The original documents are located in Box C32, folder "Presidential Handwriting 12/8/1975" of the Presidential Handwriting File at the Gerald R. Ford Presidential Library.

[12/8/75]

THE WHITE HOUSE

WASHINGTON

INFORMATION

Mr. President:

Secretary Simon submitted the attached memorandum giving his views on the proposed energy legislation.

Frank Zarb is, as you know, preparing a paper which will include everyone's comments on the subject. However, the Secretary requested that his paper be submitted to you separately. [illegible]

Jim Connor

Attachment

Trudy, keep this here [illegible]

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

December 8, 1975

MEMORANDUM FOR THE PRESIDENT

Subject: The Energy Policy and Conservation Act of 1975

I strongly recommend that you veto the Energy Policy and Conservation Act of 1975, and take action to bring about immediate decontrol of oil prices as the best way to achieve your basic energy policy objectives.

Basic Options -- It appears that you have only two viable options -- (1) to sign the Conference Bill or (2) to veto the bill and permit immediate decontrol of oil prices. From all indications, Congress will not give you a better energy bill and will probably not extend the present controls for any substantial period of time.

While there is admittedly some risk that Congress will react to a veto of the bill by passing even more undesirable energy legislation, this is a risk which, in my opinion, you must take. Furthermore, I have discussed the bill with Senator Russell Long, and he has indicated that he would press for separate legislation enacting the desirable features of the bill. He believes that this can be accomplished.

Criteria for Evaluating the Bill -- In considering whether to sign or veto the proposed bill, there are a number of key factors which I believe need to be carefully considered. They are:

1. The compatibility of the bill with your basic energy objectives.
2. The effects on the economy and economic recovery.
3. The effects on domestic petroleum supply and demand.
4. The effect on imports of oil.
5. The effect of frequent Congressional reviews.
6. The effect of continued government regulation on long-run efficiency of the petroleum industry.
7. The effect on the prospect for the ultimate complete decontrol of oil prices.
8. The effect on our international energy objectives.
9. The effect on our continued vulnerability to the OPEC cartel.
10. The effect on opposition to indexation of OPEC oil prices.

The key to evaluating the effects of the bill are the pricing provisions which roll back the composite price of crude oil to $7.66. These provisions clearly fail to advance the basic conservation, supply expansion, and import reduction objectives that you set earlier this year.

As discussed in more detail below, the bill's provisions, when compared with immediate decontrol, would: (1) increase the U.S. demand for petroleum products while reducing the supply of domestically produced crude oil; (2) result in increased OPEC imports; (3) reverse the Administration's policy of reducing the U.S. vulnerability to the OPEC cartel;

(4) create major investment decision uncertainty in the petroleum industry; (5) give the FEA broader power to allocate revenues among the various segments of the petroleum industry; and (6) continue the already excessive and unnecessary government regulation of the domestic petroleum industry.

Although the bill does contain a number of positive provisions (e.g., authority for strategic reserves, coal conversion, and standby rationing and conservation), there is nothing in these provisions which is so essential to the development of a sound energy policy that it offsets the detrimental effects of the pricing provisions. Your decision as to whether to sign or veto the bill should, in my judgment, be based on a careful analysis of the pricing provisions.

Compatibility with Your Basic Energy Policy Objectives -- The net effect of the bill is clearly incompatible with your basic energy policy objectives even though it contains a number of the components of the Energy Package you proposed earlier this year. In your State of the Union Message last January, you announced the following national energy policy goals:

1. Reduce oil imports by 1 million barrels per day by the end of 1975 and 2 million barrels by the end of 1977, through immediate actions to reduce energy demand and increase domestic supply.

2. Eliminate vulnerability by achieving the capacity for full energy independence by 1985. This means 1985 imports of no more than 3-5 million barrels of oil per day, all of which can be replaced immediately from a strategic storage system and managed with emergency measures.

The Energy Policy and Conservation Act would work in opposition of these goals by increasing our vulnerability to OPEC interruption and price escalation in that the pricing provisions would increase demand, decrease domestic exploration and production and increase imports.

