EFFECT OF PETRODOLLARS ON FINANCIAL MARKETS

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL MARKETS

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

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CONTENTS

IMPACT OF OIL IMPORT PAYMENTS AND RECYCLING OF PETRODOLLARS ON FINANCIAL MARKETS

THURSDAY, JANUARY 30, 1975

U.S. SENATE,
SUBCOMMITTEE ON FINANCIAL MARKETS,
COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 2221, Dirksen Senate Office Building, Senator Lloyd Bentsen (chairman) presiding.

Present: Senators Byrd, Jr., of Virginia, Bentsen, Gravel, Fannin, and Hansen.

Senator BENTSEN. The hearings will come to order.

This morning we are commencing a very important series of hearings concerning the impact of oil import payments and recycling of petrodollars on our economy and on our financial markets.

We are pleased to have as our leadoff witness this morning Hon. William Simon, Secretary of the Treasury.

I might say he is always very cooperative in meeting with the Finance Committee of the Senate and its subcommittees.

Mr. Secretary, we have some conflicting engagements for Senators this morning. However, knowing the limits on your time and the importance of these hearings, we are going to go right ahead.

I must say, Mr. Secretary, that I am concerned about this Nation being able to pay $25 billion a year for imported petroleum and the impact of this cost to our economy. I am even more concerned about the administration's energy tax and tariff proposals which would increase the cost of petroleum an estimated $30 billion to $50 billion this year in an effort to reduce petroleum imports by about 15 percent this year.

I do not know anyone who challenges the idea that we have to have less our reliance on foreign oil. I started 5 years ago making speeches saying that we should not be relying on Middle East oil and that we should develop self-sufficiency. Not many people were listening then.

We have a tendency in this country to go from crisis to crisis and to fail to do any long-term planning. What I am concerned with now is an overreaction. I am concerned about the problem of disruption to our economy. The question is not should we reduce imports, but the question is, how fast should we reduce them, and at what cost.

Mr. Secretary, from what I have seen so far, the benefits which the administration hopes to achieve under its program, I do not believe cover the costs. An immediate reduction in the import of oil by 1 million barrels a day represents only 3 percent of OPEC's daily production. And I don't believe that is going to bring about any great reduction in the price of oil imports.

According to the Treasury Department's estimates, OPEC has already begun to absorb around 8 billion barrels a day in excess capacity without cutting prices. And many of these countries can absorb even more, because they do not have the population base that demands the kind of expenditures that are required in heavily populated countries.

An immediate reduction of oil imports by 1 million barrels a day will reduce the OPEC funds that have to be recycled by about $4 billion a year. Now, that is not very much compared to the $100 billion in oil revenues that the OPEC nations received last year. It leaves us with $96 billion that we have to worry about. We would cut $100 billion by about $4 billion.

Now, the strongest case that I think can be made for the reduction of 1 million barrels a day is reducing our expenditures for imported oil from $25 billion to the $21 billion. But again, I do not think that is a very strong case if it aggravates and continues the present recession. When we have an economy of $1.4 trillion, and we increase our GNP by 5 percent, we are talking about an increase in wealth of $70 billion. But now, with our economic output declining, those payments of $21 billion last year, or $24 billion, or $25 billion, which are figures you use, are coming right out of the present standard of living.

What concerns me is that if we really dampen our recovery from recession and if we really stifle increases in the GNP, aren't we possibly losing more on the one hand than we are gaining on the other hand?

The Congress, the businessman, and the labor leaders that I have talked to say that the administration's energy program will add significantly to inflation, will cost us jobs, and will cost us an increase in our GNP in 1975. I am against that. I am against putting the tariff in effect this weekend, which will begin taking money out of consumer's hands, with no machinery in place for putting that money back into the economy.

In the last quarter this Nation's economy went downhill faster than at any time since we started collecting quarterly data in 1947.

An economic policy must not only be tough, but it has to make sense. We are trying to nurse a very sick economy back to health. I believe it makes sense to reduce our imports somewhat more slowly and certainly in ways that produce less of an impact on inflation.

But I know, Mr. Secretary, you are a very persuasive advocate for your cause. And I am not going to delay you any longer in presenting your point of view. Please go ahead.

[The Committee on Finance press release announcing this hearing follows:]

PRESS RELEASE

FOR IMMEDIATE RELEASE
January 24, 1975

COMMITTEE ON FINANCE
Subcommittee on Financial Markets
UNITED STATES SENATE
2227 Dirksen Senate Office Bldg.

BENTSEN SUBCOMMITTEE HEARINGS TO EXAMINE IMPACT OF OIL IMPORT PAYMENTS AND RECYCLING OF PETRODOLLARS ON FINANCIAL MARKETS

The Honorable Lloyd Bentsen, (D., Texas), Chairman of the Finance Committee's Subcommittee on Financial Markets, today announced that the panel will begin hearings on the impact of oil import payments and petrodollar recycling upon the U. S. economy and upon financial markets at 10:00 A.M. on Thursday, January 30, 1975, in Room 2221 Dirksen Senate Office Building. The leadoff witness will be Treasury Secretary William E. Simon.

Chairman Bentsen stated that it is the Subcommittee's intention to explore the effects of the President's energy program on U. S. financial markets as well as the Treasury Department's plans for international monetary recycling. "At the present time and for the foreseeable future, vast amounts of wealth are being transferred to the oil-producing countries. The implications of this massive transfer are not fully understood, but it is certain that it is having a significant impact upon our economy," Chairman Bentsen stated. "The President has proposed a program to curb our dependence on Middle Eastern oil. This program involves a substantial cost to the economy. These hearings will attempt to examine those costs and the impacts upon broader, related issues: the level of production of the U. S. economy, international financial stability, the drive to make the United States self-sufficient, and the prospects for capital formation."

Requests to testify. -- Senator Bentsen advised that witnesses desiring to testify during this hearing must make their request to testify to Michael Stern, Staff Director, Committee on Finance, 2227 Dirksen Senate Office Building, Washington, D. C. 20510, not later than Friday, January 31, 1975. Witnesses will be notified as soon as possible after this cutoff date as to when they are scheduled to appear.

Written statements. -- Senator Bentsen stated that the Subcommittee would be pleased to receive written testimony from those persons or organizations who wish to submit statements for the record. Five copies of these written statements should be submitted not later than February 6, 1975 to Michael Stern, Staff Director, Senate Committee on Finance, 2227 Dirksen Senate Office Building, Washington, D. C. 20510

PR # 1

STATEMENT OF HON. WILLIAM E. SIMON, SECRETARY OF THE TREASURY

Secretary SIMON. Thank you, Mr. Chairman. It is a pleasure for me to be here today. And I hope I can answer some of these questions you raised today about the President's proposal to deal with the energy problems. I recognize that in the short run some of our proposals might seem to be conflicting and contradictory, but maybe for the first time we should begin to approach our problems looking to the long term. Unfortunately, too often in this country the long term when we set policies in Washington goes as far as the next election. And that is probably what has gotten us in some of the problems we are in today.

We have now entered a second year of inflated oil prices and of dealing with the problems those prices create. The hearings called by this subcommittee provide a welcome opportunity to discuss our experience in this situation and our plans for the future.

With the quadrupling of international oil prices, unprecedented amounts of money have begun flowing into the hands of a few oil-producing countries. We estimate that in 1974 the 13 OPEC countries received about $90 billion from oil exports, or roughly four times the amount they earned in 1973. In addition, their other exports amounted to about $5 billion, bringing their total receipts to $95 billion. During this same period, the OPEC nations spent approximately $35 billion, leaving about $60 billion available for investment abroad. Let me emphasize that these are only estimates, since official data on these transactions is limited.

What happened to this balance of approximately $60 billion? Where did the OPEC countries place this money? Some of the OPEC countries publish very little information on this subject, our answers must be based largely on information compiled by the recipient nations and reports on individual transactions. Recognizing, then, that our fingers are both rough and tentative, let me review our best estimates on what happened to these OPEC funds in 1974:

Some $21 billion, or about 35 percent of the surplus, apparently went into the Eurocurrency market, basically in the form of bank deposits.

Some $11 billion, or 18½ percent, flowed directly into the United States. Available figures suggest that of this amount, roughly $6 billion went into short and longer term U.S. Government securities, while some $4 billion were placed in bank deposits, negotiable certificates of deposit, bankers' acceptances, and other money market paper. As best we can tell, less than $1 billion was invested in property and equities in this country.

Some $7½ billion, or about 12½ percent, is believed to have been invested in pound sterling denominated assets in the United Kingdom, some of it in United Kingdom Government securities, some in bank deposits, some in other money market instruments and some in property and equities. This amount, I should note, is quite apart from the large Eurocurrency deposits there.

Some $5½ billion, or about 9 percent, may have been accounted for by direct lending by OPEC countries to official and quasi-official institutions in developed countries other than the United States and the United Kingdom.

About $3½ billion, or 4 percent, has flowed from the OPEC countries to other developing countries. This includes funds channeled through various OPEC lending institutions such as the Kuwait Fund and the Arab Bank for Africa.

With regard to the remaining 15 percent, we have only limited information, but this residual would cover funds directed to investment management accounts as well as private sector loans and purchases of corporate securities in Europe and Japan. There are, of course, other transactions we simply know nothing about.

It is our view that there are two important points to be drawn from these figures.

First, these surpluses were not somehow withheld by OPEC but were placed somewhere in one of the oil importing countries. Earlier, concern had been expressed that OPEC would somehow cut off the flow of capital to the oil importing world—in the same way that they could cut off the flow of oil. Such concern was based on a misunderstanding. So long as the OPEC countries as a group run large payments surpluses, those surpluses must by definition be matched by an increase in OPEC's financial claims on oil importing countries as a group. In short, recycling must occur between the OPEC and the oil importing world. The only question is how it occurs and to which oil importing countries the money flows.

Second, the OPEC capital flows were rather widely disbursed among markets in the oil importing nations. OPEC funds did not move to one or only a few attractive capital markets, as once was feared. The United States, with the largest capital markets, received directly only $11 billion, or 18½ percent, of the total, an amount substantially less than OPEC's increased receipts from oil sales to the United States. It should be noted that the United States also continued to export large volumes of capital to other areas abroad, and that our net capital imports last year, as measured by our current account deficit, were probably in the range of only $3 billion.

The relatively balanced pattern of OPEC investments last year explains in part why the massive shifts in financial assets did not lead to the financial crises that some envisioned. The world was also well served by the greater flexibility of exchange rates which prevailed. In addition, there were steps to open up financial markets in several countries, moving toward a more integrated world capital market. Another major factor was the worldwide network of private financial institutions which generally responded to a drastically altered situation with skill and flexibility.

Concern about pressures on the banking system was nevertheless widespread, and a few individual institutions in the United States and elsewhere did in fact experience difficulties. But their troubles arose mainly from internal management problems which came to the fore in an environment of inflation, restrictive money policies, and generally rising interest rates, or from their own failure to exercise proper supervision as they rapidly expanded their foreign exchange trading. The difficulties they experienced were not the result of massive inflows of OPEC moneys.

