The original documents are located in Box 15, folder "Energy - Oil Decontrol: Economic Impact Report (1)" of the John Marsh Files at the Gerald R. Ford Presidential Library.

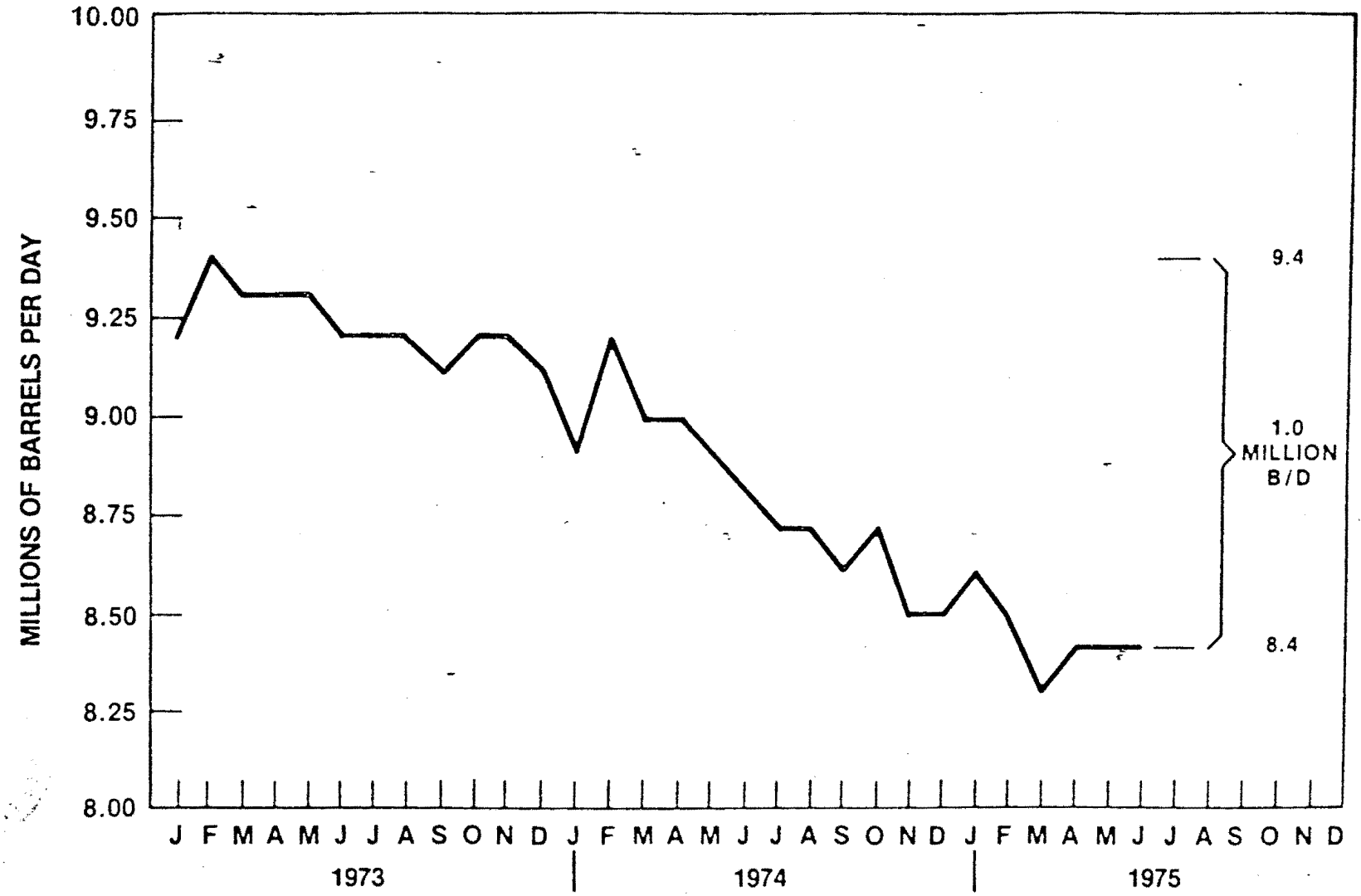
ECONOMIC IMPACT OF THE PRESIDENT'S PROPOSED PROGRAM ON PHASED DECONTROL

JULY 17, 1975

Office of Economic Impact
Office of Analysis
Federal Energy Administration

CHART 1

DOMESTIC PRODUCTION OF CRUDE OIL



EXECUTIVE SUMMARY

Background

The President has proposed the gradual removal of price controls from domestic crude oil, at the rate of 3.3 percent a month over a 30-month period ending January 31, 1978. At the present time old crude oil is subject to a ceiling price at approximately $5.25 per barrel. The decontrol of old crude would tend to raise this price to the level of world oil--the price that refiners in the United States pay for imported crude oil. However, the President has also proposed that a new ceiling price for all domestic crude oil (other than stripper well crude oil) be put into effect during the 30-month decontrol period. This ceiling price will be approximately $13.50 per barrel. The ceiling would assure that further OPEC price increases would not trigger additional domestic crude oil price increases during the phase-out period. Finally the president has proposed other energy taxes, including a windfall profits tax on the revenues that accrue to producers as a function of the decontrol of old oil. The revenues from these taxes would be returned to consumers to maintain consumer purchasing power in the face of higher petroleum prices.

The reason for decontrolling old oil is to remove regulations (and the two-tier price system) from the petroleum industry market. These regulations have tended to inhibit the production of new supplies of crude oil (see Chart 1).

Benefits of Decontrol

With the decontrol of old oil, the decline in the domestic production will be arrested and additional supplies of domestic crude will be forthcoming over the next decade. In addition, the higher prices caused by decontrol will stimulate additional energy conservation, while greatly increased supply will not occur immediately, by 1977.

Import savings of approximately 363,000 barrels per day will result. By 1985, decontrol will result in an estimated 1.4 million B/D of increased supply. Two benefits will accrue to our reduced reliance on imports both in the short term (1977) and the long term (1985). First, the reduced reliance of the United States for its petroleum imports on insecure sources of imports will reduce dramatically the impact of future embargoes on the United States

economy. In 1977 the cost of a future embargo without a program would be approximately $33 billion, whereas the cost of an embargo with the President's program would be approximately $12 billion. By 1985, the cost of an embargo without the President's program would be approximately $110 billion whereas with the President's program there would be essentially no costs imposed on the United States economy by an Arab oil embargo. In addition, the reduced reliance on imports will reduce the dollar outflow from the United States economy for the purchase of foreign oil. In 1977 approximately $2 billion more would flow out of the economy without the President's program than with the President's program just in terms of the higher cost of imported crude oil. By 1985 the additional dollar outflow from the economy without the President's program would be approximately $50 billion. These dollar outflows clearly would have an adverse effect on the balance of payments and hence would exert adverse pressure on the value of the American dollar overseas.

Costs of Decontrol

The phased decontrol of old oil will increase petroleum prices to the refiners and hence to consumers. By the end of 1977, total costs to consumers per household will be approximately $114 annually. Direct costs will be approximately $61 and indirect costs approximately $53 per household. Due to the phased program, cost increases for the remainder of 1975 will be approximately $13 per household. Gasoline prices will increase gradually over the decontrol period to approximately 7¢ per gallon by the end of 1977, but only by slightly over 1¢ during the remainder of 1975.

In order to ascertain the impact of the President's proposed decontrol program on the national economy, a macroeconomic simulation was performed using the President's program with respect to energy prices as a basic input. This analysis indicated that the President's program would insignificantly affect the unemployment level in 1975 and 1976 and would increase the unemployment rate (over what it would have been without any program) by less than .1 percent during 1976 and an average of about .1 percent during 1977. The rate of inflation would be increased by

approximately one-half of one percent through 1977. However, the windfall profits tax and the import fees would be rebated to consumers and hence consumer purchasing power would be maintained in the face of these higher prices. The analysis showed that real GNP would decrease on average in 1976 by approximately $1 billion (compared to what it would have been without any program) and by approximately $5 billion in 1977.

In doing large simulations of an economy as complex as the United States' economy, there are considerable uncertainties involved. The levels of impact determined are small relative to the other uncertainties and various small changes in other policy variables would eliminate the adverse effects indicated. For example, small changes in monetary policy would completely wash out the negative effects of the President's program both on real GNP and prices and on unemployment. In addition the level of the effect on real GNP is clearly within the random variations of the performance of the economy as measured by analytical models. And in fact, the statistical error of national income accounts is close to the level of the effect on real GNP.

Combining the effect of the President's proposed decontrol program on GNP with the costs of future embargoes, it can be seen that a six-month embargo in the fourth quarter of 1977 without the President's program would decrease real GNP by approximately $33 billion whereas with the President's program, real GNP would be decreased by only $12 billion. The net effect would be to put real GNP under the President's program on a level of approximately $11 billion higher than real GNP without the President's program in the event of an embargo (see Chart 2). Further, the effect of an embargo on unemployment in 1977 would be approximately .5 of a percentage point higher without the President's program (see Chart 3). This more than offsets the added increment to the unemployment rate due to the President's program.

