6	6.4
Other industrial countries	+4.6	+1¼	−12	−8 to −11	52.9
Industrialised world	*+3.8*	*+10*	*−51*	*−33 to −40*	*139.8*
Less developed oil importers	na	−15	−9	−15 to −22	29.4
Opec countries	na	+5	+60	+55	11.3

**The OECD's forecasts differ significantly from ours only in a few instances: America's deficit is put at $4 billion, Britain's at $8 billion and Germany's at $1 billion exactly.*

The forgotten poor

The less-developed countries are the real victims of oil

The combined oil bills of the less-developed countries will rise by no more than $8 billion–$10 billion in 1974. This is less than a fifth of the expected rise in the oil bills of industrial countries and amounts to no more than a quarter of the accumulated reserves of a country like Germany. But those are not the comparisons that count. Paying up on oil will mean, in effect, handing over virtually the whole of the gains of the poorer countries from the commodity boom—or, alternatively, the whole of their normal receipts of aid.

The picture is even less pretty when it is realised how cruelly uneven the impact will be from one country to the next. It is not only such obvious weak brethren like India who will need rescuing. So will some high performers like Korea who have been particularly successful in building up industry, yet whose income a head remains vulnerably low. They have not been the main gainers from the commodity boom. For that matter, it is easy to forget to what extent the gainers have been the industrial countries themselves: members of the Organisation for Economic Co-operation and Development are 80 per cent self-sufficient in raw materials. On food and fertilisers alone the terms of trade have swung against the developing countries to the tune of $5 billion over the past year.

The World Bank divides the developing countries into three broad groups—leaving aside those oil-lucky devils like Nigeria and Indonesia in a league all of their own. There are those, like Ghana, which have built up their reserves on the back of the commodity boom (or, like Turkey, on the backs of their emigrant workers). Second, there are those, like Brazil and Mexico, which have high enough credit ratings to hope to keep their toeholds in the Euro-currency markets—though the going here will be much tougher this year than last (when publicly-announced medium-term Eurobank lending to less developed countries soared to $8 billion) and relative newcomers to the market, like Chile, may find themselves pushed to the very end of the queue. Third, there are those unfortunates with virtually no reserves, insufficient credit ratings to tap the private international markets for funds and yet not much capacity to reduce imports.

India, of course, is the prime example in the last group. Its oil bill will rise this year by at least $550m–600m, or maybe, some say, by nearer $1 billion. At most India can cover about $300m from its own slim resources—but not much more and not for long. A modest $62m drawing from the International Monetary Fund has pushed the deadline back a shade but before that came, it looked as if India would be out of funds entirely by end-May. Other countries particularly hard-hit by the oil crisis include the rest of the sub-continent—Bangladesh, Pakistan and Syr Lanka—and some of the Latin and central American countries, particularly Uruguay. Most of these are such obvious hard-luck cases that, at the crunch, their very weakness might prove their strength—the rich are resigned to bailing out India regularly. But other countries normally regarded as at least the partial successes of past aid programmes will also be in serious trouble, above all Korea, as we have already said, but also Taiwan and Thailand.

The need for special outside help to pay increased oil bills may be held down this year to perhaps no more than $3 billion–$4 billion. Current earnings of key commodity producers are still very healthy; there is perhaps $3 billion in developing countries' reserves that can be used in payments. Another $2 billion might still be winkled out of the Euro-markets by the creditworthy countries. But what of next year? The commodity price boom, already past its peak, will then have been finally punctured by the lagged impact of the slowdown in world growth, and the fat now in countries' reserves will have been eaten up. Also, mounting debt burdens and curtailed export earnings will make the Euro-bankers most unreceptive to calls from the third world. (Obviously the more you have borrowed the lower your credit rating goes.) The financing gap for the less developed countries in 1975 is more likely to be on the order of $7 billion–$9 billion than this year's $3 billion–$4 billion.

Who will fill the gap, and how? The popular answer—certainly from the industrial countries facing oil deficits of their own—is that the money ought to come from the oil producers themselves. This is fair enough, but nevertheless it will be disastrous if the rich think they need not play a part. The oil producers are extremely unlikely to be willing to lend enough either directly to the less-developed countries or, at one remove, to the established intermediaries like the World Bank.

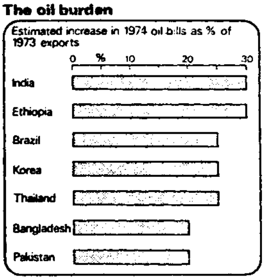
Though some promising noises are being made from various quarters, notably Iran, the actual aid effort of oil-producing countries to date has not been impressive. Middle East countries (and particularly Kuwait) have been lending about $700m–$750m a year to the World Bank, but such sums amount to no more than a recycling of the net aid ($770m in 1972) garnered by the 12 major oil producing countries from OECD sources in the first place. To the extent that the oil producers do not themselves give back to the developing countries as much as they take from them on oil, the industrial countries (which, obviously, will be the net gainers) will have to bridge the gap instead.

Which route?

Unfortunately, the industrial countries, facing payments problems of their own, will be tempted to reduce, rather than increase, their own aid programmes. Indeed, even the relatively well-placed Americans have been making ominous noises. Not only has the House of Representatives baulked at contributing towards the replenishment of the exhausted resources of the World Bank's soft-loan agency, the International Development Association (IDA); the normally responsible Senator Fulbright has gone so far as to argue that the United States should scrap all of its aid save some modest "compassionate" programmes. This may be silly as well as mean—after all, a dollar given to the less-developed countries is likely to come back almost immediately in the form of an export order and so help both to sustain growth and to diminish the current payments imbalance of the OECD countries as a whole. It is nonetheless a political fact of life.

This danger makes it all the more important that the major international

The oil burden



organisations, which can act as intermediaries for Arab money, do their jobs efficiently. Two points follow. First, the International Monetary Fund will have to become more of a source of medium- to long-term general support aid for the poor—a point already noted implicitly in the plans of the new managing director, Mr Johannes Witteveen, for a special oil-financing facility. Second, the rules of World Bank lending, and the demarcation lines between the Bank and its affiliate organisation, IDA, will need a radical rejigging.

Much has been made of the ability of the World Bank to tap the oil producers' new wealth indirectly, through the Euromarkets or New York, as well as directly, through, for example, Kuwaiti dollar issues. The bank's own credit rating is excellent, but it does not have the flexibility to direct its funds where they are most needed, or as quickly as they are needed. Because its loan terms are relatively hard, the World Bank tends to finance the relatively strong, just those countries which do, or should, go directly to the commercial Euromarkets. This February alone the bank not only lent as much as $214m to Mexico but also $75m to Iran, while Venezuela obtained $22m the month before. Also the World Bank, like most of its regional counterparts, is geared to financing specific projects; the inevitable time spent finding these, then vetting and launching them explains why the bank's disbursements have lagged so embarrassingly behind its commitments. There is no quick-footing here. Nor is that all: although the bank has made some effort to discriminate between various categories of borrowers in the past few years, all too often all comers, relatively strong and weak alike, have wound up being subsidised, getting their money at less than it cost the bank to acquire the funds.

Probably it would be wrong to argue that the World Bank should drop its project approach to lending altogether; the job of finding general balance of payments support (as well as specific financing for oil) for the poor might be better left to the IMF. However, it would clearly be useful if the World Bank could use its financial muscle more directly to help beef up the resources of IDA. Indeed, perhaps the demarcation lines here should be broken down completely, not only on the fund-raising but also on the lending side of the equation, and a single schedule of rules drawn up to govern which less-developed country would be allowed to borrow how much on what terms. Such a schedule should make the relatively strong eligible for loans only if alternative finance is not forthcoming from private market sources and then make it available only on commercial terms. The very poor, on the other hand, should be given particularly concessionary terms—and the scale of charges in between judged much more flexibly, on a case by case basis, than it is now.

Finally, there should be much closer co-ordination between the IMF on the one hand and the World Bank group on the other. It is reassuring that the staff of the two organisations are already swapping data and guesstimates on the impact of oil on their members. It is less reassuring that their respective chiefs, Mr Witteveen and Mr Robert MacNamara, are touring the Middle East on separate fund-raising missions. This is a time for a policy of togetherness in all fields of international finance but, above all, on development aid.

The gold conundrum

Will gold be mobilised to finance aid?

For nearly two years now, ever since the free market price of the metal really took off, no central bank has willingly parted with gold. The 1.2 billion oz hoard locked into official vaults does not bulk large; it could all be jammed into a short freight train. Yet at today's rates of output it would take the world's mines more than three decades to produce. Even at the nominal official price, of $42.22 an oz, it is worth almost $50 billion—an amount uncannily close to the windfall oil producers hope to exact this year through higher oil prices. Valued at free market prices—say, in mid-February when gold first burst through the $150 an oz barrier in London—it would be worth roughly $180 billion, an increase that would boost total world reserves (including the 154m oz of gold held by the International Monetary Fund) by two-thirds.

The effective freezing of gold was occasionally inconvenient even in the days of world boom, dollar glut and cheap energy. It now looks totally, even dangerously, absurd. Resistance to using reserves as one option for financing oil deficits has obvious dangers in a world already teetering on the brink of recession. Unlocking gold, of course, is not the only answer; emergency issues of SDRs, enlarged swap lines among central banks and special IMF facilities are more sophisticated solutions. But gold is familiar and already at hand, and the advocates of using it are growing.

Three different approaches suggest themselves: a straight rise in the official gold price; the abolition of any official price; or the funding of national gold holdings into, say, the IMF (which could either use the metal as a secondary asset in effect, as a backing for its own paper money, SDRs, or could gradually sell it off on the free market or, perhaps, directly to Arab oil producers). In *The Economist*'s view the third choice would be by far the best. Unfortunately, it is probably also the least likely, just because it is the least straightforward and time (or, rather, patience) is running out. By May at the latest the common market's monetary committee is supposed to come up with its own proposals for a joint EEC approach. So it is important that governments get their thinking clear on the alternatives while there is still time.

Raise or abolish the official price?

The EEC opts for an increase in the official price. After all, its members hold nearly half of the official gold of all industrial countries combined. From Brussels's point of view there would be something to be gained even if such a step were taken unilaterally—that is, if the gold price were raised for transactions among EEC central banks alone—if only because the move would make it easier for the present defectors (particularly France) to rejoin the European snake. But that would be relatively small beer. Obviously Brussels would prefer it if a higher price could be applied in dealings with other central banks as well—especially Arab ones.

