The original documents are located in Box 4, folder: "Testimony, September 8, 1975, House Interstate and Foreign Commerce Committee - Subcommittee on Energy and Power" of the Frank Zarb Papers at the Gerald R. Ford Presidential Library.

STATEMENT

OF

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BEFORE THE

SUBCOMMITTEE ON ENERGY AND POWER

INTERSTATE AND FOREIGN COMMERCE COMMITTEE

U.S. HOUSE OF REPRESENTATIVES

SEPTEMBER 8, 1975

ON

THE EFFECTS OF DECONTROL

Mr. Chairman, Members of the Subcommittee: In the aftermath of the President's announced intention to veto the six-month extension of price controls on domestic oil, I am pleased to have this opportunity to discuss the reasons for this action and its probable impacts on the American economy. Let me stress at the outset that this has not been a rash decision on the Administration's part. On the contrary, this action was taken only after a carefully reasoned analysis of the current energy problems confronting this Nation, the consequences associated with continued delays in the implementation of a comprehensive energy plan, and the economic impact of decontrol.

Since the beginning of this year, the President has genuinely attempted to seek a compromise on the decontrol issue with Congress:

- In his State of the Union Message on January 15, 1975, President Ford called for a comprehensive energy program to reduce this country's dependence on imported crude oil. Among specific complementary measures proposed to curtail domestic energy production, the President stressed the necessity of decontrolling the price of domestic crude oil. Other parts of the President's program called for additional legislative action coupled with decontrol. In particular, a windfall profits tax and rebates to the consumer were proposed to the Committees of the Congress having jurisdiction over those matters.

- When Congress failed either to adopt the President's program or to develop a comprehensive energy program of its own, the Administration then, on July 14, proposed a gradual thirty-month phaseout of the price ceilings on crude oil. The Congress rejected the proposal.
- Two weeks later, on July 25, the President announced a compromise plan to again decontrol the price of old oil, this time over a 39-month period of time. The plan also included an $11.50 cap on domestic oil prices to insure that any future OPEC increases would not result in higher domestic oil prices. Congress rejected this proposal also.

Months of intense negotiations with the Congress on this issue have yielded no viable remedy to the decontrol problem. Further delays will only force us even deeper into the mire of dependence on insecure sources of foreign oil. Our reliance on imports has grown dramatically from 18% in 1960 to 37% in 1974, and will most likely reach 40% by the end of this calendar year. Our bill for that oil has skyrocketed from $3 billion in 1970 to $26 billion last year. At the present price levels, we could be paying out more than

$32 billion in 1977 if nothing is done to curb our need for foreign oil. As our vulnerability increases, so does the possibility of this Nation's becoming once again a target for another embargo. The 1973 Arab embargo resulted in about a $15 billion reduction in Gross National Product and the unemployment of perhaps one-half million people. An embargo of similar size and duration in 1977 would have a much greater effect on our economy. It could decrease GNP by $24 billion and increase unemployment by up to 700,000 people. Not only are our imports increasing, but a greater percentage is coming from insecure sources than prior to the last embargo. With traditional foreign sources of oil such as Canada and Venezuela decreasing exports to the United States, our dependence upon Middle East and African oil will continue to rise. By 1977, we estimate that over 40% of imported oil or three million barrels per day will be from insecure sources (see Chart A).

Under the present two-tier pricing system, we have been unable to reverse the trend of increasing imports by providing the incentives necessary to insure the maximum production of crude oil. Domestic oil production is presently at 8.4 million barrels per day, 6% below the same period last year, and about one million barrels below the same period in 1973. The maintenance of the artificial $5.25 price ceiling on what is now about 60% of our total domestic production will discourage the use of the more expensive secondary and tertiary recovery techniques while, on the other hand, encouraging out appetite for cheap, limited domestic resources. Taking into account the falling production rate of old oil fields that we are now experiencing under the two-tier price system, a continuation of controls would increase our dependence on imports and, thus, prices would rise in any event (see Chart B).

Decontrol, therefore, is the single most important action that we can take to increase supply, dampen demand through higher prices, and eliminate a cumbersome set of Government regulations. Our reliance on insecure imports would diminish. Our vulnerability to future embargos would be lessened.

The President has announced his intention to remove the supplemental import fees if his veto of the Emergency Petroleum Allocation Act extension is sustained. Hence, decontrol and removal of the fees, coupled with the proper windfall profits tax package and rebates to the consumer will minimize adverse effects on the Nation's GNP and unemployment.