CHART 2

IMPACT OF AN EMBARGO ON GNP

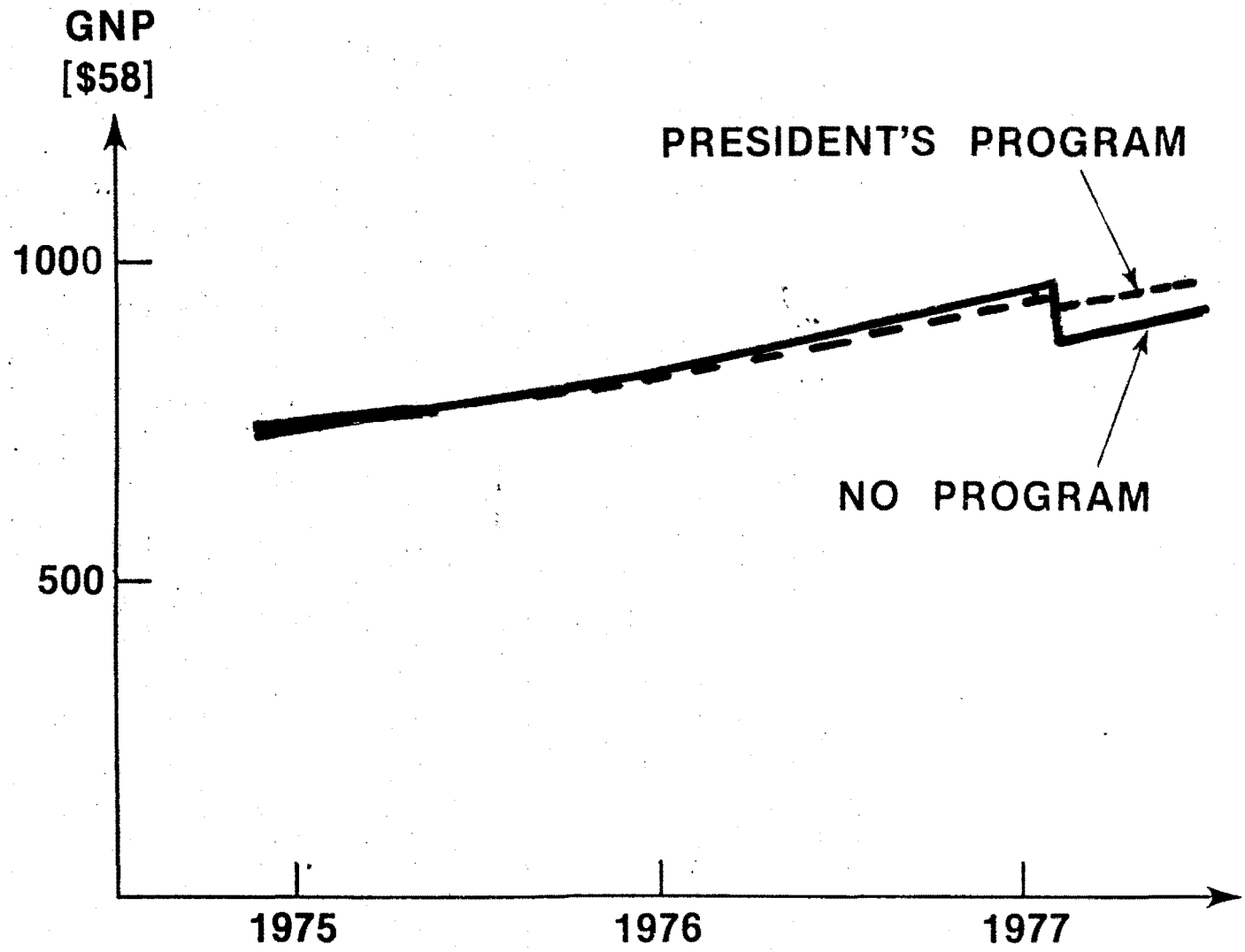
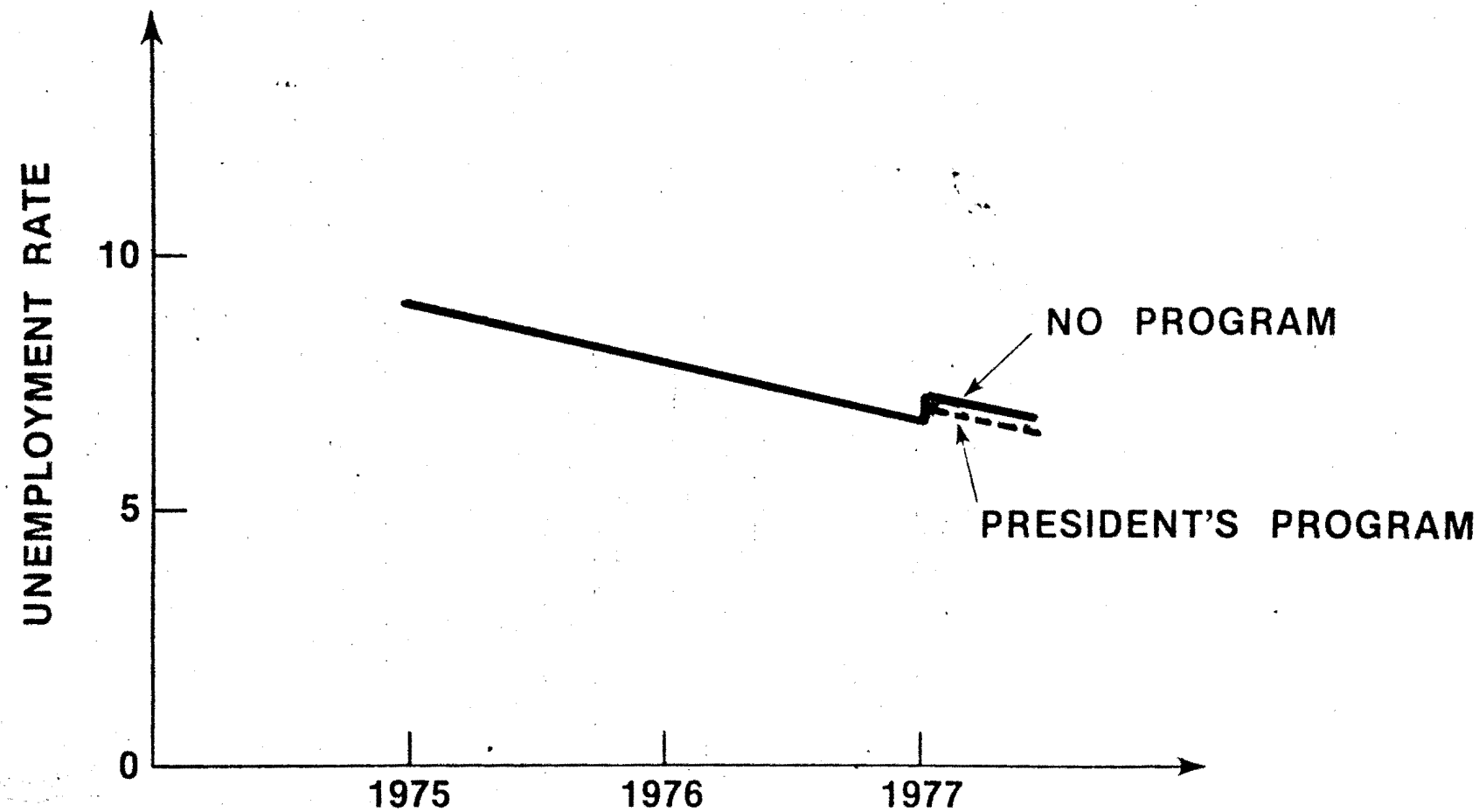


CHART 3

IMPACT OF AN EMBARGO ON UNEMPLOYMENT



Conclusions

In summary, the President's proposed phased decontrol of old oil together with a windfall profits tax and the rebates to consumers of the windfall profits revenues and the crude and import fees collected will dampen demand and increase supply, which reduces U.S. reliance on insecure imports without significant adverse economic impact. This, in turn, reduces our vulnerability to future embargoes. These benefits far outweigh the negligible adverse effects of the program on economic growth and employment.

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I. INTRODUCTION

The Federal Energy Administration is proposing an amendment to its regulations to implement the President's proposed gradual removal of price controls from domestic crude oil. The amendment, unless disapproved by either house of Congress, will decontrol "old" crude oil (now subject to a ceiling price averaging about $5.25 per barrel) at the rate of 3.3 percent a month over a 30-month period ending January 31, 1978.

The Amendment also provides for a new ceiling price for all domestic crude oil (other than stripper well crude oil) to be in effect during the 30-month decontrol period equal to the highest price charged for uncontrolled crude oil produced from the particular property concerned in the month of January 1975, plus $2.00 per barrel, equaling approximately $13.50 per barrel. This ceiling, which approximates the present world price level plus the $2.00 per barrel supplementary import fee, will prevent any future crude oil price increases by OPEC from triggering still higher domestic crude oil prices.

Finally, the President has proposed a windfall profits tax and consumer rebates to assure no unfair gains in the petroleum industry and to offset increased energy costs with energy tax rebates for consumers.

This paper is divided into five sections. The first section discusses the background situation of the economy with respect to the petroleum industry, the objectives of the Emergency Petroleum Allocation Act of 1973, and the rationale underlying the proposed decontrol of a 30-month period. The second section discusses the benefits of decontrol in the context of ensuring the economy against the costs of future embargoes. The third section discusses the direct effects of petroleum price changes on energy prices and consumption. The fourth section presents the impact of the phased decontrol of old oil on energy consumption and consumer costs. Finally, the fifth section presents a macroeconomic analysis of the impact of the phased decontrol program, the windfall profits tax on additional revenues accrued to oil companies on old oil, and the rebate of money to consumers to compensate for higher prices of energy.

Background

The petroleum industry has been subject to various forms of price controls since 1971. When the general Phase IV price controls ended on April 30, 1974, with the expiration of the Economic Stablization Act of 1970, the only industry which remained subject to price controls (as administered by the FEO and subsequently the FEA) was the petroleum industry.

The reason for continuing price controls on the petroleum industry was, of course, the serious shortage of crude oil and hence petroleum products in late 1973 and early 1974. In response to this emergency situation, the Emergency Petroleum Allocation Act of 1973 was enacted in November 1973, providing for the continuance of price controls on the sale of crude oil and derivative products.

The Act was chiefly concerned with assuring adequate supplies through regulatory mechanisms to ensure that covered products would be equitably allocated to all regions and to all users throughout the product distribution chain. Price controls were retained to further assure that reduced supplies would not lead to inequitably high prices.

At present, about one-third of total domestic production of crude oil is not subject to the ceiling price. This amount represents crude oil which is under the Congressionally-mandated stripper well lease exemption and crude oil which is allowed to be priced at market levels under existing production-incentive regulations concerning "new" and "released" crude oil. Including imported crude oil, about 56 percent of all domestically refined crude oil is not subject ot price ceilings.

Domestic crude oil subject to price ceilings, defined as "old" crude petroleum, sells at an average of $5.25 a barrel (or about 12-1/2 cents a gallon), while the average price of uncontrolled domestic crude oil rose from about $11.30 a barrel in January 1975, prior to the increase in import fees, to a current level of about $12.25 per barrel (29 cents a gallon).

The Emergency Petroleum Allocation Act of 1973 permits exemptions from allocation and price controls for products subject to the Act to be granted only under certain conditions. An exemption may apply to only one product and may extend for a period of not more than 90 days. Any

proposed exemption must be submitted to Congress prior to implementation, together with findings that (1) there is no shortage of the product concerned, (2) the proposed exemption will not have an adverse effect on the supply of any other product, and (3) controls on the product concerned are no longer necessary to carry out the purposes and goals of the Act. The exemption may not be implemented if disapproved by either house of Congress during the period of five sessional days allowed by the Act for legislative review by each house.

Decontrol will ultimately permit all domestic crude oil prices to rise to the current prevailing world price levels, so that the demand-dampening effects which have been felt worldwide would be felt to the full extent in the United States. Under the two-tiered price system now in effect, the price of most domestic oil is held at a level less than half that of current world price levels, so that the impact which the escalation of world market prices has had on demand else here in the world has been considerably cushioned in the United States.

In addition to conserving domestic supplies by reducing demand, decontrol of domestic crude oil prices would stimulate domestic production, or at least greatly reduce the rate of decline in domestic production as evidenced in Chart 1, displacing some supplies of crude oil that would otherwise have to be imported. Measures to promote maximum domestic production of crude oil--especially new exploration and drilling activity and implementation of secondary and tertiary recovery techniques--are considered essential in order to help assure adequate and dependable energy resources for the United States until alternative domestic energy resources cna be developed over the long term. Furthermore, the FEA has found that the production incentives afforded by the rules permitting "new" and "released" domestic crude oil to be sold at free market prices are of decreasing impact of effectiveness, as production levels, because of natural rates of decline, are generally falling further below 1972 levels, and 1972 levels of production for a property must be exceeded before the new and released price rules can have any effect.

Thus, many producers, especially those whose current production levels are substantially below the 1972 base levels and are further declining under primary recovery techniques, remain unaffected by the incentives presently

afforded because those incentives are too remote to outweigh the cost of implementing the substantial secondary or tertiary recovery programs which would be necessary to bring production up to and above the 1972 base levels. Under the FEA decontrol program, when fully implemented, all production, including additional production, would bring the higher prices now available to uncontrolled oil.

The existing incentives to increase production are, for properties that were producing in 1972, only effective for limited periods of time in any event, since the inevitable slackening of output will eventually bring production below 1972 levels, to the point where esixting incentives are no longer adequate to encourage investment in secondary/tertiary recovery and other costly programs designed to increase total output of crude oil. Although the additional incentive afforded by the gradual decontrol of old oil would also eventually diminish in effect with respect to existing properties, due to the inevitable decline or exhaustion of worked-over reservoirs, the purpose of decontrol is not to provide a permanent solution to limited domestic production capabilities. Rather, it is intended simply to provide incentives of sufficient effectiveness and duration and will yield maximum levels of domestic production until such time as supplementary energy resources can be developed and exploited. Although existing incentives are believed to have contributed substantially to the current reduction in the rate of decline in domestic production, FEA believes that existing incentives clearly cannot work to maintain domestic production at levels now thought necessary to avoid an unacceptable degree of reliance on imported fuels over the next few years.

An additional benefit of the decontrol of domestic crude oil will be the elimination of economic distortions caused by the present two-tiered pricing system of domestic oil. The two-tiered pricing system inevitably causes cost disparities among refiners and marketers of petroleum products. Although these cost disparities have been substantially reduced by the crude oil entitlements program, they can never be entirely eliminated while the two-tiered pricing system exists. Such cost disparities significantly hinder FEA's ability to ensure the competitive viability of the independent sector of the petroleum industry.

Moreover, the existing complicated structure of price controls at all levels of distribution, which is necessitated in large measure by the existence of cost disparities resulting from the two-tiered price system, tends to be self-defeating over the long run by reducing normal incentives toward increased production and cost control, and by eliminating the ability of the industry to engage in long range business planning. As effectiveness of price controls lags over time, regulations of greater complexity and reach become necessary to maintain a controlled-price structure. And tightening of controls, in turn, tends further to stifle initiative and to contribute to greater economic distortions.

There is currently no shortage of crude oil available to U.S. refiners. Worldwide production capability substantially exceeds current demand. U.S. refiners have been able to obtain from foreign sources all requirements needed to fill the domestic production shortfall. Inputs to U.S. refineries, which dropped markedly during the first 3 months of 1974, now exceed pre-embargo levels.