The figures I mentioned earlier, tracing flows of OPEC moneys, suggest that the commercial banking systems of the major industrialized countries probably accepted something approaching half of the $60 billion OPEC surpluses last year, with the Eurocurrency banks alone receiving some $21 billion. They placed these funds in a variety of outlets throughout the world. During the course of the year, the

46-883—75——2

pattern of OPEC investment changed to respond to changing conditions, as banks shifted their policies to induce longer term placements, and as they more frequently played the role of broker rather than lender of deposits. In addition there was increased emphasis on official financing, as OPEC countries began to undertake direct loans to oil importing nations, and as existing official institutions and governments gradually expanded their activities.

No one can say what the precise mix of private and official financing will be this year. It seems clear that existing institutions, public and private, will continue to play the dominant role in redistributing OPEC funds. Banks may not accept as large a portion of the surpluses in 1975. The trend toward government-to-government lending and direct purchases of marketable securities of governments is likely to continue. Disbursements under OPEC commitments of assistance to LDC's should increase. The relatively minor proportion going into corporate securities around the world may also increase somewhat. This complex of channels is likely to meet the need.

Nevertheless, all are agreed that the international community should have in place adequate supplementary facilities to meet major financing problems should they develop. Without assurance that financing will be available on reasonable terms, there is a danger that countries might lapse into restrictive actions which would disrupt the world economy. The risk of nations engaging in these practices and other nations taking retaliatory measures cannot be ignored.

Strengthening Multinational Facilities

It is with these concerns in mind that the United States and other countries have been working to assure that adequate multilateral facilities will be available as needed to supplement existing financial arrangements during the period ahead. Last year the United States put forward a comprehensive series of proposals, involving expanded use of International Monetary Fund resources, establishment of a "safety net" arrangement among the industrial countries of the Organization for Economic Cooperation and Development, and the setting up of a trust fund for the poorest developing countries. Other nations have also put forth proposals.

These various proposals were discussed here in Washington in mid-January at meetings of the Group of Ten, the IMF "Interim Committee," and the IMF/IBRD "Development Committee." I am happy to report that in our meetings there was an encouraging spirit of cooperation and of willingness to compromise and work together toward common goals. As a result, agreement was reached on a package of measures which should be of significant help not only in meeting the immediate challenges in the financial and energy fields, but also in the longer term strengthening of the international monetary system. Let me describe the main points:

Agreement was reached among the major OECD countries that a new solidarity fund, a financial support arrangement along the lines of the U.S. proposal for a $25 billion "safety net," should be established at the earliest possible date. This arrangement is to be available to provide supplementary financing, if the need arises, to participating OECD countries which follow cooperative economic and energy policies. Detailed work on this new arrangement is to be completed in time to permit approval by governments by the end of February 1975.

Agreement was reached among IMF countries that IMF resources would continue to play a role in 1975 to the extent needed. As one expression of this intent, it was agreed that the IMF oil facility should be continued on a limited basis during 1975. Borrowing from oil producers and others for this facility will be limited to about $6 billion—or 5 billion SDR's—less than some countries originally favored. This agreement was preceded by considerable discussion of different methods of using IMF resources. One approach is to use the Fund's resources in effect as collateral for loans as is done for the special oil facility. A second approach is to mobilize the Fund's resources directly for lending. In the end, it was agreed to do both. There will be some new borrowing and also increased direct use of IMF resources to meet the needs of nations in difficulty. Contributions from oil producers and industrial countries to subsidize interest costs of the IMF oil facility for the very poorest countries may also become a feature of the facility in 1975.

Agreement in principle was also reached to increase IMF quotas of member countries by approximately one-third, subject to agreement on a related package of amendments to the IMF articles of agreement. The major oil exporters' collective share of the total IMF quotas will be doubled in order to call for greater participation and a greater voice for these countries in the activities of the International Monetary Fund. Quota increases will be dependent upon the agreement of countries receiving quota increases not to veto use of their currencies when such use is economically justified.

Agreement was also reached on the general lines of a number of other amendments to the IMF articles, with the particulars to be worked out over the months ahead. These amendments are designed to improve the structure of the IMF and bring it more in line with current realities. One amendment supported by the United States will provide that member countries are no longer required to maintain their exchange rates within narrowly fixed margins, but can float their currencies—a practice which is not legally permissible under the IMF articles as now written.

Considerable progress was also made toward narrowing differences with respect to the broader question of gold and its role in the international monetary system. It was agreed in principle that the official price of gold—and hence its central function as "numeraire" of the monetary system—should be abolished and that obligations on the part of members to pay the IMF in gold, and on the part of IMF to receive gold, should be ended. Progress was also made toward replacing the existing prohibition against members of the IMF buying gold in the private market with safeguards assuring that this freedom would not be used to return gold to the center of the monetary system.

Our aim is to arrive at workable arrangements which will take gold out of the center of the international monetary system, while also allowing countries greater freedom to utilize their gold holdings. It is my hope that the entire package of quota provisions and amendments, including those relating to gold, will be ready for approval at the Interim Committee meetings scheduled for this June.

Less progress was made at these meetings than had been hoped in organizing assistance for developing countries, some of which face very serious difficulties. As I mentioned earlier, there was some support for measures to subsidize interest rates for loans to these countries from the IMF oil facility. The U.S. proposal for a new facility—a trust fund managed by the IMF which would channel funds to the poorest of the developing nations on concessional terms—remains under study. It continues to be our hope that appropriate arrangements can be devised, and that OPEC nations will provide an appropriate part of the contributions to this effort.

"Real" Versus "Financial" Aspects of Oil Prices

Mr. Chairman, in thinking about high oil prices, I find it useful to distinguish between the "financial" and the "real" aspects of the problem posed for oil importing countries. The "financial" aspects are concerned with assuring that nations can one way or another—usually by borrowing—obtain adequate amounts of money on reasonable terms to meet oil bills. The "real" aspects concern the costs for those nations of transferring a growing volume of economic resources to the OPEC nations on a continuing basis and the danger posed for their economic security by the threat of further supply disruptions. If I may be permitted an analogy, suppose that a landlord tells a tenant that he is tripling the rent but, to make sure that the tenant can make the payments, he will lend him the necessary money. The tenant may have his financing problem solved but he nevertheless faces very real economic problems. For nations, the problem is not so much that they cannot make financial arrangements to cover higher oil costs as it is that they cannot afford them.

I do not want to underestimate the financial problems generated by inflated oil prices. They are very important, but I think that last year's experience, and the agreements concluded earlier this month, provide grounds for believing they are manageable.

There is growing consensus among economic forecasters that the financial accumulations of the oil producers will not reach some of the huge figures predicted last year. Some of these initial projections of accumulations ranged as high as over a trillion dollars by 1985. These predictions, however, tended to underestimate substantially both the responsiveness of oil supply and demand to high oil prices over the long run and the capacity of the oil exporting countries to accelerate their imports of goods and services. Recent projections of OPEC financial accumulations through 1985 have been on the order of $200 to $300 billion, as measured in 1974 dollars. They also suggest that by the late 1970's or early 1980's the process of accumulation will have been substantially completed, and that the oil exporters collectively will begin to run a current account deficit. Indeed, one private projection suggested recently that this would occur by 1978.

The substantial reduction in projections of OPEC financial accumulations supports the view that the international financial aspects of the oil situation are manageable. They do not suggest, however, that the "real" aspects of the oil problem can be ignored. In my view, it is these real aspects which are of critical importance.

The real economic costs of the oil situation are not eliminated because over time our oil imports will be fully paid for by increased exports of real goods and services rather than capital imports. Nations cannot be expected to accept the prospect of swollen, unending transfers of real resources to the OPEC countries, at the cost of lower standards of living at home. Perhaps most fundamentally, the oil consuming countries will not find it acceptable to see their economic security indefinitely imperiled by the threat of supply interruption.

THE PRESIDENT'S ENERGY PROPOSAL

We must concentrate our efforts on dealing with the real aspects of the oil problem. This requires the achievement of a new energy balance, which can be attained only by forceful domestic and international programs.

Domestically, President Ford has proposed a comprehensive program to increase our energy independence which is essential if we are to regain control over our own economic destiny. Our experiences with the embargo and with the quadrupling of international oil prices are convincing evidence that we cannot continue to place such heavy reliance on foreign energy sources. The President's energy program is therefore designed to reduce our vulnerability by curtailing consumption and encouraging the development of alternative energy sources.

Let me discuss for a moment the impact of these proposals on energy conservation. It is clear that an increase in the relative price of oil will reduce its consumption. Although some laymen seem skeptical on that point, economists are certain. For every percentage change in the price of a product, there is a percentage change in the demand for it, and the ratio of the two percentages is referred to as the "elasticity of demand."

We know from economists' studies and from the experience of the last year that there is substantial price elasticity in the demand for petroleum. The price increases which occurred last year caused the consumption of petroleum to be substantially less than it otherwise would have been. During the decade prior to 1974, total U.S. petroleum demand increased at an annual rate of just over 5 percent. But from April to September 1974, when petroleum prices were substantially higher, petroleum demand was under the comparable 1973 period by 2.7 percent. Thus, in that period of increased prices, consumption was reduced 7.7 percentage points below expectations.

Similar results have occurred in other countries. Thus, yesterday's Wall Street Journal reports:

> Britain, West Germany and a majority of countries depend upon rising prices to encourage cuts in energy use. The Petroleum Economist, an oil weekly published in London, estimates that in the first half of last year, fuel consumption dropped from a year earlier by 14 percent in West Germany, 9 percent in Britain, and 6 percent in France * * *

I think they are a bit low on France.

The elasticities should be even higher in the longer term after households and business firms have had time and opportunity to react fully to higher prices by making energy-saving investments, substituting products and materials which require less energy and otherwise changing their habits and ways of doing business.

Thus, we have every confidence that the President's energy program will cause the desired reduction in consumption.

Mr. Chairman, I know that some members of this subcommittee have also asked about the impact of the President's energy proposals on economic activity during the coming year and, specifically, whether they would have a depressing effect on the economy. Let me address this question, although I want to emphasize that it is an extremely difficult issue, and a high degree of uncertainty necessarily surrounds the answer.

And at this point, Mr. Chairman and gentlemen, I would like to apologize for not having copies of my testimony. There seem to be so many testimonies these days, we are cranking the machine night and day. They are on the way up.

But I have a table that I would like you to take a look at when they arrive that will illustrate what I am about to talk about.

