The decontrol of all U.S. crude oil and refined products prices on January 28, 1981 marked the end of a 10-year period of some form of price control for the domestic oil industry. The decontrol was total in that it eliminated all restrictions on the price or profit margins of any crude oil or petroleum product sold in the U.S.

The oil price controls had their inception in the general wage and price controls of 1971. By August 1973 only the oil industry was still subject to price controls. Had it not been for the massive foreign oil price increases announced by OPEC in October and December 1973 there is little doubt that decontrol would have been extended to the oil industry, too, before long. Thus, for most of its duration the justification for U.S. oil price controls was the perceived need to protect the public from the full effect of the foreign oil price increase and to prevent domestic oil producers from reaping exceptional gains by raising their prices to the new foreign level which in 1974 was about 75%, or $5/bbl, above the U.S. wellhead price.

The U.S. policy of trying to restrain the impact of the foreign oil price increases on the domestic company differs from that of most other major oil importing countries. But, of course, these countries had no choice, since they depend for all or nearly all their oil on imports in 1974 whereas the U.S. was 63% self-sufficient.* Thus, by keeping domestic crude oil prices under

*U.S. self-sufficiency dropped to 52% in 1977 but rose to 60% in 1980.
control, the composite crude oil cost to U.S. refiners was kept substantially below the cost of foreign oil.

Initially there was widespread domestic political support for this policy which included some incentive provisions for production from new fields and for increasing production from existing fields. However, in the second half of the 1970's when U.S. oil demand started to rise again at a substantial rate (following a 2-year decline) while domestic production continued to drop, the political pendulum began to swing in the other direction. Naturally, oil producers and legislators from oil producing states were in the forefront of those clamoring for removal of price controls. But, interestingly, an increasing number of academic economists with no bias towards the oil industry began to argue that since the decline in the supply of domestic crude oil required a growing volume of imports, it made no economic sense to sell the domestic output below its replacement cost. They felt that such a policy gave misleading signals to consumers about the future cost of oil products and reduced incentives for producers to find and develop the marginally highest cost domestic oil.

The incoming Administration of President Carter in 1977 accepted this principle on the demand side in order to stimulate oil conservation and substitution but proposed a "Crude Oil Equalization Tax" to prevent domestic producers from receiving the full replacement value for this oil. A modified version of this plan was the Windfall Profit Tax which was passed in 1980. It is based on prices, not profits, and its rate is very high for most oil produced from existing deposits but substantially lower for newly discovered oil and for oil obtained through tertiary recovery.
While President Reagan's decontrol order of January 28th was symbolically important because it marked the end of an era of insulating domestic oil prices from the reality of the world market, its direct impact on U.S. oil prices has been relatively modest because the official phase-out program for domestic crude oil had been underway since June 1979 and would have ended no later than September 30, 1981, but probably 2 or 3 months earlier, if President Reagan had not acted. Furthermore, all oil from newly discovered deposits and certain other special classifications had been decontrolled earlier.

Yet even in its last full month (December 1980) with the volume of controlled oil down to one third of what it had been at the beginning of the phase-out period, the domestic crude oil price control system still provided U.S. refiners with substantial savings from what they would have had to pay otherwise for their feedstock. As the table on the following page shows, last December the advantage amounted to about $3/bbl.

The approximately ten percent price increase caused by the decontrol order will contribute to this year's expected 2-3% decline in oil demand, which will be the third in a row. U.S. oil production (outside of Alaska), which last year dropped by nearly 200,000 B/D, may fall by less than half that much this year, partly because of price decontrol. Together, this will result in a further decline in oil imports in 1981.
### U.S. Refiners Crude Oil Acquisition Cost

<table>
<thead>
<tr>
<th></th>
<th>Controlled (1)</th>
<th>Imported (2)</th>
<th>All Crudes (3)</th>
<th>Differential (3) - (2)</th>
<th>Volume of Controlled Crude Oil 000 B/D</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 78</td>
<td>9.76</td>
<td>14.47</td>
<td>12.36</td>
<td>2.11</td>
<td>7,053</td>
</tr>
<tr>
<td>Dec. 78</td>
<td>10.29</td>
<td>14.92</td>
<td>12.93</td>
<td>1.99</td>
<td>6,899</td>
</tr>
<tr>
<td>June 79</td>
<td>11.55</td>
<td>21.00</td>
<td>17.00</td>
<td>4.00</td>
<td>6,542</td>
</tr>
<tr>
<td>Dec. 79</td>
<td>14.14</td>
<td>28.91</td>
<td>23.63</td>
<td>5.28</td>
<td>6,069</td>
</tr>
<tr>
<td>June 80</td>
<td>14.67</td>
<td>34.52</td>
<td>28.80</td>
<td>5.72</td>
<td>4,208</td>
</tr>
<tr>
<td>Dec. 80</td>
<td>14.95</td>
<td>34.55</td>
<td>31.39</td>
<td>3.16</td>
<td>2,317</td>
</tr>
</tbody>
</table>