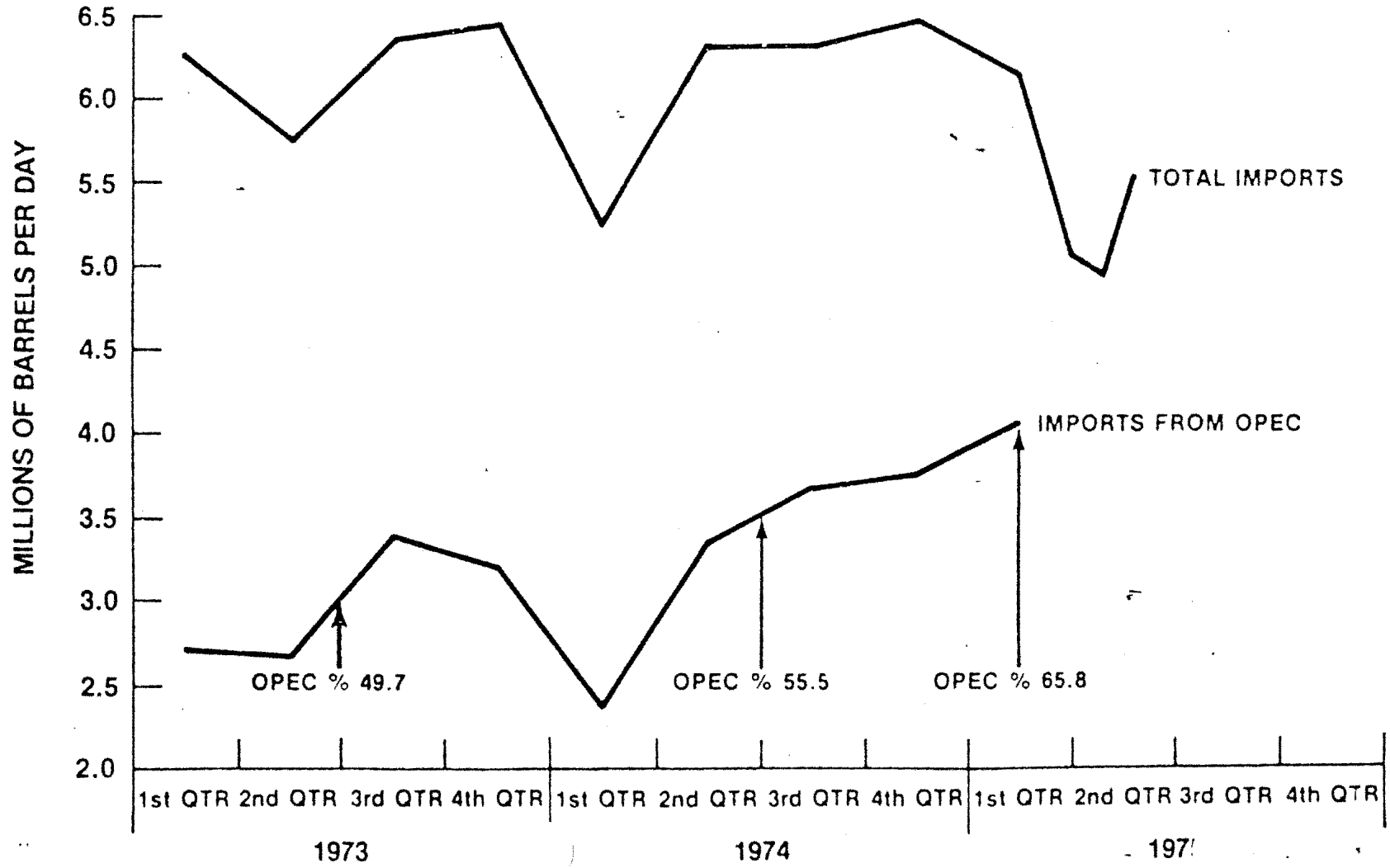
The level of crude oil production in the OPEC countries continues to decline due to reduced demand. At the end of March 1975, output was 25.72 million barrels/day (b/d), compared to 28.85 million b/d at the start of 1975, a drop of 11 percent. These production figures represent 66 percent of OPEC's currently estimated producing capacity of 39 million b/d.

U. S. petroleum inventory and import estimates for late April 1975 show an inventory-to-import ratio of approximately 167 days. This is considerably higher than the 123 days of stocks available in April 1974. Petroleum stocks were approximately 852 million barrels at the end of April 1975 and 815 million barrels at the end of April 1974, an increase of 4.5 percent. Imports for the same periods were approximately 5.1 and 6.6 million barrels per day respectively, a decrease of 23 percent (see Chart 4).

The general availability of crude oil to meet U.S. demands is also demonstrated by current data concerning the FEA allocation programs. For example, allocation fractions for all major refined products and residual fuel oils are at or close to 1.0, generally indicating that crude oil is in sufficient supply to meet virtually all demand for refined and other products derived from crude oil. While

CHART 4

IMPORTS OF CRUDE OIL AND PETROLEUM PRODUCTS



supplies of propane are not always adequate to meet demand in all regions of the U.S., such shortage problems as occur relate principally to the fact that most propane is produced from natural gas rather than crude oil, and there has been a decreasing supply of natural gas.

In addition, activity under the FEA's crude oil allocation program has slackened during recent quarters. The buy-sell program in its current form enables small and independent refiners to obtain crude oil supplies from the major refiners to supplement their own supplies. The fact that more and more small and independent refiners are obtaining thier supplemental crude oil supplies through normal market channels further indicates the general availability of crude oil at all levels and in all regions of the U.S.

To the extent that decontrol contributes, as expected, to stimulate domestic crude oil production by encouraging increased exploration and drilling activity and the use of secondary and tertiary recovery techniques, decontrol obviously tends to enchance rather than adversely affect the supply of products derived from crude oil. To the extent that higher prices resulting from decontrol dampen demand, as expected, decontrol will also tend to increase rather than reduce supplies of petroleum products.

Increased production and reduced demand brought about by decontrol will not result in any domestic surplus of crude oil. It is expected that the result will be an offsetting decrease in the amount of crude oil or refined product that would otherwise be imported to meet domestic needs. To this extent, decontrol will not change the overall availability of petroleum products in this country, However, because domestic crude oil is a more reliable source of crude oil for production of petroleum products than is imported crude oil, decontrol will tend to have a beneficial rather than adverse impact on the nature of the domestic supply of petroleum products subject to the Act.

All of the purposes and goals of the Act are predicted upon alleviating the emergency conditions resulting from shortages of crude oil, residual fuel oil and refined petroleum products which were being experienced or appeared imminent when the Emergency Petroleum Allocation

Act was made law late in 1973. As indicated above, shortages of crude oil no longer exist. Inasmuch as the underlying condition to which the purposes and goals of the Act generally relate is no longer present, the necessity of price controls on old oil to carry out the Act is no longer apparent.

The express purpose of the Act, as stated in paragraph 2(b) of the Act, is to grant to and direct the President 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 specific goals to be reached by exercise of the authority granted under the Act, as set forth in paragraph 4(b) (1), may be placed in the following groupings: (a) to protect the general welfare and the national defense; (b) to maintain residential heating, public services and gricultural operations; (c) to preserve and economically sound and competitive petroleum industry; (d) to allocate crude oil in order to permit refineries to operate at full capacity; (e) to provide for equitable distribution of crude oil, residual fuel oil and refined petroleum products at equitable prices among all regions and among all users; (f) to allocate residual fuel oil and refined petroleum products in order to maintain exploration and production or extraction of fuels; and (g) to provide for economic efficiency and minimization of economic distortion, inflexibility and unnecessary interference with market mechanisms.

The decontrol of old oil prices should serve to further the goals indicated in items (c) and (g), above, under present conditions. The economic inefficiencies and distortions brought about by price controls when they are extended over a long period of time are discussed in Section B, above. In addition, the gradual removal of price controls during a period of adequate supply should lead to improvement in the economic position of the petroleum industry and stimulate resumption of normal competitive conditions. These results are particularly desirable in view of the major effect which will be required to alter the trend of declining U.S. crude oil production.

The adequacy of supply under current conditions means that the threat to the national security and welfare posed by an existing or imminent shortage of crude oil under free market conditions no longer exists. Price controls on crude oil are therefore no longer necessary to achieve the short-term goals of the Act concerning protection of the national defense and public welfare (item (a)). For the longer term, removal of price controls should have a favorable effect on the national defense and public welfare. However, the heavy reliance by the United States on imported crude oil poses a significant threat to the national security. As noted above, the decontrol of old oil prices should over the long run significantly reudce reliance on foreign sources of oil.

The goals indicated in items (d) and (f) above relate primarily to the allocation program or to petroleum products other than crude oil. These goals are therefore not directly affected by the proposal to decontrol the price of old oil.

The goals in item (b) address the threat to adequate supplies of fuel for residential heating, public services and agricultural operations resulting from imminent crude oil shortages. This threat was countered primarily by the allocation of crude oil used to produce fuels for these needs, and by the allocation of these fuels themselves. This fact, plus the current absence of any shortage of crude oil, leads to the conclusion that price controls on crude oil are no longer necessary to achieve the goals of the Act relating to maintaining adequate fuel supplies for residential, public service, and agricultural needs.

The goal of providing for "equitable distribution of crude oil...at equitable prices among all regions and...all users" (item (e)) is one which is clearly predicated upon the existence or imminence of a serious crude oil shortage situation. When supplies are short, normal market mechanisms may not assure equitable distribution of supplies across the country and do not prevent price gouging and other shortage-related pricing abuses. In other words, the goal of "equitable prices" should not be isolated and read out of context as mandating permanent price ceilings, even

when supplies of crude oil are adequate to permit normal market mechanisms to function. In the absence of shortages of crude oil, therefore, price controls on crude oil are not necessary to carry out the goal of equitable distribution at equitable prices.

In addition, FEA believes that "equitable" prices, within the meaning of paragraph 4(b)(1)(F) of the EPA Act, will be achieved by restoring normal market mechanisms during a period of adequate supply and by eliminating economic distortions caused by the current two-tier pricing system. However, to the extent that a return to normal market mechanisms at this time would bring prices on crude oil to levels which might be viewed in certain sectors of the economy as inequitably high because they result in higher prices on certain petroleum products, this view is outweighted by the need to achieve other objectives of the Act and by other considerations, including the fact that decontrol is being phased in gradually and the availability of legislative measures to alleviate, through tax relief or rebates, the impact of price increases on consumers and other sectors of the economy.

On the basis of the above considerations, the FEA has concluded that price controls on crude oil are not necessary to carry out the intentions of the Act.

II. BENEFITS OF DECONTROL

In assessing any policy proposal, the benefits accruing to the proposal as well as the costs must be ascertained. This section addresses the benefits of decontrol in terms of the increased supply of domestic oil over the next decade, in terms of the conservation effect which in conjunction with the supply effect reduces the United States' level of imports and hence reduces U.S. vulnerability to future embargoes, and in terms of the reduction of the out flow of dollars from the economy.

The Arab oil embargo of 1973/74 resulted in a significant drop in our gross national product, approximately $10-20 billion on an annual basis, and produced unemployment of approximately one-half million members of the labor force. However, today even more of our imports are coming from the Middle East than did a year ago. Now over half of our petroleum imports come from sources outside of the western hemisphere. In addition, as our dependence on foreign imports grows, these imports are made up primarily from OPEC. Thus since all of the increase will virtually come from insecure sources, by 1977 the United States economy will be almost twice as vulnerable to embargoes as in the winter of 1973-74. In comparison to the program that the President has proposed, the economy will be almost three times as vulnerable to embargoes without his program than it would be with his program. Translating vulnerability into costs underscores the need for an energy program. If no program is enacted, a six-month embargo would cost approximately $33 billion in 1977 and over $110 in 1985. With the President's energy program, including the proposed phased decontrol, the standby authorities, the emergency storage program, and the already imposed import fees, the costs of future embargoes are greatly reduced. An embargo in 1977 would cost approximately $12 billion and, by 1985, there are essentially no costs imposed on the United States economy by an Arab oil embargo with the President's program.