Economy and Economic Recovery -- When compared with immediate decontrol, the pricing section of the bill does provide some short-term macroeconomic benefits which need to be weighed against the harmful effects on supply and greater dependence on OPEC. Immediate decontrol would admittedly decrease real GNP growth and increase unemployment and inflation.

The Treasury Department estimates the following macroeconomic impacts when comparing the present pricing situation to the Conference Bill and immediate decontrol:

MACROECONOMIC IMPACT OF
CHANGING FROM CURRENT CONTROLS

	1976		1977	
	Immediate Decontrol	Bill	Immediate Decontrol	Bill
GNP Growth Rate	-0.4%	+0.8%	-0.6%	+1.0%
Unemployment Rate	+0.1	-0.1	+0.2	-0.3
Inflation Rate				
(a) GNP Deflator	+0.6	-0.7	+0.6	-0.6
(b) CPI	+0.3	-0.6	+0.5	-0.5

Fiscal and monetary policy could, however, substantially reduce the impact of decontrol. Therefore, I believe that on balance the short-run adverse economic effects of immediate decontrol are less of a danger to the nation than the long-term economic and national security risks inherent in the increased imports of petroleum from insecure sources.

Domestic Petroleum Supply and Demand -- The immediate effect of the bill (including elimination of the import fee) is to roll back crude prices from an average of $8.75 per barrel to $7.66. This will cause a loss of producer revenue of $3 billion the first year. When considered along with the recent elimination of percentage depletion, this results in a substantial reduction in cash flow to the industry and in funds available for exploration and development. In addition, the roll back means that, upon expiration of the price controls in the bill, the real price of oil could be lower than it is at present -- especially if Congress uses its power to prevent price increases.

Signing the bill would, therefore, be a clear signal to producers that the investment climate is unfavorable and would encourage them to make investment decisions on the most pessimistic set of prices that could result from the bill. The result will be reduced exploration and development activities, particularly in high-risk areas, and in enhanced recovery. Production will continue to drop and this decline in production will accelerate as the effects of diminished exploration and development are felt. While it is difficult to provide an accurate estimate of the supply benefits of immediate decontrol as compared with the bill, various estimates suggest that they could reach 500,000 barrels per day within 2-3 years.

In addition, there will be a decline in average petroleum product prices as a result of the bill. Depending on one's assumptions, this could range initially from 1.8¢ to 3.3¢ per gallon which would mean that the bill could increase demand by as much as 500,000 barrels per day within 2-3 years when compared with immediate decontrol.

Imports -- Increased demand coupled with declining domestic supply can only result in increased imports from the Mideast. Over the forty month decontrol period, Treasury estimates that the bill would increase imports by at least 1 million barrels per day above the level that could be expected with immediate decontrol. In addition, some industry estimates show an increase of 3 million barrels per day by 1980 and 5-7 million barrels per day by 1985.

Frequent Congressional Reviews -- The proposed bill provides for Congressional review of Presidential actions concerning prices with disapproval possible upon a majority vote of either house. Actions subject to review include:

1. Establish a separate price ceiling for Alaskan oil,

2. Modification of the ten percent adjustment limitation, and

3. Modification of the three percent incentive adjustment.

The ultimate effect of the Congressional review authority is to create great uncertainty in the mind of the producers that future oil prices will even approach the level which would otherwise be permitted under the bill. If the proposed bill is vetoed and immediate decontrol occurs, that result can only be disapproved by a two-thirds majority in both Houses, while a simple majority in either House can prevent part of the price increases contemplated by the bill.

Continued Government Regulation on Efficiency of the Petroleum Industry -- The present system of price controls, allocations and entitlements has created great distortions in the energy industry. The bill would add a new layer of uncertainty for the oil industry as companies would have no way of knowing (1) how Congress will exercise its restraining role in determining the rate of oil price increase, (2) how FEA will make its determinations as to how to price new and old oil to reach the composite price, or (3) how FEA will exercise its authority to allow exceptions to the pricing rules.