But the problem of getting everyone, gold-rich or gold-poor, to agree may prove difficult enough even within the common market, let alone on the international plane. Moreover, even if finance ministers can come to terms, there remains the time-consuming hurdle of parliamentary (more especially, American Congressional) assent to clear. Then there is the question of what price.

The fashionable answer these days is a "market-related" one. But no one has defined precisely what that means: today's price, an average of the past six months' prices, the price on settlement day, the market price less, say, 10 per cent or what? Finance ministers may not simply pull a figure out of a hat (however market-related at the time) and then attempt to stick to it come what may. But even a floating gold price could prove tricky.

It is easy to forget how thin and volatile the free markets in gold are. A heavy day's turnover in the London and Zurich markets combined is only 25 tons or, even at $150 an oz, only $120m, a ludicrously tiny sum compared with turnover on the world's bourses or foreign exchanges. The price has been known to fluctuate by 12 per cent in a day.

Moreover, although it is difficult to put a precise figure to the proportion of total market demand coming from "investors" and speculators (because no one knows how to break down the data for jewellery), it is obviously very large. Certainly in recent months the market has been dominated by wheeler-dealers rather than firm holders of gold. Betting on the free market price of gold is likely to prove as wild a ride as betting on the price of any other commodity. Although the rules now allow the big central banks to sell on the free market, not one has tested the water yet—partly because the bankers are not sure that present IMF rules would allow them to change their minds and repurchase but also because they are all too well aware of the depressant factor on the price of any significant unloading.

In the long run, no doubt, gold will continue to appreciate, however dramatic its gyrations along the route. But that probability is of limited help. Indeed, if anything, it throws further doubt on the efficacy of the whole exercise of linking the official price of the metal to the market price. For it suggests that central banks might continue to regard their gold hoards primarily as an investment not to be used except as a very last resort.

Finally, there is the old problem of equity. A rise in the official price of gold to market-related levels would not, of itself, reward private speculators in the metal—they have managed to do quite nicely on their own. It would award the official hoarders—that is, precisely those rich countries which were most bloody-minded about international co-operation in the days of dollar glut—while doing nothing to help the poorer countries. Where gains did match oil deficits, that happy outturn would be pure accident. If the object of the exercise is to increase world liquidity, there are better ways of going about it.

The abolitionists propose a backdoor route to a market-related price for official stocks. Its advantage over the front-door approach is that it ducks the problem of coming up with one definitive price formula. Each central bank would be left free to strike whatever deal it could with whatever partner it liked—the Arabs, presumably, standing to get prime terms. The solution would amount to formally treating central bank gold holdings as second-line reserves, rather like Britain's old dollar portfolio. That might be more realistic. It would still require international agreement and still run foul of the equity argument.

Then there are the awkward implications for the future of SDRs. That a higher official price would make a nonsense of the current debate about defining SDRs in terms of a basket of currencies (or in terms of currencies in general) would not be too serious if an official gold price remained: the simple solution then would be to leave the valuation provision of SDRs alone. As matters are now the unit is effectively defined in terms of gold. Coping with an abolition of the official gold price would be much stickier.

But the more serious objection is the likelihood that a rehabilitation of national gold reserves would unleash Gresham's law. Though they may differ in their recipes for mixing exchange rate flexibility and stability, virtually all finance ministers now pay lip service to the idea that any permanent system of world money should be based on SDRs and must not risk a return to a sloppy compromise between a gold and a dollar standard. Whether these sentiments would be translated into practice once official gold stocks were revalued, however, is another matter altogether.

Funding in the IMF

For all these reasons, *The Economist* would favour funding national stocks into the IMF. In exchange for their gold, central banks could be offered special profit-linked SDRs; if the IMF subsequently sold gold at a higher price than it had paid to buy it in, some part of the profit, say half, would be distributed proportionately among the original owners, the balance to be applied to beefing up the IMF's resources for concessionary lending to less-developed countries (a link in another guise) or, during an interim period, to Mr Witteveen's proposed oil-financing scheme.

Actual sales, if any, would be left to the discretion of the IMF. Normally they would be made through the free markets—and all central banks would be free to buy (and sell) gold on those markets after the initial funding of their existing holdings. Alternatively, for an interim period, the IMF could be authorised to sell gold directly to the central banks of oil-producing countries.

Even this scheme would not be wholly "fair". Today's official gold hoarders would still get something of a windfall, both because the initial conversion price of gold would have to be pitched higher than the present official gold price and because they would share in the profits of any subsequent IMF sales. But it would be fairer than the other alternatives. Moreover, while giving a needed initial boost to the resources both of the IMF and of individual countries, it would not prejudice the long-term position of the SDR but, rather, directly or indirectly, enhance it. Agreement would not be easy—and our sketchy outline is full of technical gaps. But such an approach should at least be discussed before the issue is prejudged by the actions of one small club.

The official hoarders

(at $42.22 an oz)

	Official gold ($ billion)	As a % of: total reserves	normal imports	additional oil bills
Industrial countries:				
United States	11.7	81	16	128½
Germany	5.0	15	9	86½
France	4.3	50	11½	85
Switzerland	3.5	43½	29	426
Italy	3.5	54	12	84½
Holland	2.3	35	9	139
Belgium	1.8	35½	8	108
Canada	0.9	16	4	112
Japan	0.9	7	2	10
Britain	0.9	14	2	21½
Austria	0.9	30½	11½	267
Other developed countries:				
Portugal	1.2	41½	34	n/a
S. Africa	0.8	65½	13½	n/a
Spain	0.6	9	6	61
Less developed (excl. oil producers)	2.6	9	3	2½
IMF	6.5	—	—	—

Gold and total reserves at end-1973. Normal imports are total import bills, at annual rates, in the 2nd or 3rd quarter of 1973 (eg. before the first rise in oil prices). Additional oil bills are estimates for 1974.

DECEMBER 27, 1973

Hobart Rowen

The Impact of Arab Oil Demands

The Western World, which should have known better, can now see that appeasement of the Arab nations didn't pay. Europe and Japan, which had gracelessly bowed to Arab blackmail, are confronted with a new doubling of the price of crude oil, which is likely to plunge them into an economic tailspin.

International oil experts calculate that the world's imported oil bill has suddenly jumped about $40 billion, on top of a $17 billion increase created by higher prices announced October 16.

Oil price inflation of this magnitude —which bears no real relation to costs — can have a disastrous effect on the less developed nations, and poses extraordinary problems — possibly unmanageable — for some of the industrial countries.

The "Christmas present" of reduced cutbacks means very little when the more important factor of prices is considered. This sober thought is beginning to be reflected in reaction from consuming countries all over the world. Japanese authorities, for example, estimate that if oil imports are maintained at this year's volume, their entire currency reserves of $13 billion will be wiped out by the higher costs.

And the ball game isn't over yet: the new prices, according to the Kuwaiti oil minister, cover just the first quarter of 1974. Another boost is in the offing.

There may be some naive observers left who still believe that the Arab oil weapon is merely a diplomatic tool wielded to force Israel back to her old borders.

But the latest examples of Arab greed should convince any fair-minded person that the oil weapon is being wielded primarily to enhance the wealth and the economic leverage of the small group of nations clustered around the Persian Gulf.

Their embargo against a handful of nations, and the on-again, off-again series of production cutbacks are merely devices by a well-run cartel to maximize already swollen profits.

What will be the Western response if the Arab nations, inundated by paper money, take it into their heads

"What will be the Western response if the Arab nations demand payment for their oil in gold?"

to demand partial or total payment for their oil in gold?

So far, the Western World, the United States included, has betrayed a shameful impotence in the face of the Arabs' economic aggression, which—as Prof. Richard Gardner of Columbia has pointed out—violates existing international rules.

The world has been willing to delude itself into thinking that if the Israeli "liability" could be brushed aside, all would be well.

But is there anyone around who expects that once the Arab-Israeli dispute is settled, the Persian Gulf nations will lower the price of oil in grateful acknowledgement that their political goals have been met?

If the price of oil ever moves down, it will be becsuae the Arab oil weapon —the boycott combined with the unbelievable price jumps—propels others into a crash program to develop alternate sources of energy.

The new market price for Persian Gulf oil is about $8.50 a barrel, which works out to a delivered price here of about $10 a barrel, a four-fold increase in a year. But according to energy czar William E. Simon, the United States could boost domestic production from 4 billion to 8 billion barrels at $[illegible] a barrel.

Nonetheless Simon makes clear that the administration, if not actually assured of an end to the Arab embargo, is indeed quite hopeful that its old friends, the Saudis, will soon turn the spigot on.

Simon's decision against coupon rationing of gasoline at this time is a compound not only of a fear of the bureaucratic mess involved but an intuition that it really won't be necessary.

What is needed at this point, in addition to a long-run program for new sources of energy, is a set of new international rules and procedures to assure reasonable access to vital raw materials, along the lines of proposals already initiated by Sen. Walter Mondale (D-Minn.)

The Arab nations, as Gardner says, should be put "on notice that they cannot wage economic war upon us with impunity."

THE MONEY MANAGER APRIL 15, 1974

'Gnomes' of Moscow Recycling Oil Money to West

By ROGER LOVE

A portion at least of Arab oil revenues are being recycled through the Eurodollar market to frantic oil-hungry borrowers—but perhaps not in the way that Western monetary draftsmen had intended.

Demand for money is certainly there; first quarter medium-term Eurodollar loans by international banks are estimated to have reached a record $10.5 billion, nearly four times the $2.9 billion total of the 1973 first quarter and more than double the $4.9 billion of the 1973 fourth quarter.

The latest borrowings compare with the previous quarterly record of $7.8 billion in the 1973 third quarter. France, Italy and the United Kingdom drew an estimated $8.2 billion in official borrowings from the Euromarket in the first quarter, and may be seeking more than $6 billion additional in the next few months.

Sources say that a portion of the money borrowed did originate with oil-producing countries, but some of it bypassed the traditional financial pipelines through Zurich, London or Frankfurt, and came instead through Moscow.

The recycling mechanism of the Moscow "gnomes" worked as follows: hard currencies from Western and other consumers to oil producers to pay for oil; hard currencies from oil producers to Egypt and Syria for Mideast war and re-armament expenses; hard currencies from Egypt and Syria to the Soviet Union for military hardware; and hard currencies from the Soviet Union to Euromarkets for foreign borrowers.

The amounts involved are difficult to determine, but some sources indicate that activity of Soviet banks as Eurocurrency offerers, mainly dollars, increased substantially in the first quarter this year, to the extent of several billion dollars.