In addition to dampening demand, a salient feature of this decontrol plan is to provide incentive for increasing domestic supply. Without the President's program, the rate of production of domestic crude would continue to decline over the next few years. With the President's program, however, the decline would be arrested and additional domestic supplies would be forthcoming. By 1977, the President's program would have increased domestic supply by almost 200,000

barrels per day. By 1985, the President's program would have increased domestic supply by approximately 5,000,000 barrels per day more than would have occurred without his program. The implications of the reduced demand due to the President's program and the increased supply due to the President's program can be viewed also in terms of the dollar outflow to the United States economy. In 1977, approximately $2 billion more would flow out of the economy without the President's program just in terms of the higher cost of imported crude oil. By 1985, the additional dollar outflow from the economy with the President's program would be approximately $50 billion. These dollar outflows will exert adverse pressure on the balance of payments for the United States economy and hence adverse pressure on the exchange rate.

III. DIRECT PRICE EFFECTS OF PHASED DECONTROL ON ENERGY PRICES

The President's energy program will affect the costs of energy resources and these changes will be either partially or fully passed on to consumers in the form of higher prices. The prices of other products will also be affected both directly and indirectly by changing the costs of the inputs used in the production of these other products such as steel, chemicals, and air transportation.

The proposed program will affect the prices paid in energy markets primarily because of the following three factors. First, decontrol will raise the prices to energy consumers. Secondly, the proposals will not affect all energy supply relationships equally. For example, the supply prices of petroleum and natural gas will be increased more than the supply prices of coal and nuclear energy. Because of these changing relative prices, the demand for related sources of energy will be shifted. (The amount of coal and nuclear power that is demanded by consumers at any price will increase because the price of petroleum has increased and natural gas is in short supply.) Petroleum prices will increase by 1978 to the level of import prices or $13.50, whichever is lower.

Higher energy prices will affect the economy through supply and demand channels. The prices of energy and energy intensive goods will increase relative to nonenergy intensive noods. This will result in higher costs to producers and consumers and shifts in the composition of demand between energy and nonenergy related goods. The changes in costs (supply) and demand will result in changes in employment and economic output.

There is also a temporal dimension to the effects of the energy program. Although there will be an immediate rise in energy prices, the supplies which are called forth will appear gradually over a number of years. In a similar manner the effects of the program on the spending patterns of consumers and producers will change over time. Initially there will be reductions in energy use through actions such as less driving and the lowering of thermostats. In the longer run, more efficient cars will be purchased, houses will be better insulated and business will purchase capital equipment that is more energy efficient.

Petroleum Prices

Currently, about two-thirds of domestic crude oil production, "old" oil, is price controlled at a level of approximately $5.25 per barrel. More specifically, this price represents the selling price on May 15, 1973, plus a $1.35 per barrel adjustment allowed by the Cost of Living Council in a series of steps during the latter portion of 1973. The remaining domestic production, classified as "new, released or stripper-well oil", sells at a price established by free market forces - currently about $12.25 per barrel. This price is presently in a state of flux since the full impact of the $2.00 per barrel supplemental import fee - particularly the second $1.00 increment - has yet to be fully reflected in increased prices for uncontrolled domestic crude production. It is expected that an equilibrium price of $13.00 to $13.50 per barrel would be reached in several months in the absence of further changes in the price structure. At the present imported crude amounts to somewhat more than 4 million barrels per day. The landed cost of foreign crude averages about $14.50 per barrel, including the $2.00 per barrel supplemental import fee.

The two-tier system of pricing domestic crude oil, instituted by the Cost of Living Council in 1973, was principally intended to stimulate increased levels of domestic production activity while minimizing the stress to the economy that would have occurred had full decontrol been implemented at that time. It was envisioned that the price of crude oil increased far more than was originally expected (creating a very large gap between the two tiers) and since the economy continued to be in a very delicate state, there was no opportunity to carry out this transition. Consequently, the two-tier price system has remained in place longer than planned and some adverse impacts are now being felt. Most notable of these is a severe reduction in the incentives to engage in secondary or tertiary recovery projects in old fields.

The average price of crude input to refineries calculated below assumes an imported average price for crude oil of $14.50 per barrel and phased decontrol of old oil at the rate of 3.3 percent per month with a price ceiling of $13.50 per barrel on domestically produced crude. The average price of crude that results is shown in the following table.

Year: Quarter	Average Price per Barrel for all Domestic Crude Oil
1975:3	11.05
1975:4	11.30
1976:1	11.60
1976:2	11.80
1976:3	12.10
1976:4	12.35
1977:1	12.65
1977:2	12.90
1977:3	13.15
1977:4	13.40

IV. THE ENERGY CONSUMPTION AND CONSUMER COST EFFECTS OF PHASED DECONTROL OF OLD OIL

I. Direct Consumer Price Effects on Energy Sources

A. Energy Price Effects

The effects of phased decontrol effective August 1, 1975 over a 30-month time path on consumer energy costs are shown in Table 1. Gasoline prices increase by about 8.4 percent over the case of continued control including the effects of the import fees imposed on February 1 and June 1, 1975. The price of heating oil rises 9.5% by 1977. Electricity prices rise .9 percent by 1977, causing a decrease in the demand for electricity, and thus coal, which further causes a decline in coal prices by 1.2 percent. Natural gas prices will not be significantly affected by this action.

Table 1

Percent Change in Consumer Energy Costs From Phased Decontrol

Type of Energy	1975	1976	1977
Gasoline	1.0%	4.2%	8.4%
Heating Oil	1.4	5.4	9.5
Coal	0	-0.4	-1.2
Electricity	0	0.8	0.9
Natural Gas	0	0	0

B. Petroleum Consumption Effects

The phased decontrol of old oil will reduce imports by approximately 363,000 barrels per day by 1977 as shown in Table 2 below. Petroleum demand rises between 1975 and 1977 due to the rapid recovery of the economy during this period. However, higher prices caused by decontrol will offset some of this rise.

Table 2

Summary of the Petroleum Supply-Demand Situation
(MBD)

	1975	1976	1977
Demand (All Products)			
Base	16,766	16,507	17,408
Phased Decontrol	16,756	16,439	17,232
Supply (Domestic)			
Base	10,653	10,550	10,400
Phased Decontrol	10,653	10,550	10,587
Imports			
Base	6,113	5,957	7,008
Phased Decontrol	6,103	5,889	6,645
Import Savings	10	68	363

II. Socio-Economic Impact

A. Direct and Indirect Consumer Costs

Table 3 below shows the effects of phased decontrol on the consumer costs of petroleum related energy. The increase in 1975 is approximately .8 percent of current petroleum related energy costs; this increase rises to about 3 percent in 1976 and 7 percent during 1977. Gasoline and motor oil account for approximately 85 percent of the increase.

Table 3

Impact of Phased Decontrol on Direct Energy Expenditures a/

	Costs Without Decontrol b/	Additional Annual Costs Due to Phased Decontrol		
		1975	1976	1977
Gasoline & Motor Oil	$616	$6	$26	$52
Heating Oil	74	1	4	7
Electricity	230	0	1	2
Total	$920	$7	$31	$61

a/ Less natural gas

b/ Includes import fees

B. Total Costs.

The methodology for estimating total and indirect consumer costs of phased decontrol is the same as the methodology reported in the paper entitled, "The Impact of the President's Proposed Energy and Economics Program on Net Energy Costs to Consumers," page 11. Table 4 below summarizes the results. Basically, the methodology involves forecasting the effects that the higher energy prices will have on the Consumer Price Index (using a stage of processing model developed by Data Resources, Inc.) and using this change to estimate the change in consumer costs per household.

Phased decontrol will cause about a .85 percentage point increase in the annual rate of change of the Consumer Price Index by 1977. Based upon this estimated change, the total cost per household of decontrol and the fees is $114 and the indirect effects are about $53 per household. It is important to emphasize that the estimated consumer costs shown here are based upon the assumption that all of the increased costs will be passed on to consumers.

Table 4

Estimated Total and Indirect Consumer Costs
(In 1977)

1. Estimated Personal Consumption Per Household

a.	Estimated current personal consumption	= $942.8 billion a/
b.	Estimated number of households	= 70 million
c.	Consumption per household	= $13,469

2. Estimated Costs Per Household

Total b/	Indirect c/
$114	$53

a/ From DRI April 2, 1975 Control Forecast.
b/ Estimated as .85 percent x $13,469.
c/ Total less direct costs.

C. Direct Consumer Costs by Income Class.

The lowest income class, those with an average income of $3,000, bear the greatest burden (see Table 5). While the absolute increase in energy costs due to phased decontrol increases as incomes increase, the increases as a percentage of average incomes decrease from about .7 percent in the lowest group to about .3 percent for the highest income group.

Table 5

Average Increase in Direct Energy Costs by Income Class
(In 1977)

	Lowest Income Group ($3000 Avg)	Lower Middle Group ($9600 Avg)	Upper Middle Group ($16800 Avg)	Highest Income Group ($29400 Avg)
Gasoline	$15	$36	$66	$77
Heating Oil	6	6	6	8
Electricity	1	2	2	3
Total	22	44	74	88
Percent of Average Income	.7%	.5%	.4%	.3%

V. MACROECONOMIC ANALYSIS

A. Taxes and Consumer Rebates

The President's program proposes a windfall profits tax on decontrolled old crude and rebates to consumers to maintain the purchasing power of consumers in the face of higher energy prices. For the sake of analysis, this paper considers a windfall profits tax that is levied on the accrued revenues to the decontrol of old oil. The manner in which the assumed windfall profits tax is levied is equivalent to 90 percent of the difference between the price at which the decontrolled oil sells minus approximately $5.25 per barrel with a 50 percent plowback and the tax is levied only on old oil. Essentially then, the windfall profits tax is approximately 50 percent of the revenues that accrue to the oil companies as the price per barrel rises from $5.25 to $13.50 (if imported oil exceeds that amount). In addition, the analysis assumes that the supplemental import fees on crude oil and refined products will remain in existence.

The purpose of the rebates to consumers is to mitigate any adverse economic impact to consumers due to higher petroleum prices. Thus, this paper assumes that the aggregate revenues that are collected by the Government on the windfall profits tax and supplemental import fees would be rebated to consumers in an aggregate amount by increasing their disposable income. The revenues used in this analysis are given in the table below for 1975, 1976, and 1977. The first column of the table indicates the revenues that would have been collected by the imposition of the $1 fee imposed in February of this year through July 31 of this year. The other columns indicate estimates of the fees that will be collected and disbursed to consumers over the next 30 months under the assumed rebate program.

TABLE 6

REVENUES AVAILABLE FOR CONSUMER REBATES
(Billions $)

Revenue Source	2/1/75-7/31/75	8/1/75-12/31/75	1976	1977	Total
° Supplemental Import Fees					
(a) Crude Oil	$1.0	$1.0	$2.9	$3.5	$ 8.4
(b) Refined Product	.1	.2	.5	.6	1.4
° Deregulation Tax	___	.2	1.4	3.0	4.6
TOTALS	$1.1	$1.4	$4.8	$7.1	$14.4

B. Simulation Results

From an aggregate point of view higher energy prices will cause structural shifts in the pattern of demand for goods in the economy and it is expected that the shifts will be different in the short run than in the long run. The immediate effects will be to raise the prices of energy intensive goods relative to other goods and to cause some unemployment. The problems are greater in the shorter term and the effects on economic output and employment are not as great in the longer term.

The economy will feel the effects of the program through many channels. On the demand side, there are countervailing effects. Decontrol of domestic crude oil price will provide a substantial boost in investment by domestic energy industries. A second stimulus will occur by reducing the level of imports. Instead of being drained from the economy these dollars can be maintained in circulation here to create more jobs.

There are restraining effects on GNP as well. The higher prices have two effects on demand. They reduce real consumption because consumers will not be able to substitute completely away from the higher cost items. More importantly, however, they cause the pattern of demand to change. Energy intensve commodities will become relatively more expensive while commodities which don't depend on much energy for their production or use will become relatively cheaper. This, of course, leads to a powerful stimulus to conserve energy. In the process, it will increase costs in some industries more than in others. This may cause some temporary structural unemployment while workers shift from the industries producing energy intensive commodities and while the high energy use industries modify their products and processes so that they use less energy. It is important to emphasize that this structural unemployment, while a very real problem, is both small and temporary.

Two simulations have been run by introducing exogenous changes into the OPEC Zero 7/1 solution of the DRI Macro Model recently run by DRI. The exogenous changes made in the OPEC Zero 7/1 solution include adjustments to: the price and quantity of crude oil imports; the wholesale price index for fuels and related products, and power; and corporate and personal tax rates. The wholesale price index adjustments were based on a stage of process price model that is used to develop implicit price deflators. The corporate and personal tax rate changes are used to represent the windfall profit tax and rebate effects that are essential to the President's program.