[The table referred to follows:]

DIRECT BUDGET IMPACT OF THE PRESIDENT'S ECONOMIC AND ENERGY PROPOSALS

[In billions of dollars]

	Calendar year— 1975 I	1975 II	1975 III	1975 IV	1976 I	1976 II	1976 III	1976 IV
Energy taxes	+0.2	+4.1	+12.6	+7.6	+7.6	+7.5	+7.5	+7.5
Return of energy tax revenues to economy:								
Tax reduction	0	−3.2	−9.0	−9.0	−5.6	−7.9	−6.3	−6.4
Nontaxpayers			−2.0				−2.0	
S. & L. governments	0	−.5	−.5	−.5	−.5	−.5	−.5	−.5
Federal Government	0	0	−.8	−.7	−.8	−.7	−.8	−.7
Temporary tax cut	0	−6.1	−7.9	−.6	−.8	−.9	0	0
Net effect	+.2	−5.7	−7.6	−3.2	−.1	−2.5	−2.1	−.1

Mr. SIMON. The President's energy proposals were designed to provide the incentive for energy conservation without having an adverse impact on the economy as a whole. The energy taxes—including the excise taxes on crude oil and natural gas, the increased import fees, and the windfall profits tax—will raise the energy bills of U.S. consumers by some $30 billion annually. On the other hand, however, the income tax reductions and related proposals will return that same $30 billion annually to the economy. The net budget impact of these energy proposals include the $16 billion antirecession tax cut, which means that the overall effect of the President's economic and energy total program on the economy will be stimulative.

A closely related question that has been raised concerns the timing of the various proposals—the energy tax increases, the offsetting income tax reductions, and the $16 billion temporary tax cut. We examined this matter carefully. The pattern of these changes in terms of their direct budget impact, quarter by quarter, is shown in table 1, attached. In the first quarter of 1975, the increase in import fees should take $200 million out of the system, an insignificant amount in a $1,500 billion economy. Thereafter, the program as a whole would provide stimulus to the economy in every quarter of this year and next, appropriately concentrated in the second and third quarters of 1975.

In addition to the budget flows shown in the table, both the extent and the timing of the economic stimulus or restraint of each of the various measures will depend on such factors as the indirect effects of the budget changes, the timing of the passthrough of higher energy costs to final users, the extent to which the changes are anticipated, and a variety of monetary and financial developments that arise out of these changes. On balance, we believe that the timing of these proposals will have no significant adverse effects on the economy as a whole.

Federal Deficits and the Private Capital Markets

In conclusion, Mr. Chairman, I would like to address a separate but related matter: The issue of the huge Federal deficits that are now anticipated for the current and coming fiscal years, and the impact of those deficits on the private capital markets. As you know, our projections now show that the Federal deficit for fiscal year 1975 is likely to be close to $35 billion and in fiscal year 1976 promises to be about $50 billion. These deficits result from a combination of factors: Increased spending required by programs enacted in prior years, declining revenue estimates and higher unemployment benefits as a result of the recession, and the proposed tax cut to help us support economic recovery.

There is, of course, a dispute as to whether the anticipated deficits will strain our private financial markets. Many economists do not anticipate a problem because in past recessionary periods, private credit demands have fallen off at the same time that the Federal Reserve System moved to maintain or increase the rate of growth in money and credit.

The current recession, however, may be somewhat different. Current borrowing demands by the private sector are relatively heavy, especially for this period in the recessionary cycle. In large part, this is because inflation has seriously eroded the liquidity base of both households and business, with the result that large amounts of credit are necessary in the private sector just to sustain existing levels of private economic activity. Moreover, with a depressed stock market, new equity financing has not been feasible for many firms, and this has created an unusually large demand for long-term debt financing. Furthermore, because of the high cost of financing oil consumption, external financing needs of many businesses have remained large.

Our latest projection is that new corporate bond issues, which grew from $12½ billion in 1973 to an estimated $25 billion in 1974, will increase even further to $30 billion or more in 1975. And I want to add at this point that I took the middle-range conservative estimate on long-term corporate debt financing this year. There are many active investment banking firms that estimate the increase at at least 36 billion in 1975, an extraordinary amount during a recessionary period, which amply demonstrates the illiquidity of financing and nonfinancing institutions in our economy today. And the increase was in the context of interest rates which were already high. In addition, despite some slackening from 1974, we expect that the demand for short-term business credit will still be one of the highest yearly totals on record.

In order to meet Federal borrowing needs, we now anticipate that during calendar year 1975, the Treasury Department will be coming into the capital markets for almost $70 billion of net new financing, of which about $65 billion will be in the form of new marketable securities. And it is also very interesting to me that economists traditionally use the net concept, and this silly assumption—and I think it is silly, having worked in the marketplace for many years—ignores what the gross financing is. Now, they are making the assumption that if we have $5 billion of maturing issues which we must roll over, that this $5 billion is going to automatically catch the same buyers and investors in the same net that we had before. Unfortunately, this is not correct, and the market must cope with gross financing, not net. And to assuage my friends in the economic fraternity, I will adhere to the net numbers, although I wish to pose this very clear danger. On top of this immense total, federally sponsored agencies—FNMA, Federal Home Loan Banks, the Farm Credit Agencies, and others—may account for another $10 billion in borrowing. As a result, the Federal Government will be raising more net new money in the capital markets than was raised by all borrowers combined—public and private—last year, or in any other year in the past.

I believe this amount of borrowing poses potentially large risks.

I have been quoted in recent days—constantly quoted—as saying things that I have never said. But that is all right; that is part of the hazards. I am posing potential dangers, because I think I am laying out a reasonable scenario, but you must recognize that these may not occur. And I go on to explain things which could mitigate part of these problems.

The strains could be relieved if the recession becomes deeper than we expect, if inflation subsides more rapidly than we anticipate, if the OPEC nations put a larger amount of their accumulated funds into investment in this country, or if the American public spends less and saves more. We cannot, however, be sure that any of these events will occur and it would be foolish to base our assumptions upon their occurence. It is therefore imperative that we not enact vast new spending programs that could create excessive strains in the capital markets.

And you know these very large numbers—and that is a moderate statement by me—suggest that the $3 billion in recisions that the President sent up in November and the additional $17 billion which the President is requesting in the current budget, are going to be enacted. And if they are not enacted by the Congress, then you can add another $20 billion on these already swollen numbers.

It also, Mr. Chairman, makes what some people think is a silly assumption, that the Government is not going to spend any money over the next 17 months in any way, shape, or form, for other than energy proposals, which would, of course, add another demand.

If excessive strains do develop, it is likely that housing—which despite massive Federal assistance programs—is always at the end of the line in credit markets—will not recover to the extent that all would hope. In addition, marginal businesses, especially small businesses, would be cut off from the supply of credit. Neither this prospect—nor the alternative of an excessively easy monetary policy with the threat of even more rapid inflation in the future—is tolerable.

I stress, therefore, the fundamental importance of adhering to a tough budgetary policy in order to restrain the momentous growth in

Federal outlays and also of enacting an energy plan which will reduce the financing burden of oil imports not only on ourselves but on all consuming countries.

Mr. Chairman, I believe that prompt enactment of the President's program is vital for our own economic health and that of the world economy at large. Let me stress that the rest of the world is looking to the United States to proceed with a realistic and effective program. The success of the financial and energy initiatives we have launched to move oil-importing countries collectively toward a new and viable energy balance will depend heavily on our own efforts here at home. We cannot expect to obtain optimum cooperation from others unless we ourselves also take effective action.

Thank you.

Senator BENTSEN. Thank you very much Mr. Secretary. Because I know the limitations on your time, we will limit the questioning to 10 minutes per member.

Mr. Secretary, last summer I was saying that we were in a recession, and we were heading into a more serious one. I could not get anyone in the administration to admit to that until after the election. I look at consumer confidence and I think a lot of economic criteria are not going to be applicable. But I am deeply concerned about the depth of the recession that we are going into. And I look at a situation where the OPEC countries have increased the price of petroleum by 400 percent, and how disruptive it was to our economy and the economy of the world. Should not that sick patient have a chance to recover from that?

I do not question that we have to reduce the imports. But it seems to me that there are economic tradeoffs. If you reduce imports with the impact that you are talking about, you are going to substantially increase inflation, add to interest costs, dampen the recovery from the recession, and hurt our GNP. In the tradeoff, you are going to get a net negative.

If this is the approach, then it should be one of a gradual approach that is taking place over 1, 2, or 3 years. You cited some numbers and some estimates, and I suppose part of that is from the Morgan Guaranty study, saying that in 5 or 6 years we are going to be able to handle the cost of the imports of oil insofar as our balance of trade or balance of payments. And I think that is probably true. But I am very concerned about an overaction here on the part of the administration by trying to increase the cost of petroleum that fast in so short a period of time. Will you address yourself to that?

Secretary SIMON. We talked a great deal about this in our deliberations with the President before his policy was put forward, Mr. Chairman. And we do not believe that this is an overreaction.

Now, as far as our economy is concerned, let me address myself to that for a second. First, about your remark about the elections. Elections have never inhibited my comments. And I testify lots up here, and my comments all during that period were, well, when the official entity puts its stamp of approval on the recession or no recession, the Bureau of Economic Research, which is accepted by anyone as the official body to do this, it was my judgment—and Alan Greenspan said the same thing—that this would probably be a recession. But that does not mean, whether it is a recession or not a recession, that we did not know what the current statement of the economy was at that time, and that we were guiding it between problems of inflation and recession, coupled with, obviously, our energy policy. Therefore, we had to design policies which did not focus on one at the expense of the other, and also would not focus on one and make the other one worse.

No one could foresee the decline in consumer confidence—the confidence level of the American people—that occurred in the late fall and early winter. The confidence level has really been declining for about 10 years in this country—for a number of reasons—going back through the Vietnam war, and student riots, and all the economic problems we have had stemming back through 1966. And I guess everyone would agree that the culmination, of course, was——

Senator BENTSEN. The great acceleration in the last 6 months?

Secretary SIMON. That is correct. And double-digit inflation has frightened and confused many people. They have lost confidence in their government's ability to manage their economy. I agree with that, Mr. Chairman.

And then of course the recession and the rise of unemployment pushed it over the brink.

I think that if we are to be concerned we had better be concerned about overreacting for a prolonged period of time as far as the recession we have in our country, which will bring back inflation even more severely than we had it before, creating even greater unemployment and a greater business downturn than this last inflation did.

And that is where your real economy still remains. And that is the difficult in coping with this.

Senator BENTSEN. Let me ask you this. In studying this, because you say it was a concern—and I am sure it must have been, it had to be—how did you arrive at a figure of 1 million barrels a day for this year, and then 2 million?

Secretary SIMON. That is through 1977, Mr. Chairman, the 2 million barrels a day.

Senator BENTSEN. Through 1977.

Secretary SIMON. We did the economic analysis on how much can be saved, which could be defined as fat in our system, versus biting into the muscle. And we believe that we could achieve a million barrels a day reduction without severe—or even less than severe—impact, and that we could reasonably save that amount out of just normal conservation by the American people, and by industry. And of course industry is of prime importance.

Senator BENTSEN. So substantial studies were made prior to the decision on the 1 million barrels and the 2 million barrels.