Besides the oil-currency-arms circuit to Moscow, the Soviet Union has also been profiting on foreign sales of raw materials at high world prices, including the prices paid for Soviet oil deliveries to many European countries—at Middle East prices. Soaring prices for gold in Western markets, in small part reflecting Arab demand for the metal rather than currencies, has attracted some Soviet bullion sales, helping to feed the Moscow dollar pool and expand Soviet Eurodollar lending, sources say.

Some of this Moscow money, at interest rates of 10% or better, has been going to both oil-strapped industrial countries and chronically-cash-short developing countries through the Eurodollar market, with hard-nosed Soviet bankers apparently no readier than anybody else—including the oil producers—to make cash available to the poorest countries at anything less than the highest going rate.

The demand for medium-term Euromoney to meet oil and other payments deficits appears insatiable. France raised $2.3 billion in this area in the first quarter this year, contrasted with no borrowing last year, and may be seeking a further $8 billion in the next few months. Italy raised $2.2 billion in the first quarter alone, against about $4.4 billion through all of last year, and some projections are that it may seek a further $2.5 billion in the near future.

British Eurodollar borrowing totaled $3.7 billion in the first quarter, against $2.3 billion in all of last year, and London may seek another $1 billion. Some Euromarket sources see a further $20 billion in demand for Eurocredit in the coming period: France, $3 billion; Britain, $1 billion; Italy, $2.5 billion; Japan, $2 billion; Brazil, $2 billion; Spain, $1 billion, and the rest split among other countries.

At the same time, demand and inflationary pressures have caused a sharp shift from the long end of the Euromarket into the medium-term area, of seven-to-ten years maturity. This largely reflects accelerating inflation in all industrial countries, which is making investors increasingly reluctant to put money into long-term securities.

In fact, the total of long-term Euro issues in the first quarter was down over 40% from the final quarter of 1973, with continuing inflation making it unlikely that the trend will be reversed. The secondary Eurobond market has also been adversely affected, by a general malaise, sharp price declines and reports that major Swiss investment funds were unloading large portions of the Eurobond portfolios and shying away from new issues in the face of demands from fund holders for repayment.

The unprecedented demand for Euromoney from industrial countries has of course boosted interest rates

Activity of Soviet banks as Eurocurrency offerers, mainly dollars, increased substantially in the first quarter this year, to the extent of several billion dollars.

and caused governments to resort to considerable "arm twisting" pressures on underwriting and issuing syndicates over terms of their issues and in some cases the reluctance of syndicates to proceed with planned offerings. Some observers say that the British Government was lucky to get the terms it did for its recent $2.5 billion ten-year borrowing, even with major British commercial banks handling the issue.

The spread London obtained over three, six or twelve month Eurodeposit rates (at the borrower's option) is staggered from a respectable 0.375% for the first two years of the issue to 0.75% for the final three years, the latter a rate generally imposed on lesser-quality borrowers. The "base" Eurodollar deposit rates have recently been running at a shade above or below 10%, though in recent weeks they shot to 10⅝% and higher.

There is little indication of any decline in these rates, given both the enormous projected demand and the lack of evidence of any intergovernmental consensus on staggering borrowing to avoid driving interest rates through the roof.

Japan was switched from a lender to a borrower of Eurodollars under the lash of the oil crisis. Optimists hope that Arab oil revenues will more than make up the gap of supply and the increased demand. But Arab oil producers have thus far shown reluctance to lend money at even market rates to international institutions, which are "politically safe" and which would also safeguard against currency depreciations and devaluations. The Arabs appear to wish to keep veto power over the end-use of their funds, even in development and balance of payments aid to the poorest countries, which generally supported the Arab cause in the Mideast war.

Borrowers from the industrial world,

There is little indication of any decline in Eurodollar rates, given both the enormous projected demand and the lack of staggering of borrowings.

who were generally lukewarm if not opposed to the Arab cause, may well find similar policies affecting their attempts to tap Arab cash via the Eurodollar market. Denmark, for instance, is a traditionally heavy Eurodollar borrower and is also in Arab badbooks for its alleged pro-Israel attitude. ■

Iran Proposes A New 'World Bank'

UNITED NATIONS—Iran has pledged $1 billion for a series of wide-ranging measures to increase world money flows and provide development funds for the less advanced countries, Iranian Finance Minister Jamshid Amouzeghar told the three-week special General Assembly session on economic problems.

"At the core of these proposed measures is the establishment of a new special development fund with an initial capital of $2 billion to $3 billion, to be financed jointly by the oil-exporting as well as industrialized countries," he said.

Iran will open its plan to any oil-exporting and industrialized countries willing to put up capital, Mr. Amouzeghar said.

His country wants to establish a special development fund, he said, because "10 industrial countries have 51% of the vote in the World Bank and, as a result, very important projects have been proposed by developing countries and been rejected on political grounds."

His government wants a "one man, one vote" board of governors for the new institution, representing developing, oil-exporting and developed countries equally, he added.

WORLD FINANCIAL MARKETS

Morgan Guaranty Trust Company of New York

January 1974

Table 1

*Energy self-sufficiency**

percentage derived from domestic sources, in 1971

	oil	total energy
Japan	0	11
Italy	6	15
Belgium	1	18
France	5	22
United Kingdom	2	53
Germany	7	51
Netherlands	7	64
Canada	98	110
United States	74	89

*Source: OECD, Economic Outlook

The impact of oil on the dollar

In recent months the exchange markets' assessment of the dollar and other currencies has been influenced heavily by the developments in the supply and price of oil. Soon after the changes began to occur in October, market participants adopted the view that the United States' economy and balance of payments would be affected less adversely than those of Japan and Europe. This view is based on several presuppositions. First, the United States is less dependent on foreign energy sources than most other industrial countries (see Table 1). Second, its industrial activity would be directly affected relatively little as the United States has a large capacity to save oil and energy in general, particularly in the household sector. Third, this country has a very great potential for increasing its domestic energy supplies and could again become self-sufficient in energy in a matter of years. Fourth, the United States' large and sophisticated financial markets would attract a major portion of OPEC investments.

While there is an element of truth in all these presumptions, the adverse impact of the current level of oil prices on the U.S. balance of payments for the next few years should not be underestimated. As shown in Table 2, net imports of oil and gas amounted to 10% of total U.S. imports in January-October 1973. This ratio is considerably higher only in Japan, but it is lower in all European countries. Since it requires some time to develop substitutes for oil, these ratios give some indication of the relative adverse impact of higher oil prices on various countries' imports. Furthermore, as the table shows, the share of oil and gas in total U.S. imports rose sharply in recent years. This reflects the fact that increased domestic demand for some years now has had to be covered entirely by imports. In fact, before October, i.e. before the embargo and price increases were announced, and allowing for the completion of the Alaska pipeline, it was anticipated that the volume and value of U.S. oil imports would increase at average annual rates of about 13% and 20%, respectively, between 1973 and 1980 and that the share of oil in total U.S. imports would continue to mount. This underscores the belief that it will require a major effort on the part of the United States to reverse the trend toward increasing foreign oil imports.

Estimates of increased net oil and gas imports, and of trade and current-account balances for major industrial countries are given in Table 3. U.S. oil and gas imports are projected to rise by about $11 billion on the assumption that the *physical volume of imports in* 1974 will not exceed that of 1973 and that there will be some weakening of oil prices. This will push the trade and current accounts into defi-

Table 2

Net oil and gas imports

as percentage of total imports

	1970	1972	1973[a]
United States	6.3	7.6	10.0
Japan	15.1	19.6	17.3
United Kingdom	8.5	8.6	8.5
Germany	7.1	7.8	8.5
France	8.6	9.9	7.7
Italy	8.2	9.6	7.6
Switzerland	4.8	5.2	6.0
Belgium	4.0	5.6	3.5
Netherlands	1.2	3.4	2.2
Canada[b]	(2.5)	(3.2)	(4.4)

[a]based on data for imports prior to the effects of oil price increases in October
[b]net exports

cit again in 1974 after 1973's brief respite. The trade balance could be in deficit by $3 billion this year, following an estimated surplus of $1 billion (customs basis) in 1973. In view of the continued high grain prices, agricultural exports will again do well, and may even exceed the already high $18½-billion level of last year. The balance on non-agricultural trade (excluding oil and gas) should be considerably more favorable, assuming at least the current level of dollar devaluation is maintained, and may rise from approximate balance in 1973 to about $6 billion this year.

However, it seems unlikely that the adverse swing in total trade, including oil, will be offset significantly by an improvement of net invisible transactions in 1974. Among the major items, U.S. interest payments to nonresidents may not be very much different. Outstanding U.S. liabilities to foreign official institutions of *industrial* countries on average are likely to be well below those of last year, but there could be an offsetting increase in interest-bearing liabilities to oil-producing countries. Since it is somewhat doubtful that U.S. interest rates in 1974 on the average will be below those in 1973, interest payments on these foreign liabilities may not change much. Repatriated earnings of U.S. companies may well decline in line with reduced growth and profitability abroad, in response to eased U.S. foreign-direct-investment controls, and due to the appreciation of the dollar in recent months.

In contrast, net tourist expenditures as well as direct military expenditures abroad could decline moderately, and overseas military sales may well increase, partly to the oil-producing countries. Thus, the overall current account may reflect rather closely the expected weakening of the trade balance, and shift adversely by about $4 billion to a deficit of perhaps $2 billion or more in 1974. Beyond 1974, the trade and current accounts could deteriorate further on account of the 10% effective appreciation of the dollar over the past six months and in the event that agricultural exports should fall.

Along with the United States, nearly all other industrial countries will experience considerable deterioration in their trade and current-account balances. There will be wide variation in the extent of this weakening, however. Germany still is likely to have a sizable trade surplus. The current payments balances of Britain and Italy, already bad, will probably worsen further. Canada and Holland are hardly affected at all by the oil developments, on a net payments basis, because of their own considerable oil and gas resources.

The guesstimates presented in Table 3 imply that the major industrial countries will achieve a substantial collective improvement in their non-oil and gas trade performance. Most of this gain can be anticipated to arise through increased OPEC-country spending on industrial products, together with some net improvement *vis-à-vis* non-oil, developing countries — perhaps through some decline in commodity

Table 3

Trade and current-account guesstimates
in billions of dollars

	change in net oil/gas balance	*trade balance*		*current account*	
	in 1974	*1973*	*1974*	*1973*	*1974*
United States	−11	+1	−3	+2	−2
Canada	+½	+1½	+1¾	−½	−½
Japan	−11	+3¾	−3½	0	−7
United Kingdom	−4	−5½	−8½	−3½	−6
Germany	−6	+12	+5½	+3½	−3½
France	−6	+1½	−3½	+½	−4½
Italy	−5½	−5	−8	−3	−5½
Belgium-Lux.	−2½	+½	−2	+¾	−2
Netherlands	−½	+½	0	+1½	+½
Switzerland	−1½	−2¼	−3	+¼	0

prices — or through enlargement of the Socialist countries' net deficit position with the West.