Phased decontrol will cause the rate of change of the Consumer Price Index to increase about 0.3 percentage points in 1976 and 0.4 points in 1977 above the case were controls are continued (see Tables 7 and 8). Both real GNP and unemployment are slightly affected by the higher energy prices. Table 9 gives the real GNP impacts by quarter through 1977. Since the quarterly GNP reductions are in annual rates, Table 9 illustrates that phased decontrol puts the economy on a slightly lower growth path of about three billion dollars per year during 1976 and 1977 (obtained by averaging the quarterly numbers). This is relatively minor when compared to the costs of future embargoes.

TABLE 7

INDEX POINT DIFFERENCES IN THE LEVELS OF THE CPI AND WPI RELATIVE TO THEIR BASE CASE VALUES **

	Scenario #2 ** (Phased decontrol)	
	CPI	WPI
1975:3	0	0.1
1975:4	0.1	0.4
1976:1	0.2	0.8
1976:2	0.3	1.2
1976:3	0.4	1.8
1976:4	0.6	2.3
1977:1	0.8	2.9
1977:2	1.0	3.5
77:3	1.1	4.2
/7:4	1.3	4.8

* Indexes defined on 1976=100.

** Numbered scenario minus base case scenario.

Unemployment, like GNP, is slightly affected by the higher prices with most of the impact occuring during 1977. The impact is insignificant in 1975 and 1976 and increased the rate of unemployment by approximately 0.15 percentage points in 1977. As we discussed in the initial paragraph of this section, the longer term impacts of decontrol, beyond 1977, will be even smaller because industries will be able to modify their production methods and products so that they use less energy.

In doing large simulations of an economy as complex as the United States' economy, there are considerable uncertainties involved. The levels of impact determined are small relative to the other uncertainties and various small changes in other policy variables would eliminate the adverse effects indicated. For example, small changes in monetary policy would completely wash out the negative effects of the President's program both on real GNP and prices and on unemployment. In addition the level of the effect on real GNP is clearly within the random variations of the performance of the economy as measured by analytical models. And in fact, the statistical error of national income accounts is close to the level of the effect on real GNP.

TABLE 8

PERCENTAGE POINT DIFFERENCES IN THE ANNUAL RATES OF CPI AND WPI CHANGE (FOURTH QUARTER TO FOURTH QUARTER) FROM THEIR BASE CASE VALUES

	Scenario #2 (Phased decontrol)	
	CPI	WPI
1974:4 to 1975:4	0.0	0.3
1975:4 to 1976:4	0.3	1.1
1976:4 to 1977:4	0.4	1.2

TABLE 9

REAL GNP IN SPECIFIED SCENARIOS MINUS REAL GNP IN BASE CASE *
(Percentage difference in parenthesis)

	Scenario #2 (Phased decontrol)
1975:3	0 (0)
1975:4	-0.2 (-0.03)
1976:1	-0.2 (-0.02)
1976:2	-0.5 (-0.06)
1976:3	-1.3 (0.15)
1976:4	-2.2 (-0.25)
1977:1	-3.4 (-0.38)
1977:2	-4.7 (-0.52)
1977:3	-6.4 (-0.70)
1977:4	-7.7 (-0.84)

* GNP in billions of 1958 dollars at annual rates.

TABLE 10

DIFFERENCES IN UNEMPLOYMENT RATES FROM BASE CASE VALUE

	Scenario #2 (Phased decontrol)
1975:3	0
1975:4	0
1976:1	0
1976:2	0
1976:3	0
1976:4	0.1
1977:1	0.1
1977:2	0.1
1977:3	0.2
1977:4	0.2

APPENDIX A

Regulations on the Phase-Out of Old Oil Price Ceilings

TITLE 10 - ENERGY

CHAPTER II - FEDERAL ENERGY ADMINISTRATION

PART 211 - MANDATORY PETROLEUM ALLOCATION REGULATIONS

PART 212 - MANDATORY PETROLEUM PRICE REGULATIONS

Phase-Out of Old Oil Price Ceilings

A. Introduction

The Federal Energy Administration hereby adopts an amendment to its regulations to provide for the gradual removal of price controls from domestic crude oil. The amendment, unless disapproved by either house of Congress, will decontrol "old" crude oil (now subject to a ceiling price averaging $5.25 per barrel) at the rate of 3.3 percent a month over a 30-month period ending January 31, 1978.

The amendment also provides for a new ceiling price for all domestic crude oil (other than stripper well crude oil) to be in effect during the 30-month decontrol period equal to the highest price charged for uncontrolled crude oil produced from the particular property concerned in the month of January, 1975, plus $2.00 per barrel, or a total of approximately $13.50 per barrel. This ceiling, which approximates the present world price level plus the $2.00 per barrel supplementary import fee, will prevent any future crude oil price increases by OPEC from triggering still higher domestic crude oil prices.

This proceeding was initiated on April 30, 1975, when the Federal Energy Administration issued a notice of proposed rulemaking and public hearing (40 F.R. 19219, May 2, 1975) to amend Part 212 of Title 10 of the Code of Federal Regulations to phase out over a 25-month period all price controls on crude oil at the producer level.

Fifty-nine written comments were received in response to the notice of proposed rulemaking before the close of the period for receipt of such comments. Oral presentations were made by 29 persons at the public hearings held on May 13 and 14, 1975. All these comments and presentations were considered by the FEA, and certain modifications in the proposed amendments have been made, to arrive at the final amendment adopted today, reflecting FEA's consideration of these comments and presentations as well as other information available to FEA. These modifications included in the decontrol rule now promulgated are discussed in Section E, below.

B. Background

The petroleum industry has been subject to various forms of price controls since 1971, a period of about four years. When the general Phase IV price controls ended on April 30, 1974, with the expiration of the Economic Stabilization Act of 1970, the only industry which remained subject to price controls (as administered by the FEO and subsequently the FEA) was the petroleum industry.

The reason for continuing price controls on the petroleum industry was, of course, the serious shortage of crude oil and products derived therefrom in late 1973 and early 1974. In response to this emergency situation, the Emergency Petroleum Allocation Act of 1973 was enacted in November, 1973, pursuant to which price controls on the sale of crude oil and derivative products have been retained.

As its name suggests, that Act was chiefly concerned with assuring adequate supplies through regulatory mechanisms by which covered products would be equitably allocated to all regions and to all users throughout the product distribution chain. Price controls were retained to further assure that reduced supplies would not lead to inequitably high prices.

At present, about one-third of total domestic production of crude oil is not subject to the ceiling price of 10 CFR 212.74. This amount represents crude oil which is under the congressionally-mandated stripper well lease exemption and crude oil which is allowed to be priced at market levels under existing production-incentive regulations concerning "new" and "released" crude oil. Taking into account imported crude oil, about 56 percent of all domestically refined crude oil is not subject to price ceilings.

Domestic crude oil subject to price ceilings, defined as "old" crude petroleum, sells at an average of $5.25 a

barrel (or about 12-1/2 cents a gallon), while the average price of uncontrolled domestic crude oil rose from about $11.30 a barrel in January, 1975, prior to the increase in import fees, to a current level of about $12.25 (29 cents a gallon).

The Emergency Petroleum Allocation Act of 1973 permits exemptions from allocation and price controls for products subject to the Act to be granted only under certain conditions. An exemption may apply to only one product and may extend for a period of not more than 90 days. Any proposed exemption must be submitted to Congress prior to implementation, together with findings that (1) there is no shortage of the product concerned, (2) the proposed exemption will not have an adverse effect on the supply of any other product, and (3) controls on the product concerned are no longer necessary to carry out the purposes and goals of the Act. Pursuant to §4(g)(2) of the Act, the exemption may not be implemented if disapproved by either house of Congress during the period of five sessional days allowed by the Act for legislative review by each house.

Having received written comments and having held public hearings on its old oil deregulation proposal, the FEA has transmitted this final decontrol amendment to the Congress together with the findings set forth below. Under the amendment adopted today, old oil will be gradually decontrolled over a 30-month period, beginning immediately upon expiration of the five-day period prescribed in §4(g)(2)

of the EPAA and ending on January 31, 1978. The FEA plans to issue a notice before August 1, 1975, stating what congressional action, if any, was taken under §4(g)(2) and, if this amendment was not disapproved by either house of Congress within the period provided by §4(g)(2), the date this amendment became effective.

The rate of decontrol of old oil will be at 3.3 percent for each month from August, 1975, through January 31, 1978. Since it appears that the five-day legislative review period prescribed in the Act will expire on or about July 21, 1975, one percent of old oil will also be decontrolled for the month of July, 1975, to achieve the same rate of decontrol for approximately one-third of the month of July remaining after the effective date of the amendment. Because crude oil is generally produced and sold to the same purchaser in a continuous flow for an entire month, with prices under the two-tier system calculated for the month concerned in the subsequent month, the only practicable method for determining the amount of old oil to be decontrolled under this amendment for the remainder of the month of July is to determine a decontrol rate for July which bears the same approximate ratio to the 3.3 monthly percentage rate that the number of days remaining in July after the amendment becomes effective bears to the total number of days in July. The purpose of FEA in this respect is to avoid retroactive application of the amendment adopted today while assuring that the important national benefits of decontrol will begin to accrue at the earliest possible date.

As explained in the notice of proposed rulemaking issued April 30, 1975, the FEA's "old oil" decontrol program (which implements one phase of the overall energy conservation program put forward by President Ford in his State of the Union Message) would affect only crude oil sales at the producer level. It would not affect the crude oil allocation regulations or the allocation or price regulations for any other product at any level of distribution. The old oil decontrol program would both help curb domestic consumption and spur domestic production, thus furthering the important national goal of reducing dependence on imported crude oil.

Decontrol will ultimately permit all domestic crude oil prices to rise to the current prevailing world price levels, so that the demand-dampening effects which have been felt worldwide would be felt to the full extent in the United States. Under the two-tiered price system now in effect, the price of most domestic oil is held at a level less than half that of current world price levels, so that the impact which the escalation of world market prices has had on demand elsewhere in the world has been considerably cushioned in the United States.

In addition to conserving domestic supplies by reducing demand, decontrol of domestic crude oil prices would stimulate domestic production, or at least greatly reduce the rate of decline in domestic production, displacing some supplies of crude oil that would otherwise have to be imported. Measures to promote maximum domestic production of crude

oil -- especially new exploration and drilling activity and implementation of secondary and tertiary recovery techniques -- are considered essential in order to help assure adequate and dependable energy resources for the United States until alternative domestic energy resources can be developed over the long term. Furthermore, the FEA has found that the production incentives afforded by the rules permitting "new" and "released" domestic crude oil to be sold at free market prices are of decreasing impact or effectiveness, as production levels, because of natural rates of decline, are generally falling further below 1972 levels, and 1972 levels of production for a property must be exceeded before the new and released price rules can have any effect.

Thus, many producers, especially those whose current production levels are substantially below the 1972 base levels and are further declining under primary recovery techniques, remain unaffected by the incentives presently afforded because those incentives are too remote to outweigh the cost of implementing the substantial secondary or tertiary recovery programs which would be necessary to bring production up to and above the 1972 base levels. Under the FEA decontrol program, when fully implemented, all production, including additional production, would bring the higher prices now available to uncontrolled oil.

The existing incentives to increase production are, for properties that were producing in 1972, only effective for limited periods of time in any event, since the inevitable slackening of output will eventually bring production below 1972 levels, to the point where existing incentives are no longer adequate to encourage investment in secondary/ tertiary recovery and other costly programs designed to increase total output of crude oil. Although the additional incentive afforded by the gradual decontrol of old oil would also eventually diminish in effect with respect to existing properties, due to the inevitable decline or exhaustion of worked-over reservoirs, the purpose of decontrol is not to provide a permanent solution to limited domestic production capabilities. Rather, it is intended simply to provide incentives of sufficient effectiveness and duration as will yield maximum levels of domestic production until such time as supplementary energy resources can be developed and exploited. Although existing incentives are believed to have contributed substantially to the current reduction in the rate of decline in domestic production, FEA believes that existing incentives clearly cannot work to maintain domestic production at levels now thought necessary to avoid an unacceptable degree of reliance on imported fuels over the next few years.