Secretary SIMON. You say substantial. I would not use the term "substantial." Lots of work was done on it; yes. And you know that any time people do economic analysis you are going to have lots of economists that use different assumptions and work from different bases, and they are going to come out with obviously different answers. And that is where the debate will range in the future.

But still in all, our projection—and that is the most important thing—is as shown in this chart: a net plus in the second, third, and fourth quarters of this year as far as stimulus of the economy is concerned, and all through next year, if enacted in this balanced way.

Senator BENTSEN. Let me ask you about your $25 billion safety net that you and Dr. Kissinger are interested in. I understand the principle of it. But, I would appreciate your touching on some of the details of it. I am concerned, as I understand it, that we, in effect, would be the endorser of some of these obligations, or the guarantor of some of these obligations for imports for weaker industrialized nations—Italy, for example. And I am concerned about the increased liability that this country would be taking on. And I know Chancellor Schmidt in Germany was concerned about the same thing, because we were talking about a substantial share of that obligation for Germany. Would you touch on that, please.

Secretary SIMON. Yes, Mr. Chairman.

Our proposal—and it is consistent with what I have talked about here—recognizes that the real costs are the quadrupling of oil prices rather than the financial aspects of it. All the facilities that have been suggested and designed have dealth with what we consider the narrow financial aspect of recycling—recycling to those countries that would not receive these funds in the normal market process in time—as well as the trust fund concept, as well as subsidation for the lesser developed countries and the more seriously affected nations. This was an attempt to link our economic, financial, and energy policies together to create a facility which would perform recycling, and be a safety net—a lender of last resort—which would give confidence to the countries that wished to join this facility in the OECD. They would have a lender of last resort if private market and other mechanisms were not available or had been exhausted. The purpose, of course, is obviously to conserve.

Now, we purposely did not put forth many of the specifics of this proposal, because we do not wish to impose our will. There are options. Do we want the contributions to be made directly, on call, to a specific need, or do we want guarantees? How should it be financed? We have clearly said that what we wish to do is work with the Congress and discuss indeed our percentage, which we envision would be somewhere in the area of 25 to 30 percent. But it has not yet been set.

Senator BENTSEN. Mr. Secretary, we want very much to be a part of that decision. We do not want it brought to us after the fact.

Secretary SIMON. No, sir, that was never our intention. And we made extensive Hill calls on the proposal before it became public, Mr. Chairman, and have testified several times before any specifics come up. And we will be——

Senator BENTSEN. Along that line, was not this million barrel figure perhaps even more a diplomatic number than it was an economic number?

Secretary SIMON. Obviously there are foreign policy aspects to energy and economy today. It is inextricably interrelated. So, sure, there are foreign policy considerations that have to be taken into account. You mentioned correctly that there are about 8½ million barrels a day of glut in production in the world. And you correctly say that a million barrels a day does not seem like much and what does that mean? It will put pressure on oil prices.

Secretary SIMON. We will recognize first the OPEC nations' internal demand for funds. On my trip over there last July, when I studied the budgets in Saudi Arabia, when I heard it said that it would be more questionable as to their ability to absorb these funds and spend them productively in their country. I really exploded. I do not think there is any question about the ability of rich men to spend money.

Senator BENTSEN. Let me ask you this one. You made a statement that the President's proposals would result in a net stimulus to our economy. However, you estimated that you were increasing the cost of petroleum and the products related to it in this country by some $30 billion. And yet we have Library of Congress figures making an estimate of $50 billion. Now, if the $50 billion is right—and I frankly do not know which of you is right in this instance—but if the $50 billion is right, then you are talking about a negative impact on the economy.

Secretary SIMON. It is measured popularly by the consumer price index. And all of these indexes are necessarily imprecise, because they are based on incomplete data. The CPI by our indications, shows that the maximum impact is going to be 2 percent. That is a one-time impact. Others have done studies that say that the impact is going to be around 4 percent, or 3½ percent. Everybody has a different result, because they work on somewhat different assumptions. But none of these recognize the fact that we are returning to the economy the amount that we are extracting. We are making petroleum more expensive, because if it is made more expensive, people are going to conserve, and they will have more money to be spent on other goods and services in this economy. And I can make the case that there is a plus as far as the energy tax proposal alone, forgetting the $16-billion proposal, because the windfall profit tax, which is taken from a relatively small sector in our economy, the producer sector, is taken from them and redistributed to the entire economy.

Senator BENTSEN. My time has expired, Mr. Secretary. But we will discuss this some more this weekend.

Secretary SIMON. Yes; we will.

Maybe you should subtract my answers from the time of your questions. I probably talk too much.

Senator BENTSEN. No.

I would like to defer to Senator Fannin here.

Senator FANNIN. Thank you, Mr. Chairman.

Mr. Secretary, in your prepared statement you state: "The net budget impact of these proposals is, therefore, zero." In addition, the President's proposal includes the $16 billion antirecession tax cuts, which means that the overall effect of the President's economy and energy total program on the economy will be stimulated.

I think you have made it very clear that this is absolutely dependent on the import fees, is that correct?

Secretary SIMON. Yes; of course it is. That is the only thing that the President has in his power to do immediately. And he felt the time for action in the energy area, after all the dialog in the last several years, was now.

Senator FANNIN. Taking for granted that you are correct—and I certainly do agree with you—you say that elasticity of demand from the pricing mechanism is a very important factor, and it has been proven that it is a very important factor. And you have referred to certain other countries of the world. On that basis, then, we would have the tremendous increase that we have had in imports if that is brought about. Don't you think that, with the flooding of the imports that has come about, that we face a catastrophe if it is continued?

And first, let me just say that the figures I have—and this is from the U.S. Bureau of Mines and the U.S. Bureau of the Census Report—that the imports of materials, raw and processed minerals, were $19 billion in 1973, and jumped to $42 billion in 1974. As I have said, would not that be a catastrophe if it continued?

Secretary SIMON. There is no doubt about that, Senator Fannin. We paid a little over $27 billion last year for petroleum and products imports alone. That is up from $8.3 billion in 1974, and about $3 billion in 1970. And there is a presumption of small growth in our petroleum demand, of course, whether the incremental barrels come from the Middle East or elsewhere. And our estimates are that it will be over $28 billion in 1975, and on up.

Senator FANNIN. So this is the reason the President just felt compelled to take this step, which has gotten the attention of the Congress, as well as the attention of industry and the American people.

Secretary SIMON. The world, Senator, talks about leadership, and we talk a great deal about leadership in this country. And some people have the mistaken belief that the definition of leadership is popularity as well, that everyone will embrace what you do. And sometimes there are tough decisions. And if the United States is to be a leader in this world, as we believe that we certainly should be, we have to take a tough positive action. And I have had so many of my counterpart finance ministers from around the world puzzle with me for the past year as to why we were not taking the tough actions that were required. They decried the counterproductive use of rationing and allocation and other bureaucratic measures which, while indeed they can achieve some conservation, have the other disadvantages that we have talked about so long, and do nothing to bring on the additional supply that the United States can bring on. Just look at every country in this world. Gasoline ranges from $1.50 to $2.25 a gallon. Here in the United States our gasoline today is about 53 cents a gallon, up from 37 cents. And what a furor that created. Well, look, what happened? In Europe everybody drives small automobiles. The cars get 20 to 30 miles to a gallon. And that is illustrated in their refinery production of gasoline. Here in the United States about 42 to 48 percent, depending on the time of the year, is produced as gasoline. In Europe it is under 20 percent.

Senator FANNIN. You certainly have a valid argument, that the pricing mechanism has been successful——

Secretary SIMON. The President thought it was fair to do it all the way across the barrel, because with heating oil and residual, we can achieve significant savings in all products.

Senator FANNIN. Mr. Secretary, you commented on the IMF activities. The President has recommended that the International Monetary Fund make more funds available to countries with balance-of-payments problems caused by the high prices of oil. Is it true that the OPEC countries bear very little of the risks of IMF recycling of petro dollars?

Secretary SIMON. The which countries?

Senator FANNIN. The OPEC countries—at the present time they are bearing very little of the recycling?

Secretary SIMON. It is growing, yes, Senator Fannin. They recognize their responsibility, that they must have some share in the risk in this, especially with the most seriously affected nations, they contribute a significant amount. Kuwait increased their funds for Arab economic development from $680 million to $3.4 billion, and so they are dedicating an increasing amount of money as each month goes by to direct assistance.

Senator FANNIN. In the conference now scheduled for the OPEC countries and the consuming countries, do you expect this would be one item of consideration at that conference?

Secretary SIMON. Well, sir, it has not been scheduled yet. The consuming nations are developing an agenda for the future meeting between the producers and consumers, and it most certainly will be on the agenda, yes.

Senator FANNIN. Mr. Secretary, this is vital to both the OPEC countries as well as the consuming countries, is it not?

Secretary SIMON. It certainly is, sir.

Senator FANNIN. Mr. Secretary, do you feel the countries which form collusive cartels that withhold supply—or charge an outrageous price for providing raw materials—should be given tariff preference in the United States? I know this is a touchy subject. And I realize the position that you are in, in this respect, and perhaps you would just rather not comment on that.

Secretary SIMON. That has foreign policy implications, and basically we quite often have to look at that on a case-by-case basis.

Senator FANNIN. I realize the position you are in. And I certainly accept your answer as being sufficient under the circumstances.

Mr. Secretary, recently there have been stories in the press that the President has formulated new policies to encourage foreign investment in the United States. Could we just have a little preview of these plans. How do you address the foreign domination of our industries? And there is growing concern in the Congress that the present system is inadequate for the monitoring of petroleum investments of this magnitude. And I think the chairman has been quite involved in this matter. And I just wonder if you could comment.

Secretary SIMON. Yes, Senator Fannin.

We are doing two things. One, we are conducting a study that was ordered by Congress—legislation was passed. The Treasury and Commerce Departments are conducting studies on the overall foreign investment in the United States, which will be presented to the Congress.

No. 2, in the short run, realizing that this comprehensive study will not be done for a year, we have embarked on a study which will be ready in a short period of time, which will address some of the immediate concerns that some people have.

We basically favor a free and open trading and investment world. So let's start with that philosophy. We wish to encourage investment. At the same time, we must make sure that we have adequate safeguards in this country to protect our national security. There are many Defense Department regulations—the Antitrust, the Securities and Exchange Commission, the Trading with the Enemy Act—we have a whole raft of safeguards. The definition of this whole area of national security has, I think, as I have said quite often, been broadened in recent years: Where a few years ago it could be deemed just mainly military, today we have to look at economic and financial also. And this is what we are addressing ourselves to.

Senator FANNIN. Thank you, Mr. Secretary. Thank you, Mr. Chairman. And thank you, Senator Byrd, for permitting me to proceed.

Senator BENTSEN. Senator Byrd.

Senator BYRD. Thank you, Mr. Chairman.

Mr. Secretary, what means does the Government have to determine whether OPEC countries are buying control in publicly owned U.S. companies.