Moreover, whenever a higher price is allowed for one type of crude, a lower price will be required for some other type of crude to meet the composite price. The net effect would be to give FEA increased authority arbitrarily to transfer and allocate as much as $9 billion among various sections of the oil industry.

Lastly, the price roll back on new and stripper well oil would have a far greater impact on independent petroleum producers than on larger companies. The independents drill 9 out of 10 new exploratory wells and make 75% of new field discoveries. IPAA calculations indicate the bill would reduce the independent producers' gross oil revenues 15-20% in the first year alone.

Ultimate Decontrol -- The bill postpones the inevitable decision on price decontrol. Postponing decontrol will merely entrench the vested interests created by economic distortions resulting from controls and continue extensive controls over the petroleum industry contrary to your general policy to minimize governmental interference in the private sector of the economy.

In addition, most analyses of the effects of the bill suggest that (1) the gap between the U.S. domestic oil price and the world oil price will be the same (if not greater) at the end of 40 months and (2) the impact of the end of decontrol on gasoline prices and the economy will be larger in 1979 than now. These factors all suggest that it is highly unlikely that controls would be allowed to automatically expire at the end of 40 months. Thus, I believe that, if you sign the bill, price controls on oil will become permanent as in the case of natural gas.

U.S. International Energy Objectives -- While formalizing our participation in the International Energy Program, the authority contained in the bill is not absolutely essential for the U.S. to satisfy most of its obligations under the international emergency oil sharing program. In addition, the bill works against two of the basic goals of IEA -- fostering conservation and the development of alternative energy sources.

Vulnerability to OPEC -- The conference bill would strengthen OPEC and increase U.S. dependence on OPEC oil at a time when many OPEC countries are having a difficult time marketing their crude output. The bill would lessen U.S. responsiveness to an OPEC price increase and mean that each increase in OPEC price would be met by a smaller decrease in U.S. imports from OPEC than if we had decontrol.

Indexation -- The bill accepts the concept of indexation of oil prices by relating prices to a GNP deflator. We have strongly opposed this concept when OPEC has suggested indexing its prices. Approval of the bill would make it difficult, if not impossible, for us to avoid accepting indexation of OPEC oil prices and an extension of the concept to other commodities -- e.g. coffee, copper and bauxite.

William E. Simon

William E. Simon

A

SUMMARY OF THE ADVERSE EFFECTS

OF THE ENERGY POLICY AND CONSERVATION ACT OF 1975

National Security

--Increases imports in absolute terms and as a percentage of consumption.

--Increases vulnerability to interruption of supply and price increases.

--Signals lack of determination to OPEC and firms up OPEC price structure.

--Encourages consumption making implementation of standby restraints difficult.

Economic

--Increases demand, reduces domestic supply and increases higher priced imports.

--Discourages development of more economic domestic sources of fuel such as conventional oil and gas and coal.

--Will tend to increase GNP and employment temporarily but could have long-run detrimental effects on the economy by increasing imports from insecure sources.

--Adversely affects the balance of payments by increasing the outflow of funds for foreign fuels.

--Imposes burden of improving economy upon one industry and a limited number of producing states.

International

--Weakens our leadership in IEA.

--Accepts indexation for domestic price increases and imperils U.S. position opposing indexation in international negotiations.

Industry

--Will damage investor confidence in energy investments and the industry's capability to raise necessary capital for adequate production.

--May divert oil industry capital to other opportunities with greater returns.

--Increases uncertainty and reduces industry's decision-making capability and administrative efficiency.

--Will discourage exploration and development in high-risk wildcat areas and restrict operations to known areas.

--Will create vested interests resulting from distortions brought about by controls.

--Continues entitlement and allocation program which penalizes efficient operators and subsidizes the inefficient.

--Will impact especially hard on independent petroleum producers who drill 9 out of 10 new exploratory wells.

--FEA will have authority arbitrarily to allocate several billion in profits among producers.

Other

--Abandons principle of permitting market to regulate price so as to decrease demand and increase domestic supply.

