THE NEW NATIONAL ENERGY LEGISLATION

AND FUTURE U.S. OIL IMPORTS

by

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In the early morning of Sunday, October 15th, the U.S. House of Representatives voted in favor of the Administration's comprehensive National Energy Act, just hours before the end of the Congressional session. The vote was the final step in an 18 month battle by the Administration of President Carter for an overall energy policy which would enable the U.S. to reduce its level of oil imports. Now that this policy is about to become law—the President is expected to sign it in the next few days—the question asked both here and abroad is what will its real impact be on future U.S. oil imports? Since the U.S. is, by far, the world's largest oil importer, the question is of legitimate concern to foreign nations as well.

A good starting point for the answer is the original National Energy Plan sent by the President to the U.S. Congress in April 1977. It was the basis for all the energy legislation submitted to Congress by the President. However, the legislation which Congress eventually passed bore only very limited similarity to the National Energy Plan. Among the key provisions of this Plan had been a number of tax measures designed to raise the price of domestic crude oil to world levels, make oil and gas more expensive than coal for industrial users, increase the cost of cars with high gasoline consumption rates and raise the existing sales tax on gasoline.

All of these tax provisions were eventually rejected by Congress. Consequently, the eventual impact of the new energy legislation on oil imports will of course be less than if the Administration's entire package, including the tax provisions, had been adopted. However, the difference may not be very substantial, since some of the tax provisions...
were probably in the nature of an "over-kill", that is they would have been superimposed on a variety of non-tax provisions which can be expected to have the same effect on oil consumption as the proposed taxes. Many members of Congress felt that some of these tax measures would raise fuel costs without significantly reducing fuel consumption.

The most important tax provision rejected by Congress, the Crude Oil Equalization Tax, would have raised controlled domestic crude oil costs for refiners to world market levels with very little of the increase going to oil producers in the form of additional profits. This particular tax provision might have reduced oil imports by several hundred thousand b/d by the mid-1980's when its full impact would have been felt. However, after next April when the existing oil price control legislation expires, the President will be in a position to raise domestic oil prices on his own to world levels. In line with his public commitment at the Bonn economic summit meeting last summer, he can be expected to do so by 1980 or 1981, with or without accompanying tax legislation. Thus, failure by Congress to approve the crude oil equalization tax does not necessarily mean that domestic oil prices will remain significantly below world market levels after 1980.

The new energy legislation falls into three broad categories: natural gas pricing, energy conservation and increased utilization of coal. The most important of these, measured by its potential impact on future oil imports, is the gas pricing legislation. It is extremely complex and difficult to understand for anyone not familiar with the intricacies of the existing natural gas legislation, such as the difference between intrastate and interstate gas sales.* Historically, *Intrastate sales are for consumption within the producing state. Interstate sales are shipments to other states.
intrastate sales, which account for 45% of total U.S. gas sales, have not been under federal price control while interstate sales have been. The new legislation extends price control to intrastate sales, thereby creating for the first time a "national" gas market with more unified prices than existed previously. One result will be a short-term increase in the flow of gas from the intra-state to the interstate market, including an estimated 0.5-1.0 trillion cubic feet of gas currently locked in the ground because of a temporary saturation of the intrastate gas market and an unattractive price for such gas in the interstate market prior to the new legislation.

More important is the fact that under the new legislation the price of all categories of gas will be allowed to rise. The minimum increase will be in line with the inflation rate of the U.S. economy and will apply to "old" gas, that is gas found and produced prior to April 20, 1977, the date on which the National Energy Plan was issued. The price for "new" gas, that is gas produced from reservoirs found after this date, is being raised immediately from its current interstate price of $1.50/Mcft to $2.09/Mcft and will be permitted to increase by the U.S. inflation rate plus a 4% average annual "incentive" factor between now and the end of 1984. After that it is to be de-controlled.

The price for "new" gas is approximately at parity (on a Btu basis) with that of competitive fuels. However, the average price of all gas is of course still below parity, since most of it consists of "old" gas. But as the share of "old" gas declines while that of "new" gas increases, the average price of U.S. gas is bound to rise substantially. By 1984-85 it could well reach or approach parity with competitive oil products.
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It is expected that the sharply increased price for "new" gas will bring forth additional supplies. But it is difficult to quantify its impact.

The Department of Energy has estimated that the higher prices will increase U.S. gas supplies by 2 trillion ccf annually by 1985. This would be equivalent to nearly one million b/d in oil import substitution. Most industry estimates however, are considerably lower.

Besides the pricing provisions the new gas legislation also stipulates that a large portion of the delivered price of Alaskan gas can be averaged by the pipeline companies with the price of less costly gas from other sources in order to blunt the impact of the cost of Alaskan gas on consumers. Without this provision, Alaskan gas, which will be very high priced in U.S. markets ($4-5/Mcft in 1985) because of the distance it has to travel, may not have been saleable. If the pipeline is built, which is still not certain, it will carry an initial annual volume of 0.8 trillion ccf by 1985, equal to about 380,000 b/d of oil.

Thus, the government estimates the additional gas production resulting from the new legislation will reduce oil imports by 1985 by about 1.4 million b/d from what they would have been without it.