Secretary SIMON. There are Securities and Exchange Commission requirements which are made public.

Senator BYRD. But does that get to the heart of the question? What about buying in names of nominees and other devices?

Secretary SIMON. It is entirely possible, of course, that they can go through hidden nominees and buy it from a foreign bank and so forth. And this is exactly the type of thing that we are looking at. Whether anything needs tightening up.

I want to say one thing in this regard. In my conversations with the OPEC leaders, I have found that they are very conservative investment people. Some countries like Kuwait have been in this trading and investment business for many, many years, long before the United States was discovered. And they had no desire to come over and buy the large corporations in the United States. And prior to making investments on a preliminary basis, being the very conservative people that they are, they have contacted us, and I believe will continue to contact us, asking, is this something that would be objected to. They are very well aware of the dialog that occurs right here in this room. And before any investment would be taken that is questionable, we would certainly come to the Congress and have these discussions.

But what we are trying to do is develop these safeguards and have a reporting system that will not discourage investment, because we think that is counterproductive, and indeed we should encourage productivity in the United States, but not at the expense of our national security, broadly defined.

Senator BYRD. What I am getting at, though, is, as I understand it, there is no sure way today to be really certain just how much they are buying into our publicly owned companies.

Senator BENTSEN. You do have that 5-percent disclosure provision, do you not? Once they accrue over 5 percent in a publicly owned corporation, the SEC——

Secretary SIMON. The SEC has very specific provisions. But this is why I hesitate. Whether it covers the nominee that Senator Byrd brings up when you buy it through a Swiss bank account, et cetera, or not, I question whether that would be part of it.

Senator BYRD. To what extent if any are the OPEC countries buying U.S. bonds?

Secretary SIMON. They purchased last year, approximately $6 billion worth. We have, for obvious reasons, not specified the country or the amount or the maturities, but we continue to sell them securities, and not only U.S. Government securities, but indeed some intermediated securities, and hopefully longer dated ones this year.

Senator BYRD. At what sort of interest rates?

Secretary SIMON. We sell them at the same interest rates that every other investor pays in this country and outside. They receive no safeguards for inflation or indexing or any other consideration. Our securities market is the most liquid and most secure in the world from a credit point of view. And this is a sufficient attraction.

Senator BYRD. Do you expect the investment in U.S. bonds to increase by the OPEC countries?

Secretary SIMON. Yes; I do, Senator Byrd. But it is difficult to tell to what extent it will, because their internal demands are growing quite dramatically, the internal demands for goods and services, as they go about industrializing and diversifying their economy.

Senator BYRD. Senator Bentsen mentioned the $25 billion funds that Secretary Kissinger suggested. And you indicated, as I recall, that the U.S. share is expected to be 25 to 30 percent. What percent do you envision for the other major companies? Take Western Germany and Japan and England.

Secretary SIMON. That is one of the specifics that we did not put forward. That will be negotiated in the group, and it is expected that Western Germany will have a significant share.

Senator BYRD. But it is envisioned that the U.S. share would not exceed 30 percent, and probably would be more like 25 percent.

Secretary SIMON. Yes.

Senator BYRD. You mentioned the net borrowing of the Federal Government for the current calendar year at $85 billion, is it?

Secretary SIMON. I had it in a table here, Senator Byrd.

Senator BYRD. I could not find the table in your statement.

Secretary SIMON. I just mentioned that in my statement. The net financing would be approximately $70 billion. I do not have the table in front of me. It is $65 billion in the form of new marketable Treasury securities plus $5 billion nonmarketable Treasury securities. In addition, the sponsored agencies may account for another $10 billion in borrowing.

Senator BYRD. $70 billion plus $10 billion?

Secretary SIMON. $70 billion and $10 billion, Senator Byrd.

Senator BYRD. That is the net figure. You emphasize the importance of the gross figure. So what would the gross figure be?

Secretary SIMON. Approximately $93 billion of marketable Treasury securities, Senator Byrd.

I will submit this for the record. I will put all these charts in the record.

Senator BYRD. That will be helpful. Thank you.

Secretary SIMON. Including the chart that shows the percentage of Federal securities as a percent of the total securities in our capital market. And that goes back to 1954, and shows the increase of the Federal Government participation in our capital market.

Senator BYRD. That would be a very interesting and significant table. Thank you.

[The tables referred to follow:]

TREASURY MONEY MARKET BORROWING (INCLUDING FOREIGN NONMARKETABLE SECURITIES)

[In billions of dollars]

Calendar year	1st half				2d half				Full year			
	Gross new issues [1]	Maturities [2]	Net new money	Peak increase in borrowing	Gross new issues [1]	Maturities [2]	Net new money	Peak increase in borrowing	Gross new issues [1]	Maturities [2]	Net new money	Peak increase in borrowing
1970	$22.5	$24.1	−$1.5	$4.2	$31.5	$15.2	$16.3	$16.6	$54.0	$39.3	$14.8	$15.1
1971	27.7	23.9	3.9	4.3	36.6	14.6	22.0	22.0	64.3	38.5	25.9	25.9
1972	12.6	15.2	−2.5	7.0	21.3	7.3	14.0	15.5	33.9	22.5	11.5	13.0
1973	16.9	15.8	1.1	9.6	20.2	15.1	5.1	5.1	37.1	30.9	6.2	6.2
1974	16.8	21.8	−5.0	3.9	32.5	17.8	14.7	14.7	49.3	39.6	9.7	9.7
1975	45.0	17.0	28.0	31.0	48.0	11.0	37.0	37.0	93.0	27.0	65.0	65.0
1976	49.0	23.0	24.0	28.0								

[1] Includes increases in regular bills. [2] Includes paydowns in regular bills.

NET FUNDS RAISED IN THE CAPITAL MARKETS BY MAJOR SECTOR

[Fiscal years, billions of dollars]

	U.S. Treasury and Financing Bank	Federal and sponsored agencies	Total Federal sector	State and local	Corporate and foreign [1]	Total securities	Federal sector as a percent of total securities	Government sector as percent of total securities [2]
1954	3.6	1.7	5.3	5.5	3.4	14.2	37.4	76.0
1955	1.7	-.1	1.7	5.4	2.6	9.7	17.4	73.1
1956	-4.3	.6	-3.7	4.6	3.3	4.1		21.0
1957	-3.6	.9	-2.7	4.0	5.7	7.0		18.6
1958	6.3	.8	7.1	5.1	6.9	19.2	37.1	63.9
1959	8.0	1.4	9.3	5.7	4.7	19.7	47.5	76.4
1960	.8	2.0	2.8	5.7	3.5	12.1	23.5	70.7
1961	2.0	.1	2.1	4.9	5.0	12.0	17.7	58.5
1962	8.8	2.4	11.2	6.0	5.5	22.7	49.4	75.6
1963	6.4	1.1	7.6	5.5	5.5	18.6	40.7	70.3
1964	2.7	1.5	4.2	5.2	3.8	13.2	31.8	71.4
1965	3.1	2.2	5.4	6.9	5.2	17.5	30.8	70.4
1966	-1.0	6.7	5.7	7.3	9.2	22.2	25.8	58.9
1967	.6	2.6	3.3	6.0	12.2	21.5	15.2	43.3
1968	18.2	5.5	23.8	7.2	15.1	46.1	51.6	67.3
1969	-1.9	5.7	3.8	12.0	14.7	30.5	12.4	51.8
1970	6.8	8.1	14.9	9.7	14.8	39.4	37.9	62.4
1971	20.5	2.7	23.2	15.0	23.0	61.3	37.9	62.4
1972	19.6	8.7	28.2	15.6	15.8	59.7	47.2	73.5
1973	18.5	14.3	32.8	12.6	10.5	55.9	58.6	81.2
1974	2.1	21.3	23.3	16.7	15.6	55.6	41.9	72.0
1975e [3]	43.8	10.9	54.7	12.6	26.3	93.6	58.4	71.9
1976e [3]	61.6	12.2	73.8	14.6	22.7	111.1	66.4	79.6

[1] Bonds issued by nonfinancial corporations.
[2] Includes State and local as part of government sector.
[3] Assumes adoption of President's State of the Union program, with budget deficits of $35,000,000,000 in fiscal year 1975 and $50,000,000,000 in fiscal year 1976.

Source: Fiscal year 1954-74 data based on FRB "flow of funds." Office of the Secretary of the Treasury, Office of Debt Analysis, Jan. 22, 1975.

Senator BYRD. Now, you mentioned—I am not sure that I can quote this accurately, and for that reason I would like to repeat it—that the Federal Government this year will be raising net by new borrowings more than all of the borrowings by the Federal Government, the local and State governments, and private borrowings, than in any previous year?

Secretary SIMON. Yes.

Senator BYRD. More than all the others put together in any previous year?

Secretary SIMON. Yes.

Senator BYRD. Thank you, sir.

Thank you, Mr. Chairman.

Senator BENTSEN. Senator Gravel.

Senator GRAVEL. Mr. Secretary, the administration's proposal has two pillars. One is the money it takes away from the people through the increase in cost of energy, and the other is the money it gives back to people. And this whole process of the administration is to try and take us out of the recession we find ourselves in. I do not think we will get any argument as to the fact that energy is interlaced in all facets of economic activity. And so if as a part of Government policy you seek to cause a shrinkage of that use of energy, you will in point of fact cause a shrinkage in the total economy. So, is not the administration at cross purposes—if we are trying to get out of a recession, why would we want to shrink the economic activity of the Nation, which means jobs?

Secretary SIMON. In order to avoid, Senator Gravel, the shrinkage that you correctly describe—if we took $30 billion out of the economy that would create the shrinkage. But we are putting the $30 billion back——

Senator GRAVEL. No; you are not. You are asking this Nation to conserve energy. That means cut down 1 billion barrels of oil. That represents jobs, that represents economic activity. I do not care what you swap the money around with after, that shrinkage will take place, and it will mean that you will have increased cost, whether it is in a plastic cup—you will be manufacturing less plastic cups, and they will cost more because you have forced an increase in energy. And so the shrinkage is what you call conservation—and I think that the general public looks upon it as driving around in their automobiles less. That is not going to be the only shrinkage that will take place—it will mean that that plastic cup will cost more, we are going to manufacture less, and this is going to mean less jobs. So in point of fact, the desire of the administration to shrink 1 million barrels of oil is going to cause less jobs. And that is going to aggravate the situations we find in the economy today.

Secretary SIMON. Senator, we just have a different opinion. As I said to the chairman before, we believe this million-barrel-a-day saving this year, and subsequent 2 billion barrels a day, recognizing that people can adjust more in the intermediate and long term to this energy utilization, will just cut into the fat and not the muscle. People are going to be more efficient, and they will waste less. And that is the important thing, is wasting less. And you would not see as many plastic things thrown away in the future, in industry——

Senator GRAVEL. Is the administration bent on being so efficient that it is going to be totally counterproductive to pulling us out of a recession? If the purpose of the administration is to make this economy efficient, the price is going to be in human terms in the economy.

