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MEMORANDUM

To: Secretaries of Delegations

From: Executive Secretary

The Impact of the Present Crisis on
the Economies of NATO Countries

The Secretary General thinks that the attached note prepared under the instructions of the Assistant Secretary General for Economics and Finance may be of interest to delegations.

(Signed) COLERIDGE

7th December, 1956

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THE IMPACT OF THE PRESENT CRISIS ON THE
ECONOMIES OF NATO COUNTRIES

The closing of the Suez Canal and the destruction of a number of pipelines with terminals on the eastern Mediterranean are having a considerable effect on the economies of some NATO countries. Industrial output, balance of payments, gold and dollar reserves, prices and, in some cases, budgetary positions are being affected.

2. As long as both the length of time the Canal and the Iraq Petroleum Company pipelines remain inoperative and the degree of help to be expected from the United States are not known, a full evaluation of the impact of the present crisis on the economies of NATO countries will not be possible. A number of effects are, however, already clear. This paper does not attempt to outline the possible implications of the present crisis on the military effectiveness of NATO forces.

Importance of Suez Canal and IPC pipelines

3. European NATO countries are normally largely dependent upon the route via the Suez Canal for the import of such commodities as oil, rubber, jute and wool. The importance of the rôle played by the Canal in the supply of these commodities to the United Kingdom, France and the Netherlands may be seen from the following table:

Destination	Percentage of commodity to pass through Suez			
	Oil	Rubber	Jute	Wool
United Kingdom	56	85	95	70
France	47	76	97	70
Netherlands	63	62	91	23
United Kingdom	15	-	-	10

Oil was the most important single cargo passing through the Canal, with nearly 70 million tons a year normally taking this route to Western Europe. The oil situation has been rendered even more serious by the severing of the Iraq Petroleum Company pipelines, which regularly delivered a further 25 million tons annually to Western Europe (see Annex I). Indeed, Western Europe as a whole depends on the Middle East for over 80% of its net imports of crude oil and finished products (see Annex II).

Shipping

4. To maintain the normal flow of commodities between Western Europe and countries east of Suez without using the Canal, it would require some 55% more tanker tonnage for the oil and some 20% more dry cargo space for other commodities. Existing shipping tonnage

does not, however, permit an expansion of this order. Tankers formerly employed on the route from the Persian Gulf through the Canal and now diverted around the Cape can carry in a given period only about 60% of the oil that they formerly carried. Even with the most efficient use being made of existing tanker tonnage and available sources of supply of oil, it is doubtful whether Western Europe will be able to secure much more than 75% of normal supplies in the short run. Such an operation would require an increase in output of perhaps over 110,000 tons of oil per day by producers in the Western hemisphere and the reactivation of the reserve tanker fleet - a difficult task even with the co-operation of the United States administration.

Stocks and measures to limit consumption

5. Stocks in European NATO countries of many of the commodities which regularly pass through the Suez Canal seem to be generally sufficient only for a few months. Thus in the United Kingdom there are apparently less than two months' stocks of oil, rubber, copper, tin and lead, while there are probably three to five months' stocks of zinc, tea and wool. In some countries the situation is already critical. Stocks of long-fibre cotton in France are considered to be sufficient only for two months, while stocks of heavy fuel oils are thought to be adequate for only one month. The situation has been worsened in a number of NATO countries owing to stockbuilding by individuals. In the United States, on the other hand, oil stocks amounted to some 40 million tons as of 17th November; however, not all of these stocks are available for export demand.

6. Now that the last tankers using the Suez Canal have arrived and those diverted around the Cape are only just beginning to arrive, existing stocks must bear the brunt of the demand for oil. Steps to limit the consumption of oil have been taken in a number of Western European countries. OEEC countries have thus agreed to reduce consumption as a whole by some 25%. Measures introduced thus far include a ban on pleasure motoring on Sundays in Belgium, Luxembourg, the Netherlands, Portugal and Turkey; rationing in the United Kingdom, France and Denmark; and a cut in fuel oil deliveries in many European NATO countries. No limitation is contemplated however on the sale of oil or its derivatives in North America.

7. Shortages of oil may be partly compensated by a greater use of coal. Nevertheless since there is little likelihood of any appreciable increase in European production, this would involve additional imports of coal from the United States once domestic stocks were exhausted. The lack of shipping space may, however be expected to impede any significant shift to coal as a source of energy.

Industrial and agricultural production

8. Industrial production in the United States and Canada seems to be somewhat stimulated by current events. An expansion of the tanker construction programme in the United States, coupled with a rise in demand for pipes for oil drilling is intensifying existing shortages of steel plate and pipe. The supply of steel plate is now

about 40% behind requirements. This is expected to contribute to an expansion in steel production, which may rise to 120 million tons in 1957, some 3 million tons above the record year of 1955. The production of crude oil in the United States is apparently already expanding under the pressure of the increased European demand, and output in Canada is also expected to react favourably.