As also noted in the April 30, 1975, notice of proposed rulemaking, an additional benefit of decontrol of domestic crude oil will be the elimination of economic distortions caused by the present two-tiered pricing system. The two-tiered pricing system inevitably causes cost disparities among refiners and marketers of petroleum products. Although these cost disparities have been substantially reduced by the crude oil entitlements program, they can never be entirely eliminated while the two-tiered pricing system exists. Such cost disparities significantly hinder FEA's ability to assure that the competitive viability of the independent sector of the petroleum industry is maintained.

Moreover, the existing complicated structure of price controls at all levels of distribution, which is necessitated in large measure by the existence of cost disparities resulting from the two-tiered price system, tends to be self-defeating over the long run by reducing normal incentives toward increased production and cost control, and by eliminating the ability of the industry to engage in long range business planning. As effectiveness of price controls

lags over time, regulations of greater complexity and reach become necessary to maintain a controlled-price structure. And tightening of controls, in turn, tends further to stifle initiative and to contribute to greater economic distortions.

C. Findings

1. There is no shortage of crude oil.

As FEA representatives have previously testified at congressional hearings, there is currently no shortage of crude oil available to U.S. refiners. Worldwide production capability substantially exceeds current demand. U.S. refiners have been able to obtain from foreign sources all requirements needed to fill the domestic production shortfall. Inputs to U.S. refineries, which dropped markedly during the first three months of 1974, now exceed pre-embargo levels. Domestic crude oil inventories have also increased, and exceed pre-embargo levels.

The level of crude oil production in the OPEC countries continues to decline due to reduced demand. At the end of March, 1975, output was 25.72 million barrels/day (b/d), compared to 28.85 million b/d at the start of 1975, a drop of 11 percent. These production figures represent 66 percent of OPEC's currently estimated producing capacity of 39 million b/d.

U.S. petroleum inventory and import estimates for late April 1975 show an inventory-to-import ratio of approximately 167 days. This is considerably higher than the 123 days of stocks available in April 1974. Petroleum stocks were approximately 852 million barrels at the end of April 1975 and 815 million barrels at the end of April 1974, an increase of 4.5 percent. Imports for the same periods were approximately 5.1 and 6.6 million barrels per day respectively, a decrease of 23 percent.

The general availability of crude oil to meet U.S. demands is also demonstrated by current data concerning the FEA allocation programs. For example, allocation fractions for all major refined products and residual fuel oils are at or close to 1.0, generally indicating that crude oil is in sufficient supply to meet virtually all demand for refined and other products derived from crude oil. While supplies of propane are not always adequate to meet demand in all regions of the U.S., such shortage problems as occur relate principally to the fact that most propane is produced from natural gas rather than crude oil, and there has been a decreasing supply of natural gas.

In addition, activity under the FEA's crude oil allocation program has slackened during recent quarters. The buy-

sell program in its current form enables small and independent refiners to obtain crude oil supplies from the major refiners to supplement their own supplies. The fact that more and more small and independent refiners are obtaining their supplemental crude oil supplies through normal market channels further indicates the general availability of crude oil at all levels and in all regions of the U.S.

2. The proposed exemption will not have an adverse impact on the supply of any other oil or refined petroleum products subject to the Act.

Under today's conditions, 20 months after passage of the Act, national policy requires that dependence on imported crude oil be reduced. This can be done by stimulating domestic crude oil production and by curbing demand for residual oil and refined petroleum products. The proposal to decontrol old oil is an important step toward a greater degree of self-sufficiency in meeting our energy needs.

To the extent that decontrol contributes, as expected, to stimulate domestic crude oil production by encouraging increased exploration and drilling activity and the use of secondary and tertiary recovery techniques, decontrol obviously tends to enhance rather than adversely affect the

supply of products derived from crude oil. To the extent that higher prices resulting from decontrol dampen demand, as expected, decontrol will also tend to increase rather than reduce supplies of petroleum products.

Increased production and reduced demand brought by decontrol will not result in any domestic surplus of crude oil. It is expected that the result will be an offsetting decrease in the amount of crude oil or refined product that would otherwise be imported to meet domestic needs. To this extent, decontrol will not change the overall availability of petroleum products in this country. However, because domestic crude oil is a more reliable source of crude oil for production of petroleum products than is imported crude oil, decontrol will tend to have a beneficial rather than adverse impact on the nature of the domestic supply of petroleum products subject to the Act.

3. Price controls on crude oil are not necessary to carry out the Act.

All of the purposes and goals of the Act are predicated upon alleviating the emergency conditions resulting from shortages of crude oil, residual fuel oil and refined petroleum products which were being experienced or appeared imminent when the Act was made law late in 1973. As indicated

in Finding 1, shortages of crude oil no longer exist. Inasmuch as the underlying condition to which the purposes and goals of the Act generally relate is no longer present, the necessity of price controls on old oil to carry out the Act is no longer apparent.

The express purpose of the Act, as stated in §2(b), is to grant to and direct the President 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 specific goals to be reached by exercise of the authority granted under the Act, as set forth in §4(b)(1), may be placed in the following groupings: (a) to protect the general welfare and the national defense; (b) to maintain residential heating, public services and agricultural operations; (c) to preserve an economically sound and competitive petroleum industry; (d) to allocate crude oil in order to permit refineries to operate at full capacity; (e) to provide for equitable distribution of crude oil, residual fuel oil and refined petroleum products at equitable prices among all regions and among all users; (f) to allocate residual fuel oil and refined petroleum products in order to maintain exploration and production or extraction of fuels; and (g) to provide for

economic efficiency and minimization of economic distortion, inflexibility and unnecessary interference with market mechanisms.

The decontrol of old oil prices should serve to further the goals indicated in items (c) and (g), above, under present conditions. The economic inefficiencies and distortions brought about by price controls when they are extended over a long period of time are discussed in Section B, above. In addition, the gradual removal of price controls during a period of adequate supply should lead to improvement in the economic position of the petroleum industry and stimulate resumption of normal competitive conditions. These results are particularly desirable in view of the major effort which will be required to alter the trend of declining U.S. crude oil production.

The adequacy of supply under current conditions means that the threat to the national security and welfare posed by an existing or imminent shortage of crude oil no longer exists. Price controls on crude oil are therefore no longer necessary to achieve the short-term goals of the Act concerning protection of the national defense and public welfare (item (a)). For the longer term, removal of price controls should have a favorable effect on the national

defense and public welfare. As the Secretary of Treasury found in connection with the President's Proclamation regarding imposition of import fees, the heavy reliance by the United States on imported crude oil poses a significant threat to the national security. As noted above, the decontrol of old oil prices should over the long run significantly reduce reliance on foreign sources of oil.

The goals indicated in items (d) and (f) relate primarily to the allocation program or to petroleum products other than crude oil. These goals are therefore not directly affected by the proposal to decontrol the price of old oil.

The goals in item (b) address the threat to adequate supplies of fuel for residential heating, public services and agricultural operations resulting from imminent crude oil shortages. This threat was countered primarily by the allocation of crude oil used to produce fuels for these needs, and by the allocation of these fuels themselves. This fact, plus the current absence of any shortage of crude oil, leads to the conclusion that price controls on crude oil are no longer necessary to achieve the goals of the Act relating to maintaining adequate fuel supplies for residential, public service and agricultural needs.

The goal of providing for "equitable distribution of crude oil . . . at equitable prices among all regions and . . . all users" (item (e)) is one which is clearly predicated upon the existence or imminence of a serious crude oil shortage situation. When supplies are short, normal market mechanisms may not assure equitable distribution of supplies across the country and do not prevent price gouging and other shortage-related pricing abuses. In other words, the goal of "equitable prices" should not be isolated and read out of context as mandating permanent price ceilings, even when supplies of crude oil are adequate to permit normal market mechanisms to function. In the absence of shortages of crude oil, therefore, price controls on crude oil are not necessary to carry out the goal of equitable distribution at equitable prices.

In addition, FEA believes that "equitable" prices, within the meaning of §4(b)(1)(F) of the Act, will be achieved by restoring normal market mechanisms during a period of adequate supply and by eliminating economic distortions caused by the current two-tier pricing system. However, to the extent that a return to normal market mechanisms at this time would bring prices on crude oil to levels which might be viewed in certain sectors of the economy as inequitably

high because they result in higher prices on certain petroleum products, this view is outweighted by the need to achieve other objectives of the Act and by other considerations, including the fact that decontrol is being phased in gradually and the availability of legislative measures to alleviate, through tax relief or rebates, the impact of price increases on consumers and other sectors of the economy.

On the basis of all the foregoing considerations, the FEA concludes that price controls on crude oil are not necessary to carry out the Act.

D. Comments on Old Oil Decontrol Proposal

Comments in opposition to the FEA old oil decontrol proposal generally reflected the following arguments:

1. The argument that U.S. crude oil price levels should be based on production costs and not reflect arbitrary OPEC pricing decisions.

The FEA decontrol program permits old oil prices ultimately to rise to the vicinity of current prevailing world market prices, plus the supplementary import fee of $2.00 per barrel. Some commentators who opposed the FEA decontrol program generally felt that the world price was artificial and therefore unnecessarily high, and might go higher, resulting in still higher domestic prices for decontrolled crude oil. In order to provide appropriate incentive toward

increased domestic production, it was proposed that the old oil price ceiling be retained but set at some higher intermediate level, such as $7.50, $8.50 or $10.00 a barrel.

While no indisputable conclusions in this matter are possible, it is clear that current world price levels, including the supplementary import fee, do not exceed the point at which further price increases cannot be expected to bring significant returns in terms of increased crude oil production. In the view of FEA, decontrol at prices up to current world price levels (plus U.S. import fees) will effectively stimulate domestic production and over time substantially reduce our dependence on imported oil. Nevertheless, in order to be responsive to the concern that further OPEC price increases could result in further domestic price increases above those levels providing the maximum useful production incentives, the amendment adopted today imposes an ultimate ceiling on domestic crude oil prices.

It should be remembered in this connection that the great bulk of new domestic production of crude oil will come not from traditional production techniques within the contiguous portions of the continental United States but from more sophisticated and expensive production techniques within this area, or from the continental shelf and remote areas of Alaska. Most offshore production

is expected to come from previously untapped areas of the Atlantic and Pacific rather than from the more familiar and tested reaches of the Gulf of Mexico. These considerations all point to the need for new technologies, heavier investment burdens, greater risks and greatly increased costs of production.

In addition, the potential exists for substantial new recoveries from worked-over "onshore" reservoirs provided technology for secondary and tertiary recovery is further developed or existing technology becomes economically feasible as prices rise. While not as costly as recovery from offshore and Alaskan frontiers, recovery utilizing secondary/tertiary recovery techniques is generally substantially more costly than primary recovery.

Unfortunately, the level of incentive needed to induce high-risk exploration and cost estimates for successful development projects vary considerably due to the substantial uncertainties connected with exploration and ultimate recovery from remote and unhospitable regions and considerable doubt as to future rates of inflation. Thus, even if costs could be projected with great precision, necessary incentives for increased

production could not be provided by setting prices which merely covered costs. While producers acknowledge that current uncontrolled domestic crude oil price levels provide sufficient incentive to produce new oil, nevertheless as long as three-fifths to two-thirds of production must be sold at the old oil price ceiling of approximately $5.25 per barrel, cash flow, together with other sources of capital, will not be adequate to generate enough capital to finance exploration and development of new oil, no matter what price it may be expected to bring. This problem is of even greater urgency now that tax reform has removed the depletion allowance as a means of accumulating capital for exploration and development.

In this connection, comment provided by oil producers indicates that while industry profits were high in 1974, profits for the first quarter of 1975 have dropped to an

average of about two-thirds of the level of the first quarter of 1974. On an annualized basis, this level of profit would produce a return on stockholder equity of 10.5 percent. For the ten-year period prior to 1974 the rate of return on stockholder equity was 11.4 percent for the petroleum industry compared with 11.6 percent for all manufacturing. These figures tend to support the view that the high profit levels of 1974 were not typical, and were the result of short-term non-recurring forces. According to industry comments, the steep decline in industry profits this year, while attributable in large degree to the change in the depletion allowance, significantly exceeds the decline attributable to that change.