Secretary SIMON. We do not believe this is going to impose costs in human terms, and that is why this chart on the back shows there is a positive stimulus to the economy each quarter.

Senator GRAVEL. Mr. Secretary, if you agree with me that if we are going to consume 1 billion barrels of oil less than we presently are consuming, then that means that the economy has got to atrophy in terms of energy to the tune of 1 million barrels, that has got to mean jobs, it has got to be economic activity. We are not swapping money around; we will have less oil to swap around. So if the administration in the White House is putting forth this package to give a stimulus to the economy, it is doing just the opposite.

Secretary SIMON. The overall package, Senator, gives stimulus to the economy, coupled with a reduction as well in the energy waste. The energy taxes are designed to cut the waste and the fat in our consumption in our economy.

Senator GRAVEL. Then let's bill it that way; let us just say that the administration, without concern for the economic consequences, wants to go after the fat in the economy.

Secretary SIMON. That is not the case, that we are not concerned with the economic consequences.

Senator GRAVEL. What is more important? We have got now three choices. We have an inflation problem, we have got an unemployment problem, and a fat problem. Apparently the administration is going after the fat and is not concerned with inflation and unemployment.

Secretary SIMON. The President has proposed a tax reduction for 1 year designed to attack the recession, and attack the unemployment problem, and put these people back to work, so that our revenues will increase, obviously, and narrow the budget deficit.

Senator GRAVEL. Mr. Secretary, any job that any American is going to hold is going to be tied to energy, and so you are going to put people back to work. What are they going to do, work in front of idle machines? Because it takes oil to move the machines.

Secretary SIMON. You are making a major assumption, Senator Gravel, that 1 million barrels a day is going to do this great damage to the economy.

Senator GRAVEL. I am not saying that it is going to do great damage; all I am doing is making the point that it will atrophy the economy, and in a period of recession anything that causes atrophication causes a recession. And so when the White House comes to this Congress and says, we have got a program to help economic activity, when it is in fact contributing to the economic recession, we are hoodwinking the public. I do not say you are doing this by intent, but it is the result of what you are doing.

Secretary SIMON. You will have economists argue and economists disagree on various impacts. We have an experience of what happened when oil prices shot up in a very brief period of time.

Senator GRAVEL. But we are in a recession now as a result of that.

Secretary SIMON. But we were heading for this before the embargo and before the quadrupling of prices. And in 1973 that was a contributing factor, there is no doubt about that. The inflatien is what caused the major portion of our problems today, and will again if we do not get that under control.

Senator GRAVEL. So if you are shifting to the argument that inflation is causing the problem, then why is it that not only does the administration come in with a program to atrophy the economy, but it also comes in now with a program to increase inflation? This package is inflationary, and it is admitted.

Secretary SIMON. As I said before, many times, when you put forth proposals that are designed to deal with the long term, seemingly the short run implications of it are conflicting and though the consumer price index by our analysis shows up to 2-percent impact as far as inflation is concerned, that does not take into consideration the fact that the money is being returned to the economy as well. And I think that that is an important fact.

Senator GRAVEL. Then what is the purpose of it? Are we in business just to circulate money, or in business to try to get a net gain.

Secretary SIMON. The purpose of it, Senator, is to achieve our conservation goals in this country as far as our consumption of energy is concerned.

Senator GRAVEL. I would submit—and I hope the Congress has a different goal than just conservation, cutting out the fat—that our goal would be to get this economy moving.

Secretary SIMON. This has many international as well as domestic implications. Attempting to conserve and exercise leadership in getting the consuming nations of the world to conserve with us and integrate these policies, as I said before, is going to put further pressure on the prices of oil.

Senator GRAVEL. I don't see that this is great leadership in the international economy. The Germans have done a lot better than we have. And you claim that they had 14 percent cutback, and that was done through simple price mechanisms, they did not have to tax the people and take the money away and give it back to them and cause atrophication.

Secretary SIMON. That is the price mechanism. It is exactly what we are suggesting.

Senator GRAVEL. That was the only decent proposal that the administration had, was to deregulate gas and oil. And it has totally overshadowed what you have done in this other area.

Secretary SIMON. We have been trying to get deregulation for a long time, and if we just relied on that law to pass, then we would have no energy policy whatsoever.

Senator GRAVEL. I submit that it is the only thing you are proposing that would bring about any energy in this country, because under this present proposal you are not adding one incentive more to go out and look for oil and gas. Now, under deregulation you are. But all you are doing is washing money. When you say you are making the hard decisions with respect to energy, you are not making any hard decisions. The hard decision would be to really push for deregulation, and let the price mechanism do it. You are going to turn around and tax domestic oil. You are going to take it away from the oil companies that need the money to go drill. How does that make any sense.

Secretary SIMON. The windfall profits. The fact that the cartel quadruples the price of oil does not represent any relationship to production costs, or I might say economic reality, as far as petroleum is concerned. We have recommended decontrol, and a windfall profit tax to phaseout over a brief period of time. And that will not inhibit production at all. As a matter of fact, decontrolling oil and phasing out of the windfall profit tax recognizes the fact that by the time this oil and gas that is going to be looked for in the next year or the year after, by the time it comes on stream, we will have a one price free market system, which is what you and I would certainly desire.

Senator GRAVEL. Sure, Mr. Secretary. But why should not the administration, rather than take the money back, make the windfall profits tax, so that you would insure that the money goes into the expansion of our energy base? This way the proposal that you come forward with really does not expand the base of your energy. And that is the problem. We want to get more energy so that we can get the economy moving. And I cannot find anywhere in the administration's proposal where they get more money into the energy industry of this country to do the job.

Secretary SIMON. There is no compelling proof or reason that the windfall profit tax that has been proposed and passed out of the Ways and Means Committee last year is taking the money away. There is still plenty left by any historical comparison, and the indication is that the people are going to explore and produce, just as they are today at the record levels.

Senator GRAVEL. I submit that they are not going at record levels. They are increased. But I think we can just look at the returns on capital and equity and see that the profitability is not such as to warrant this.

But touching on another point you raised by the liquidity—I will just finish this question quickly—and the Federal Government is going into the marketplace. It is also forcing an industry which conventionally has not gone into debt financing to similarly go into debt financing, because by not letting the price mechanism pay as you go, or raise the money to go and look for energy, you are taking that ability away, and you are forcing the energy industry to go into the debt market, which compounds the problem that you pointed out, that the Government is going into the debt market.

Secretary SIMON. I not only agree with that on the energy industry, but I think we are doing that in more industries on account of the loss of the recognition of the profit incentive. I have no problem with what the U.S. Government is doing nor the free energy price system, and I have said so often.

Senator GRAVEL. Thank you very much, Senator Bentsen.

Senator BENTSEN. Thank you.

Senator HANSEN. Thank you, Mr. Chairman.

I am sorry, Mr. Secretary, that I was unable to be here for the beginning of the testimony. I was at the Senate prayer breakfast helping to pray for the country.

Senator GRAVEL. It needs it.

Senator HANSEN. I think that the chaplain of the Senate was quite right when someone asked him, do you pray for the Senate, he said, no, I watch the Senate, and pray for the country.

Mr. Secretary, I do not agree——

Secretary SIMON. I do not laugh because I agree with it, Senator Hansen, but I think a little bit of humor once in a while helps us all.

Senator HANSEN. If it could have some relationship to the truth it could be even more humorous.

I gather the problem we are discussing this morning is what can we do to minimize the effect of the great outflow of money for imported oil that has to be spent to provide the extra energy needed to run America. I am certain that some of the questions already asked have touched upon those facets of the problem.

I would like to take a different tack. Is it your conviction, Mr. Secretary, that as we increase the price Americans have to pay for energy, specifically oil and gas, there will be a reduction in the demand for oil and gas.

Secretary SIMON. Yes, Senator Hansen, that is correct. And that has been demonstrated, as I put forth in my testimony, by what has been saved, due to the price increases in the past year, both with the caroming of oil prices as well as the taxes that have been levied on specific products by many other countries.

Senator HANSEN. I think it is easy to focus on gasoline. I understand that about a third of all the petroleum pumped from the ground is converted into gasoline.

Are there petroleum reduction methods, that come to mind which would not effect the employment and economic activity of the United States? I am inquiring about such things as people agreeing, because heating fuel costs more, to reduce their home thermostats to 68 or 67. Could this sort of thing be accomplished, and would it be, in your judgment?

Secretary SIMON. Yes, Senator Hansen. As I was saying to Senator Gravel a minute ago, we believe the saving of a million barrels a day out of a total consumption of 17 and a half million barrels a day in this country today is cutting into the fat, and can be accomplished through discipline and conservation by industry as well as the American people doing just as you say, and doing all the things they did last winter. And that is only in the short run. In the intermediate and the long run, in the case of the automobile companies, we have been reading about all these plans and the agreements that we have made with the automobile companies to get us 40 percent greater efficiency in domestic automobiles, and industry, spurred by the increase in prices, begins to find better ways to save energy, better ways to build our buildings, better insulation, and light them and heat them.

Senator HANSEN. I share the concern that has been expressed by my colleague from Alaska for those actions that may on the one hand increase economic activity, provide more jobs, and those actions that may have the opposite effect. But it occurred to me that the sort of tax that the President has recommended, and in fact already imposed on foreign oil, will do two things. I ask if my conclusion is correct.

No. 1, raising the price of energy is going to discourage its wasteful use. Second, raising the price will accelerate the development of alternative domestic sources of energy.

The coal industry is an example. The coal industry has been criticized because for a number of years it did not plow back any money in research and development. However, this resulted because the Federal Power Commission having limited the price of natural gas, there was no incentive for the coal industry to have much of a research program.

Do you think, as the price of oil goes up, particularly because of the import tax on foreign oil, that there will be more development of domestic energy?

Secretary SIMON. Yes, I do, but not solely for that reason. It certainly will cut down on demand on that part, I agree.

On the second part about bringing the superabundance of energy resources that we have in this country, it makes the great assumption that Government is going to act with uncharacteristic wisdom, that after having been warned about this energy problem many times over the past 20 years, that we are heading on a collision course, with our energy consumption and our energy requirements growing at these extraordinary rates every year, while exploration and production is declining, while our reserves in natural gas fell from over 23 years to under 10 years today, regulating it at the well head at prices.

And we utilized 3 percent of Outer Continental Shelf in the 20 years of the leasing, and effectively stifled and stagnated the coal industry that has a nearly infinite supply.

And we have not moved ahead with our nuclear. We are the founders of atomic power in this world, and what have we done? Because of Government regulations, we have exported our nuclear capacity, and today it takes $11\frac{1}{2}$ years to build a nuclear plant in this country. And it take $4\frac{1}{2}$ in Japan. Japan is building the first nuclear park. And we do not have one. And as a result, our nuclear gives us about 1 percent of our energy requirements today.