Some of the conjecture that has been circulating as to the amount of OPEC investments likely to flow to the United States in 1974 is almost certainly exaggerated. Decisions concerning the investment of surplus oil revenues will be based on a variety of factors, including rates of return, safety of principal, and liquidity. From the viewpoint of such criteria, U.S. financial markets offer some attractive investment opportunities. However, as will be discussed in a subsequent section, investment in the United States is just one of a number of possible channels for capital flows from the oil-exporting to the oil-importing countries. OPEC countries will undoubtedly want to diversify their investments in terms of currency and political risks. Even as regards dollar-denominated investments, the Euro-dollar and Euro-bond markets may offer relatively more attractive rates of return than are obtainable in the U.S. domestic market. Funds invested in the Euro markets, of course, do not result in capital flows to the United States unless the funds are relent to U.S. residents.

If the United States were to receive large *net* capital inflows, obviously the dollar would become very strong. Too strong a dollar would adversely affect our trade and current-account balances. In effect, a large share of the combined current-account deficit of industrial nations with the OPEC countries would be shifted to the United States — probably an unacceptable development.

Thus, if the United States receives a disproportionate share of the oil-exporters' investible funds, these large inflows will need to be offset by U.S. capital outflows to avoid too strong a dollar and excessive deterioration of the country's current-account balance. Indeed, progress is being made on facilitating capital outflows. At the turn of the year, a significant relaxation of U.S. capital controls was announced: the interest equalization tax was reduced; the regulations covering U.S. direct investment abroad were eased to the extent that they no longer compel the financing abroad of new investment, and in fact permit net repayments of part of U.S. companies' outstanding foreign debts; and the ceilings covering foreign claims of banks and nonbank financial institutions were raised by a modest amount.

As regards capital *inflows*, the continued application of Federal Reserve Regulation M — which imposes reserve requirements on banks' Euro-dollar repatriation to the United States — appears to indicate that the Federal Reserve is interested in moderating short-term capital inflows. It also should be recognized that the possibility of large-scale equity investments in U.S. companies and in U.S. real estate by foreign parties already has stirred concerns in some quarters, including the Congress.

The use of OPEC revenues

The oil revenues of the OPEC nations can be projected to rise from about $22 billion in 1973 to approximately $105 billion in 1974. This projection assumes that OPEC crude oil production averages approximately 34 million bpd in 1974 compared with nearly 30 million bpd in 1973 — possible only if the Arab producers end their cutbacks — and that oil prices remain at roughly today's levels. This projection also makes allowance for the impact on average oil prices of participation agreements now in effect in a number of oil-producing countries.

The possibility of such an increase in oil revenues has raised questions concerning their disposition, and particularly whether it is feasible for the world's financial markets to absorb such large sums not only this year but in the years ahead. Several observations concerning the magnitude of these revenues and their absorption can be made.

It is questionable whether the oil revenues of the OPEC nations actually will reach $105 billion. Current prices for oil are on the high side. In the past, OPEC countries expressed concern because the price of their major export had not risen in tandem with the prices of their imports. As shown in Table 4, however, the most recent round of oil price increases has much more than redressed the past imbalance in relative price movements. To be sure, the many years during which crude oil prices lagged well behind the increases in prices of manufactured goods represent substantial OPEC country income foregone. Nonetheless, the oil price adjustments made last October were more than sufficient to restore the purchasing power of the oil-exporting countries. The further doubling of oil prices at the turn of the year has put the price of crude oil substantially out of line relative to the prices of manufactured goods, as well as of agricultural commodities and non-ferrous metals.

It appears also that crude oil prices may be above medium-term equilibrium levels. With the most recent round of price increases, there was a dramatic change in the economics of the energy industry. The present oil price level will spur intensive development of existing and new oil and gas resources, as well as major efforts to develop alternative energy sources — which in the long run could turn out to be cheaper than oil at today's prices. Indeed, a spokesman for Saudi Arabia, the world's largest oil exporter, has publicly expressed reservations about the magnitude of the most recent oil price increases, and has suggested that some price reduction should be considered. A relatively small reduction, e.g., about 10% would still leave crude oil prices high relative to the prices of manufactured goods and to the medium-term equilibrium price level for oil, but it would be a step in the direction of making payment of the consuming countries' oil import bills, and the employment of producing countries' revenues, more manageable.

It seems, furthermore, not unlikely that the combination of higher oil prices, new conservation measures, and slower economic growth in the industrial countries may curb somewhat the demand for oil. It is possible that the volume of oil consumed in the importing countries as a group in 1974 may be little changed from the 1973 level.

If oil prices were to be reduced, say, by 10% from today's levels, and if OPEC oil production were to remain at its 1973 level, then the 1974 oil revenues of the OPEC countries would be about $85 billion — perhaps a more realistic expectation than the previously mentioned $105 billion.

The new oil prices represent above all a very significant increase in the ability of the OPEC countries to purchase goods and services in the world market. The capacity of the oil-exporting countries to make productive use of such goods and services tends to be underestimated, however. To be sure, several of the OPEC countries, including Saudi Arabia, the largest producer, will for the foreseeable future be able to make use of only a fraction of their revenues. Many others, however, will be able to spend productively most or all of their oil earnings.

The major oil-exporting countries'

Table 4

Comparative export prices in U.S. dollar terms
index numbers, base 1950 = 100

	1960	1970	latest [a]
Manufactured goods	126	150	209
Food	94	111	203
Non-ferrous base metals	124	215	269
Saudi Arabian light crude	108	105	681

[a]Third quarter 1973 for manufactured goods, food, and non-ferrous base metals; January 1, 1974 for Saudi Arabian light crude

goods imports from the rest of the world totaled about $17 billion in 1972. In 1973, that figure may well have been close to $25 billion. As total OPEC oil revenues were about $15 billion and $22 billion in 1972 and 1973 respectively, it is clear that in both years some of the oil-exporting countries spent more on imports than they received in oil revenues.

In fact, six of the OPEC countries — Algeria, Iran, Iraq, Indonesia, Nigeria, and Venezuela — have in the past been substantial capital importers, both as recipients of development assistance, and as borrowers in the international capital markets. The combined external debt of these countries probably exceeded $17 billion at the end of 1973, including more than $5 billion borrowed in the Euro-currency market since 1970.

Furthermore, per capita incomes in the six OPEC countries just mentioned remain very low by the standards of the developed countries, even considering the recent oil price increases. In the attempt to improve living standards and transform their economies, most of the oil-exporting countries already have, or are in the process of mapping out, very ambitious development programs involving significant expansion of their economic and social infrastructures, and major industrialization programs. They also are becoming directly involved in many sectors of the petroleum industry, ranging from the exploration for and development of crude supplies, to the production and distribution of end products. Many of the projects and programs envisaged by the producing countries are highly capital intensive, and will require expenditures and imports of billions of dollars. In addition, military equipment purchases by some OPEC nations, from both the West and from the Soviet bloc, have been and are likely to remain very large.

Moreover, the prices of the goods purchased by the producing countries will increase considerably as a result of the inflationary forces set in motion by the recent oil price increases. This would bring about at least a partial reversal of the recent swing in the terms of trade between the oil-producing and consuming countries. Since exchange rates can play only a minor role in the adjustment process between the oil-producing and consuming countries, the adjustment is likely to occur directly through relative price changes.

In sum, it seems likely that the combined expenditures on imports of goods by the oil-exporting countries could easily reach $35 billion or more in 1974, implying unspent oil revenues on the order of $50 billion. Since many of the oil exporters will be able to spend most, if not all, of their revenues, the bulk of this $50 billion will accrue to a handful of countries. This $50 billion also represents the approximate current-account deficit of the oil-importing countries with the OPEC nations, which one way or another has to be financed in 1974.

There are a number of possible approaches to channeling funds from the oil-exporting to the oil-importing countries. The latter could transfer primary reserve assets to the former. Some observers have suggested, for example, that oil-importing countries could sell gold to the producers at market prices. Non-OPEC countries have gold reserves amounting to approximately one billion ounces. Oil-importing countries also could transfer SDRs, the supply of which could be increased by new allocations.

Some of the excess OPEC revenues could be placed in the Euro-currency market, leaving it to Euro banks to channel the funds to the oil-consuming nations, partly to help finance their current-account deficits. With the net size of the Euro-currency market having approached an estimated $150 billion at the end of 1973, up from appoximately $105 billion at the end of 1972, this market has demonstrated the ability to absorb a large influx of new funds.

This is not to say that there are no limitations on the Euro-currency market's capacity to absorb funds. There are limits to the amount of credit risk that Euro banks would be willing to take in relending the funds to countries with weak current-account balances of payments, and mounting external indebtedness. There is, in short, no assurance that the direction of such loans — which would be determined in large part by factors such as relative interest rates, credit demands, creditworthiness as determined by the Euro banks, and national capital flow policies — would be the best in terms of international payments equilibrium.

Some of the surplus oil revenues may be invested directly in the national money and bond markets of the developed countries, with or without special bilateral arrangements involving exchange-rate guarantees, or special security issues. The oil-producing countries already hold part of their reserve assets, for example, in sterling and dollar balances (bank deposits, Treasury bills, and government bonds) in the United Kingdom and the United States. But in the perspective of the combined size of the major industrial countries' money and bond markets — whether measured in terms of the value of outstanding securities, or the volume of annual new issues — the amount of oil revenues that could be absorbed by these markets is substantial. In fact, such investments might initially involve little more than a shift in asset ownership from the central banks of oil-importing countries to those of the oil-exporting countries.

Another approach to recycling the surplus oil revenues would be to channel them through a multilateral organization, such as the IMF. One proposal being given consideration would involve an enlargement of the General Arrangements to Borrow, whereby the Fund would borrow from the oil-exporting countries, and relend to the oil-importing countries. The value of the exporting countries' claims on the IMF could be guaranteed in terms of SDRs. The terms of the oil-exporters' loans, including the value guarantee, would have to be sufficiently attractive to induce them to participate. Moreover, IMF credits would have to be for much longer terms than current short-term facilities. However, if such a scheme could be worked out to the mutual satisfaction of the creditor and debtor countries, it could permit an orderly recycling of oil revenues to the consuming countries, and make it possible for the latter to avoid a breakdown into competitive trade and payments bilateralism.

