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STATEMENT OF FRANK G. ZARB
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BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS

AND THE

SPECIAL SUBCOMMITTEE ON OIL AND NATURAL GAS
PRODUCTION AND DISTRIBUTION

OF THE

COMMITTEE ON COMMERCE

UNITED STATES SENATE

WEDNESDAY, JULY 16, 1975



Mr. Chairmen and Members of the Subcommittees:

I appreciate the opportunity to appear today to discuss recent trends in gasoline supply and price. While I do not wish to minimize the significance of conditions that have gained prominence in the press in recent days, I urge that we conduct a detached and objective evaluation of the situation. This is precisely the type of forum that can aid in quieting fears of a shortage that could cause panic buying and thereby create that very shortage we seek to avoid. I hope that this public hearing will eliminate some of the misunderstanding of what has been and what is actually happening, and thereby serve to reduce speculation about impending shortages.

In this testimony, I will discuss FEA's mission, responsibilities, authorities, and the reliability of the data FEA uses to carry out its legislated mandate; then move to a case study of this mission, mandate and use of data within the context of the current gasoline situation. The remainder of the testimony will deal with gasoline supply, crude oil and gasoline prices, and our compliance efforts. I will conclude with a discussion of our position on the need for an extension of the Emergency Petroleum Allocation Act and the related question of phased decontrol of old oil.



FEA's Mission and Authorities under the EPAA

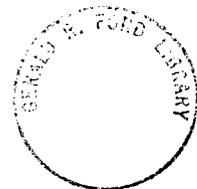
Section 2(b) of the Emergency Petroleum Allocation Act grants to the President and directs him to exercise, ". . . specific temporary authority to deal with shortages of crude oil, residual fuel oil, and refined petroleum products or dislocations in their national distribution system. The authority granted under this Act shall be exercised for the purpose of minimizing the adverse impacts of such shortages or dislocations on the American people and the domestic economy."

The Federal Energy Administration, created by Public Law 93-275, has been designated as the agency responsible for exercising the President's authority in this regard. Accordingly, the FEA's mission with respect to these responsibilities is to promulgate and enforce regulations that accomplish to the maximum extent practicable the objectives set forth in Section 4 of the Emergency Petroleum Allocation Act. As the statement of purpose in the Act itself and the legislative history make clear, the authorities granted in the Act were those deemed necessary by the Congress to deal effectively with a shortage of crude oil, refined petroleum products, and residual fuel oil.

With respect to the issue of prices, about which these Subcommittees have expressed concern, Section 4(b) of the Act requires FEA, "to the maximum extent practicable, to provide

for equitable distribution of crude oil, residual fuel oil, and refined petroleum products at equitable prices among all regions and areas of the United States and sectors of the petroleum industry, including independent refiners, small refiners, nonbranded independent marketers, branded independent marketers, and among all users." It further directs that, in specifying prices (or prescribing the manner for determining them), such regulation shall provide for "...a dollar-for-dollar pass-through of net increases in the cost of crude oil, residual fuel oil, and refined petroleum products to all marketers or distributors at the retail level; . . ."

The relevant question, therefore, is, "Have the recent increases in the price of gasoline been in accord with the provisions of the Emergency Petroleum Allocation Act and FEA's implementing regulations?" It should be clear at the outset that FEA has neither the mandate nor the authority to prevent cost-justified increases in the prices of petroleum products to consumers.



FEA Data Sources

FEA requires extensive and detailed information on the inventories, production, distribution and pricing of crude oil, residual fuel oil, and petroleum products to discharge its responsibilities. Principal data sources include:

- Data certified by company officials and verifiable by audit, collected under the provisions of the Mandatory Petroleum Allocation Regulations. These data include inventory levels, production, and distribution by state of 18 separate covered petroleum products and projections for a three-month period as to supply availability and supply obligations by state for each product.
- Periodic reports of "surplus" product, i.e., product which is available in excess of mandatory supply obligations which assigned base period customers have failed to purchase. Such surplus product must be reported to FEA and disposed of in accordance with FEA regulations.
- Monthly reports certified by company officials as to the composition and total of available cost pass-throughs, pass-throughs taken, the

distribution of pass-throughs across each covered product, and unrecovered cost pass-throughs from each refiner.

