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THE WHITE HOUSE

WASHINGTON

April 9, 1976

ADMINISTRATIVELY CONFIDENTIAL

MEMORANDUM FOR: JAMES T. LYNN
FRANK G. ZARB

FROM: JAMES E. CONNOR JEC

SUBJECT: Federal Energy Administration Budget Issues

Confirming phone calls to your offices this morning, the President reviewed your memorandum of April 6 on the above subject and made the following decisions:

PRICE OF OIL

Alternative #2: $11.00 per barrel

INDUSTRIAL STORAGE

Alternative #2: Assume no industrial storage requirement for planning and budgeting purposes pending outcome of FEA's analysis and rulemaking procedure and add an additional $110 million to FEA's 1977 budget amendment.

Please follow-up with appropriate action.

cc: Dick Cheney

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THE WHITE HOUSE

WASHINGTON

April 8, 1976

MR PRESIDENT:

Federal Energy Administration
Budget Issues

The attached memorandum from Jim Lynn and Frank Zarb was staffed to Messrs. Buchen, Cannon, Friedersdorf, Greenspan, Marsh, Seidman, Scowcroft and Morton. All concur in the recommendations of Frank Zarb and Jim Lynn.

Jim Connor

THE PRESIDENT HAS SEEN....

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

APR 6 - 1976

ACTION

MEMORANDUM FOR: THE PRESIDENT

FROM: James T. Lynn
Frank G. Zarb

SUBJECT: Federal Energy Administration Budget Issues

Since our meeting on March 25, OMB and FEA have worked to develop suitable compromises on the issues presented to you. These included the State conservation grant, petroleum industry audit and strategic storage programs.

We are in agreement on the following:

° State conservation grant program

Instead of making a final decision on the structure of the State conservation grant program at this time, the OMB option and an alternative formula approach developed by FEA will be discussed with selected Governors. This approach will enable us to maintain the working relationships we have established with the Governors on energy issues while keeping all of our options open prior to your final decision.

° Petroleum industry audits

FEA has agreed to accept the OMB recommendation of 1,326 positions for FY 1976 and 1977.

° Strategic storage program

A commitment will be made to complete the first phase (150 million barrels) of the 500 million barrel storage system in three years at the lowest feasible cost per barrel. Although several aspects of the system are still uncertain (e.g. cost estimates for facilities range from $1.00-$1.30/barrel), $300 million in budget authority will be requested in 1976 for construction of facilities. Outlays are estimated at $6 million for 1976 and $240 million for 1977. The $300 million in budget authority should be sufficient to meet the 150 million barrel goal--indeed, even at the high end of present per barrel estimates, it should be enough for more than 200 million barrels.

- If the $300 million is not sufficient, a supplemental appropriation will be requested, and funds then held for oil purchases can be reprogrammed to maintain facility construction levels until the supplemental is approved.

- If, on the other hand, the full $300 million is not required for the early system, the unutilized amount will be allocated to expand the early storage system to the 500 million barrel system intended within seven years.

OMB and FEA agree that 50 million barrels will be placed in storage in 1977, with the remaining 100 million barrels of the early system being stored in 1978.

We have also reached tentative agreement on two other issues that require your consideration: the price of oil to be included in the budget for the storage program and the industrial component of the program.

. PRICE OF OIL

The price of oil to be included in the budget has a major impact on outlays for 1977 and 1978, since at least 40 million barrels will be purchased in 1977 and at least 55 million barrels in 1978. Two alternatives that employ different mixes of domestic (old and new) and imported crude oil are:

	price/ barrel	% old oil (5.75)	% new oil (12.40)	% imported oil (13.00)	1977 outlays $ millions
Alt. #1:	7.50	75%	-	25%	300
Alt. #2:	11.00	25%	35%	40%	440

The $11.00 price is the national average crude oil price paid by all refiners. The $7.50 option is an arbitrary price that could be achieved, at least theoretically, through FEA's regulatory powers. The advantages and disadvantages of these alternatives are summarized in the following:

Alternative #1: $7.50 per barrel

- The main advantages of this option are:

  (1) A budgetary savings of $3.50/barrel or $140 million in 1977 and $193 million in 1978; and

  (2) A shift of this difference in financial burden from taxpayers in general to oil consumers (the beneficiaries of the program) in particular by raising prices at the pump about 1/20¢ per gallon.

- The main disadvantages of this option are:

  (1) Additional legal risks involved in using FEA's price control authority to place the government in a preferred position vis-a-vis domestic refiners. If this could not be sustained against court challenges under the relevant statutes, and FEA's General Counsel has concluded it would be difficult, timely completion of the system would be delayed;

  (2) Little opportunity to negotiate bilateral purchases of oil at below world market prices, because foreign producers not likely to sell us oil at $7.50 per barrel;

  (3) Difficulties in explaining to the Congress and to the public why the government has elected to use cheaper oil for storage while raising prices to consumers, although only an average of 110,000 barrels a day out of an available 4.5 million barrels a day of old oil would be used; and

  (4) The paradox of using price controls--which the Administration has opposed--to the advantage of the Federal Government to keep budget outlays down, since we would not even be paying the same price that other crude oil purchasers would be paying.