Still another possibility could involve long-term capital flows from the oil-exporting to the oil-importing countries. In this category would fall development assistance to the less-developed countries (LDCs). Part of this assistance could take the form of bilateral grants and credits. The oil-exporting countries have also indicated their intention of establishing various development institutions through which assistance would be channeled. Moreover, existing development finance organizations, including the World Bank, the Asian Development Bank, the African Development Bank, and the Inter-American Development Bank could seek funding for a portion of their lending programs from the oil-exporting countries.

Some of the surplus oil revenues also probably will be utilized for various long-term investments, in equities, in real estate, and even in direct investments. However, in 1974 it is likely that the bulk of the revenues will be employed in the ways described earlier: deposited in the Euro-currency market; invested in national money and bond markets; channeled through the IMF; and disbursed as aid to developing countries. Only a relatively modest portion is likely to go into stock markets and other equity investments in the near future.

Impact of the oil situation on the LDCs

For the large group of the less-developed countries (LDCs) which are not major petroleum producers, the cost of petroleum imports will rise from an estimated $5 billion in 1973 to a range of $13-$15 billion in 1974, assuming currently prevailing prices and 1973 volumes. The 1973 oil import level represented already a substantial increase over the 1972 level of $3.7 billion. Also, some slowing in LDC export growth is expected. As a result, a trade deficit of about $22 billion (c.i.f. basis) for all non-oil-exporting LDCs for 1974 seems likely, versus about $11 billion last year and $9.5 billion in 1972. Their net deficit on services would add perhaps a billion dollars. The non-oil-exporting LDCs are therefore facing a current-account deficit of about $23 billion this year, which compares with an annual average of $10 billion in the 1970-73 period.

Part of this deterioration no doubt will be covered by drawdowns of these countries' international reserves. Indeed, recent record rates of export growth and capital inflows have given the non-oil-exporting LDCs a cushion to absorb a portion of the increment in oil costs. In terms of import cover, reserves of approximately $27 billion at end-1973 represented about 4 months' cover, based on the import outlook for the coming year. A drop back to 3 months' cover would allow a reserve rundown of $3 billion, which would cover 13% of the estimated current-account deficit. A drop to 2½ months' cover would yield $7 billion, or 31% of the deficit.

The remainder of the increased current-account deficit will have to be met through capital inflows. Many uncertainties obviously exist in this area. In the past, nearly two-thirds (or about $11 billion in 1972) of the total net capital flow from the OECD countries (about $18 billion) to the LDCs has been from private sources. In some LDCs, the adverse impact of the oil situation on the current account of the balance of payments may make private lenders and investors more cautious.

As regards official capital flows, it is worth noting that official development assistance from the OECD countries in 1972 amounted to about $7 billion. This aid effort by the industrialized nations would be more than offset by the estimated $9-billion increase in LDC petroleum import costs. Moreover, in view of the industrialized nations' own projected current-account deficits, the maintenance of the aid flow at present levels may now be in question. Previous commitments may hold the flows at something close to recent levels in the near term, but certainly no increase appears feasible. Thus, a search for ways to shift more of the aid effort to the OPEC nations is likely. This search essentially breaks down into two parts: (a) redirection of flows within existing aid programs; and (b) mechanisms to directly increase the aid flows from the OPEC nations toward the non-oil-exporting LDCs.

As regards the former, the potential seems limited. Based on mid-1973 figures on development credits from the World Bank, IDA and the Inter-American Development Bank, 12 major oil-exporting countries accounted for about 12%, or more than \$3 billion, of total outstanding loans approaching \$27 billion. Actual net flows of aid funds from all OECD sources to these 12 countries amounted to \$770 million in 1972, or 9.8% of the total of such flows to all LDCs. Some redirection could be accomplished in the short run by partial prepayment of already disbursed loans and relending of current aid flows by oil exporters back to the source. The short-run potential for redirection of this sort, however, probably does not exceed \$2 billion to \$3 billion.

The potential in the second category — increasing OPEC funds directed toward the LDCs — is clearly much greater. The various possibilities — rechanneling through the IMF, development assistance directly from OPEC to the LDCs, greater funding of existing international development organizations from the OPEC nations — have already been mentioned in the previous section. However, the near-term financial needs of some LDCs will be sufficiently urgent that the timing of these possibilities becomes an important question. In the short run, the OPEC countries could grant short-term credits to finance the purchase of oil, which could later be rolled over or re-financed into longer-term debt. Another possibility would be the creation of a new IMF long-term facility similar to that now available to LDCs for compensating drawings due to export shortfalls.

However, other possibilities will no doubt take more time. For example, the World Bank and similar regional organizations essentially make *project* loans, so that unless the World Bank were willing to start making *program* (or general support) loans, it might be some time before greater funding from the OPEC countries would have much impact on new funds available to LDCs. Further, the organization of an OPEC-financed development bank, already mentioned by the Secretary-General of OPEC, will require considerable time.

Among the non-oil exporting LDCs, the primary and secondary impacts of the new international petroleum situation will of course vary widely, due to the skewed distribution of gold and foreign-exchange reserves, differences in relative dependence on imported petroleum and levels of development. Although very approximate in some cases, the data in Table 5 attempt some evaluation of the *primary* effects in a selection of countries for which data are readily available. Of this group, Chile appears to be the most vulnerable due to relatively high dependence on oil and low international reserves, although the oil crisis comes at a time when the international financial community has become more disposed toward Chilean credits. Brazil, which heads the bottom half of the ranking, is an interesting case of high overall dependence on petroleum imports but sufficient financial resources to

Table 5

Selected less-developed countries

	estimated 1974 oil imports millions of dollars, c.i.f.			
	1974 total	increment 1974 over 1973	increment vs % of gross reserves	% of energy consumption not covered by domestic production (a)
Chile	\$ 295	\$ 175	59%	60%
Korea	800	500	48	54
Philippines	600	350	41	97
India	1,200	550	40	17
Taiwan	820	500	33	52
Central America (b)	225	145	31	93
Brazil	2,200	1,300	20	45
Mexico	450	200	17	9
Peru	110	75	13	39
Argentina	225	145	12	10

(a) Based on U.N. data for 1971, except for Brazil and Chile.
(b) Excludes Panama.

get through the short run.

Secondary impacts of the oil crisis will affect all LDCs in some degree regardless of relative dependence on oil imports. For example, the slowdown in economic growth in the United States, Japan, and Western Europe, brought on in part by the worldwide oil shortage, will reduce demand for many LDC exports — probably affecting commodity prices as well as the growth of manufactured exports. Also, sharp price increases for industrial goods imported by many LDCs for use in manufacturing — as well as direct increases in fuel costs — will add to inflationary pressures. Finally, petrochemical scarcities will adversely affect both industry and agriculture, the latter due to fertilizer shortages. Thus, the secondary impact of the oil situation, while not quantifiable at present, will tend mainly to aggravate the primary balance-of-payments effects discussed above.

THE WASHINGTON POST April 20, 1974

Big Powers to Tap Euro-dollar Mart For Arab Oil Debt

From News Dispatches

TOKYO—A meeting of some of the world's major industrial countries on the oil problem ended yesterday with forecasts they would have to pay billions of dollars to Arab and other petroleum producers and then borrow much of the money back.

The conclusion emerged from a two-day meeting of a working party from the Organization for Economic Cooperation and Development, a club of 24 of the world's advanced countries. Eleven countries were represented at the meeting, the United States by outgoing Treasury Under Secretary Paul A. Volcker.

The group's spokesman, Dr. Otmar Emminger, vice president of West Germany's Central Bank, predicted the huge sums of dollars being accumulated by oil producing countries would be partly channeled back to western nations and Japan through the European currency market.

Although Emminger refused to discuss figures, conference sources said OECD countries would suffer balance of payments deficits of $25 to $40 billion this year trying to pay for oil.

They forecast also that Middle East countries and other producers would control a hoard of $200 to $250 billion in "oil dollars" by 1980.

"In any case the figures are enormously large," Emminger told a news conference. "The problems they raise for the advanced countries and international financial markets are great."

The West German official said that as oil countries accumulate dollars the problem of investing them is bound to arise.

"To begin with, a relatively large part will be invested in liquid form in international money markets," Emminger said.

"Up to now international money markets, particularly the European dollar market, have performed reasonably well as a medium between oil producing countries and medium term borrowers."

Emminger said medium term loans totaling around $12 billion have been channeled through the European currency market so far this year.

He added that "under the present circumstances" the Eurodollar mechanism appeared able to handle the task.

But the Dow Jones New Service reported from London that there has been concern expressed in the Eurobond market over the drop in the dollar exchange rate, notably against the German mark.

The service observed that Emminger, at the Tokyo meeting hinted that the mark could appreciate further. Emminger said that West Germany is willing to assume some deterioration in its balance of payments to make it possible for deficit countries to improve their payments positions.

He went on to say that exchange rates must play some role even if they couldn't be used exclusively to even out surpluses and deficits.

With both the interest rate and currency outlook unfavorable to the Eurodollar bond market, underwriters have been looking for special situations that will appeal to investors.

IMF Survey

MARCH 4, 1974

Shah Offers Proposal

Fund Advances Work on New Oil Facility As Iran Pledges to Lend Its Financial Aid

Intensive international efforts are continuing in the search for solutions to the balance of payments problems arising from the recent sharp increases in petroleum prices.

In Washington, the Fund's Executive Board is currently discussing an outline prepared by the staff for the establishment of a new facility, often referred to as the oil facility, to assist countries in financing current account deficits from higher oil bills. Such a facility was proposed by Managing Director H. Johannes Witteveen to the Committee of 20 (Committee on Reform of the International Monetary System and Related Issues) at its Rome meeting (*IMF Survey*, January 21, 1974, page 17), and the Committee of 20 asked the Executive Board to explore the idea urgently.

In Teheran, meanwhile, the concept that the new oil facility would receive supplementary financing from the higher earnings of the oil producing countries was advanced as the Iranian authorities pledged to set aside at least $1 billion this year, the bulk of which is to be directed to the new facility. The balance is to be used to purchase World Bank bonds, and to provide part of the financing of a new institution proposed by the Shah of Iran to make loans on concessionary terms to developing countries that do not produce oil, and are thus especially hard hit by higher oil prices.