- Specific additional detailed justification for any cost pass-throughs claimed upon demand by an FEA auditor.
- Specific documentation supporting the reported distribution of covered products in accord with allocation regulations upon demand by an FEA auditor.
- Summary reports of inventory, refining, distribution, and marketing operations as required by FEA regulations.
- Data collected and reported by other government agencies (e.g., Bureau of Mines, Department of Commerce, U.S. Customs, Department of Treasury, etc.)
- FEA commissioned surveys to determine conditions in the market for petroleum products (e.g., retail gasoline prices, market shares of gasoline marketers, propane prices, etc.).
- Publicly available data (Platt's Oilgram, American Petroleum Institute reports, Oil Week price surveys, etc.).



- Specific information on individual issues as required from specific groups, industry associations, and other available sources.

These different sources are used for different purposes. For example, to determine whether companies' price and distribution actions have been in conformity with FEA regulations, FEA relies only on data certified to it by company officials. These data are submitted under penalties prescribed by statutes for false reporting and FEA conducts such audits as it deems necessary to verify the accuracy of this data. To monitor trends in the important variables of industry operations--stocks, refinery runs, production, data, etc.--FEA needs data that are available on a more timely basis than is feasible for data requiring certification.

Accordingly, in the spring of 1974 FEA implemented a weekly Petroleum Information Reporting System. This required each refiner to submit by Sunday of each week to FEA by mailgram its best estimates of that company's operations and inventory position for the week ending close of business Friday. These data were tabulated and published, usually within one to two weeks of the date of their submission.

Our experience with the system disclosed both problems with its operation and questions about its utility, given the ready availability of similar data from other sources. Some

of its problems were:

- Imposition of a substantial and costly data processing requirement on the FEA to handle weekly reports from all reporting companies.
- Respondents were forced to make estimates of data to meet tight reporting deadlines.
- Accordingly, data were not certified and were subject to frequent and substantial correction.
- The large volumes of data and tight deadlines increased the incidence of accidental errors, both in reporting and processing.
- Wide week-to-week fluctuations in weekly values reduced the utility of the information for policy-making or predictive (trend analysis) uses.

To overcome this last deficiency, four-week moving averages were substituted for weekly values. This had the effect of making the outputs of the weekly system more nearly comparable to those compiled by the API.

It is important to understand that weekly data are not used as the basis for making decisions on regulatory actions. Rather, their principal purpose is to serve as an "early warning" system that will provide indications of emerging



problems. Weekly data are used to generate questions as to what FEA might need to do, not to provide answers as to what it should do. Once questions have been raised by analysis of the weekly data, other data sources are used to develop the necessary information on which to base our actions. Among the primary sources of this other information are certified data submitted in accord with the Mandatory Petroleum Allocation and Price Regulations and specific inquiries directed to company and industry representatives.

Over the 11-month period that it operated, the weekly system was compared to the weekly data published by the American Petroleum Institute. Allowing for the differences in definitions used and the more comprehensive coverage of the FEA system--a census of all companies as opposed to the sample of companies used by the American Petroleum Institute--the results of the two systems corresponded very closely. Given the limited use to which the weekly data could be put, the earlier availability of the API data, FEA's ability to use other sources of information as the basis for regulatory actions, and the fact that the resources devoted to the system could be better employed in improving other aspects of our data, we discontinued FEA's weekly data system on April 4, 1975. I have instructed the FEA staff, however, to

develop a weekly reporting system that will avoid the overlap and burdensome reporting requirements and improve accuracy over the previous system. That evaluation is now in progress. We are now in discussions with the General Accounting Office staff about this matter.