9. In Western Europe, in contrast, despite limited increases in output occurring in some sectors of industry, it is already evident that the overall rate of industrial progress is being compromised. Even though shipyards in the United Kingdom, Western Germany and the Netherlands are benefiting from the shortage of shipping and the output of crude oil in Europe itself may somewhat increase, the reduction in oil supplies is having an adverse effect on industries using oil as a source of energy. Industries most affected are steel making and finishing, glass making, cement and chemicals. In the United Kingdom a 10% decline in fuel supplies might well result in a 750,000 ton reduction in the output of finished steel. France, on the other hand, which has fewer open-hearth furnaces using oil, may be expected to suffer relatively less. Even should oil supplies decline by as much as a third, output of steel might not fall by more than 200,000 tons. Countries where oil plays a particularly important rôle as a source of energy, such as Greece, Iceland, Portugal and Denmark, are in a particularly susceptible position. In general, the adverse effects on industry may be cushioned by the extent that priority is given to industrial consumption and limited to other users.

10. Another effect of the present crisis has been the reduction in the output of the motor car industry in a number of European NATO countries, owing both to a drop in internal demand and difficulty being experienced in finding shipping space for exports.

11. At this time of year, agriculture should not feel much adverse effect from the oil shortage. Whether agricultural production suffers much depends on the oil situation early next year.

Transport

12. Transport, which normally accounts for some 40% of the oil used in Europe, is probably experiencing the most serious impact of the shortage. Road, railway, air and water transport are all affected. There may be a limited possibility of shifting from road to rail, which is the least dependent on oil. Clearly it is very important to maintain distribution services to avoid disrupting production.

Balance of payments and the gold and dollar reserves

13. Both exports and imports are being hindered by lack of shipping facilities. Whether the balance of trade of European NATO countries will be significantly influenced by the situation in the Middle East is still a matter of speculation.

14. Invisible earnings on the balance of payments may be expected to react sharply to the Suez conflict. Some freight rates are above the peak of the Korean period. Net earners on the shipping

account, such as the United States, the United Kingdom and Norway, apparently stand to gain from a rise in freight rates. In so far as the United Kingdom is concerned, however, this will probably not be so since, while the United Kingdom exports some 30% of her tanker tonnage, she is a net importer of tramp tonnage.

15. The terms of trade of European NATO countries may be expected to be adversely affected. The surcharge on imported commodities as well as higher insurance rates raise the cost of imports without, at the same time, assuring that export prices may be raised to a commensurate degree. Already in October import prices were up by nearly 3% in the United Kingdom over the previous month, owing largely to an increase in tanker freight rates. The additional cost of shipping oil round the Cape has been estimated at some £2 a ton.

16. Both sterling and the franc came under rather heavy selling pressure after the operation in the Suez area. Nevertheless, even though the London market is particularly vulnerable to the vagaries of international events on account of the extent of short-term capital, selling pressure in recent weeks has not been as strong in recent weeks as might have been expected. This may be largely explained by the fact that the blocking of Egypt's sterling accounts in the United Kingdom and the tension following nationalisation of the Suez Canal led many holders of short-term capital to take measures in advance. Though exchange equalisation is still limiting the pressure on sterling through release of gold and dollars, intervention is apparently not being required on a large scale to maintain free rates close to official parities. The considerable pressure exerted on the franc was to be seen in the rise in the price of gold and the rise in the "parallel" rate of the dollar. On the Continent the premiums on sovereigns over their gold points parity increased by as much as 27%; however, the intervention of central banks when the free market rate deviated from the official parity limited undue rises in the price of gold. A counterpart of this flight from sterling and the franc is to be found in the afflux into Switzerland of foreign funds. Most other NATO countries seem to have suffered little adverse effects from the Suez crisis. Thus even in Greece the gold sovereign increased in price only from 75 to 78 shillings.

17. Capital investments of France and the United Kingdom in Egypt will undoubtedly receive a serious blow from the decree issued by the Egyptian Government on 1st November sequestering all French and British property. Indeed total French assets in Egypt may well value several hundred million pounds. French and British interests in the principal commercial and industrial companies alone, exclusive of either the Suez Canal Company, the Suez base, or other property holdings, have been estimated to have a value respectively of £75 million and £55 to £60 million.

18. Increased purchase of oil in the Western hemisphere by European NATO powers, while partly counterbalanced by a decline in dollar purchases in the Middle East, can be expected to have an adverse effect on their gold and dollar reserves. The loss to Western Europe in dollars, assuming that oil deliveries will be 75% of normal, might range between £100 and £180 million over the next six months. This is a cause for considerable concern in France,

despite the fact that exchange reserves are high (about £530 million at the end of October). The trade deficit for 1956 was already expected before the oil crisis to be of the order of £250 million. Only slightly less preoccupying is the situation in the United Kingdom, where in November gold and dollar reserves fell by £100 million. The positions of France, the United Kingdom, Italy and the Netherlands are all rendered more difficult by the fact that they will have to turn to the dollar area not only for net imports of oil but also for supplies which are normally re-exported (see Annex II).