--Abandons principle of minimizing government interference in private sector.

--Abandons principle of decreasing bureaucracy.

--Does not guarantee end of price controls. In fact, decontrol will be more difficult at end of 40 months.

--Will be perceived as an undesirable political compromise.

--President will be always in role of urging higher prices for industry and Congress in the role of protecting the consumer.

--Necessary higher prices will be more difficult to obtain as majority of one house can disapprove price increases under the bill.

--Creates constant political pressure to manipulate composite price subcategories to benefit certain interests.

--Disadvantages the producing area of the nation for the benefit of the consuming area.

B

STAFF REPORT

DEPARTMENT OF THE TREASURY

ON THE

ENERGY POLICY & CONSERVATION ACT OF 1975

December 3, 1975

Recommendation

The Bill's extension and modification of the current petroleum allocation and price controls, run counter to the conservation, supply expansion and import reduction goals the President set over a year ago.

The pricing provisions of the Energy Policy and Conservation Act would:

(1) increase the U.S. demand for petroleum products while reducing the supply of domestically produced crude oil,

(2) increase oil imports,

(3) increase the vulnerability of the U.S. to the OPEC cartel,

(4) create major investment uncertainty because future oil prices are based on political processes,

(5) give the Federal Energy Administration broader power to allocate revenues among the various segments of the petroleum industry,

(6) encourage misallocation of investments in both energy production and usage, and

(7) reinforce the already excessive and unnecessary government regulation of the domestic petroleum industry.

For these reasons, we strongly recommend that the President veto the bill, allow immediate decontrol, and suspend the $2 per barrel supplemental fee on imported crude oil.

Growing U.S. Dependence on Foreign Petroleum Supplies

The United States presently imports almost 40% of the crude oil and petroleum products it consumes. FEA's Project Independence Report speculated that petroleum imports could rise to 7.5 mmb/d in 1985 (business as usual, $11 per barrel case). However, more recent studies by respected petroleum analysts suggest that the U.S. will require petroleum imports of 7.5 - 8 mmb/d by 1980 (20 - 30% above this year's 6.2 mmb/d) and 8 - 12 mmb/d by 1985.

Consequently, the President has consistently stressed the need to reduce dependence upon foreign sources of oil. He emphasized this in his October 8, 1974 address to the Congress, his January 15, 1975 State of the Union address and in subsequent energy policy addresses to the nation.

Basic Energy Policy Options

House and Senate Conferees reached final agreement November 12, 1975 on the Energy Policy and Conservation Act. The most controversial and significant part of this Act is its treatment of petroleum price controls that are now part of the Emergency Petroleum Allocation Act. The President who must now consider this bill, will have two basic options:

(1) Sign the Conference Bill or

(2) Veto the Bill, which if sustained, would result in immediate petroleum price decontrol. (This would raise the possibility of proposing an extension of the existing controls beyond the 1976 election if the President believes the Congress may still pass acceptable legislation.)

In either case, it is assumed that the $2 per barrel supplemental fee on imported crude oil would be removed. Only if the present controls are extended would we need to continue the fee.

Evaluation Criteria

To evaluate the pricing provisions and the desirability of signing this bill, we must consider the bill's impact on:

(1) shortrun economic activity (i.e., GNP, inflation and employment),

(2) U.S. petroleum supply and demand and import requirements,

(3) OPEC's solidarity,

(4) the long-run capability of the domestic petroleum industry in meeting our energy challenge, and

(5) the role of our government in the U.S. economy.

It is upon the Bill's pricing provisions that the President must decide whether to sign or veto this legislation.

Description of the Pricing Provisions

While the legislation is not yet in final form, we have sufficient knowledge of its provisions to evaluate the Bill. A final draft should be available in the near future.

The Conference Committee chaired by Senator Jackson and Congressman Staggers agreed to a composite pricing concept for domestically produced crude oils. This concept, in general, would:

(1) Extend direct petroleum price and allocation controls for 40 months and standby controls for five years.