Alternative #2: $11.00 per barrel

- The main advantages of this option are:

  (1) Significantly reduced legal risks, since the government would not be in a preferred position, vis-a-vis other domestic crude buyers (i.e., it would be paying the same price);

(2) Adequate price levels and funds to negotiate bulk purchases from foreign producers at below market rate; and

(3) Greater ability to defend a program to Congress and the public that has the government proposing to pay the same price for its oil as everyone else.

- The main disadvantages of this option are:

(1) Higher budgetary outlays in 1977 and 1978, resulting in breaking through $394.3 billion; and

(2) Shift in some of the financial burden of the program from oil consumers to taxpayers (via higher budget outlays).

We recommend Alternative #2 ($11.00/barrel). The outlays are well within the allowance for contingencies for this program used in preparing the 1977 budget. The reason for breaking through the $394.3 billion is not this program, but HEW's original miscalculation of the cost of the Medicare catastrophic protection proposal, which required using up $700 million of the contingency allowance shortly after the budget was published. Using Alternative #2, budget outlays through your actions would be $394.6 billion for 1977. Adding about $1.5 billion of congressional add-ons to date would bring it up to $396.1 billion.

. INDUSTRIAL STORAGE

The statute provides FEA authority to require the petroleum industry to purchase part of the oil--up to 180 million barrels--that is to be placed in the reserve. Although FEA and OMB agree that this is a valid program objective that ought to be implemented, a final decision cannot be made until further information is gathered and a public rulemaking procedure is completed. FEA has a major study of industrial storage underway which is scheduled for completion in August.

The issue is what position to adopt regarding implementation of the industrial portion of the reserve at this time. Some position is required for budgetary purposes and in order to complete a report on the Early Storage Program that was due on March 22 to Congress. Two options are assessed below:

Alternative #1: Indicate that no final decision will be made on the industrial program until FEA's analysis and rulemaking is completed, but that we are using a tentative industrial requirement of 10 million barrels for planning and budgeting purposes in 1977 and 45 million barrels in 1978 for planning and budgeting purposes. This could cost the industry up to $150 million in 1977 and $675 million in 1978.

- The principal advantages of this approach are:

  (1) Budgetary savings of $110 million in 1977 and $495 million in 1978 (assuming $11.00 oil is used); and

  (2) Early, albeit tentative, notice to the industry and the Congress that the petroleum industry will have to share part of the costs of the program.

- The principal disadvantages of this approach are:

  (1) Industry's opposition to utilization of the industrial program and the possibility of a lobbying effort to block the program if early notice is given; and

  (2) The need to seek a sizable supplemental if the industrial program is not eventually implemented.

Alternative #2: Assume no industrial storage requirement for planning and budgeting purposes pending outcome of FEA's analysis and rulemaking procedure and add an additional $110 million to FEA's 1977 budget amendment.

The principal advantage of this option is reduced opposition in near term from petroleum industry and suspension of lobbying effort until final decision is made.

The principal disadvantage of this option is major outlay impacts of $110 million in 1977 (beyond the $440 million required for purchase of oil at $11.00 per barrel in 1977), creating further pressures on the $395 billion target.

We recommend Alternative #2 because it is premature to make a decision on the extent to which industry should participate in the storage program until the FEA study has been completed and we have had a chance to review it.

FEA Budget Status

April 6, 1976

(Assumes President accepts recommendations on last two strategic reserve issues)

	1976				TQ				1977			
	BA		Outlays		BA		Outlays		BA		Outlays	
	Pres. Bud.	Revised	Pres. Bud.	Revised	Pres. Bud.	Revised	Pres. Bud.	Revised	Pres. Bud.	Revised	Pres. Bud.	Revised
Non-storage	142.6	159.7	147.0	155.8	25.2	38.5	14.6	33.4	99.9	193.2	126.0	203.8
Storage	0.4	313.6	0.4	5.6	0.1	0.6	0.1	4.6	100.0	557.7	30.0	789.7
Facilities	-	(300.0)	-	(0)	-	(0)	-	(0)	-	(0)	-	(228.0)
Oil	-	(0)	-	(0)	-	(0)	-	(0)	-	(550.0)	-	(550.0)
Other	-	(13.6)	-	(5.6)	-	(0.6)	-	(4.6)	-	(7.7)	-	(11.7)
Total	143.0	473.3	147.4	161.4	25.3	39.1	14.7	38.0	199.9	750.9	156.0	993.5