Iran's pledge of $1 billion for the three purposes followed discussions in Teheran among Iranian authorities, Mr. Witteveen, and Robert S. McNamara, President of the World Bank Group. Iran's Prime Minister, Amir Abbas Hoveida, announced the decision at a press conference on February 21 that was attended by Jahangir Amuzegar, the Minister of Finance, and by Mr. McNamara and Mr. Witteveen. Staff members of both the Bank and the Fund have been holding discussions with authorities of oil producing countries on the problems stemming from higher prices, and in the months ahead, Mr. Witteveen plans to visit other oil producing nations.

Role of Oil Facility

Following the decision of the Committee of 20 in favor of urgent exploration of the new oil facility, the 13 industrial countries represented at the Washington Energy Conference agreed on February 13 to lend impetus to this and other efforts to deal with oil-related balance of payments disequilibria underway in the Fund, the World Bank, and the Organization for Economic Cooperation and Development (*IMF Survey*, February 18, 1974, page 49).

The oil facility would assist Fund member countries in meeting the initial impact of the increase in oil import costs by permitting drawings in amounts related to their oil-induced deficits, to the size of their reserves, and to their quotas in the Fund. Access to the new facility would be subject to an assessment of members' balance of payments position, and it would be supplementary to their other access to Fund resources.

From the outset it has been envisioned that the Fund would use its existing resources but might need to supplement them by borrowing mainly from oil exporting countries. The Fund's recent discussions with these countries have been to sound out the possibilities for such financing, and Iran's proposal for loans to the Fund for the oil facility is at market-related rates.

The existing resources of the Fund consist of holdings of gold and SDRs and currencies which can be supplemented by additional (Please turn to next page)

borrowing under Article VII, Section 2, of the Articles of Agreement to replenish the Fund's holdings of any member's currency. The financing of a new oil facility in part by borrowing would be an instance of the Fund's obtaining additional resources from its member countries.

At the end of January, the Fund's holdings of currencies were equivalent to SDR 23.889 billion, its holdings of gold to SDR 5.370 billion, and its SDR holdings were SDR 508 million. Among the currencies were holdings of U.S. dollars equivalent to SDR 6.129 billion, deutsche marks to SDR 481.2 million, and Canadian dollars to SDR 819.6 million.

Currencies of oil exporting countries held by the Fund were equivalent to SDR 1.17 billion, including Venezuelan bolivares equivalent to SDR 218.5 million, Trinidad and Tobago dollars to SDR 63 million, Iranian rials to SDR 144 million, Iraqi dinars to SDR 81.5 million, Kuwaiti dinars to SDR 45.3 million, Saudi Arabian riyals to SDR 100.5 million, Algerian dinars to SDR 97.5 million, Libyan dinars to SDR 18 million, Nigerian naira to SDR 102 million, and Indonesian rupiahs to SDR 279.2 million.

Proposal of the Shah

In Teheran, Mr. McNamara and Mr. Witteveen promised urgent and sympathetic consideration by the World Bank and the Fund of the Shah's proposal for a new lending institution to provide concessionary loans to developing countries that do not produce oil. Under the Iranian proposal, the institution would have total capital in the first year of from $2 billion to $3 billion, contributed in about equal parts by the oil exporting countries and by industrial nations. Iran will present the proposal to the Organization of Petroleum Exporting Countries.

The proposal calls for the institution to have a board of governors providing about equal representation for oil exporting, industrial, and developing countries. This board would supervise and direct policy, and would appoint a board of directors, selected on the basis of their economic and financial competence, to conduct normal operations. Technical and administrative work would be done by the management and staffs of the World Bank and the Fund. For the future, it is envisioned that the new institution's lending would be primarily long term in character, and for development projects; but at the outset, it would make shorter-term loans for balance of payments support.

Press Conference Comments

As explained in the Teheran press conference by Mr. Amuzegar, the Iranian suggestion is for the 12 member countries of the Organization of Petroleum Exporting Countries and 12 industrial countries each to contribute some $140 million to $150 million to the institution to provide its capitalization of $2 billion to $3 billion.

Mr. Witteveen welcomed the Shah's proposal as constructive not only under present conditions, but for the future as well. He noted that the higher cost of oil and changes in other prices create very large surpluses among a number of oil producing countries and a number of very large deficits among both developing and industrial countries. Under such circumstances, he said, it is important that governments react in an appropriate way, for if they were to react in the wrong way, applying more or less mechanically old classical doctrines of restoring balance of payments equilibrium immediately, the world might face very serious problems.

The proposed oil facility, he said, would overcome immediate difficulties in an appropriate way, with the Fund helping to finance the deficits, and for this purpose he said it would be desirable if some of the surplus countries would give their

Regarding the developing countries which do not produce oil, Mr. Witteveen recognized that their problem will be especially acute, and not merely one of financing the deficit, but also a problem of the debt burden which has to be met.

THE ANNUAL REPORT

OF THE

COUNCIL ON INTERNATIONAL ECONOMIC POLICY

February 7, 1974

The Rise of Oil Prices: Implications for the World Economy

Export prices have now been divorced from factors such as costs and return to capital and are largely determined by the producer governments. Beginning in February 1971 with the Tehran Pact, effective control over oil prices has rested increasingly with producer countries working through the Organization of Petroleum Exporting Countries (OPEC). Posted prices rose approximately 70% between October 1970 and October 1973. In October 1973, the Persian Gulf producers announced unilaterally that posted prices would rise another 70% immediately. Libya joined them in announcing larger price increases. Nigeria, Venezuela, and Canada—the three largest suppliers to the United States—also declared substantial increases in their export prices—in some cases beyond those imposed for oil from the Persian Gulf. Then in December, the Shah of Iran announced on behalf of the Persian Gulf members of OPEC that the posted prices announced in October would be doubled beginning 1 January 1974. Current oil prices are shown in the table on the following page.

Price and Balance of Payments Impacts

The drastic increases in oil prices will have a significant short-term impact on both the domestic economies of all nations and on international economic relationships. However, because a price change of this magnitude for a basic industrial product has no modern precedent, the extent of the impact is uncertain.

Impact on Domestic Economies

Even before the recent price hikes, many of the world's economies were already decelerating. It was expected that growth would slow from its recent exceptionally high pace to a more sustainable one, where product shortages and inflationary pressures would ease. The higher oil prices will

PRICE STRUCTURE FOR SELECTED CRUDE OILS, 1 JANUARY 1974

(See also oil price tables in Appendix B)

US $ per Barrel

	(34° Crude) (Saudi Arabian) Persian Gulf	(34° Crude) Nigerian	(40° Crude) Libyan	(26° Crude) Venezuelan
Posted price [1]	11.65	14.69	15.77	13.67
Production cost	0.10	0.35	0.30	0.51
Government revenue	7.01	8.73	9.49	8.59
Of which:				
Royalty	1.46	1.84	1.97	2.28
Profit tax	5.55	6.88	7.42	6.31
Estimated oil company profits	0.50	0.50	0.50	0.50
Estimated sales price (f.o.b.)	7.61	9.58	10.29	9.60
Estimated transport cost [2] (to US Gulf Coast)	1.48	0.67	0.65	0.46
Estimated sales price (c.i.f.) (to US Gulf Coast)	9.09	10.25	10.94	10.06

[1] Differences in posted prices reflect differences in oil quality and transport costs.

[2] Transport costs are assumed to be about the same as the average for 1973 (i.e., Worldscale 100).

accentuate this slowdown by reducing consumer purchasing power, slowing demand for petroleum-based products, and causing deferral of some business investment as well as consumer purchases. The result will be a reduction in economic growth, somewhat higher unemployment than expected and, of course, a continuing high rate of inflation with increased oil costs adding to other price pressures.

The reduction of growth, however, should be only temporary. The duration of the expected slowdown will depend largely on the ability of each economy to adjust to the new price structure. Production patterns in the world's industrial countries are now beginning to shift to meet demand for products which contain or use less petroleum. The prime example in the US is of course the shift toward smaller automobiles. The investments needed to make this structural shift will help to avoid an economic downturn, and even to increase growth in the near future. For these reasons, and because of the general soundness of the world economy, many observers believe that the economies of most nations will begin to accelerate again during the latter half of 1974.

This sequence will not come automatically. Governments will have to carefully adjust their monetary and fiscal policies so that they can help to accelerate the structural shifts without adding further inflationary pressures. Further, all nations must cooperate to avoid a competitive trade war, which could lead to a serious recession: some nations might be tempted to try to stimulate employment during this difficult period by providing export incentives or imposing import barriers, and such "exporting of unemployment" could provoke retaliation by other countries.

Impact on the World Economy

The price increases will also affect balance-of-payments accounts and international financial markets. The consuming countries' oil import bill will increase dramatically this year if current crude oil prices are maintained. At present consumption levels, world oil imports would jump from $45 billion in 1973 to about $115 billion in 1974 or about a $70 billion increase. Exporting countries' revenues will increase in 1974 to nearly $100 billion or three-and-a-half times the 1973 level. As shown below, the Arab states will receive about half of the total revenue increase, with Saudi Arabia showing the largest gain.

REVENUES FROM OIL EXPORTS

(Billion US$)

	1973 Estimated	1974 Estimated
Total	27	95
Arab	15	51
Saudi Arabia	5	20
Kuwait	2	8
Libya	2	7
Algeria	1	3
Iraq	2	6
Other	3	7
Non-Arab	12	44
Iran	4	18
Indonesia	1	4
Nigeria	3	8
Venezuela	3	11
Other	1	3

Most producers will be able to spend only a small part of their increased revenues on foreign goods and services. Even before the recent price increases, the earnings of Saudi Arabia, Kuwait, and the other small Persian Gulf states exceeded their absorptive ability. Their imports and aid disbursements will probably grow substantially in 1974, but by nowhere near the amount of the increase in earnings. Other Arab producers have a greater current need for oil earnings to finance their economic development and military programs, but even in these countries the magnitude of the revenue increase and the normal delays in planning make it virtually impossible to spend all revenue this year.

The major non-Arab oil exporters—Iran, Indonesia, Nigeria, and Venezuela—will find it somewhat easier to expand imports immediately. For the most part, these countries have larger populations and greater opportunity for economic diversification than do most Arab producers. Nevertheless, the revenue increases are bound in the short run to outstrip the ability of even these countries to absorb foreign goods and services. In all, oil-producing countries will probably have extremely large surpluses to invest or deposit abroad.

These available investment funds will flow mainly to oil-consuming countries. Some will be invested in long-term assets such as real estate and securities. But because these types of investment decisions take time, most of the funds will probably go into short maturity assets—such as Eurodollars—and dollar deposit accounts. While the international financial markets will be able to absorb these investment funds, their magnitude will probably depress interest rates. Lower interest rates should, in turn, stimulate new investments in productive facilities.