The favorable impacts of these actions would be significant. First of all, our imports can be expected to be reduced by some 680,000 barrels per day in 1977 and over two million barrels per day in 1985. Secondly, the net effect of decontrol and the removal of the import fees will be a price rise averaging no more than three cents per gallon on refined petroleum products by the end of 1975.

It is most important to remember that what price increases there are will not accrue to the oil companies, but will be subject to a windfall profits tax and will be returned to the consumer in the form of tax reductions and rebates.

The effects of these price increases on the national economy would be minimal. The Gross National Product will continue to rise in terms of real dollars, and the unemployment rate will drop. In a study recently completed in conjunction with the Council of Economic Advisors, we estimate that the rise in the Consumer Price Index, attributable to the proposed decontrol actions, would be 0.2 percent in 1975 and about 0.8 percent by 1977. While we find any increase in the CPI to be undesirable, the associated reduction in oil imports - two million barrels per day by 1985 - makes this minimal increase acceptable.

Through 1977, our macroeconomic analysis indicates slight adverse effects of decontrol on real GNP and unemployment. For example, by the end of 1977 we estimate the GNP to be under one percent - lower than it would be under continued price controls - and the unemployment rate is forecasted to be about 0.1 percent higher. But these impacts are small and could be completely negated by minor changes, for example, in the Nation's monetary policy. Even so, the level of this effect on real GNP is clearly within the variations of the performance of the economy as measured by analytical models.

And these higher prices for petroleum will encourage people to conserve. It has been demonstrated that in the first three months of 1975, U.S. energy consumption was 11.4% lower than we would have expected it to be had historical growth rates continued. The slowing down of economic activity during the last year does not explain all of this reduction, since the GNP was only 5% below expectations. With the exception of a few non-price conservation programs like the 55-mile-per-hour speed limit, almost all conservation programs proposed by either the Congress or the President have yet to take effect. The magnitude of the reduction in consumption that I just mentioned leads to the conclusion that increased prices have reduced energy consumption (see Table I). Indeed, where energy prices have not risen substantially, consumption has continued to grow markedly. For example, the price of electrical energy in the Middle Atlantic States increased 38% between 1973 and 1974. During that same period, electrical use decreased by 2.5%. In the Mountain States, by contrast, prices rose only 11% - about the same as the inflation rate - and electrical consumption <u>increased</u> nearly 5% during the same period of time (see Table II). Higher prices plus the numerous other conservation measures proposed by the President can contribute significantly to a general reduction in energy consumption.

The effects of higher petroleum prices on costs of other forms of energy should be minimal. Since about 80 percent of our coal production is under long-term contract, it would not be affected by an oil price increase. Further, any coal sold on the open market competes at the margin with residual fuel oil, which currently sells at about the world market price and is predominantly supplied by imports. The price of residual oil should not increase with decontrol, since it will still sell at the world price, and in fact will decline by about $.20 to $.40 per barrel as a result of removing the $.60 import fee on petroleum products. Thus, short-term increases in the price of coal due to decontrol are unlikely.

Natural gas will be only slightly affected by decontrol. Most of the natural gas used in this country is regulated by the Federal Power Commission at no more than 52 cents/mcf. Although one-third of the gas is sold in the unregulated intrastate market, this gas has been competing with $12-per-barrel oil for some period, and yet the average intrastate price is about $.50 per mcf. Further, while new contracts are being negotiated as high as $1.50 - $2 per mcf, the average new intrastate contract has been about $1 per mcf. Thus, decontrol should not increase gas prices to the BTU equivalent price of oil (about $1.50 - $2 per mcf).

Mr. Chairman, if decontrol is not permitted to occur and old oil prices are not allowed to rise, there will be no incentive to increase our domestic supply and, in turn, no incentive for this country to curb its voracious appetite for energy. Without decontrol we are faced with the unsavory prospect of steadily increasing demand, bolstered by steadily increasing imports. This would by necessity lead to greater dependence upon insecure sources for our energy supply, with even more money being siphoned out of our economy to pay for that imported oil. It is a prospect which could have the gravest consequences for this country.