Oil shale, we should have been moving along in a crash program, whether it is similar to the synthetic rubber experience in World War II or is a similar joint venture with industry, not Government.

There is really, as I have said so often, there is no mystery to what has to be done in this country. We have been blessed by our Good Lord with everything that we have been given. And maybe that is one of our problems.

Senator HANSEN. Let me say, I do not agree with everything the President has recommended. But I want to make this point, I think that we do need to assure—and as a member of the Finance Committee I certainly propose to join my colleague on this point—that the short-term formula that has been discussed with respect to excise and windfall profits taxes on the domestic industry, is not excessive. My feeling is that presently the formula is excessive. If the formula has the net effect of rolling prices back so as to reduce the rise of stripper, new and matching oil on a 1-to-1 basis from the levels this oil now sells for, and if it reduces those prices significantly, then I think the formula is counterproductive. I know Senator Gravel and I agree on this point. I think that in this instance the formula is too tough, and I do not think it should be accepted.

But on the other hand, I recall what Russ Cameron told me a number of years ago. Mr. Cameron was one of the pioneers in the oil shale development. He said if the price of crude oil in this country were to approach $7 a barrel, that the then existing technology would make feasible the production of oil shale. Obviously since he made that statement all prices have gone up, and I am sure that his statement is no longer true.

But the point—and on this I wanted to ask your opinion—is it not a fact that as we make the conventional sources of energy more costly, we will certainly increase the business interest to develop oil shale, gasification of coal, and the liquifaction of coal?

Secretary SIMON. Well, first of all, you said that some of our proposals may be counterproductive. And let me assure you, Senator Hansen and Senator Gravel, that we did not wish to make anything that would be counterproductive as far as achieving the ability for self-sufficiency in this country. We recognize that this is going to be open to dialog and debate, and there are going to be necessarily differences of opinion. But certainly the higher price is stimulating bringing on not only what I have always called "the existing state of the art,"—oil, coal, and nuclear—but also it is more expensive alternate sources of energy. And oil shale is a prime example. Occidental Petroleum, estimates—and many people are skeptical about it—that they can make synthetic crude from oil shale at $4.50 a barrel. Even if it is wrong by a third, that is only $6. Our goal originally was $7 to $8 a barrel. And we are certainly in that range today. And that is only in the first generation of technology and experience. And there again, the synthetic rubber experience shows you that as you get 10 to 20 years of improving your methods, it is going to be much cheaper then. But we have to get going and stop talking about it.

Senator HANSEN. My time is up.

Senator BENTSEN. Mr. Secretary, I am normally a pretty optimistic man. But last summer I started warning about this recession. And everything I warned about has come true, and more.

Before the Joint Economic Committee we have had economists who have almost unanimously stated that we are in the worst recession since 1930, and economists yesterday stated that unemployment may go to 9 percent.

You say that this total package is a stimulant. If it is, I think it is a modest one. If it is a $30 billion figure by which you increase the cost of the products of petroleum, then you do have a net balance and modest stimulant. If the numbers of the Library of Congress are correct, and it is $50 billion, you have a very negative impact. I think that this recession is the most immediate and the most critical problem we have. And I would frankly say that the administration is overreacting on the energy side, which is a serious problem, trying to do too much with it in too short a period of time. And that gives me a great deal of concern.

But that is one man's opinion.

Now, I told you I would try to get you out by 11:30——

Senator GRAVEL. I have one more question, if I could?

Senator BENTSEN. Yes.

Senator GRAVEL. As a problem with respect to investments, do you feel that more money could be recycled by OPEC nations if we found some device to cause them to invest it in this country?

Secretary SIMON. What kind of a device?

Senator GRAVEL. What I was thinking of is, if I were a member of an OPEC nation, I would be hesitant to put money into the United States for fear that if things went bad in the Middle East, it might be nationalized, it might be confiscated, a whole host of things. And what I am thinking of, if we took the initiative to bring about a treaty, a treaty with the OPEC countries, recognizing that under no circumstances would their money ever be in jeopardy if they invested it in minority interests in this country, as long as they went to no majority interest, on the strength of such an agreement or a treaty, we might be able to get considerable more money invested, because those leaders of the OPEC nations that I have talked with do have this subtle concern as to what could happen to their money.

Secretary SIMON. I agree with that, Senator. And it is a subtle concern, I think you have put that very correctly. It is not an overriding concern that they have.

We have a joint commission today with Saudia Arabia. And one of the things we have worked toward is just this kind of a tax treaty, which we of course submit to the Senate, which will include many of these things that you suggest. But I have seen no reticence on the part of these countries in investing in equities and making investments in real estate.

I think the major inhibition to this in the last year has been a declining stockmarket, and the recession-inflation problem in this country. And I look for greater investment now that we seem to be pulling out of this, because I must admit that I agree with much of what our chairman says about our recession.

But I also—and I am not being an optimist, and I do not believe I am looking through rose-colored glasses—I have seen the automatic stabilizers at work for some months now, that are always there in our business cycle, that are working toward pulling us out of this.

And we have an extraordinary inventory problem in this country. We are going through right now, a recent analysis shows, a very sharp liquidation of these inventories. And that is a very positive sign. If we were just going through a slow erosion of inventories, you could look for months, and just more malaise and deterioration. But the faster we can get through this inventory liquidation the better it is going to be.

We have 3 months of inflows to our thrift institutions, positive inflows.

And of course interest rates have declined dramatically. Short-term Treasury bill rates are down 4 percent, over 400 basis points. And of course this has helped with money inflows into the thrift institutions.

And this is the first harbinger of a better housing market come spring. Housing starts turned positive for the first time last month.

And all of these things are going to work—of course, I am not predicting what the stockmarket is going to do, but the market seems to be saying, by the third quarter and fourth quarter, to varying degrees, anywhere from 3½ to 5 percent positive growth in the fourth quarter of this year. And that is what the market is telling you, that you have to suffer through this recessionary period. A period of deflation always follows— it's the hangover that follows the revelry. And we should avoid the "stop-and-go" policy that we have had in Government so many years.

Senator BENTSEN. Mr. Secretary, I think that we ought to take some of the steps you are talking about. I think we ought to build them in over a period of time. That is my major point.

You are an articulate spokesman for your point of view. And we appreciate very much your attendance.

Secretary SIMON. Thank you, Mr. Chairman.

[Whereupon at 11:40 a.m. the subcommittee adjourned.]

[By direction of the chairman, the following communication was made a part of the printed record:]

STATEMENT OF H. A. MERKLEIN, PH. D., DIRECTOR, INTERNATIONAL INSTITUTE, UNIVERSITY OF DALLAS

Mr. Chairman and members of the committee, petroleum engineers are well aware of the fact that poisonous hydrogen sulfide gas, if present in very low concentration, will deaden the sense of smell. If the hydrogen sulfide concentration slowly rises, the typically sour odor of the gas cannot be detected by the numbed senses. Unless someone from the outside steps in and sounds the alarm, those exposed to the gas may well fall victim to their own environment. I submit to you that this peculiar danger of hardly noticeable but potentially fatal escalation of trouble is not totally absent in the Halls of Congress.

Let me give you an example of what I am driving at. There has not been a concerned American, and therefore there has not been an American, who has not become alarmed lately over rising prices. Still, few people seem to realize how bad things really are. Suppose the U.S. had a law on its books, whereby it would be obliged to shift to a new base period whenever the consumer price index reaches 120. Starting with the actual base period of 1958, the first shift would have occurred in 1968, exactly 10 years later. The second base period would have been mid-1972, four years after that. The third base period would have been August, 1974, or 1.8 years after the second base. I shudder at the thought of extrapolating these figures, even though they may well lend themselves to extrapolation. The current annual rate of price increases runs at 13–14 percent, which corresponds to a 1.5-year life of a base period, nor have I seen any signs of fiscal or monetary constraint that might help to ease that rate. It is my contention that our senses have become so numbed by this "inflationary" environment that we have lost track of our standards. If we could reduce the price-level increase to 8 percent per year, I am sure that we would consider this a major breakthrough, when as little as three years ago we would have considered this rate intolerably high.

This phenomenon of having one's senses numbed by a poisonous economic environment is also clearly discernable in the area of unemployment. The great debate of the prosperous sixties was whether th U.S. economy should consider 3 or 4 percent unemployment as the trigger level for remedial economic policies. The pessimists leaned toward the 4 percent level. Today, we would be more than happy with 5 percent.

One of the greatest tragedies this nation has been facing in recent years has been its notorious lack of success in applying standby economic remedies. The 1969–1970 "recession" was the first major instance of a complete failure of monetary and fiscal remedial policies. With consumer prices rising faster than 6 percent annually and unemployment well above 5 percent, President Nixon introduced his now-forgotten two-phase economic game plan. The key to the success of this strategy, according to the administration, lay with the judicious timing of monetary and fiscal policies. Since both rising price levels and falling real GNP's occurred at the same time, the idea was to bring the price level under control first—via restrictive policies. Then, having reached that goal, the game plan called for a stimulation of the nation's GNP and subsequent reduction of the level of unemployment.

The plan had not the slightest chance of success, its brilliant economist brain fathers notwithstanding. The problem at the time was a simultaneous "inflation" and "recession," so in terms of available policy alternatives, what was needed was a monetary and/or fiscal policy that was both expansive and restrictive, that both stimulated and destimulated spending. Put that way, the built-in incongruence of the plan is immediately apparent and, of course, the plan was a complete disaster. This did not deter President Nixon, always quick to claim victory, from calling the plan a complete success when he said, in his Economic Report of the President dated February 1971: "Faced with one of the largest inflations in American history, we have sought first to stop its rate from speeding up and then to get the rate down. This has been done. . . . Fiscal and monetary policy both became more expensive early in 1970, in order to get output rising again while the cost of living slowed its rise. This result was achieved."

Six months after this announcement, Nixon had to eat his presidential words when, on August 15, 1971, he abruptly replaced his spending policies with his well-known but disastrous 4-phase program of wage and price controls.

The Committee will forgive me for bringing up historical problems when it is seeking answers to current difficulties. However, the relevance of the 1969–1970 "recession-inflation" lies in the fact that today's economic problems are but an extension of earlier problems. If this is true, then the policies that failed so dismally 4 or 5 years ago are bound to fail again, and for the same reasons. Just as there were economists in 1969–1970 who saw that President Nixon's two-phase economic game plan would be a disaster, so there are many economists today who are saying the same thing of President Ford's economic policies. It is a credit to this Committee to allow one such economist to voice his concern.

This simultaneous occurrence of a recession coupled with inflation has by now achieved a status of notoriety that has resulted in a name to describe the condition: The United States is presently in the grip of the deepest stagflation it has ever seen. Having said that, allow me to state what the U.S. is currently *not* faced with. There is no inflation and there is no recession. This, ladies and gentlemen, is of the utmost importance. Inflations and recessions are spending related (the economist would say aggregate-demand related), and the manipulations of the nation's spending level are proper economic remedies for these conditions. A stagflation, however, is production related (aggregate-supply related), and changing the level of spending in the U.S. economy does nothing to remedy the stagflation problem. Yet, ever since 1969–1970, when stagflation problems had become severe in this country, we have not once made a serious attempt to strike at the heart of the stagflation problem, and experts from academia, from government and from business and labor continue to propose the old and proven monetary and fiscal policies. The only thing proven about these policies, however, is that they will not work in a stagflation.