This is where the real controversy over the impact of the new law begins. The government estimate assumes implicitly that without it U.S. gas prices would have remained unchanged in real terms over the next seven years. Yet, actually, gas prices have increased at a fairly rapid rate in real terms throughout the last several years under existing legislation and would probably have continued to do so. Similarly, the government could have permitted the averaging of high-cost Alaskan
gas with lower cost gas from other areas under existing legislation.

Thus, it is argued, that the government's estimates of the additional gas production and conservation might have been achieved under the old legislation, too, and therefore do not represent a true improvement from the production levels that would have prevailed by 1985 without the new law.

There is undoubtedly some truth to this and it reflects the fact that the existing incentives to develop new production and improve conservation were not as weak as the Administration has claimed, nor are the incentives under the new law as strong. Nevertheless, the new law has eliminated a number of uncertainties, is freeing some gas from price controls within 12 months and holds out the promise that all "new" gas will be decontrolled by 1985. Hence, on balance, the new gas legislation represents an improvement over the existing legislation and can be expected to stimulate a higher level of gas production, although not as high as its proponents are claiming.

The other provisions in the new energy bill are expected to save a total of 1.1-1.3 b/d in oil imports by 1985, according to the Administration.

The coal utilization measure requires most new industrial and power plants to burn coal, rather than oil or gas. Existing power plants will have to stop using gas and possibly oil by 1990. However, a considerable number of exemptions are permitted for plants that for one reason or another cannot conform to these requirements. In order to spur conversion Congress approved tax incentives for business firms installing boilers for fuels other than oil or gas. It also provides
loans for electric utilities to install air pollution equipment so that they can use coal without violating environmental restrictions.

Here again, the new legislation is not essentially different from the one it is replacing but rather builds on it. Furthermore, economics favor the new legislation, since coal has been significantly cheaper than oil on a Btu basis since 1973. As a result, between 1972 and 1977 U.S. coal consumption rose by nearly 13%, compared to less than 2%, in the previous 5-year period. The principal bloc to increased coal consumption is not lack of demand or available supply but environmental regulations prohibiting or curtailing the burning of coal. Recently these regulations have been made more severe, making it even less likely that the National Energy Plan's original target of nearly 1.3 billion tons of coal consumption by 1985 can be reached. However, a level of one billion tons may be attainable. This would represent a 61% increase from last year's consumption.

Of all the proposed measures to curb gasoline consumption the only ones which survived the Congressional scrutiny was the so-called gas "guzzler" tax, that is a tax by 1980 on automobiles with an efficiency of less than 15 miles per gallon. This is to be progressively raised to 22.5 miles per gallon by 1986.

The tax itself is fairly steep but its impact on gasoline consumption will be quite moderate, largely because of legislation passed in 1975 requiring automobile manufacturers to lower the average gasoline consumption of their car fleet progressively from 18.0 miles per gallon for 1978 models to 27.5 miles per gallon for 1985 models. (Current average U.S. automobile efficiency is nearly 15 miles per gallon.) The mandated efficiency standards together with a nationwide speed limit of 55 miles per hour in existence since
1974 and the generally anticipated slower growth in the driver-age population can be expected to reduce the annual volume of gasoline consumption from about 1980 on. The gas "guzzler" tax will contribute to the reduction but far less than these other factors.

Finally, the new legislation contains a number of tax and other incentives for energy conservation. These include tax credits for residential insulation and loans and grants to public buildings for installation of energy saving devices. These provisions will somewhat accelerate the significant existing trend towards more and better insulation which has been under way since 1974 for purely economic reasons.

In evaluating the impact of America's new energy policy on future oil import levels it is important to keep in mind that the new policy is not a radical departure from the past but builds upon a solid foundation already in place 18 months ago when the great debate over a "comprehensive U.S. energy policy" got under way.

Even more important is the continuing market reaction to the energy price increases of the last five years. Thus, total U.S. energy demand rose by only 1.6% between 1973 and 1977, compared to 15% in the previous 4-year period. The principal reason for this remarkable slowdown in the face of continued economic growth was energy conservation throughout the economy in response to the higher prices. The reason oil imports rose by 2.5 million b/d from 1973 to 1977 was not higher consumption requirements but the decline in domestic oil and gas production which had to be made up by higher oil imports. This year domestic oil production has increased for the first time in eight years because of Alaska. As a result, oil imports in 1978 will be about 700,000 b/d below last year. However, since Alaskan output has now reached a
temporary peak and production in the rest of the U.S. continues to decline, imports next year can be expected to rise again, probably by the same amount by which they will have fallen this year.

By 1985 U.S. oil imports are now expected to amount to 9-10 million b/d, according to a recent estimate by Energy Secretary James Schlesinger. This would be only a modest increase from last year's 8.7 million b/d but substantially higher than the 6-7 million b/d target for 1985 contained in the National Energy Plan. However, that target was always considered unrealistic by most non-government energy experts. The new estimate, on the other hand, is in line with a number of forecasts by industry and research organizations and may be achievable.

There is no doubt that without the new energy legislation imports would be higher by 1985. Thus, America's new energy policy will make a contribution to curbing the growth in U.S. oil imports. But market forces and resource availability will continue to be more important determinants of future import levels.