The reflow of most oil exporting revenues back to the oil consuming countries will mean that, as a group their overall payments position will be balanced. Individual nations, however, may experience problems, since there is no necessary relationship between a country's higher oil import bill and the reflow of funds from the producing countries. The US will be in a fortunate position because it possesses substantial quantities of domestic oil and alternative energy sources. The sharp strengthening of the dollar in exchange markets in January 1974 reflects in part the expectation that the US balance of payments will be less severely affected than those of other industrial nations. The dollar's renewed strength, however, is a mixed blessing: continued appreciation of the dollar may reduce the competitiveness of US goods in world markets.

Developing countries face especially serious problems as a result of the price increases. The non-oil-producing LDC's face an increase in their collective oil import bill of near $10 billion this year, an amount roughly equivalent to the total development assistance being disbursed by developed countires. An undetermined but substantial figure must be added for the impact of the increased prices for imports which grow out of the increase in energy costs. It may be that some of these countries could borrow to meet increased costs, but, to the extent they do so, their ability to borrow for other purposes is reduced. The alternatives are to reduce their standard of living, receive more foreign aid, or see energy prices reduced.

THE IMPACT OF THE RISE IN THE PRICE OF CRUDE OIL ON THE WORLD ECONOMY: Prognosis and Policy Options

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THE IMPACT OF THE RISE IN THE PRICE OF CRUDE OIL ON THE WORLD ECONOMY

--Prognosis and Policy Options--

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THE IMPACT OF THE RISE IN THE PRICE OF CRUDE OIL ON THE WORLD ECONOMY

--Prognosis and Policy Options--

In October and December 1973, the OPEC countries raised effective oil prices from $3.45 a barrel landed in North America and Western Europe to roughly $9 a barrel. Even if the Arab oil embargo and cut-back of production were ended shortly, the price increase alone will raise massive economic problems for the world:

--Inflation, already a serious problem, will be given a sharp stimulus: some 3 percentage points will be added to to the rate of price increase in 1974.

--Domestic demand, and hence output, employment, and real income, might be reduced significantly in 1974--by some 2 percentage points more than would otherwise have been the case.

--Acute balance-of-payments problems will face most countries--notably non-oil producing less developed countries, but also Japan, the United Kingdom, and Italy in 1974.

Whether these problems materialize in a substantial way will depend in part on the policies adopted by the industrial countries and the degree of cooperation among them. Moreover, the problems are so massive, and the rise in the price of oil so great, that it seems unlikely that current oil prices can be long maintained.

This memorandum discusses the above estimates and their implications for policy. The estimates are necessarily rough. Their only purpose is to provide a reasonable framework for the development of economic policy.

I. Impact on Prices

The increase in the price of imported oil will have a major impact on world prices. As can be seen in table 1, for the OECD countries as a whole the increased cost of imported oil should raise domestic prices (more technically, the GNP deflator) by more than one percentage point.

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TABLE 1

Impact of October and December 1973 Increase in Price of Imported Oil

	Effects on Imports $ billions a/	As % of Total Expenditures (1973)
Selected Countries		
U.S.	9.5	0.7
Japan	8.3	1.5
France	4.5	1.2
Germany	5.3	1.2
Italy	5.0	1.8
U. K.	5.0	1.8
BLEU	1.5	1.8
Netherlands	1.5	1.5
OECD total	46.6	1.2
Non-OECD	7.5	
Grand Total	54.0	

a/ The estimates show the effect of the change in oil prices on the 1973 volume of oil imports.

Source: OECD, Economic Outlook, Paris, December 1973 and Federal Reserve estimates January, 1974 (Memorandum of Helen Junz).

Moreover, since the increases will be passed along more in percentage rather than absolute terms (in order to maintain mark-up margins constant as a percent of costs), and since wage-push inflation is also likely to develop, the price increase for the OECD countries could well be higher than that implied in table 1. Indeed, it might amount to 3 percentage points or more. (The impact on the United States would be well below average since domestic energy supplies are large.)

II. Impact on Demand and Output

The price increase for imported oil is identical in its economic impact to a tax on oil consumption. The net economic impact depends on the public's reaction to the "tax" and the use to which the "tax collector" puts the revenue.

Helen Junz of the Federal Reserve estimates that the direct impact of the increase in the price for imported oil would be to reduce GNP by 1.5 to 2.2 percentage points below what it otherwise would have been. a/ This seems reasonable since, as can be seen in table 1, the increase in the price of imported oil--the additional "tax" imposed by the oil-exporters--amounts to some 1.2 percent of 1973 GNP.

As can be seen in the appendix, the "tax", or increase in oil earnings by the oil-exporting countries, is expected to amount to some $60 billion in 1974 as earnings of OPEC countries, which were $25 billion in 1973, soar to $84 billion in 1974. b/ Part of this will be offset by increased purchases of goods and services by the oil-exporters.

In 1973, these countries bought some $20 billion worth of goods and services from the rest of the world. A 50 percent increase--an increase in purchases of $10 billion--could be readily financed but would be difficult to accomplish in one year. Yet, even if such an increase took place, it would leave the rest of the world with a deflationary impact of roughly $50 billion.

A greater increase in expenditures by the oil-exporting countries is not likely. As can be seen in table 2, a substantial part of the increase in revenue will accrue to Arab countries with limited absorptive capacity--small populations and unambitious programs for economic development. Even the other oil countries will experience a lag before they can turn their increased financial resources into effective purchasing programs.

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a/ Mrs. Junz uses indirect tax elasticities derived from Bent Hansen (Fiscal Policy in Seven Countries, 1955-65, OECD, Paris, March 1969) or from national models.

b/ The data in the tables are roughly consistent. Such inconsistencies as exist do not alter the analytical or policy conclusions.

Table 2: Increase in Oil Revenues of OPEC Countries, 1974 over 1973

Arab Countries with limited absorptive capacity	$26.0 billion
Saudi Arabia	
Kuwait	
Abu Dhabi	
Other Pers. Gulf	
Libya	
Other Arab Countries	6.6
Iraq	
Algeria	
Other	
Other Countries	30.6
Iran	
Nigeria	
Other W. Africa	
Venezuela	
Other Latin America	
Indonesia	
Other Far East	
USSR & E. Europe	
OPEC	59.3
World Total	62.8

Source: Appendix.

Until that happens, the impact of the increase in the price of oil is certain to depress demand and income in the oil-importing countries. The fact that the increase in financial assets of the oil-exporting countries will be invested in the oil-importing countries does not offset this conclusion.

III. The Balance of Payments

The increase in the price of oil will have a staggering impact of the balances of payments of all countries. The most recent estimates, shown in table 3, are exceedingly rough but they suggest the following general conclusions:

--The oil exporting countries may earn some $55 billion net in 1974, compared to $6 billion in 1973.

--The United States, which ran an estimated surplus on current account (trade, services and private transfers) of $4.5 billion in 1973 now is projected to run a deficit of $1 to 2 billion (instead of an earlier forecasted surplus of $9 billion).

--The United Kingdom and Japan especially, but Italy, France and Germany as well, face large current account deficits in 1974.

--Finally, the non-oil producing less developed countries, which ran a deficit of $9 billion in 1973, are expected to show a deficit of $23 billion in 1974 if it can be financed. With foreign aid running at $8 billion, financing such a deficit will be quite difficult.

These estimates, which, to repeat, are subject to wide margins for error and are not forecasts, give a reasonable idea of the orders of magnitude involved in the change in the price of oil. The swings envisaged are enormous.

There would be no balance-of-payments problem if the oil exporting countries spent their increased earnings for goods and services, though there would be a major transfer of real resources from oil importing to exporting countries. (Indeed, until the latter increase their purchases in other countries, no real burden is placed on the oil importers.)

Nor would there be a balance-of-payments problem if the increased earnings of the oil exporters came back to the importers as either short-term or long-term investments. This is almost certain to happen at least for the next year and more. But these loans and investments would have to equal, country by country, the increase in net imports from the oil countries. This is a most unlikely constellation. Thus, 1974 seems certain to present the developed countries and the non-oil producing less developed countries with major policy problems.

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Table 3: Balances of Payments on Current Account a/
($ billion)

	1972	1973	Projection: 1974 Before Dec. Oil Price Rise	Projection: 1974 After Dec. Oil Price Rise b/
Oil exporting countries	1.6	6.1	12.5	55.0
United States	-6.2	4.5	9.0	-1.5
All other countries	8.1	-1.1	-21.5	-53.5
Japan	7.0	1.5	-0.9	-6.0
France	1.0	0.6	-0.2	-3.7
Germany	2.2	5.5	3.6	-2.5
Italy	2.4	-1.4	-2.0	-3.5
U. K.	0.7	-2.4	-3.5	-7.5
Non-oil producing primary producers	-7.5	-9.0	-17.7	-23.0 c/

a/ Goods, services and private transfers.
b/ The estimates also allow for a somewhat lower volume of oil imports and additional exports to the oil producing countries.
c/ Largely non-oil LDC's, but also includes Sino-Soviet countries and errors and ommissions.

Source: First two columns: IMF, OECD "World Economic Outlook" December 26, 1973. Third: column Helen Junz of Federal Reserve. Last column: OECD, source, January 12, 1974.

IV. Policy Options for the United States and the Other Industrial Countries

The policy options open to the industrial countries seem clear. Most important, more than any time since the Great Depression of the 1930's, economic cooperation among the industrial powers is essential. This point seems obvious, but recent developments suggest that the cooperation may be no more forthcoming now that it was almost half a century ago.

The general lines of policy are not in dispute as broad principles. The communique of January 18, 1974 of the International Monetary Fund's Committee of Twenty meeting in Rome, spelled them out as follows:

> ...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.

The only question is whether actions will conform to these principles.

These principles, with one major addition, and their rationale are spelled out below:

A. Reduce price of crude oil

Though not agreed by the Committee of Twenty, the most obvious and most effective policy would be to induce the OPEC countries to lower the price of crude oil. To do this, the rest of the world would have to show that such action is in the self-interest of the OPEC countries. Such an approach might be facilitated if it took place in an atmosphere which does not condone the OPEC action on price.

Arab spokesmen, certainly, but even a number of impartial observers in the American press and elsewhere suggest that the OPEC action is a normal and legitimate use of economic power, analogous to the pricing policies of American corporations. It is also argued that the action is moral as well since income is transferred from the rich to the poor. Both propositions are questionable.

