

Petroleum Industry Research Foundation, Inc.**122 EAST 42nd STREET****New York, N. Y. 10017****THE ROLE OF PETROLEUM IN THE U.S.****TRADE BALANCE****A Statement by****John H. Lichtblau
Executive Director****Before the****Joint Economic Committee
of the Congress****Washington, D. C.****October 11, 1977**

Thank you for inviting me to participate in today's hearings of your Committee on the subject of the U.S. Trade Deficit. Following your request, I will address myself primarily to the present and future role of oil imports in our trade balance.

As our trade balance has been moving from last year's substantial surplus into this year's substantial deficit much attention has been given to the rapidly rising volume and cost of our oil imports. A figure of \$45 billion is being officially quoted as the likely cost of our oil imports this year. The figure would seem to apply to the landed (c.i.f.) cost of oil imports. The f.o.b. value (the definition used in our balance of payments statistics) will of course be somewhat lower, probably \$42.0-42.5 billion for the year. This would be a substantial increase from last year, as the following table shows:

F.O.B. VALUE OF U.S. PETROLEUM IMPORTS

	<u>Total Value</u> (\$ Million)	<u>Volume</u> (000 b/d)	<u>Change (%) From</u> <u>Previous Year</u> <u>Value</u>	<u>From</u> <u>Year</u> <u>Volume</u>
1972	4,798	4,726.8	-	-
1973	7,765	6,320.6	62	34
1974	24,668	6,112.5	218	(3)
1975	25,197	5,989.4	2	(2)
1976	32,226	7,229.4	28	21
1977 (est'd)	42,200	8,700	31	20

Source: U.S. Department of Commerce, FT-900 Series.

About two-thirds of the value increase will be due to higher volume, the remainder to higher prices and increased imports of higher value products such as heating oil in the first quarter.

The projected \$10 billion increase in our oil import cost this year has naturally given rise to the question of whether we can "afford" oil imports of this magnitude. The answer from some members of the Administration as well as some other analysts has been an emphatic no, with the magnitude of the quoted figure presumed to be sufficient evidence by itself that our oil imports must be curbed. Yet, I believe the question of what level of oil imports we can afford, and any meaningful answer to it, is much more complex than that. A large amount or even a large increase from a large amount, taken by itself, does not tell us anything about what we can or cannot afford.

Our oil import problem has been identified as a security problem and a potential resource problem. Having to depend for 46% of our oil requirements on foreign sources with a very high concentration on one area entails certain political risks. It also makes us indirectly subject to the individual resource policies of the major oil suppliers which in the future may differ from our interests. In addition, in the view of most petroleum geologists, physical resource constraints are likely to appear before the end of the next decade if the U.S. and the rest of the world should continue to increase their oil requirements at the long-term pre-1973 rate of about 7% annually or even at this and last year's average rate of 5.0-5.5%.

These factors provide the rationale for our policy to curb the growth in oil imports. If they did not exist, if the known oil reserves around the world were substantially larger than they are and much more evenly distributed, geographically and politically, would oil imports still represent a problem at this time because of their cost? I believe the indications are to the contrary: The value of oil imports has risen by nearly 600% between 1972 and 1976, yet in all but one of these years our trade balance of goods and services was positive. Our current account balance was positive in only one of the last three years; but it was also negative in each of the six years prior to 1973 when oil prices were relatively low and oil accounted for less than 6% of total imports; the deficits after 1973 were, on the whole, no larger than those before.

Thus, at least through 1976 the staggering increase in the value of oil imports has not impaired our ability to pay for them, as evidenced by the overall balances in our foreign transactions. In large part the reason lies in the fact that the OPEC oil price increases affected both sides of the ledger. For instance, U.S. merchandise exports to OPEC members rose from \$3.6 billion in 1973 to \$12.6 billion in 1976, as the following table shows:

U.S. MERCHANDISE EXPORTS TO OPEC MEMBERS
(\$ billion)

1973	3.6
1974	6.7
1975	10.7
1976	12.6
1977 (est'd)	14.7

Source: U.S. Department of Commerce

In addition to these exports, our service exports and military exports to OPEC members, particularly those in the Middle East, have also increased very sharply. All these increases are of course the direct result of the rise in OPEC oil prices. So is the increase in our petroleum exports from \$500 million in 1973 to \$1 billion in 1976.

There are still other less measurable but no less real balance of payments offsets to the cost of U.S. oil imports. Thus, OPEC's total merchandise imports rose from \$20 billion to \$67 billion between 1973 and 1976. Last year, the U.S. supplied directly less than 20% of this total. But the foreign affiliates of U.S. firms participated on a significant scale in the rest and their remittances of earnings and dividends to the U.S. improved correspondingly. U.S. exports to a number of non-OPEC nations were also higher because of these nations' exports to OPEC. Similarly, U.S. bank earnings abroad have been favorably affected by their access to OPEC surplus funds for the purpose of foreign lending. All these factors and probably some others, such as part of the U.S. foreign oil industry's repatriated income (\$4.3 billion last year), must be taken into account in determining the total impact of the cost of foreign petroleum on our balance of payments.