Here, as in other areas, we continually seek to improve the availability of accurate and timely data required to discharge our regulatory, reporting, and general monitoring responsibilities. For example, we now have underway a major developmental effort that will require not only refiners, but also companies at other levels in the distribution system to report their cost recovery performance in greater detail on formats designed to improve the speed and efficiency of FEA's audits for compliance with the price regulations. We are reviewing the effectiveness of the data collected under the allocation regulations and developing modifications to those reporting requirements so as to be better able to exercise control over the distribution of product in the event of future shortages. We will continue these efforts to improve what is already the most comprehensive and detailed data collection system ever employed by any federal agency in the discharge of its regulatory responsibilities.



A Case Study of FEA Operations

The recent developments in the gasoline market, about which the Subcommittees have expressed interest, provide a good case study that illustrates the scope of FEA's mission and authorities, its mandate from the Congress, and the availability and use of data. This section will describe FEA's actions by outlining:

- the manner in which FEA monitored trends in gasoline production and inventories;
- the actions taken by FEA to generate additional information as those trends raised questions;
- the actions taken by FEA to avoid what it saw as an emerging problem; and
- the actions remaining to be taken with respect to the issue of gasoline supply and pricing.

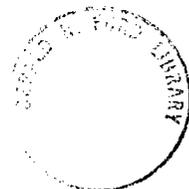
Our actions in this case illustrate two elements common to FEA's treatment of many issues:

- First, FEA's responsibilities are not always clearly defined in the statutes. Our statutory responsibility sets out clearly the actions FEA is supposed to take in a situation of product shortages. Nonetheless, we feel an additional, broad responsibility to watch the development of a situation that could provoke a shortage, to take preventive action within the

limits of our authorities, and to assure that any price increases are fully justified under law and regulation. While we lack, for example, authority to direct increased refinery runs, we believe we have all the authority we need and we have not hesitated to exercise it.

- Because we act in accordance with this broad view of our responsibility, we are criticized by some for being unduly severe in our regulatory actions. Others, however, say we are lax when we do not immediately take the actions urged by some who are not fully familiar with all the implications of such actions. This, I believe, is an inevitable consequence of FEA's even-handed approach to the solution of the complex issues that understandably generate widespread concern.

In describing FEA's actions, I will neither defend the actions of the industry nor make unsubstantiated charges. Rather, I will lay out the facts, the conclusions we derived from them, and the actions we took. To begin, I believe it would be instructive to review briefly the developments in the gasoline supply situation during 1975.



Gasoline Supply Trends

At the start of 1975 gasoline stocks were normal and demand had declined slightly during 1974. Supplies appeared to be entirely adequate to meet expected demand over the next few months.

Traditionally, the industry builds gasoline stocks in winter in anticipation of increased summer demand. Normally, gasoline stocks increase to around 230+ million barrels in April and decline to about 200 million in October. Inventories below 200 million generally indicate a tight market situation.

Since distillate stocks and residual fuel stocks also were normal at the beginning of the year, we did not anticipate any unusual problems for the next few months.

The next several months were warmer than normal. Gasoline stocks built up and distillate stocks did not decline as much as usual. The high stock levels caused refiners to reduce runs. This was both normal and expected. At the end of March, stock levels were normal or above normal for all products, and demand continued to be weak.

During April gasoline stocks dropped 13.2 million barrels, somewhat more than normal. Stock drawdowns in April are not unusual since April is traditionally a month of heavy "turn-arounds." Most refinery units must be taken out of

service for several weeks about every two to three years for maintenance and repairs. Such downtime is traditionally scheduled for April or October, two months with generally lower than normal demand. Even with the relative high April stock reduction, gasoline stocks were still considered to be normal, or at least adequate. The April reduction was not unexpected since refineries had been run at low rates during the month. We had anticipated low operating rates as the refineries attempted to reduce, by then, unseasonally high distillate stock levels.

When viewed in isolation, gasoline stock levels at the end of April by themselves were not disturbing. However, the imbalance in total product stock levels caused us some concern. Distillate stocks were still appreciably above normal. If the industry continued to run its refineries at low rates to reduce distillate stocks to more normal levels, gasoline stocks might be drawn down excessively, thereby creating some problems in gasoline.