Perhaps more important than the impact of decontrol on total U.S. oil supply and demand will be its impact on individual companies' access to crude oil. The price control program contained a complicated mandatory system of "entitlements" for the purpose of equalizing the crude oil cost of all refiners regardless of whether they processed imported or price-controlled domestic crude. As is generally the case with government bounties, special interest groups soon began to request larger shares of the entitlements for a variety of reasons. And the government, for a variety of reasons, gave in to some of these requests. The most important were the additional entitlements given to small refineries to help offset their economy-of-scale disadvantage vis-a-vis larger plants. The end of price controls means of course also the end of the entitlements system as well as all other forms of government-protected access to domestic crude oil. Thus, those refiners who benefitted most from this system will be hurt most by its demise.
How will decontrol affect U.S. refined products imports? U.S. refiners have been protected from competition with foreign refiners for nearly 25 years either in the form of import quotas, import fees or lower crude oil cost due to price control. Now all of this protection has been removed* and U.S. refiners must face the full impact of foreign competition.

Large volume products imports are practical only for the U.S. East Coast which traditionally has had a deficit in local supply of all products. This had to be made up by shipments from the U.S. Gulf Coast, the two U.S. Caribbean possessions (Puerto Rico and Virgin Islands) and foreign sources.

The East Coast supply most vulnerable to foreign import competition would be light products shipped by tanker from the Gulf Coast because the Jones Act requirement for domestic flag transportation raises the shipping cost by several cents/gallon above that from Caribbean or European locations. However, light product tanker shipments from the Gulf Coast have declined substantially—nearly 200,000 B/D since 1979—as demand has declined on the East Coast and an increasing share of these products shipments have been shifted to pipeline transportation. We expect this trend to continue.

The competitiveness of U.S. refiners vis-a-vis foreigners will be greater in gasoline than in middle distillates because of the rapidly growing share of unleaded gasoline in the U.S. market--

*Except the nominal statutory import duty of 52¢/bbl on gasoline, 10¢/bbl on middle distillates and 5¢/bbl on residual fuel oil,
currently 50% and expected to rise to 75% by 1985. Most foreign refiners do not produce unleaded gasoline with a high enough octane rating to make it marketable in the U.S. and could not do so without substantial capital investment. This, plus the fact that non-U.S. Caribbean refineries produce much more distillate fuel oil than gasoline, is likely to cause any increase in light products imports to be primarily in the form of middle distillates. Of course, our assessment of future likelihood of light products imports assumes reasonably balanced markets both in the U.S. and abroad. During temporary market imbalances these imports could rise or fall sharply, depending on the cause of imbalance.

The absence of a significant volumetric increase in light products imports would not mean that U.S. refiners have been unaffected by the end of virtually all import protection. The landed price of imported product will tend to set a ceiling on products prices at the East and Gulf Coasts and obviously U.S. refiners no longer have the cost cushion of an import fee or controlled crude. Thus, if foreign prices fall because of a surplus abroad, U.S. prices will tend to follow suit. However, if foreign prices rise because the market abroad is tightening, U.S. prices may not rise correspondingly since their ceiling (up to the level of the landed foreign price) is determined by competition among domestic refiners—all of which will have increasing spare capacity under normal marketing conditions. Consequently, in the absence of any new import restrictions U.S. refiners will not escape the impact of unrestricted foreign competition even if their sales volumes should not show it.
The outlook may be somewhat different regarding residual fuel oil imports. The U.S. has traditionally depended on imports for a large share of its demand for this product. From the mid-1960's on the share of imports increased steadily until it reached two-thirds of total supplies in 1973. After that the trend was reversed as the lower domestic crude oil cost enabled U.S. refiners to displace imported residual fuel oil. By last year the share of imports had dropped to 37%.* The new parity between foreign and domestic crude oil is likely to reverse this trend and cause the share of residual fuel oil imports to rise once again since Gulf Coast refiners will no longer be able to compete effectively with foreign refiners in the East Coast market. Last year about 225,000 B/D of residual fuel oil was shipped from the U.S. Gulf Coast to the East Coast.

Price decontrol is also likely to affect certain U.S. exports, particularly petrochemicals. The lower feedstock costs of U.S. petrochemical manufacturers relative to their foreign competitors have enabled them to increase their share of world chemical exports since 1974. With price decontrol of crude oil as well as propane, petrochemical feedstock costs are bound to rise. However, since U.S. natural gas remains under price control, petrochemical manufacturers using gas as feedstock or fuel in their plants will continue to have an advantage over foreign competitors, other things being equal.

The President's order to decontrol all oil prices was followed almost immediately by significant increases in gasoline, diesel and heating oil prices which were perceived by the public as stemming largely from his action. Despite this the political and editorial

*Including shipments from the U.S. Virgin Islands.
opposition to his action has been quite muted. It appears that after years of fiery debate, a consensus has finally emerged on the issue of government controls versus market forces in dealing with America's energy problem: price controls have hindered rather than helped America's drive toward efficient energy production and use.