Management decisions as to capital needs and adequacy of price incentives necessarily rest with producers and, unless control of oil production is to be assumed by the government, oil firms cannot be forced to develop and market additional amounts of crude oil, even if price levels deemed

"adequate" by FEA or Congress were to be adopted. Several commentators made reference in this connection to the serious decline in natural gas production that has occurred under long-term federal price regulation.

Taking into account both FEA and industry estimates, adequate incentive for development of new "onshore" crude oil (i.e., enhanced recovery from traditional domestic reservoirs by secondary/tertiary methods) is currently estimated at between $7.00 to $10.00 a barrel; for development of new oil from Alaska and offshore or continental shelf regions, at between $7.00 to $12.00 a barrel; for development of oil from shale, at between $12.00 to $15.00 a barrel; for development of oil from coal, at about $18.00 a barrel. This array of estimates suggests that if imports are to be held at acceptable levels by substituting significant amounts of new domestic production, it will be both necessary and appropriate to allow prices to rise to the vicinity of currently prevailing world market levels.

The foregoing estimates are generally supported by estimates provided to FEA by other sources. For example, industry data submitted by the Society of Petroleum Engineers

indicates that cost of developing and producing a barrel of crude oil in 600 feet of water in the North Atlantic and North Pacific is 3.5 times the cost at the same depth in the Gulf of Mexico, while the cost in the Gulf of Alaska may range up to six times that in the Gulf of Mexico. Lag times are more than twice as great in these frontier areas. In addition, an independent economist testified before a congressional committee that the replacement cost or "economic cost" of domestic crude oil reached a level of $12.73 a barrel in 1974. The high cost of finding "replacement" barrels of crude oil for those we consume today must be financed, in the main, by profits earned on the barrels sold today.

In the opinion of FEA, the task which the nation faces is one of providing sufficient incentives to private industry to develop, to the maximum extent possible and as quickly as possible, additional domestic crude oil resources which will reduce dependence on unreliable foreign crude oil. Revival of domestic production will require a major undertaking in frontier regions at high cost. A decision to offer maximum incentives and to pursue maximum efforts to this end is our own decision and not one dictated by foreign pricing policies.

2. The argument that decontrol would impose too great a burden on the consumer.

Most commenting refiners stated that old oil decontrol would result in an average price increase of 5 cents or 6 cents per gallon of petroleum product. Suggesting that actual dollar cost increases to the consumer would be within manageable limits, Exxon commented that gasoline prices today are below 1950 levels, in terms of constant dollars, and would remain so even if old oil decontrol were effected immediately. Other comments either directed attention to "ripple effects" or noted that the cost was a small price to pay for greater energy independence.

FEA assessment of impact on the consumer indicates that the average retail price increase attributable to decontrol by the end of this year would be only about 1.5 cents per gallon of petroleum product. This fact illustrates that the program to phase out crude oil price controls over a 2-1/2 year period will substantially diminish the impact of decontrol on consumers.

The FEA assessment of impact on the consumer also takes into account the intangible but real benefits which would accrue to the public at large through increased national economic security brought by lessened dependence on unreliable foreign crude oil sources, improved balance of

payments position, revived domestic industrial production and new jobs in the petroleum industry. In addition, the "windfall profits" tax on oil producers' excess revenues proposed by the President would yield tax receipts which would be used to provide direct rebates to energy consumers. These factors mitigate to a significant extent the actual dollar cost to consumers.

On the other hand, the FEA is aware that prices on such products as home heating oil are already very high and that further increases could impair the ability of certain consumers (particularly the aged and the poor) to pay heating bills, despite the gradual nature of the FEA decontrol program and tax relief. Specific legislative proposals, such as a home insulation tax credit, have been proposed to the Congress to minimize the impact that relatively higher energy costs, including costs of home utilities, will ultimately have on various sectors of the economy.

However, the FEA considers the immediate adoption of this gradual crude oil decontrol program of such overriding national importance that no further delay can be justified. FEA believes this action to be consistent with the admonition in the Conference Report on the Emergency Allocation Act of 1973 that in exercising authority under that Act it would be necessary to "strike an equitable balance between the

sometimes conflicting needs of providing adequate inducement for the production of an adequate supply and of holding down spiraling consumer costs."

3. The argument that decontrol will not reduce demand.

Several comments were received which stressed that consumers have already "dialed down" and taken all other available conservation steps, and that no further realistic anti-consumption measures are available, particularly to the homeowner. According to this view, the decontrol program would therefore merely squeeze the consumer.

While the FEA acknowledges that many useful conservation measures in home heating (except perhaps major insulation efforts) were instituted last year, nevertheless comments with respect to inelasticity of demand are not borne out by the demand responses experienced with respect to past price increases.

The decontrol program will contribute to the long-term goal of reducing dependence on unreliable foreign crude oil and the benefits of achieving that goal must therefore be measured on a long-term basis. The FEA position that increased prices of domestic crude oil will dampen demand domestically is based on the realistic assumption that higher fuel prices in the long run will inevitably result in or contribute to smaller and/or more efficient automobiles, more efficient home heating systems, increased construction and use of public transportation systems, and more efficient

use of fuels in commerce and industry. All of these will contribute to contracting energy demand.

Moreover, means are available for easing short-term problems relating to demand reduction. The President has consistently urged that appropriate legislative action be taken to ease the burden on consumers of the transition to an economic system based on relatively higher costs for energy than have been experienced in the past. The FEA will continue to work actively in seeking to solve transitional consumer problems.

4. The argument that decontrol of crude oil should not be undertaken unless natural gas prices are deregulated simultaneously.

A number of petroleum marketers stated that they would not support the FEA decontrol program unless natural gas prices were decontrolled at the same time. Understandably, marketers of petroleum fuels are concerned that they will lose a share of their fuel markets to natural gas marketers if petroleum fuels become increasingly non-competitive in price.

To some degree the concern of petroleum marketers in this respect may be exaggerated. The present short supply of natural gas is expected to become more critical in the coming months, so that it is most unlikely that

many consumers will be able to substitute natural gas for petroleum fuels even if the latter become more expensive. Only if Congress acts to decontrol natural gas prices substantially in advance of implementation of a program to decontrol crude oil prices could there be an expansion of natural gas supplies sufficient to permit inroads into the petroleum fuels market. In that event, of course, natural gas prices would have begun to climb before those of petroleum fuels, so that the petroleum marketers would be in a relatively better competitive position.

The FEA agrees that many of the same reasons which support decontrol of crude oil prices support decontrol of natural gas price levels. However, regulation of natural gas prices is not within the jurisdication of FEA. In exercising its responsibilities under the Emergency Petroleum Allocation Act of 1973, the FEA must move forward to develop policies and programs within its mandate, while recommending for congressional action complementary measures which are beyond FEA authority to implement.

Congress has under active consideration proposals to deregulate the prices of natural gas. In view of the

urgency of taking steps now to alter the trend toward increased imports of crude oil, and in view of the gradual phase-out approach of the FEA decontrol program, the FEA believes it is appropriate to commence gradual decontrol of old oil price ceilings without waiting for final congressional action on natural gas prices.

The FEA recognizes that the Emergency Petroleum Allocation Act of 1973 places special emphasis on protecting the competitive viability and market share of independent marketers, to the maximum extent practicable and consistent with the other objectives of the Act. FEA will therefore maintain a continuing review of the market shares of home heating oils versus competing fuels and to insure that decontrol of crude oil does not have a significant adverse impact on independent marketers.

5. The argument that decontrol of crude oil should not be undertaken until a "windfall" profits tax is enacted.

For the reasons given under argument number 4, above, the FEA believes that the decontrol program must begin now, without further delay. Action on a "windfall" profits tax can be completed within the next few months by Congress without disrupting an orderly administrative decontrol program. Increases in producer revenues will be gradual under the phased decontrol schedule, and in any event a new profits tax may be imposed retroactively.

6. The argument that decontrol by FEA would harm the airline industry, in contravention of one of the goals of the EPAA.

Representatives of the airline industry commented that U.S. airlines, already in financial difficulty because of the increases in jet fuel prices in 1974 and the effects of the recession on airline travel, would be further adversely affected by another round of fuel price increases brought about by decontrol.

The airline industry takes the position, in effect, that decontrol should not be permitted to proceed because it would impair public air transportation in contravention of one of the goals of the Emergency Petroleum Allocation Act.

The FEA recognizes that one of many express goals to be achieved by the allocation and price regulations promulgated under the Emergency Petroleum Allocation Act of 1973 is to "provide for maintenance of all public services . . . including transportation facilities." However, the concern of Congress in this respect was directed to the adequacy of supplies to keep transportation systems running. This is clearly shown by the following specific discussion of air transport problems in the Conference Report on the Act.

> The petroleum fuel shortage threatens numerous areas of commerce. The jeopardy from shortage of these fuels impacts most directly on transportation. Without adequate petroleum fuel most United States' domestic and international transportation, with no option to convert to other fuels, potentially

> would be seriously disrupted. A significant reduction of transportation capability could adversely affect all other areas of commerce and the national economy. Thus, one of the primary objectives of the Act is to assure maintenance of transportation services.

The Act clearly does not require the "maintenance" of price ceilings on certain petroleum products purchased by a particular industry.

Moreover, each of the many goals listed in §4(b) of that Act is qualified by the proviso that the allocation and price regulations need provide for those goals only "to the maximum extent practicable." In explaining why this qualification was included, the Conference Report stated, "It is fully recognized that, in some instances, it may be impossible to satisfy one objective without sacrificing the accomplishment of another." The qualification was thus intended, according to the Report, "to give the President administrative flexibility in marshalling short supplies and equitably assigning them to particular needs."

Therefore, even if FEA were to agree with the airline industry's view that decontrol does not fully meet one of the many sometimes conflicting objectives under the Act, this would not overcome the FEA's conclusion as to the overriding need to proceed with this decontrol program -- a program designed to reflect the present adequacy of supplies and to begin on a gradual basis to restore the petroleum industry to normal functioning.

The FEA is sensitive to the special problems which face the airline industry and other public service industries due to energy cost increases. The change from a 25 to a 30-month phase-out schedule should serve to reduce the impact of decontrol in industries which are especially dependent on petroleum fuels. The FEA is prepared to discuss with any industry or affected group other ways in which adverse effects under the decontrol program can be minimized.

E. Rule Modification.

1. Length of Phase-Out Period.

A great variety of suggestions were received for changing the 25-month period for decontrol proposed by FEA in its notice of proposed rulemaking in this matter. These ranged from requests for immediate decontrol, to decontrol over a 5-10 month period, to decontrol over a 4 or 5-year period. However, many commentators indicated that they would be willing to accept the FEA proposal on this issue as a compromise or second choice.

Those who proposed a longer period for phase-out were chiefly concerned with minimizing or softening the impact on the economy or on consumers, in particular. Those proposing a shorter period stressed either the need to remove the economic distortions and other deleterious effects of

controls as soon as possible or the need to achieve a greater degree of national self-sufficiency in crude oil at a more rapid pace.

The FEA must, of course, strike a balance between these opposing considerations or concerns. The FEA believes that a somewhat more gradual decontrol pace, at the rate of 3.3 percent a month for 30 months (after decontrol of one percent for the month of July, 1975), represents a reasonable balance on this issue. This will mean that the decontrol process would extend to February 1, 1978, compared with August, 1977, under the 25-month proposal and August, 1980, under the decontrol proposal contained in H.R. 7014 as recently reported out of the House Commerce Committee. This phase out program, once placed in motion, will permit planning and mobilization for long range exploration and development of new domestic crude oil resources to begin immediately. At the same time, the 30-month phase-out schedule appears to provide an appropriately gradual mechanism to minimize the impact on the economy.

2. Requirement of Maximum Feasible Rates of Production.

Comments were received which expressed concern that the decontrol program, as proposed, might have the unintended result of reducing production temporarily

if producers held back on production until the end of the phase-out period, when all crude oil could be sold at uncontrolled price levels.

In view of this possibility, the FEA has decided to adopt generally the same express requirement now applicable by its terms only to the stripper well lease exemption, which requires production to be maintained at maximum feasible rates of production. The FEA believes this requirement is appropriate to assure that the purpose and intent of the decontrol program are not circumvented. The requirement is also fully consistent with the main purpose of decontrol, which is to maintain and increase current levels of domestic production as rapidly as possible. Any holding back would defeat this purpose and would also defeat the effort to minimize adverse effects on the economy by phasing out controls on a gradual basis.