When the preliminary data for the week ending May 2 became available, FEA analysts noticed a continuing imbalance in product stocks. While gasoline stocks were still normal for the period and above 1973 levels, distillate stocks were substantially higher than normal for that time of year and above the level anticipated by industry.



Accordingly, on May 7, FEA's Office of Regulatory Programs called this imbalance to the attention of FEA forecasters, cited the possibility of a tight gasoline supply situation developing as a consequence, and asked for an updated forecast for the remainder of 1975.

On May 14, 1975, in Technical Memorandum 75-5, FEA forecasters predicted adequate gasoline stock levels for the remainder of the year. However, their projections were based on expected normal increases in refinery capacity utilization during May. As events unfolded, however, these did not occur.

On May 16, 1975, representatives of Continental Oil Company called to FEA's attention their developing concern over the adequacy of gasoline stocks for the summer peak season. CONOCO is a net buyer of product because it markets more than it refines. Accordingly, they would normally be expected to be more sensitive to the availability of gasoline than other major refiners. FEA's Regulatory Programs Office helped arrange adequate supplies to meet CONOCO's needs for June but took the CONOCO concern as evidence that trends needed watching even more closely.

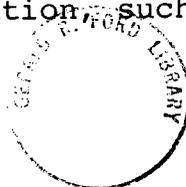
On May 20, 1975, FEA officials attending a meeting of industry representatives raised the question of the adequacy of gasoline stocks to meet summer demand. They were assured by these representatives that, in their view, the stocks of their respective companies were adequate, but that they would review the question with the appropriate officials in their companies.

On May 21, 1975, FEA contacted several selected major oil companies to get their estimate of the situation. It was assured that in the view of these companies, their own supplies would be adequate and that they foresaw no general problems, either with their respective companies or for the industry as a whole.

Notwithstanding these assurances, FEA continued to pursue the matter and noted that for the week of May 16, gasoline stocks were 212 million barrels, but crude runs to stills had not increased above the levels of April and early May and gasoline production was below 6 million barrels per day. Gasoline demand was still running below 1973 and 1974 levels.

Data for the week of May 23 disclosed a slight upturn in crude runs to stills, gasoline production of 6.1 million barrels per day, and a decline in the rate at which gasoline stocks were falling. This indicated that the industry was beginning to respond to a combination of FEA's expressed concerns and its own perception of future gasoline requirements.

The FEA staff was still concerned, however, at the slow rate at which refinery runs were increasing and, in a series of telephone calls and meetings during the last week of May and early June, FEA staff warned industry representatives that continued low refinery utilization rates could cause spot shortages. With record high crude oil stocks, adequate supplies on the world market, and low refinery capacity utilization, such shortages would be unacceptable.



Data for the week ending May 30 confirmed further increases in refinery runs and an increase in gasoline production to almost 6.4 million barrels per day. Those same data showed that motor gasoline stocks declined by only 2 million barrels from 209 to 207 million barrels. It appeared that stocks were stabilizing at well above the so-called minimum operating level of 190-195 million barrels.

Data for the first two weeks in June showed that despite continued increases in refinery runs and motor gasoline production, gasoline stocks continued to decline to a level of 200 million barrels for the week ending June 13. This new development was brought to my attention during the week of June 16, both by the FEA staff and by a call from an Exxon executive, outlining his company's plans to increase crude runs and gasoline production. Subsequently, John Hill, Deputy Administrator, Gorman Smith, Assistant Administrator for Regulatory Programs, and I spoke personally with senior officials of 17 of the largest refiners. We inquired as to their companies' conditions and gasoline supply situation over the summer peak demand season, and expressed our concern at the potential for the development of spot shortages. We immediately followed up these conversations with formal letters beginning on June 20 asking the companies to report in detail on their plans for crude oil runs and motor gasoline production for the months of July through October. The industry reported that it was increasing gasoline production and that it had adequate capacity to meet expected demand this summer.