Prices

19. Increased freight rates and, in some cases, shortages, are generally tending to lead to an increase in prices. Commodities which regularly pass through the Canal, and oil from the Western hemisphere have been the most affected, though nearly all imported goods have been affected to some degree. Western European demand for oil has resulted in Caribbean and Gulf prices for fuel oil and heavy crudes shifting upwards by as much as 10%, while freight rates have risen by between 40% and 60% in a month. In France, increased freight rates may add as much as 12% to the price of tin and 4% to the price of rubber. Most of these commodities play an important rôle in the manufacture of European finished products, and the rise in prices will tend to spread throughout the economies of the countries concerned.

Budget

20. Budgetary expenditures and revenues are both being affected by events related to conditions in the Middle East. The intervention of the United Kingdom in Egypt, the Chancellor of the Exchequer estimates, will have cost £35 to £45 million by the end of the fiscal year. The loss in revenue to the Treasury of the petrol and oil rationing will, on the other hand, be of the order of £6 million a month.⁽¹⁾ Added to this will be the loss in revenue from the licensing of cars and purchase tax revenue on new cars. French budgetary expenditures are somewhat less than those of the United Kingdom, yet a decline of some 25% in the revenue on taxes on petroleum products could mean an annual loss of £100 million in budgetary revenue.

Prospects

21. The OEEC has established a Petroleum Emergency Group (OPEG) designed to facilitate the pooling of the resources of the leading oil companies with overseas availability, and an equitable allocation of available supplies. The Group proposes to co-operate with the United States Middle East Emergency Committee (MEEC). The important rôle played by political considerations in the present crisis renders highly hazardous any estimate of the time that will eventually elapse before conditions return to normal. Tension remains in the Middle East and there is no assurance that repairs on damaged equipment will proceed unhindered.

(1) This estimate does not take account of the recently announced increase in the petrol taxes.

22. Should the situation resolve itself into the purely technical problem of clearing the 49 wrecks and 2 bridges blocking the passage through the Canal and repairing the damaged Iraq Petroleum Company pipelines and three pumping stations, conditions might well radically improve in a matter of months and return to normal in less than a year. Some observers think it may be possible to open a channel through the Canal and to repair or by-pass damaged pipelines and stations in Iraq in a few months.

23. The longer the Suez Canal remains closed and the Iraq Petroleum Company pipelines inoperative, the greater will be the impact on NATO economies. Among the more apparent effects will be a loss of gold and dollar reserves, higher prices, a worsening of the terms of trade and, in some countries, a drop in output and a more difficult budgetary position. Even more serious is the loss being faced by France and the United Kingdom in Egypt of capital investments and markets in the Middle East generally. At the same time, the dangers inherent in Soviet economic penetration will be increasing.

24. The need for as high a degree of co-operation within NATO as is being shown in the OEEC is apparent. The present crisis has adverse implications not only for the NATO economies, which are the basis of the defence structure, but also, possibly, for current military programmes.

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A N N E X IOIL PRODUCTION
(1955)

Country	Output (in million metric tons)	Percent of World Total	Shipments to West	
			Via Canal	Via Pipeline
Middle East				
Kuwait	55.0	20%	44	-
Saudi Arabia	47.0		8	16
Iraq	33.8		4	25
Iran	15.8		10	-
Qatar	5.4		5	-
Egypt	2.0		-	-
Bahrain	1.5		3	
Neutral zone	1.3			
United States	362.7	47%		
Venezuela	113.2	15%		
USSR	71.0	9%		
Canada	17.6	3%		
Western Europe	9.16	1%		
World	765.3			

A N N E X I IEUROPE'S OIL SUPPLIES(Annual rate in million metric tons,
based on January-June 1956)

Country	Gross Imports of Crude and Products	Exports (mainly to elsewhere in Europe)	Net Imports	Middle East Supplies (1)	
				Via Canal	Via IPC Pipeline
United Kingdom	39.8	7.2	32.6	23.3	3.5
France	26.0	4.8	21.2	13.8	10.0
Italy	18.2	5.8	12.4	8.6	7.0
Netherlands	15.2	8.3	6.9	9.0	(2)
Germany	10.4	1.0	9.4	1.5	2.0
Sweden	9.6		9.6	2.2	
Belgium/Luxem- bourg	8.0	2.2	5.8	3.3	2.0 (2)
Denmark	3.6		3.6	7.2	
Norway	3.2		3.2		
Switzerland	2.4		2.4		
Others	2.8		2.2		1.0
Total	139.2	30.0	109.3	68.9	25.5

(1) Based on destination

(2) Including the Netherlands