CHART A

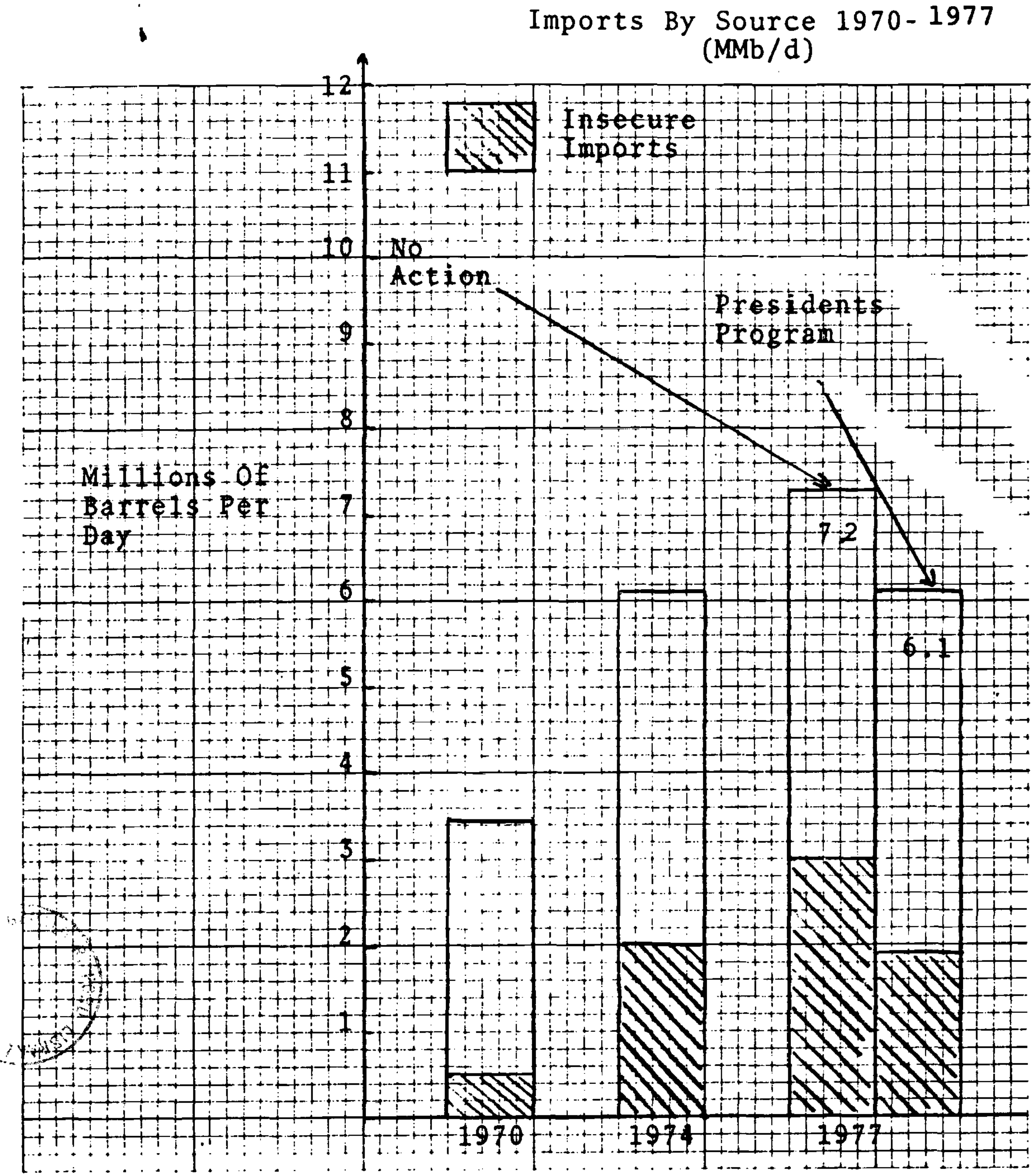
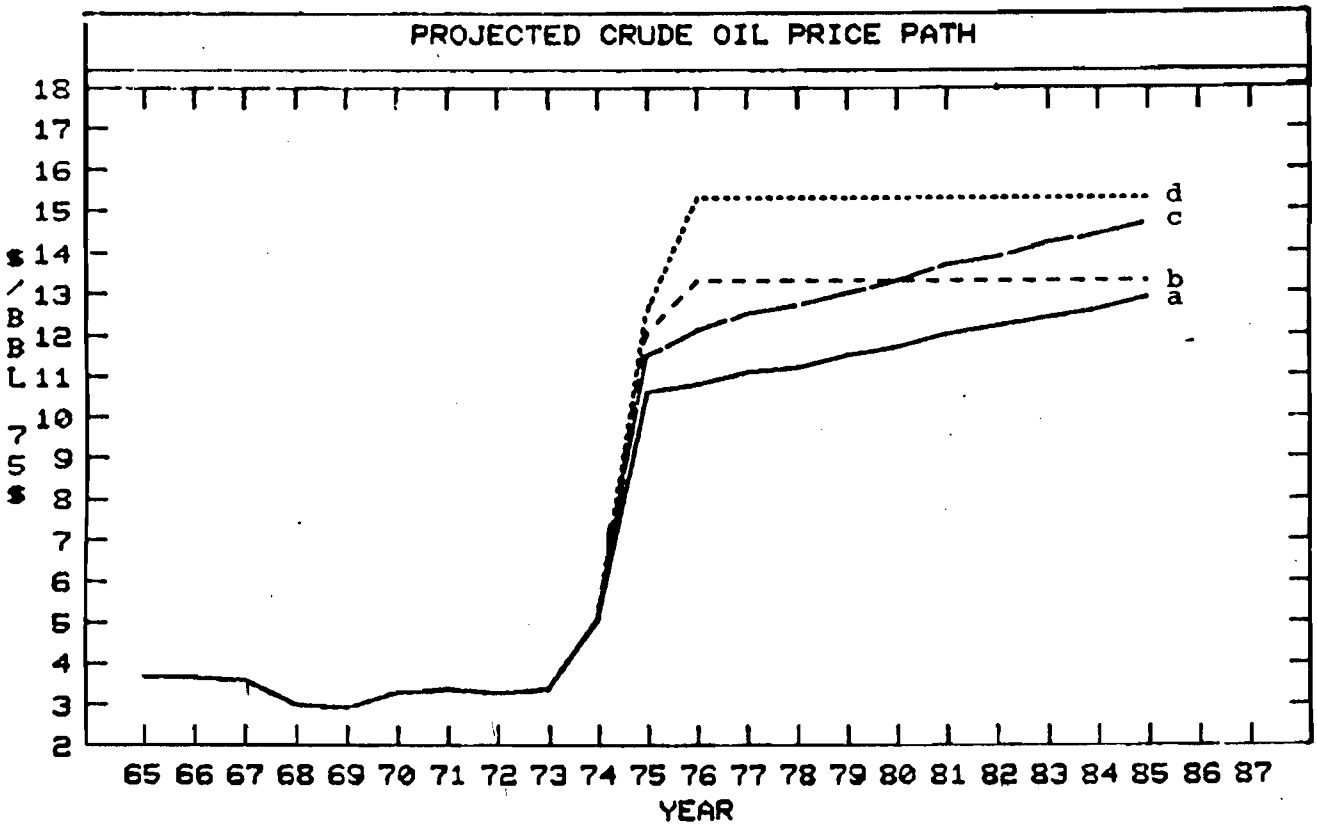