In our investigations we also discovered a number of problems that the industry was experiencing. For instance, we discovered that an unusual number of refineries or refinery units were down due to malfunctions or accidents. The fire in the Phillips Petroleum Company refinery in California in March triggered a temporary tight gasoline supply situation in that region. A problem in BP's refinery at Marcus Hook created a local problem. In addition, there were equipment problems in Texaco's Beaumont refinery and Mobil's Joliet, Illinois, refinery, as well as several others. Industry has attributed the unusually large number of unit failures to the fact that they failed to perform normal maintenance for several years while there was a refinery shortage and it was necessary to run all refineries at peak capacity without normal downtime.

Having received specific reports from 17 large refiners on their projected operations for the remainder of the summer, FEA followed up with a request for their analyses of the reasons for the apparently low level of refinery runs during May and early June. Among the reasons cited were:

- A number of unforeseen refinery operating problems.
- An imbalance in product stocks in several companies that were concerned about unduly high levels of residual fuel oil and distillates.
- The high cost of carrying large inventories accompanied by the inability under FEA regulations to recover inventory carrying costs as increased product costs.



- Underestimations of the rate of growth of gasoline demand in the early part of the summer.
- The lead time required to reactivate processing units which had been taken out of service either for normal maintenance or because they had not been required to meet current demand.
- The impact of FEA regulations on the profitability of refining and marketing operations that caused some companies to seek to reduce refinery costs wherever possible.

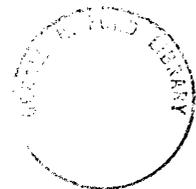
A number of industry sources have reported the possibility that speculation about impending major price increases and possible shortages before the end of the summer may have prompted unusually rapid rates of fill in secondary storage and that this may have contributed to the unexpected decline in primary stocks during May. The ability of motorists and other consumers to get all the gasoline they wanted and the absence of spot shortages even at low primary stock levels would be consistent with this explanation.

The above factors contributed to abnormal gasoline stock drawdowns, with gasoline stock levels being reduced to 196 million barrels at the end of the first week in July. It has been suggested that deliberate decisions to delay increasing

refinery capacity utilization were made to firm up prices, even at the risk of creating a shortage. We have no evidence to demonstrate that this was the case.

We do know that there was little cause for alarm about stock levels as late as early May, that the industry experienced an unusual number of refinery problems during May and early June, and that it takes considerable time to return shut-down units to full production. We also know that the seriousness of the supply situation was not clear until late May. Since time is required to make decisions and turn operations around, we have no way to determine accurately whether industry's response was as fast as could be expected, was slow due to shortsightedness, or was slow due to design, as some have charged.

I believe it is instructive, Mr. Chairmen, to recall that the first press reports on possible summer gasoline shortages appeared in Platt's Oilgram on June 18 and the New York Times on June 19, six weeks to the day after FEA had become aware of the possibility of such problems and initiated a series of actions to avoid them. I believe that this demonstrates conclusively that FEA has and exercises the capability to discharge effectively its responsibilities to the American people.



In summary, Mr. Chairmen, we have analyzed the responses to our contacts with the industry, our specific inquiries of the 17 largest refiners, and the reports received from all refiners in conformance with our allocation regulations. We note especially the high levels of crude oil stocks compared to previous years and the availability of more than one million barrels per day of extra refining capacity over 1973. Our conclusion is that projected levels of crude oil runs and gasoline production are adequate, barring unusual circumstances, to meet projected demand for motor gasoline during the peak summer season. In the absence of an unanticipated surge in demand or other unforeseen developments, we have no reason to expect any significant shortages this summer.

The question has been raised as to the relationship between gasoline inventories and prices. There is clearly some relationship between the two. However, inventory levels are only one element of the overall gasoline price picture.