(2) Adopt a composite average price of $7.66/barrel for domestic crude oil--a reduction of $1.09 from the current $8.75/barrel average. This represents a "rollback" of about 12% in the average wellhead price of domestic crude oils.

(3) Permit annual domestic oil price increases by as much as 10 percent--an automatic GNP deflator adjustment could be made to keep up with inflation and an additional 3% increase as a production incentive. The 10% could be exceeded only with the consent of Congress. After February 15, 1977, the 3% incentive adjustment could be continued or modified at the President's option unless disapproved by a simple majority of either House of the Congress. If Congress disapproved a Presidential proposal to modify the percentage adjustment limitation, no production incentive could be added to the GNP deflator unless:

    (a) a new proposal to add a production incentive was submitted under the bill's three-month rule and

    (b) the new proposal was not disapproved by a simple majority of either House of the Congress.

(Note: the GNP deflator, as derived by the Commerce Department, would be adjusted downward to exclude the inflationary impact of any future increases in the cost of crude oil and petroleum products imported by the U.S.)

(4) Provide after April 1977 for the possible exclusion of up to 2 mmb/d of Alaskan and North Slope oil from the composite price ceiling and the establishment of a separate ceiling price for this production, not to exceed $11.28/barrel as adjusted for inflation. A simple majority of one House would, however, be able to deny the President's request for exclusion.

(5) Allow the President broad flexibility to set prices administratively for various categories of domestic oil production so long as the average domestic price does not exceed the composite wellhead price ceiling established by the Act.

MAJOR IMPACTS -- DETAILED ANALYSIS

Short-Run Economic Impacts (GNP, inflation and unemployment)

In analyzing the economic impacts of signing the Bill, the Bill should be compared with a decontrol situation. However, the impacts of decontrol must be analyzed in terms of decontrol vs. the current controls situation.

The Council of Economic Advisors estimates that immediate decontrol vs. the Conference Bill would decrease the level of real GNP (1958 dollars) by about 1.2 percentage points and increase the unemployment rate by 0.3 - 0.4 percent the fourth quarter of 1976.

The Treasury Department estimates that immediate decontrol vs. the Conference Bill would decrease real GNP (1958 dollars) by 1.2% in 1976, 1.6% in 1977 and 1.3% in the first quarter of 1978. Unemployment would be increased by .2% in 1976, .6% in both 1977 and the first quarter of 1978.*

Data Resources estimates that immediate decontrol vs. the Conference Bill would reduce real GNP (1958 dollars) by .7% in 1976 and 2.2% in 1977, while unemployment would be increased by .2% in 1976 and .6% in 1977.

The above estimates vary because differing input assumptions, modeling procedures as well different economic models were utilized. The adverse economic impacts

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*See Appendix for detailed Treasury Department macroeconomic estimates.

estimated by CEA and DRI are greater than would actually result from decontrol since these estimates contrast decontrol with the Conference Bill and not with existing controls. The current cost structure has already absorbed 40 percent of the cost difference between the Conference Bill and immediate decontrol.

Domestic Oil Supply--

Should the President sign the pending Congressional energy bill, the following oil cost structure could be created:

Old Oil	$ 5.25
Domestic Currently Uncontrolled Oil	11.28
Imported Oil	12.50

The FEA has several pricing options, but this is the probable option. Along with old oil, all formerly uncontrolled domestic oil, would become "price capped". Composite wellhead crude prices would drop from $8.75 to $7.66 per barrel. The wellhead price rollback for uncontrolled domestic oils would reduce pre-tax producer revenues by over $3 billion during the first year beyond the $2 billion lost due to the removal of the depletion allowance for large producers. Investment will decline.