3. Decontrol Base Level.

Under the proposed rule the amount of decontrolled oil would have been calculated as a percentage of the base production control level crude petroleum (i.e., 1972 production) rather than as a percentage of the old oil currently being produced. It was pointed out to FEA that inasmuch as 1972 production levels are generally greater than current production levels, the monthly decontrol volume would be correspondingly larger if

the amount of decontrolled oil were to be calculated against a 1972 base. This would mean that the old oil produced from a property would be decontrolled in a period of less than 25 months, to the extent that its current production was at less than 1972 levels. Thus, the overall decontrol program, as proposed, would have extended to the end of that 25-month period, and would have affected for the full 25 months (as proposed) those properties which continue to produce at 1972 levels, but would have decontrolled properties producing at less than 1972 levels before the end of that period.

In order to clarify this ambiguity concerning the phase-out schedule and in order to assure a full 30-month phase-out for all properties which continue to be productive, the FEA has concluded that it would be preferable to calculate the amount of decontrolled crude oil on the basis of a recent level of old oil production rather than on the basis of the 1972 base level production.

The FEA has also concluded that, in view of the urgent need for increased domestic production of crude oil, the modified decontrol amendment should provide production incentives for all properties, at all

levels of production. As discussed in Section B, above, existing production incentives relating to "new" and "released" crude oil are not effective to encourage additional production in many cases where current production has declined substantially below 1972 base levels. Gradual decontrol of old oil based on the current month's production would not directly stimulate additional production in these cases, since such a decontrol formula would subject any incremental production to price controls in the same percentage as if a lesser amount had been produced.

In view of the foregoing considerations, the decontrol rule adopted by FEA today has been modified to measure decontrolled old crude oil by reference to an established base of the recent production level of old oil from the property concerned. This will provide an immediate price incentive to all properties to increase production above that level. Accordingly, the new regulation establishes a "decontrol base production level," which is defined as the average monthly production of old oil from the property concerned during the three calendar months ending June 30, 1975,

based on maximum feasible rates of production in those months. Any old oil production above that level in each month beginning with August, 1975, will be decontrolled, as will an amount of each current month's old oil production which is equal to the decontrol base production level multiplied times a percentage equal to 3.3 percent times the number of months beginning with August, 1975, through that current month, plus one percent (representing the decontrol action for July, 1975). However, for the month of July, 1975, the only production to be decontrolled will be one percent of the decontrol base production level. Since the decontrol calculations are based exclusively on old oil production levels (controlled oil less "new" and released" oil), this amendment leaves undisturbed and is in addition to the existing regulations which permit "new" and "released" crude oil to be priced at market levels.

For example, a property which had a 1972 base production control level of 2,000 barrels per month (b/m) and a 1975 "decontrol base production level" (i.e., old oil production level) of 1,680 b/m might reach the following hypothetical total production levels: in July, 1975, 1,600 b/m; in August, 1975, 1,640 b/m; in October, 1975, 1,880 b/m; and in January, 1976, 2,180 b/m.

Under the amendment adopted by FEA today, the amount of July production of 1,600 barrels which would be decontrolled

would be one percent of the decontrol base production level of 1,680 barrels, or 17 barrels. The amount of August production of 1,640 barrels which would be decontrolled would be 4.3 percent (3.3 percent for August plus one percent for July) of the decontrol base production level of 1,680 barrels, or 72 barrels.

Decontrolled production for October would be the 200 barrels of oil (all of which is old oil) produced in excess of the decontrol base production level, plus 10.9 percent (3.3 percent times three months plus one percent) of the 1,680-barrel decontrol base production level, a total of 383 barrels.

For January, in order to determine the amount of crude petroleum that could be sold at market levels, the producer would first note that the 180 barrels in excess of the 2,000 barrel base production control level comprised "new" oil, and that, accordingly, 180 barrels of "released" oil would be available (omitting for purposes of this example the cumulative deficiency requirement). This means that the month's production of old oil is 1,820 barrels. The amount of old oil which would then be decontrolled pursuant to this amendment would be the 140 barrels by which the 1,820 barrels of old oil production for the month exceeds the 1,680 barrel decontrol base production level, plus 20.8

percent (3.3 percent times six months plus one percent) of the 1,680-barrel decontrol base production level, or 349 barrels. Thus, for the month, 1,331 barrels would be subject to the old oil ceiling price and a total of 849 barrels would be sold at market levels (although subject to the higher ceiling price for "decontrolled" oil.)

The foregoing examples are intended merely to illustrate the computations under current new and released crude oil price rules, and under this amendment, where the current month's production is (1) below the "decontrol base production level," (2) above the "decontrol base production level" but below the 1972 base production control level, and (3) above both the "decontrol base production level" and the 1972 base production control level. (These examples are not intended to reflect projected rates of production for any particular property or for U.S. domestic production generally.)

4. Decontrolled Price Ceiling.

Pricing policies recently announced by OPEC indicate that world crude oil price levels, which have remained generally stable for more than a year, might be increased in the coming months.

In order to avoid the possibility that future world price increases might result in U.S. domestic price increases to levels which are above the current landed

cost for imported oil (i.e., the world market price plus the $2.00 per barrel supplementary import fee), the FEA has further modified its proposed rule, to establish in this amendment an ultimate price ceiling for decontrolled domestic crude oil of $13.50 per barrel applicable until the end of the 30-month decontrol period. This ceiling will apply to all domestic crude oil other than stripper well crude oil, which is exempt from price controls pursuant to the Emergency Petroleum Allocation Act of 1973. With respect to properties from which new or released crude oil was produced and sold in the month of January, 1975, the ceiling price shall be the highest price charged for crude oil produced and sold from that property in January, 1975, plus $2.00 per barrel; and with respect to decontrolled crude oil produced and sold from all properties which did not produce and sell new or released crude oil in January, 1975, the ceiling price shall be $13.50 per barrel.

The FEA does not intend by imposing this safeguard to alter the fundamental nature or direction of the decontrol program. While the existence of an ultimate price ceiling means in one sense that decontrol is not absolute, the experience under price controls since

the Economic Stabilization Act of 1970 indicates that no price exemption can be considered permanent where economic conditions remain unsettled or vulnerable to disruption. The FEA intends under this rule merely to make clear in advance the point above which decontrolled prices will not be permitted to rise without a price freeze and concurrent reassessment of crude oil cost/price and supply/demand forces.

Should Congress adopt a windfall profits tax measure, as urged by FEA, any increased oil-producer revenues generated due to possible future OPEC price increases would be returned to the Treasury whether or not FEA imposed an ultimate crude oil price ceiling. However, assuming a windfall profits tax is enacted and the authority of the FEA to regulate petroleum prices is extended, it would remain the responsibility of FEA to monitor progress toward import-reduction goals and to take such additional steps as might be necessary to assure that domestic production is increased at the rate and in the manner deemed most appropriate. The establishment of an ultimate price ceiling at this time helps to clarify

energy policy for both producers and consumers and is in keeping with FEA's continuing responsiblity to guide and direct attainment of energy policy goals.

5. Technical Changes.

Technical changes have been made in §§211.62 and 212.131 to conform the entitlements program and the crude oil sales certification requirements to the decontrol program.

(Emergency Petroleum Allocation Act of 1973, as amended, Pub. L. 93-159, as amended by Pub. L. 93-511; Federal Energy Administration Act of 1974, Pub. L. 93-275; E.O. 11790, 39 FR 23185).

In consideration of the foregoing, Parts 211 and 212 of Chapter II, Title 10 Code of Federal Regulations, are amended as set forth below, effective immediately upon the expiration of the period required pursuant to §4(g)(2) of the Emergency Petroleum Allocation Act of 1973, as amended, unless this amendment or any portion thereof is disapproved by either house of Congress during that period.

Issued in Washington, D.C., July , 1975.

Robert E. Montgomery, Jr.
General Counsel
Federal Energy Administration

1. Section 211.62 is amended in the definition of "old oil" to read as follows:

§211.62 Definitions.

* * *

"Old oil" means old crude petroleum less any related decontrolled old crude petroleum, as each of these terms is defined in §212.72 of this chapter.

* * *

2. Section 212.72 is revised to add, in appropriate alphabetical order, a definition of "decontrol base production level" and "decontrolled old crude petroleum" to read as follows:

§212.72 Definitions.

* * *

"Decontrol base production level" means the total number of barrels of old crude petroleum produced and sold from the property concerned during the three calendar months ending June 30, 1975, divided by three. The decontrol base production level for each property shall be based upon each well on that property having been maintained at the maximum feasible rate of production during the

three calendar months ending June 30, 1975, in accordance with recognized conservation practices, and not significantly curtailed by reason of mechanical failure or other disruption in production. In a case where the property concerned was not so maintained, the FEA may assign a decontrol base production level which fairly represents the production level which would have been attained if that property had been so maintained.

"Decontrolled old crude petroleum" means:

(1) For the month of July, 1975, a number of barrels of old crude petroleum produced and sold from the property concerned in that month equal to 1 percent of the decontrol base production level for that property;

(2) For months subsequent to July, 1975, (a) the total number of barrels of old crude petroleum produced and sold from the property concerned in the current month which exceeds the decontrol base production level for that property, plus (b) a number of barrels of old crude petroleum produced and sold from the property concerned in the current month equal to the product of the decontrol base production level for that property multiplied by a percentage equal to 3.3 percent multiplied by the number of months beginning with August, 1975, through the current month plus one percent.

3. Section 212.74 is revised to read as follows:

§212.74 New, released and decontrolled old crude petroleum.

(a) Notwithstanding the provisions of §212.73(a), but subject to paragraphs (b) and (c) of this section, a producer of crude petroleum may charge any price for the new crude petroleum, the released crude petroleum, and the decontrolled old crude petroleum produced and sold from the property concerned in the month concerned.

(b) Until February 1, 1978, no producer may charge a price for any new crude petroleum, released crude petroleum, or decontrolled old crude petroleum which exceeds the highest price charged for new or released crude petroleum produced and sold from the property concerned in January, 1975, plus $2.00 per barrel, or with respect to such crude petroleum produced from a property from which new or released crude petroleum was not produced and sold in January, 1975, a maximum of $13.50 per barrel.

(c) A producer that charges a price for decontrolled old crude petroleum which exceeds the ceiling price for old crude petroleum shall maintain each well on the property concerned at all times at the maximum feasible rate of production, in accordance with recognized conservation practices, and shall use all reasonable means to insure that production is not significantly curtailed by reason of mechanical failure or other disruption in production.

4. Section 212.31 is revised in paragraphs (a) and (b) to read as follows:

§212.31 Certification of domestic crude petroleum sales.

(a)(1) Each producer of domestic crude petroleum shall, with respect to a first sale of domestic crude petroleum, certify in writing to the purchaser: (i) the ceiling price of that domestic old crude petroleum, (ii) the amount of stripper well crude petroleum, (iii) the amount of new crude petroleum, (iv) the amount of released crude petroleum, (v) the amount of decontrolled old crude petroleum, and (vi) the amount of old crude petroleum which has not been decontrolled, provided, that the certification requirements of this paragraph (a)(1) may be complied with by a one-time certification by a producer to the purchaser as to the base production control level crude petroleum for each month of 1972 and as to the decontrol base production level for the particular property. The certification shall also contain a statement that the price charged for the domestic crude petroleum is no greater than the maximum price permitted pursuant to this part.

(2) Each seller of domestic crude petroleum, other than a producer of domestic crude petroleum covered by paragraph (a)(1) of this section shall, with respect to each

sale of domestic crude petroleum other than (i) an allocation sale pursuant to §211.65 of part 211, or (ii) a sale in which no volumes of old oil (as defined in §211.62) are deemed to have been transferred pursuant to §211.67(g) of part 211, certify in writing to the purchaser the amount of old crude petroleum which has not been decontrolled included in the volume of domestic crude petroleum so sold. The certification shall also contain a statement that the price charged for the domestic crude petroleum is no greater than the maximum price permitted pursuant to this part.

(b) With respect to each allocation sale under §211.65 of part 211, the seller shall certify in writing to the purchaser the amount of old crude petroleum which has not been decontrolled deemed (under the provisions of §211.67(f) of part 211) to be included in the volume of crude petroleum so sold. Such written certification shall be made within 25 days following the month in which the crude oil so sold is delivered to or for the account of the purchaser.

* * * * *

APPENDIX B

National Petroleum Product Supply and Demand: 1975