Gasoline Price Trends

From January 1975, when the entitlements program was initiated, through the first week of July 1975, the national average wholesale price of gasoline (delivered tankwagon price to the retail dealer) has increased by 7.1 cents per gallon, from 31.4 cents in January to 38.5 cents in July. Adding Federal and state taxes that average 12.0 cents per gallon and the retail dealer's margin, the average retail pump price for regular gasoline has risen from 52.4 cents per gallon in January to an estimated 59.2 cents per gallon during the first week in July. There are four major reasons for these gasoline price increases:

- Increases in the national average cost of crude oil, including the effect of the \$2 supplemental fee on crude oil imports.
- The operation of the old crude oil entitlements program, which FEA had to implement to deal with the two-tier crude price system.
- Delayed recovery of allowable product costs.
- Increases in nonproduct costs incurred by refiners.



Increase in the National Average Cost of Crude Oil

In December 1974 the national average cost of crude oil booked into refiners' inventories was \$9.34. By May 1974 the impact of the first \$1 supplemental fee on imported crude oil and the changing proportion of imports to domestic crude oil had raised the national average price of crude oil booked into refineries to \$9.80 per barrel. The imposition of the second \$1 supplemental fee effective June 1 is estimated to have increased the cost of crude oil booked into refineries during June to about \$10.25 per barrel. This net increase of about 80 cents per barrel in the price of crude oil would, if apportioned equivalently across all products, account for about two cents of the increased gasoline prices posted since January 1, 1975. However, prices of other petroleum products, principally distillates and residual fuel oil, have not increased proportionately. If all of the increased costs of crude oil were passed through to gasoline, they would account for almost four cents of the 1975 increases. Our estimate is that the actual impact on gasoline prices of increased crude oil costs since December 1974 has accounted for about 3 1/2 cents of the 7.1 cent increase posted since January.

Operation of the Entitlements Program

By the end of the Arab embargo, domestic oil prices had been frozen at an average level of about \$5.25 a barrel while imported oil cost in the neighborhood of \$12 per barrel. This means that refiners who had a large percentage of their refinery runs in old oil had substantially lower average crude oil costs than refiners who were more dependent on imported oil. For example, in December 1974, crude oil costs among different refiners varied from \$5.05 per barrel to \$12.94--a difference of over \$7.75. Within this range there were wide variations among the major oil companies as well as among the smaller refiners. The lowest average crude cost for a major refiner was \$9.18 per barrel and the highest was \$10.68 per barrel in December 1974.

Under FEA's price controls, refiners are limited to their May 15, 1973 prices, plus a dollar-for-dollar pass-through of increased costs, in the amounts they can charge for covered products. Accordingly, refiners with low feedstock costs were required to sell gasoline at substantially lower prices than those with high feedstock costs. Because we came out of the embargo period with gasoline stocks at unusually high levels in 1974 and because the demand for gasoline had been depressed by high prices, there was a surplus



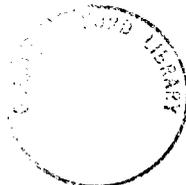
of gasoline amounting to 6.4 MMB for July 1974, and 12.3 MMB by November 1974.

As a result, refiners with lower costs--generally, but not universally, the larger companies--set the price of gasoline in the retail marketplace. Companies with higher feedstock costs had two choices: attempt to pass through those costs in the marketplace and see their volume decline, or meet the competition to maintain market share, but only by failing to recover all of the increased costs as they were incurred. They chose to meet the FEA-regulated and artificially low prices by failing to pass through all of their increased product costs. By November 1974, the national average retail price for a gallon of regular gasoline had fallen from the July high of 55.2 cents to 52 cents a gallon.

To fulfill its congressional mandate of preserving the independent sector and fostering competition throughout the petroleum industry, in January of 1975, FEA implemented regulations for sharing the price benefits of price-controlled old oil among all refiners. This "entitlements program" requires those refiners who use more than the national average of old oil (approximately 40 percent) to make payments to those refiners who use less than the national average of old oil. It thereby causes the crude costs of such refiners to escalate toward the national average cost of crude oil.

The program was effective in January 1975 for crude oil runs to stills made during November 1974. During November 1974, the national average cost of crude oil purchased by all refiners was \$9.17. Small refiners as a class had the lowest average crude cost of \$8.84 per barrel, major oil companies had an average per-barrel crude cost of \$9.09, and large independent refiners had an average per-barrel crude cost of \$10.33.