Imports By Source 1970-1977
(MMb/d)
Insecure Imports
No Action
Presidents Program
Millions Of Barrels Per Day
12
11
10
9
8
7
6
5
4
3
2
1
7.2
6.1
1970
1974
1977

CHART B



a - Before Administration Action
b - No Tariff; Immediate Decontrol
c - $2.00 Tariff; Current Controls
d - $2.00 Tariff; Immediate Decontrol

CHART C

EFFECTS OF DECONTROL ACTIONS

	1975 Change with Decontrol with Removal of Fees	1977 Change with Decontrol with Removal of Fees
Demand (thousand barrels per day)	-120	-480
Imports (thousand barrels per day)	-150	-680
CPI (% change in index)	+ 0.2%	+ 0.8%
Unemployment (percent)	0	+ 0.1%
GNP (billions of 1958 dollars)	+ 1.4 (.2%)	- 1.8 (-.2%)

TABLE I

First Quarter 1975
(Amounts in Quadrillion BTU)

	Projected Consumption*	Actual Consumption	Percent Difference
Total Gross U.S.	21.8	19.3	-11.4%
Residential/ Commercial	9.1	8.3	- 8.1%
Industrial	7.6	6.4	-15.5%
Transportation	5.2	4.6	-11.8%
Motor Gasoline	3.3	2.9	-10.1%

* From 1964-1973 historical growth rates.

TABLE II

Census Region	1974 Average Rate (¢/kWh)	Rate Increase Over 1973 (%)	Usage Increase Over 1973 (%)
New England	3.73	41.3	- 2.5
Mid-Atlantic	3.53	37.9	- 2.7
E.N. Central	2.27	19.5	- 1.0
W.N. Central	2.38	11.7	0
South Atlantic	2.47	35.0	- 1.0
E.S. Central	1.98	24.5	+ 1.0
W.S. Central	1.77	16.4	+ 2.8
Mountain	1.93	11.6	+ 4.9
Pacific	2.29	27.9	- 2.5
Hawaii	2.97	14.7	+ 7.8