Department of the TREASURY NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

STATEMENT
OF THE
HONORABLE G. WILLIAM MILLER
SECRETARY OF THE TREASURY
BEFORE
THE SUBCOMMITTEE ON TRADE
OF
THE HOUSE WAYS AND MEANS COMMITTEE
MAY 14, 1980

Mr. Chairman, I appreciate the courtesy that you and the sub-committee have shown in agreeing to hear my testimony at this point in your deliberations.

You have before you the question of whether to block implementation of the ten cent gasoline conservation fee imposed by the President in March.

As you know, the implementation of the fee was enjoined yesterday by the U.S. District Court for the District of Columbia. The government is appealing this decision. While the matter is thus before the courts, I strongly recommend that the sub-committee defer its own review of the issue. The Congress need not deal with the questions of substantive policy raised by the fee until its legal status is clarified.

However, with your permission, I will take this opportunity to deal with the major substantive issues.

Let me be blunt: For far too long, it has been assumed that the United States lacks the basic political discipline to recognize and act on its own clear self-interest in limiting its consumption and importation of foreign oil. Without this discipline, our prospects for economic security, and for a vigorous and independent foreign policy, would be very poor. Our prospects for exercising world leadership in any area of policy would be compromised. Leaving aside the legal question for the moment, for the Congress to reject this measure to reduce our oil import dependence could only be interpeted as a flight from the hard economic realities faced by the nation. The fee raises the price of gasoline by a mere 10 cents. Backing away from such a moderate and sensible step would send a very troubling signal to the American people, to the world financial markets, and to the governments of OPEC.

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This gasoline conservation fee will have direct and important benefits: after approximately 12 months, it will cut our oil imports by about 100,000 barrels per day, and the savings will increase to about 250,000 barrels after 3 years. But the fee's importance transcends these direct benefits. The fee constitutes a clear test of our national will: Are we going to squeeze the fat out of our oil consumption and proceed in an orderly manner toward energy security over the new decade? Or are we going to leave our future prosperity and national security hostage to foreign events? The fee alone will not decide this watershed question -- but it is rightly perceived as an important part of the answer.

The oil import problem

There can no be no serious question that this nation's security is threatened by excessive oil imports. Formal findings to precisely this effect, pursuant to Section 232 of the Trade Expansion Act of 1962, were made in 1975 by Treasury Secretary Simon and in 1979 by Treasury Secretary Blumenthal. In both cases, virtually every agency of the government certified in detail the acute dangers posed to our international military, political, and economic interests by excessive oil imports. During all this time, our oil import bill has steadily escalated. The dangers have multiplied.

The threat posed to our economic interest by oil import dependence was vividly dramatized by the explosion in world oil prices in 1979, triggered by the turmoil in world oil markets during and after the Iranian revolution. From December 1978 to April 1980, the average OPEC official price of crude oil on the world markets rose by 125 percent, from just under $13.00 to over $29.00 per barrel.

As in 1973, the impact of this price explosion on our economy was direct and momentous. The U.S. inflation rate last year soared to 13.3 percent as the higher world oil prices coursed rapidly through our economy. More than 3 percentage points of that increase can be traced directly to the oil price explosion. This trend intensified in early 1980. During the first three months of this year, inflation rose to an annual rate of 18 percent, with higher energy prices directly accounting for roughly one-third of the increases.

The 1979 oil price explosion was the single most important factor pushing our economy into recession this year: It was the primary cause of the acceleration in inflation, the consequent swift escalation in interest rates, and the massive drain of purchasing power which have combined to throw the U.S. economy into reverse gear.

The world's dependence on imported oil poses potentially serious problems for the international financial system. The oil exporting nations this year are likely to

earn current account surpluses totalling $100-120 billion -- larger than the GNP of most of the world's countries. The oil importing nations of course face an equivalent deficit. While the international financing requirements posed by these imbalances are huge, we believe the system can handle the recycling of these funds in an immediate sense. But it would be highly imprudent simply to stand by and watch the world's oil bill and financing needs swell year after year.

A failure to stem oil imports would have serious consequences for our own efforts to achieve lasting improvement in the U.S. balance of payments and to maintain a stable dollar. In 1978, our oil bill was $42 billion. Last year it was $60 billion. In 1980, we project it to rise to between $85 and $90 billion, in spite of an expected reduction in oil import volume. This mushrooming deficit is by far the largest single negative element in our balance of payments, threatening the stability of the dollar and thus our efforts to solve our domestic inflation problems.