The real price of a composite barrel of domestic oil would probably decrease during the 40 month "decontrol" period even if the 3% production incentive adjustment is permitted during the entire period. The 3% incentive adjustment can be viewed as an increase in the real price of oil. However, when one inflates the rolled back composite price of $7.66 by 3%, the composite price at the end of the 40 months would be only $8.45 per barrel (1975 dollars), a price <u>below</u> the current $8.75 composite wellhead price (assuming Alaskan oil is not exempted). If the actual inflation rate is greater than a 7% annual rate, or if at any time the incentive factor is less than 3%, the real price would be less than $8.45 per barrel. Increased investments in search of new domestic petroleum reserves can be assured only if the real price of oil is allowed to rise over time. The Conference Bill will not guarantee this. The only option the President has to assure this would be to allow decontrol.

The effect of alternative crude price levels on supply is extremely difficult if not impossible to quantify. By holding petroleum prices at arbitrarilly low levels, the

Conference Bill would result in lower oil supplies than would be achieved under either immediate decontrol or a continuation of the present price controls. Higher petroleum prices would encourage the development of progressively more expensive oil supplies. Restoring the power of market forces to the domestic petroleum industry would increase petroleum investment and supply by:

(1) releasing some production now being withheld because of the two-tier pricing system.

(2) making additional pumping equipment, handling facilities and operating personnel economic,

(3) increasing the proportion of oil-in-place recovered, leading to greater production from known reservoirs, and

(4) justifying exploration of less promising areas and causing development and production of previously less rewarding reservoirs.

In addition, market prices for oil will induce additional production of natural gas, in part a joint product of oil production.

Treasury analysis strongly disagrees with any contention that the Bill's pricing provisions will provide adequate production incentives. Maximum production from domestic sources will only flow from total decontrol.

Data Resources has made the following supply estimates for lower 48 crude oil production under immediate decontrol, extension of current controls and the Congressional Program.

Estimates of Domestic Crude Oil Supply
From the Lower 48 States
Under Different Regulatory Programs
(mmb/d)

	1975	1976	1977
• Deregulation	8.367	8.417	8.750
• Current Controls	8.367	8.116	8.122
• Congressional Programs	8.367	8.100	8.050

Demand--

The economic stimulus and reduced petroleum prices resulting from enactment of the Bill would increase energy consumption vis-a-vis current controls and certainly increase consumption as opposed to decontrol.

Refiner average feedstock costs (ex transportation) would drop from the current \$10.48/barrel level to approximately \$9.11/barrel, a reduction of \$1.37/barrel, or 3.3 cents on a per gallon basis. Some analysts, however, forecast only a 1 cent per gallon drop in product prices due to the legal ability of refiners and marketers to pass through "banked costs" (unrecouped costs from prior months). If the current competitive conditions continue to prevail in the petroleum products market place and we experience another warm winter, the rollback could be closer to 3 cents per gallon. If Congress should require a dollar-for-dollar pass through of the feedstock cost rollback, product prices could drop by an amount closer to 3.3 cents per gallon, depending upon the treatment of banked costs.

DRI projects the incremental demand response resulting from the Congressional Program at approximately 500 mb/d, allocated 100 mb/d to induced economic growth, 150 mb/d because of the gas shortage and 250 mb/d directly to the price rollback. The Compound annual rate of growth of petroleum demand would thereby be increased from 1.3 percent to 3.6 percent for the period 1974 through 1977. DRI stimulations have assumed the actual price rollback would approximate one cent per gallon. DRI notes that should petroleum product prices fall by Senator Jackson's projected 3.5 cents, another 100 to 200 mb/d would have to be added to their demand estimates.

Imports--

There have been a number of estimates made of increased petroleum imports under the Conference Bill vs. (1) immediate decontrol and (2) a continuation of the present controls program. While these estimates were made by different groups and covered different time periods, the estimates consistently show substantial import increase resulting from the Congressional Program as compared to immediate decontrol. These results are summarized below:

PROJECTED IMPORT INCREASES
(Conference Bill vs. Immediate Decontrol) -- (mmb/d)

• Congressional Program vs. Immediate Decontrol.