This year our trade balance of goods and services is likely to show a \$8-9 billion deficit, and our current account may be \$18 billion in the red, according to a recent Administration estimate. Obviously, if oil imports had risen much less this year than the projected \$10 billion, both these deficits would be correspondingly smaller. However, in part the high level of oil imports reflects exceptional weather conditions this year: the unusually cold winter with its higher

heating requirements and the drought in the West requiring the substitution of oil-fired power generation for water power in many utilities.

But whatever the reason for this year's deficit, so far, it is not of such magnitude that it cannot continue for a limited period without harming the U.S.'s economic strength abroad. Thus, the essential question is, what will be the cost of future oil imports and how will it affect our trade balance?

There are two separate and, at least partly, independent aspects to this question -- the future volume of oil imports and its future price. Let us look at each of these.

The Administration's National Energy Plan (NEP), released last April, projects a decline in oil imports from last year's level of about 7.3 million b/d to less than 6 million b/d by 1985. There is now general agreement among most experts that this level will not be reached or even approached by the target year. Studies by the Library of Congress, the General Accounting Office, the Congressional Budget Office as well as by private companies and researchers have all come to this conclusion. The two principal reasons are the inability to convert as large a share of U.S. industry to coal as the NEP foresees and the assumption that a substantial reduction in the total energy growth rate during the next eight years can be accomplished without any significant negative impact on the GNP growth rate.

However, failure to achieve the NEP target does not mean that oil imports will keep growing at historic rates. A combination of actions

proposed in the NEP, existing legislation designed to conserve oil, the effect of the substantial price increases on demand and, presumably, some additional incentives for new domestic energy production can be expected to curb the growth in oil imports substantially between now and 1985. But it would be unrealistic to assume that any policy acceptable to the Administration, the Congress and the public can bring about an actual decline in oil imports during this period.

Our studies indicate that an optimistic but, hopefully, not unrealistic projection might be an oil import level of 9.5 million b/d by 1985. This would be equivalent to an annual increase of 1.1%.

Now let us consider future world oil prices. After the quantum jumps of 1973 the marker price for OPEC oil (Saudi Arabian light crude) has increased from \$9.32/bbl in early 1974 to 12.70/bbl in July 1977. For the 4-year period from the beginning of 1974 to the end of 1977 this is equal to an annual growth rate of 8%.

OPEC's leading spokesmen have repeatedly declared that their price policy, following the 1973 revolution, was to maintain the real purchasing power of oil in terms of OPEC's import requirements. Thus, the 8% average annual increase over the past four years may be assumed to reflect world inflation in dollar terms during that period. Since the rate of inflation has clearly been declining since 1976 (although the weakening of the dollar has offset part of it for OPEC members), annual price increases somewhat below 8% would meet OPEC's stated objective.

Now let us consider the likely future growth trend in total U.S. merchandise imports and exports. Over the last ten years (1966-76) imports have risen at an annual rate of 15.4% in current dollars. The rate may have been somewhat distorted by the jump in oil import costs in 1974 and the high level of world inflation in the period 1973-75. However, even in the 10-year period 1962-72, when price inflation was much more moderate, the annual average growth rate in U.S. imports was nearly 12%. Thus, an increase in our total merchandise imports of about 10% annually in current dollars over the next eight years would not seem unreasonable. The same would be true of the growth in merchandise exports which have risen by 14.3% annually in the last ten years and by 9% in the period 1962-72 in current dollars.

If we now combine our growth rate in the volume of oil imports with an oil price increase in current dollars equivalent to likely world inflation rates and compare it with our future growth in total U.S. imports and exports, we can see that the value of oil imports would probably grow at a somewhat slower rate than that of total U.S. merchandise imports. Similarly, the share of U.S. exports required to pay for our oil imports would decline.

Whether our OPEC price assumptions are realistic is of course open to question. OPEC may wish to change its current price policy when the production of several of its members will have reached the capacity level or will start declining, so that higher oil revenues can only be obtained through higher unit prices. Alternately, a

continued high growth rate in world oil demand might cause market forces to push the price up more than OPEC would do on its own. Neither of these scenarios is likely to occur for at least the next 5 years. But if and when either of them does, the share of oil imports in our foreign trade accounts could conceivably rise substantially.

In closing, I would like to turn very briefly to our potential foreign trade in one other energy source: natural gas.

Last year our natural gas imports, mostly from Canada, amounted to 954 billion cubic feet or \$1.7 billion. In the future the importation of this commodity, by pipeline and by tanker, can be expected to rise substantially. We project that by 1985 the U.S. will import about 2.5 trillion cubic feet of gas at a cost of \$8.5-9.0 billion (in current dollars). This amount has to be added to arrive at our future total energy import cost. Most of it will not come from the Middle East, the source of the bulk of our future oil imports, but from such countries as Mexico, Canada, Algeria, Nigeria and Indonesia. Thus, these imports offer some diversification of energy supplies to the U.S., although in each case the gas exporting country will probably also export oil to the U.S.

Additional gas imports will of course increase the cost of energy imports and weigh negatively on the U.S. balance of trade. However, the gas exporters are in general countries with ambitious economic development programs which will require substantial imports of goods

and services and will likely force these countries to run deficits in their current account balance of payments. Thus although our gas imports from these countries will grow, so will our exports to them.