If you are ever again confronted by monetarists or fiscalists, I suggest that you have the expert witness explain in detail why, for example, a planned $50-billion budgetary deficit does *not* have a substantial impact on rising prices. There is only one honest answer to that question: Political expedience, the buying of time. But time, I submit to you, is running out fast. Unless the United States is prepared to break the dogmatic stranglehold Keynesian economics has held for too long, a major stagflation is inevitable. Time does not permit to pursue that interesting subject further. I am prepared to submit a rather lengthy statement on the subject for inclusion in the Congressional Record, if this Committee so desires.

The OPEC oil embargo and the subsequent transfer of wealth from oil importing to oil exporting countries must be viewed in this context of an already deteriorating U.S. economy. It is easy to blame OPEC for our current economic troubles, too easy, and terribly superficial. As a nation, we were driven in a corner long before November, 1973. After all, wage and price controls were instituted here, I am tempted to say "in desperation," a good two years before the embargo.

Nor is the economic impact of quadrupled oil and oil products prices all that inordinate. I am not saying there was no impact, but I am saying that the impact has been highly, and irresponsibly, magnified. For instance, I have calculated the price-level impact to be 2.4 percent—once. The U.S. government has said or implied time and time again, especially in the early days of the embargo, that the U.S. two-digit inflation rate is largely or to some considerable extent induced by higher imported crude-oil prices. When the Treasury finally undertook to do its own calculations (in a report entitled: The Impact of Oil Price Increases on Prices in Major Industrial Countries, October 24, 1974), it came up with essentially the same inflationary impact: 2.41 percent. So far as I know, there has never been an official retraction of earlier misleading statements, but the executive branch of our government has lately shown remarkable restraint in regard to oil-induced inflation charges. Indeed, when President Ford's new energy policy was released, the inflationary impact of deregulated and therefore rising domestic oil and gas prices has been labeled negligible—and quite correctly so.

What about the wealth transfer to oil-exporting nations which include, by the way, many non-Arab nations such as Iran, Nigeria, Indonesia, as well as some of our best friends and neighbors, Canada, and, of late, Mexico? To the best of my knowledge, it was Presidential Advisor Allan Greenspan who first admitted publicly on television what he must have known privately for quite some time: That the wealth transfer from the U.S. amounted to approximately 2 percent. That, of course, is not a one-time shot. It means that the U.S. GNP would be faced with a permanent 2 percent reduction, if OPEC were the only force affecting that GNP.

This reduction in U.S. wealth can be viewed as a 2 percent tax imposed on U.S. citizens by OPEC. Thus, if Joe Blow was making $1000 a month before the increase in oil prices, he is making $980 thereafter, and every U.S. citizen finds himself in a similar position. Collectively, and taken as an absolute sum, Chairman Bentsen was quite correct in referring to "vast amounts of wealth" being transferred to oil-producing nations. Yet, viewed in relation to the wealth of the United States, this is not a particularly awesome amount. For example, total U.S. oil payments to exporting countries amounted to an approximate annual rate of $26 billion in late 1974. That's just about equal to our interest payments on the U.S. national debt, and very few people are complaining about the latter.

Not all of that $26 billion per year is available for recyling. A substantial portion of the money earned through oil exports is scheduled for use in internal development. That money will either be invested in the infrastructure of the exporting nations building roads, railroads, airports, hospitals, schools, government buildings and the like, or it is used for capital goods needed in those constructions. Tractors, graders and other pieces of earthmoving equipment are examples here. One way or the other, the money used to build the oil-exporting countries' infrastructure is not available for recycling.

In addition to internal development, the oil-exporting countries will be using funds for the purchase of consumer goods and of military hardware. This leaves something like 50 percent of their total oil revenues as uncommitted currencies available for recycling. In the case of the United States, that's approximately $18 billion annually, enough to buy up the Fortune 500 corporations in approximately 20 years.

It has been said that the OPEC countries have essentially three ways of using their uncommitted petrocurrencies. These are:

(1) To pile up strong currencies such as U.S. dollars or Deutsche Mark, to name two.

(2) To invest in credit instruments, such as government or corporate bonds.

(3) To invest in equities: Corporate shares and land.

This, in any event, is the general concensus concerning OPEC investment opportunities. I submit that the only realistic long-term investment option for OPEC countries is equity holdings.

The settlement of balance-of-payments deficits with domestic currency involves no more than the printing of money. For example, in the years 1971–1973, the cumulative U.S. official reserve transactions balance amounted to a deficit of $45.1 billion. Of that sum, $41.8 billion or 93 percent was paid by handing the surplus or creditor nations U.S. dollar liabilities. Did these dollar amounts come out of the U.S. money supply? They did not, since the money supply (M_1) in the United States *rose* over that 3-year period by $56.9 billion. No wonder that the U.S. dollar suffered internationally, since it was being supplied recklessly to the world at large. In fact, during the days of the Brettonwoods International Monetary System, the United States made a virtue of a vice on the grounds that it was supplying world monetary liquidity through its balance-of-payments deficits and subsequent injection of U.S. dollars into world monetary markets.

The two devaluations of December 1971 and February 1973 cost the Arab nations a total of $1.5 billion, more or less. That was before the quadrupling of oil prices, when these countries could ill afford such losses. I hope that no U.S. government official will ignore this Arab experience and expect the Arab nations, or the OPEC nations in general, to have continued faith in the U.S. dollar after an expensive two-time failure. Nor can the OPEC nations afford to accumulate other foreign currencies, no matter how strong, since the very process of accumulation will weaken the currency being accumulated. Definitely, currency holdings make no sense at all to OPEC governments, and they are not a realistic investment alternative.

The disadvantage of investing in U.S. corporate or government bonds is that these do not protect against inflation, and they are part of a deeply troubled credit market. These troubles originate mostly with ill-advised money and credit policies using the rate of interest as an indicator of the tightness of money and credit. That is poor economic theory and poor economic policy, since the rate of interest, in addition to measuring the scarcity of credit, also measures the inflation rate. For example, an 8 percent loan will yield $8 on an investment of $100, in the case of zero inflation. However, if the inflation rate rises to 7 percent, that same investment will have to yield $15 ($15.56 to be precise) so that the invested capital plus interest will not be eroded through inflation. Thus, inflation brings about rising interest rates and the pressure is on to do something, and do it quickly. Since everybody knows that an increase in the supply of money and credit will reduce the rate of interest, the pressure is on the Fed to ease its monetary constraints. This will eventually be done, and the interest rate will come down, but the increased money supply will bring about a long-term increase in price levels and, therefore, still higher interest rates which, again, call for easy money policies. The vicious cycle is complete. This is why I get scared everytime the President claims victory in getting interest rates down, as happened during the latest State of the Union Address.

In addition to raising interest rates through the inflation rate, the government puts direct upwards pressure on the rate of interest by massive credit demands to finance its own budgetary deficit. We have been told to expect a $50 billion deficit in fiscal 1976. This corresponds to a net increase in domestic credit demands of nearly $200 million every working day. When the government enters the credit market with these demands, it will find itself competing with corporations and households, and the ensuing competition will drive up interest rates, thereby creating the illusion of tight money and credit and triggering demands for further easing of monetary policies. This will drive up prices and once more embark the U.S. on the vicious inflationary cycle.

Of course, there is a rather extremely reliable measure of the scarcity of money: The price level itself. I have never been able to see how anyone could pretend that money was scarce when the inflation rate was high. Yet this claim is made all the time by highly respected professionals. When the value of money is being eroded, this can only be so because there is too much of it in relation to the goods and services in the economy. We all knew this to be self-evident, until the economists explained it to us differently.

This leaves relatively inflation-proof equities as the only realtistic investment option for petrodollars. If we deny the OPEC countries that option, we deny them their only realistic investment outlet, leaving them no choice but to cut back production. We had better understand this very clearly, especially since this country (to the great consternation of our European allies who felt put on the spot) has obscurely hinted that the use of force may not be out of the question under certain extremely grave circumstances. By denying the OPEC countries access to our equity markets, we may well force them to cut back exports and thus to bring about the grave circumstances that might lead to armed intervention, all that, mind you, for 2 percent of our national wealth. Actually, the armed intervention itself, if it could be contained to the Middle East, would certainly cost more than 2 percent of our GNP, and we would lose along with the OPEC countries.

As a nation, we are now beginning to understand the trepidations of foreign nations failing to see that U.S. investment in their countries was an unmitigated blessing. Still, because a foreign investment dollar is more vulnerable than domestic investment, it tends to exert less influence on the host country's political environment, rather than more as is often claimed. The foreign dollar does not usually want to rock the boat—it is quiet and neutral. Because U.S. sentiment is assuredly against a complete take-over of U. S. corporations, political reality may dictate a limit on equity holdings, such as, say, 49 percent. If we were to allow no more than a 5 percent foreign equity participation, as some have demanded, we would soon stop OPEC's investment potential, and the embargo would be inevitable.

If we, as a nation, are really as concerned about energy as we say we are, we can certainly re-develop a largely independent domestic oil industry. The United States is sitting on untold potential reserves, located especially on the outer continental shelf of the Arctic and in Alaska. This is expensive oil, and it takes vast sums to develop it, but it can be done, provided the oil industry is given the required incentives.

President Ford's energy plan, as proposed in his State-of-the-Union address, is not without flaws, but it has one positive feature that more than outweighs its drawbacks: The deregulation of oil and new gas prices. Already, the Congress of the United States has given notice it will not stand for that. Gentlemen and Members of this Committee, if Congress kills the deregulation proposal, it kills all hope of the United States pulling itself out of the energy crisis. But let there be no doubt, solving the energy crisis does not solve our current stagflation problem. On that score I am sorry to predict a massive and swift failure. President Ford's overall economic policy is again oriented towards spending and for that reason it will prove to be extremely inflationary.

This Committee is concerned about the stability of financial markets. From past observations and on the basis of my estimation of what the future holds, why worry about the OPEC nations destabilizing these markets, when we already have a government with a remarkable record of doing this? What's more, at $50 billion annually, they are doing it considerably more massively than OPEC's $13 billion. Indeed, a good case can be made for allowing these $13 billion to purchase U.S. equities, for this will release an equivalent amount of U.S. funds to the credit market, thereby preventing the interest rate from rising as high as otherwise it would.

Instead, let's get on with the solution of the U.S. energy crisis and, perhaps, of the current stagflation. OPEC countries investing in the U.S. are not in the danger they are made out to be. After all, having a vital stake in this economy, they will be just as eager to see it perform satisfactorily as the next man.

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