As the entitlements program became effective in raising the crude costs of some refiners and reducing the crude costs of others, the differential between the lowest cost and highest cost category decreased from its November value of \$1.49 per barrel to about 40 cents per barrel for May 1975. The result has been to raise the effective floor on the retail gasoline price market by the equivalent of about 60 cents per barrel of crude oil costs. The estimated impact of this increase on the costs of the lower priced gasoline marketers has been to raise retail gasoline prices by about two cents a gallon.



Delayed Recovery of Allowable Product Costs

As outlined above, a consequence of the two-tier price system and FEA's regulations was to force many refiners to forego the current recovery of some increased product costs. As the gasoline market firmed up with the advent of the high demand summer season, some refiners have been able to increase prices so as to recover some of the product costs they were unable to pass through in earlier months. We estimate that between 1 and 1 1/2 cents per gallon of the total price increase can be accounted for by such price changes.

Increases in Nonproduct Costs Incurred by Refiners

In addition, refiners have been subject to inflationary cost increases as have other manufacturing operations. A major source of increased costs has been in higher priced refinery fuel. Labor rates, utility costs, interest costs, and other nonproduct costs have also increased over this period. The amounts of such increases differ widely among refiners but on the average could account for at least 1/2 cent per gallon over this period.

The particular composition of any individual company's price increase is a combination of these four components and the judgment of the company's marketing officials as to the impact of any particular price increase on their market position.

FEA Compliance Actions

FEA's compliance staff monitors industry price increases as they occur to determine whether they are fully justified under FEA's price regulations. Each refiner is required to submit by the tenth of each month to FEA a detailed computation of the costs incurred in the preceding month and the distribution of those increased costs to the prices of the products to be sold in the current month. FEA auditors begin to review those calculations as soon as they are received to verify any price increases already announced by the companies and to calculate the ability of the company legally to increase prices in that month if no increases have been announced by the time the form is submitted.

The on-site audit teams in each headquarters of the 30 largest refiners then begin a detailed verification of the entries on those forms as their first priority effort. This verification takes approximately ten days and is followed up by a more thorough examination of the documentation supporting the individual entries on the form.

FEA auditors are currently engaged in this process for those forms submitted on July 10. They will continue their audit of individual company pricing actions until the FEA is satisfied that each company's prices are in full accord with the law and FEA regulations.



With respect to the industry as a whole, however, our records show that refiners have incurred substantial amounts of product costs that they have been unable to recover from the marketplace. It is important to understand that these unrecovered product costs have already been incurred by the companies involved and are authorized under the law to be recovered in product prices.

We have no evidence at this point that leads us to believe that the recently announced price increases are not legal. However, as mentioned, we are conducting detailed audits to verify all such increases, and all companies will be held fully accountable to comply with the law.

Even if all of these price increases are determined to be entirely legal, the Administration is concerned about their impact on the welfare of American consumers. In fact, the President has proposed a program that would have helped precisely those consumers who are least able to absorb these increased costs.

Almost six months ago, the President submitted to the Congress a comprehensive energy program that would have begun to decrease our vulnerability to price increases and supply interruptions from foreign sources.

The basic thrust of the President's program was to use the market mechanism as a means for reducing consumption of imported petroleum products. It provided for higher prices, both to discourage consumption and to increase the incentives to further domestic production. It recognized that lower and middle income consumers would be most adversely affected by the higher energy costs. Accordingly, the President's program made explicit provisions for refunding energy conservation taxes to lower and middle income consumers. The refunds proposed would have been larger than the increased energy costs consumers were projected to incur under the program. Had the Congress enacted the President's program, the very consumers who are today disadvantaged would not only be protected from such disadvantage, but in fact would be better off in terms of their total after-tax income, even after paying the higher prices proposed in the President's program.



Extension of the Emergency Petroleum Allocation Act

Finally, let me conclude my testimony with a response to the Subcommittee's inquiry regarding FEA's position with respect to an extension of the EPAA.