	1976	1977	1978	1979	1980	1985
DRI	1.0	1.3	N/A	N/A	N/A	N/A
Hansen (Exxon)	.3-.4	N/A	N/A	1.0+	N/A	N/A
API	N/A	N/A	N/A	N/A	3.0-4.0	5.0-7.0
Treasury (Preliminary)	1.1	1.9	N/A	N/A	2.9	N/A

• Congressional Program vs. Present Controls

MIT	.2-.3	N/A	N/A	N/A	N/A	N/A

PROJECTED IMPORTS -- mmb/d

The FEA estimates petroleum imports with immediate decontrol as follows:

	after 1 year	after 2 years	after 3 years
Immediate Decontrol	7.659	8.405	8.024

The FEA estimates petroleum imports with an extension of the current controls as follows:

Current Controls	7.992	9.027	8.847

The FEA estimates petroleum imports under the Conference Bill as follows:

• favorable case	8.127	9.079	8.393
• moderate case	8.134	9.088	8.522
• unfavorable case	8.134	9.159	9.007

It is obvious that the Conference Bill would permit greater increases in petroleum imports than would immediate decontrol. In addition, the FEA notes that some analysts consider the agency's domestic production estimates (for the Conference Bill case) too optomistic. If true, the Conference Bill would stimulate even greater petroleum imports.

OPEC Solidarity--

When compared with immediate decontrol, the proposed legislation would increase U.S. dependence on imported crude oil both in the short and long run. These increased requirements would have to be satisfied mainly by increased imports from OPEC. Such an increase in demand would come at a very propitious moment for OPEC. At present, OPEC members are encountering increasing price adjustment pressures as they attempt to reduce production and market their output without formal prorationing in a world market typified by weak demand, glutted supply and a large degree of surplus crude oil production capacity.

In light of this development, it would be unfortunate should the U.S. reduce its composite wellhead prices and thus allow the entitlements program, which subsidizes crude imports, to make it easier for OPEC to boost prices. DRI projects that OPEC exports would increase by between 1 to 1.5 mmb/d through 1978 as a result of the Congressional Program. DRI believes such export increases would undoubtedly be sufficient to enable OPEC to achieve real oil price maintenance during this period.

As long as domestic wellhead prices remain below the world price level, the entitlements program will have to be retained. Under the present controls system, 62% of any OPEC price increase flows through to domestic consumers. The increased protection for U.S. consumers this Act would provide, would also increase protection for OPEC's U.S. market. Under the Energy Policy and Conservation Act, only 36% of any future OPEC oil price increases would actually signal the American consumer to conserve; 64% of U.S. crude oil supplies would be price capped (e.g. new, released, stripper, and old oil). The Bill would increase OPEC's monopoly power.

Only with decontrol would OPEC price increases be fully reflected in higher U.S. refiner feedstock costs and refined product prices. Given the economic structure of U.S. petroleum price controls, the Congressional Plan can only help to strengthen OPEC solidarity. In short, the Bill is the perfect vehicle for U.S. consumers to continue subsidizing high cost imported OPEC oil.

Long-Run Capability of the Domestic Petroleum Industry to Meet our Energy Challenge and the Role of the Government in the U.S. Economy

The Congressional Program would make the domestic petroleum industry subject to detailed control by the Congress operating as a Committee of the Whole. This Bill, if adopted, would set the acceptable real price of domestic oils (e.g. new, released, stripper and old) and thereby predetermine the composition of such production as well as the revenues of domestic producers.

Further extending and expanding the massive old oil entitlements income transfer program would be absolutely necessary to operate the new three tier petroleum pricing system which would result from implementing this program. Rolling back the average wellhead price of domestic crude by $1.09 per barrel would increase the cost differential between domestic refiners and petroleum product importers to an unacceptable level. Imported products would have to be included in the old oil entitlements program and a subsidy provided.

The Congressional Program would not really add much certainty to oil company operations. Producers would be assured real price maintenance plus a 3% production incentive factor until April 1977. This assurance would start only after a $1.09 per barrel real price rollback. After April 1977 not even real price maintenance would be guaranteed should the GNP deflator rises above 7%. Either House of Congress could block future price hikes that the President might propose. The casual observer might well perceive the President in the role of attempting to increase the price and Congress in the role of "keeping the lid on".