If the oil countries were companies operating within the United States, they would be in violation of anti-trust laws and subject to civilian and criminal penalties.

Moreover, there is generally a close relationship between the cost of production of a product--the intellectual and physical effort involved--and its price. But Middle East oil costs an estimated 13 cents a barrel to produce a/ and the price to the oil companies is now about $7 a barrel, for a mark-up of some 4,000 percent. Nor are the price increases accomplishing a more equitable division of world income by taxing the rich to help the poor. As shown earlier, the non-oil less developed countries, which have incomes of some $300 per person, will be hit hardest. And the oil-rich countries of the Persian Gulf will have per capita incomes amounting to some thousands of dollars per person.

The OPEC countries might be persuaded to lower their price for a number of more compelling reasons:

1. They must realize that the large and precipitous rise in the price of oil is creating major economic problems for both the developed and less developed countries. As noted earlier, the increased price is a major stimulus to inflation and economic recession. With such conditions, all would lose. Sheikh Yamani, Minister of Petroleum of Saudi Arabia recognized this in a statement in Tokyo on January 27th.

2. Balance-of-payments problems and an economic recession would result in trade restrictions and reduced demand for all imports, so that attempts of the OPEC countries to diversify their economic base and to export oil would be inhibited.

3. The OPEC countries must recognize that the increased price of oil is encouraging the development of alternative sources of energy. The result could be lower prices for oil in the future so that oil-in-the-ground would be less valuable than oil sold today.

4. Finally, the OPEC countries must recognize that if business and governments make major investments to develop alternative sources of energy, they will protect these investments through import restrictions if necessary. This implies future economic problems for oil exporters.

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a/ This is the cost for Persian Gulf oil; other costs are higher: 38 cents in Nigeria, 40 cents in Venezuela, 45 cents in Libya, 75 cents in Algeria, and $1.08 in the United States and Canada.

B. Policies to offset economic recession

The developed countries must take positive measures to avoid letting the deflationary impact of the increase in the price of oil run its course. And, countries must not let fear of balance-of-payments deficits inhibit expansionary economic measures.

If all the developed countries move to expand their domestic economies together, the adverse balance-of-payments impact will be minimized. And, as the largest single economic unit, the United States has a special responsibility not to let itself and the world continue its slide into an economic recession.

C. Balance-of-payments policies

There are two basic ways countries can meet a balance-of-payments deficit. They can finance it. They can adjust to it--encouraging economic changes which will wipe out the deficit.

There are good reasons why financing the deficit is the preferred route for most countries in 1974.

--First, the adjustment required is enormous--of the order of $55 billion, as can be seen in table 3.

--Second, it is clear that all countries will be unable to adjust--that the non-oil importers, as a group, will necessarily run a trade and balance-of-payments deficit. Thus, the attempt of one country--France, for example--to get a balance can succeed only at the expense of another country--the United States or Germany, perhaps.

--Third, currency devaluations or depreciations can only contribute to further inflation and serious social problems in the devaluing country.

The increase in oil prices will throw every major country's balance of payments into deficit. To avoid this having an unhappy psychological effect on policy, oil imports--or at least the increase in the value of oil imports--could be excluded from the normal trade account. This segregation of data would be only cosmetic, but it could clarify thinking about appropriate policy.

Financing: The oil producers will have to lend or invest most of their sharply increased earnings to the rest of the world. There is no alternative. Indeed, much of the increased earnings may well accrue to the United States with the most developed and sophisticated capital market.

The OECD countries can "recycle", or relend, the loans and investments of the oil countries to those in need of such finance. There is ample precedent for this.

Much of this "recycling" will be done by market forces. However, if they prove inadequate, governments, the IMF and national central banks can complete the task.

If the oil producers buy gold or SDRs from central banks and reduce the amount of monetary reserves thereby, the international community can replace these assets by another issue of SDRs.

Adjustment: There will be a temptation for countries to try to adjust their balances of payments rather than borrow to finance their 1974 deficits. Some countries may try to hold or attract reserves in a variety of undesirable ways--by raising interest rates above what would be required for domestic economic reasons, or by enduring deflation and unemployment. If they do, unemployment will be intensified and passed on to other countries.

There will be a temptation for countries to let their currencies float--or sink--or to restrict imports in order to restore their trade surpluses and slow their losses of financial reserves.

But countries must recognize that such actions will not draw funds from the oil producers, but will merely shift reserves from one industrial country to another. The result will be unhappy in both economic and political terms as unemployment is exported to other countries.

Real cooperation among the industrial powers is needed. The countries will have to work out common policies on:

--interest rates specifically and overall economic policies more generally;

--exchange rates--the free market or floating solution could be disasterous in 1974 however useful it was in 1973 and might again become in the future.

The argument for coordinating the monetary and fiscal policies of the major countries is clear and not controversial. This is not true of the proposition on exchange rates.

The argument against letting the market decide on the appropriate exchange rate during this period of great strain on every nation's balance of payments is twofold. First, the market generally exaggerates the influence of new factors. Second, as a result, major and partly unnecessary economic adjustments are forced on countries. These can be quite costly in terms of unemployment and inflation.

Recent events may provide an example. Since the beginning of the oil crisis the effective devaluation of the dollar has been cut in half. This reflects the assessment of the market that the United States will be relatively much less damaged by the rise in oil prices than the other major nations. The result will be to stimulate U.S. imports and to inhibit U.S. exports. Unless countervailing action is taken, this could result in increased unemployment in the United States. In addition, the depreciation of the European currencies and the Japanese yen will contribute to inflation in both areas with resultant social turmoil, and without affording any clear relief to their balances of payments.

D. Less Developed Countries

It is clear that the non-oil producing LDCs face especially difficult times. In order to maintain their recent rate of economic growth they will need at least a doubling of economic aid to finance the balance-of-payments deficit due solely to the increased price of oil.

There are only three ways out of the impasse:

--First, the LDCs will have to restrict imports or reduce domestic demand, if they cannot finance the increased deficit. This means more unemployment, a lower rate of economic growth, if any, at home, and increased deflationary pressure on the developed countries.

--Second, the usual aid donors could double or triple their aid directly or provide a special credit facility in the IMF or World Bank for loans to the LDCs. The oil producers could provide the financing and would ask for guarantees on their investments plus a reasonable rate of return.

This approach has serious drawbacks. The LDCs already have too heavy a burden of indebtedness. Their ability to repay new loans is seriously in doubt. And, such loans would not finance capital improvements which would result in future increases in output, but would merely finance current consumption. Thus, the liklihood is that there would be defaults on the new loans leaving the IMF or World Bank and, consequently, the major developed countries with another burden in addition to the one placed directly on them by the oil producers.

--The third way to meet the LDCs problem is for the oil producers to finance directly the increased balance-of-payments deficits of the LDCs. The oil producers created this special problem, they ought to be prepared to help ease it. They have ample financial resources to help.

V. Another Look at the Numbers

It is most unlikely that the projections for 1974 in this report will actually be realized. There are three basic reasons for this:

--First, it is unlikely that the less developed countries will be able to finance all of the increased cost of imported oil. Thus, their imports will be less--as will their deficit--than the projections in table 3.

--Second, the sharp increase in oil prices is likely to restrict demand. The First National City Bank estimates, roughly, that the 140 percent increase in prices since October will restrain world demand by some 10 percent in 1974. In addition, conservation measures, principally in the United States but elsewhere as well, will also cut demand.

--The drop in the demand for oil will be reflected in a fall in price. This is put at roughly $2 per barrel.

The impact of these factors on the increase in earnings of OPEC countries is summarized in table 4, below.

Table 4.--The Increase in Oil Exports of OPEC Countries, 1974 (billions of dollars)

	From OECD countries	From non-OECD countries	Total
Potential rise in receipts	$50	$10	$60
Fall in demand due to high prices	- 8	- 2	- 10
Assumed $2 price cut in June 1974	- 8	- 2	- 10
Actual increase in receipts	34	6	40
Amount spent on imports	- 8	- 2	- 10
Available for investment	26	4	30

Source: Monthly Economic Letter, February 1974, First National City Bank.

The resultant strain on the world economy and the policy options are not significantly changed by even such a major change in the financial estimates for 1974.

Appendix--Petroleum Exporting Countries: Oil Exports and Revenues

	Exports: Million Barrels a Year: 1972	1973	1974	Revenues: $/Barrel 1972	1973	1974	Total Oil Revenues: Million 1972	1973	1974
Arab Countries with limited absorptive capacity	4,897	5,270	5,125	1.509	2.19	7.32	7,390	11,524	37,516
Saudi Arabia	2,163	2,664	2,600	1.437	2.06	7.00	3,107	5,500	18,200
Kuwait	1,176	1,022	1,000	1.409	2.02	6.90	1,657	2,064	6,900
Abu Dhabi	384	425	425	1.434	2.09	7.15	551	890	3,039
Other Pers. Gulf	361	393	410	1.323	1.96	6.85	477	770	2,808
Libya	813	766	690	1.966	3.00	9.52	1,598	2,300	6,569
Other Arab Countries	815	1,095	1,235	1.700	2.58	7.67	1,386	2,832	9,472
Iraq	382	680	850	1.507	2.50	7.10	576	1,700	6,035
Algeria	373	365	330	1.877	2.74	9.00	700	1,000	2,970
Other	60	50	55	1.833	2.65	8.50	110	132	467
Other Countries	4,377	5,085	5,485	1.587	2.47	7.88	6,945	12,580	43,209
Iran	1,752	2,080	2,280	1.358	2.16	6.95	2,380	4,500	15,846
Nigeria	628	730	850	1.870	2.90	8.80	1,174	2,117	7,480
Other W. Africa	81	93	120	1.870	2.90	8.80	151	270	1,056
Venezuela	1,133	1,168	1,130	1.719	2.57	8.55	1,948	3,000	9,661
Other Latin America	82	110	125	1.719	2.57	8.55	140	383	1,069
Indonesia	330	475	560	1.748	2.53	8.65	577	1,200	4,844
Other Far East	67	79	90	1.748	2.53	8.65	117	200	778
USSR & E. Europe	304	350	330	1.500	2.60	7.50	458	910	2,475
OPEC	9,495	10,768	11,125	1.553	2.32	7.58	14,745	25,041	84,352
World Total	10,089	11,450	11,845	1.558	2.35	7.57	15,721	26,936	89,725

Note: The data for 1972 are actual; for 1973, estimates; and for 1974, projections.

Source: Federal Reserve Board, January 9, 1974.