The stability and strength of the dollar in the foreign exchange markets in recent months has a number of sound bases. But one of the major reasons is the growing perception around the world that the U.S. is at last moving aggressively to solve its energy problems. The President's decision to phase out oil price controls was a major step in building confidence in the dollar's long term prospects. This gasoline conservation fee is another such step. In both instances the world saw our system of government produce decisions in which long run economic good sense prevailed over well-entrenched political considerations. This was long-awaited good news that we had at last generated positive momentum in the energy area.

A decision by the Congress to shift now to a more passive course would be extremely short-sighted. We would be mortgaging our hopes for more fundamental improvement in our economic prospects, replacing forward momentum once again with confusion and stalement.

Questions raised about the fee

In this subcommittee and elsewhere, a number of questions have been raised about the fee. With your permission, Mr. Chairman, I would like to address the major ones.

1. Why impose a fee when oil imports are already falling and world oil markets seem to be well supplied?

U.S. oil imports have indeed declined in volume terms, to an average rate of 7.4 mmb/d so far this year compared to 8.4 for the equivalent period last year. This is largely the result of the increase in world oil prices in 1979, which have encouraged conservation through greater

energy-efficiency and, less pleasantly, through a retardation of economic growth. World oil markets have eased, and spot prices have actually declined, as world consumption has fallen temporarily below the rate of oil production.

But it is sheer folly to assume that this will last or that the energy problem is somehow "solved." As we should have learned, world oil markets do not long remain in surplus. The medium term trends for the world oil supply are not propitious; our economic growth will resume; markets will likely be tight again well before the mid-1980s. It is precisely at times of market slack that the consuming nations face the danger of misreading a temporary quiescence of oil prices and of giving up on their conservation efforts. This is what we did for nearly five years after the 1973 oil shock. That is why we suffered so greatly when the next shock arrived, in 1979.

We must not repeat this error. This fee is needed to communicate the inevitable to American consumers -- that gasoline prices, over the long term, are going up and that oil conserving improvements must continue and accelerate, not be put in mothballs. To reverse this message would invite the same reversion to business as usual that paralyzed our energy policy through the last half of the 1970's.

2. Isn't the fee inflationary?

As a technical matter, the gasoline fee will add about .5 percentage points to the 1980 inflation rate in direct terms, and perhaps another .3 percentage points indirectly over the longer run. However, without the fee, and the conservation psychology it will help sustain, we face the near certainty of even greater inflationary pressures over the longer term from a renewed surge in U.S. gasoline consumption and oil imports. The oil price increases that would result from such an increase in imports would not only add to inflation but also to our import bill. The fee revenues, by contrast, would stay at home.

3. With gasoline markets relatively soft, won't the fee in fact be passed on to other oil products, such as heating oil?

This question has been of particular concern to the sub-committee. I believe this concern to be misplaced, for several reasons:

First, the markets for heating oil and other oil products are if anything "softer" than the gasoline market. Refiners are now pricing heating oil and other uncontrolled products according to their own best economic advantage. We do not believe the fee will change their calculations. The heating oil market is exceptionally soft, with stocks at

very high levels for this time of year. Thus, there will be little opportunity for refiners to pass through any of the fee to heating oil. The same is true for residual oil and other distillate products.

Second, the fee applies to imported gasoline, but not to imports of other refined products. Thus, competition from imported distillate products will tend to prevent refiners from being able to pass the fee through to products other than gasoline.

Third, the refining companies have notified the Department of Energy that the fee will be passed through to gasoline, not to other products. DOE has established a system to monitor the pass through effects of the conservation fee. Secretary Duncan would be happy to appear before you to discuss this monitoring effort and to report the results to you on an on-going basis.

It is understandable, but short-sighted, for those who are concerned with heating oil prices to oppose the gasoline conservation fee. The conservation fee will help instill discipline in world oil markets and dampen further OPEC price increases. This will help moderate heating oil prices.

In summary, Mr. Chairman, I cannot stress too strongly my belief that it would be unwise for Congress to disapprove the President's decision to impose the gasoline conservation fee. Low gasoline prices are a major cause of our over-consumption of imported oil. By way of comparison, the tax on gasoline is $1.14 a gallon in German, $1.62 in France, and $1.83 in Italy. The conservation fee will increase gasoline prices in U.S. by a dime. If we cannot do this, one can fairly ask: What precisely are we willing to do to meet the energy challenge?

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