The future is further clouded by the delay in deciding the price at which oil from Alaska's North Slope will come on stream. Presidential price requests must be cost based and again are subject to a one House simple majority veto. The CEA's analysis shows that the energy pricing provisions of this Bill would not definitely hold out the promise of complete decontrol after 40 months. On the contrary, their analysis shows that it might be even more difficult to decontrol at the end of 40 months. Such decontrol might actually be more adverse to the economy than would immediate decontrol. Moreover, by increasing government regulation of private industry, the Bill is inimical to the President's desire to get the government out of the unnecessary regulatory business.

ADDITIONAL IMPACTS

Some of the Bill's other provisions are clearly intended to neutralize the negative aspects of its pricing measures. But a balance has not been achieved and the costs are high. The Bill requires increasing intervention in our domestic economy and a shift in our long held foreign trade policy.

International

- The Bill will increase our energy imports. This is counter to our commitments to the International Energy Agency and strengthens OPEC's power in the market place.

- The Bill formalizes U.S. participation in some ancillary IEA activities. However, the pricing provisions thwart the main objective of the IEA to reduce imports through developing indigenous energy resources and reducing consumption.

- Our trading partners may favor the Bill, in the belief that it assists our economic recovery and consequently makes their economic recovery easier. In the longer term they will object to the competitive advantage of our energy intensive industries.

- The Bill increases the barriers to energy exports from the U.S. This is counter to the President's Paris Summit announcement concerning foreign access to our resources.

Emergency Measures

- The Bill increases the need for emergency measures because the pricing provisions enhance U.S. dependence upon insecure imports.

- The emergency stock provisions cannot be accepted without some reservations. Technical considerations raise questions concerning the Bill's emphasis upon petroleum product stocks.

- The provisions empowering the President to require oil production at Maximum Efficient Rates and to exceed those rates in emergencies seem unnecessary. Legal authority already exists for most situations and the economics of oil production favor maximum production.

- The Bill provides authority to develop standby rationing and conservation plans for use in future energy emergencies. Such authority already exists for carefully defined emergencies. Judgement on these provisions must await the specific language of the Bill.

Market Intervention

- The Bill increases the need for federal regulatory authority. The multilevel price system will require continued allocation and entitlement programs in order to equalize refiner feedstock costs. Because petroleum will be selling below the market clearing price, end use controls become necessary. Two examples in the Bill are: (1) the power to force the use of coal for boiler fuel and (2) mandatory fuel-economy standards for automobiles. Higher oil costs will make such controls unnecessary. Further controls run counter to the President's program to decrease regulation.

- The coal loan guarantees insure a misallocation of financial resources rather than an increase in coal supplies. The $30 million limit is too small for economic operations which can be certain to comply with environmental and safety standards. The federal guarantees will draw investments away from more promising projects to sub-marginal operations.

- The conservation programs in the Bill cannot be evaluated fully until more specific language becomes available. Appliance labeling supports the market by increasing information and aiding consumer decision making. The voluntary conservation targets are probably meaningless. Business decisions are more likely to be influenced by comparative energy prices than by targets and norms set by federal bureaucrats.

Appendix

The Treasury Department makes the following estimates of the macroeconomic impacts of the Conference Bill vs.:

(1) immediate Decontrol (ID), and
(2) current controls (CC).

Macroeconomic Impact of the Conference Bill vs.

	1976		1977		1978 1st Qtr	
	ID	CC	ID	CC	ID	CC
• Real GNP difference						
billion 1958 dollars	+10.5	+7.1	+14.1	+8.8	+11.3	+6.0
%	+ 1.2	+0.8	+ 1.6	+1.0	+ 1.3	+0.7
• GNP deflator						
% difference	- 1.3	-0.7	-1.2	-0.6	-1.1	-0.7
• CPI						
% difference	-0.9	-0.6	-1.0	-0.5	-0.9	-0.5
• Unemployment rate						
% difference	-0.2	-0.1	-0.6	-0.3	-0.6	-0.3