The Subcommittee has asked for the Administration's view on extension of the Emergency Petroleum Allocation Act of 1973, currently scheduled to expire on August 31, 1975. Specifically, we have been asked first whether the Administration intends to veto any extension of that Act, and secondly, what modifications to the Act would, if adopted, assure approval by the President of legislation extending the period of the allocation Act's effectiveness. While the President will have to weigh carefully many factors in considering any specific legislation which may come to him in the next few days, I believe an understanding of the Administration's position requires examination of how this legislation affects the broader elements of any program necessary to achieve the energy goals crucial to diminishing our vulnerability to arbitrary OPEC pricing and political decisions.

As you know, the Act was created to meet the acute emergency faced by the Nation during the Arab embargo. By its express terms and by its rigidity, it was designed as a short-term measure to deal with a petroleum shortage. Though it was less than perfect, its flaws were not so acute

as to prevent it from serving the Nation well to contend with the embargo, and the dislocations that it was bound to produce were relatively easily absorbed in expectation of a very short period of control.

The Act was originally scheduled to expire in February of this year. By then, the acute shortage that had made it necessary was no longer in existence. Instead, the Nation was and is faced with the urgent necessity of grappling with and achieving solutions to longer term trends in energy production and consumption which, if left unaddressed, will result in the Nation being significantly and unacceptably more vulnerable to another embargo in just the next few years.

At the request of the Congressional leadership, however, and recognizing that a mid-winter expiration of the Act was undesirable, the Administration agreed to a simple, six-month extension of the Allocation Act on the assurances of the leadership that during the interim period, the Congress would work with the Administration to produce a mutually acceptable decontrol program. Now the end of this extension is at hand, but there has been no real progress toward achieving a workable legislative approach to decontrol. And again it is proposed that the Act be extended for another period, with one pending bill



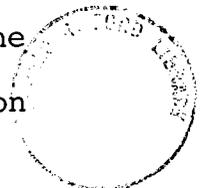
proposing extension until the middle of next year. Another bill, which has just been reported by a House-Senate conference, would not only extend the Act to the end of this year but, by rolling back "new" oil prices, would actually set back our efforts to enhance domestic production and reduce our dependence on imported oil.

In your letter, you asked for a specific comment on the question of an extension of the Emergency Petroleum Allocation Act. On Monday, the President proposed a compromise whereby there would be a phased decontrol over a 30-month period, together with a ceiling on the price of uncontrolled domestic oil over the same period.

By removing government controls, production of oil here can be stimulated and energy conserved. Decontrol and the import fees imposed earlier will reduce our dangerous reliance on foreign oil by almost 900,000 barrels a day in just over two years.

There is no cost-free way to reduce our dependence on increasingly expensive foreign oil. Gradual decontrol will result in a price increase on all petroleum products less than 1 1/2 cents per gallon by the end of this year, and 7 cents by 1978. This is a small price to pay for our national independence from the costly whims of foreign suppliers.

If the Congress acts on this compromise and on the President's proposed energy taxes, including the tax on



excessive profits of oil companies, and on his proposed refunds to the American consumer to make up for higher energy costs, the burden of decontrol will be shared fairly, our economic recovery will continue, and we will be able to protect American jobs.

Clearly, some regulatory authority over prices will be required during the period of decontrol proposed by the President. However, we believe that many of the existing provisions of the Emergency Petroleum Allocation Act are unduly rigid. Accordingly, the Administration supports, in conjunction with congressional approval of the President's decontrol proposal, an extension of the Emergency Petroleum Allocation Act with appropriate modifications to provide the necessary flexibility for dealing with the supply and price conditions likely to develop during the decontrol period.

Mr. Chairmen, your concern and that of the other members of these Subcommittees for the welfare of consumers is laudable and shared by the Administration, but the responsibility for what is happening to consumers today and what will happen to them to an even greater degree in the months ahead rests with the Congress. I urge that you act as quickly as possible to enact the President's program.

Mr. Chairmen, this concludes my formal remarks, and I will now be glad to try to answer any questions you might have.