After ten years of federal meddling in the oil business, we're over a barrel.

WASHINGTON'S ENERGY MESS

BY JON SAWYER

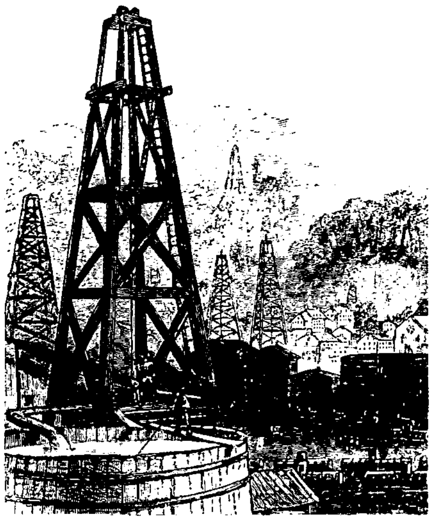
TEN YEARS AGO A PRESTIGIOUS task force commissioned by President Richard M. Nixon concluded that American consumers were paying $5 billion a year more than necessary for oil. The main culprit, the task force asserted, was federal regulation, particularly programs that restricted access to cheap foreign oil. The task force recommended that the government dismantle the import control program that, since 1959, had subsidized high-cost domestic production by restricting imports to 12 percent of total demand. It added the United States had nothing to fear from OPEC.

If OPEC attempted to impose a price increase, the task force reasoned, the higher prices would call forth a torrent of new production from America's ample oil reserves. The group found that based on the projections of major oil firms, even a $1.00 increase in the 1970 domestic price of $3.30 a barrel would enable the United States to be virtually self-sufficient. The task force said the federal government ought to stop meddling in the oil business and let the free market work. And it urged that long-festering charges of monopoly practices in the industry be resolved by an in-depth federal inquiry.

The rest, as they say, is history.

In 1970 the average acquisition cost of a barrel of imported oil was less than three dollars; ten years later it was thirty dollars. Current domestic production—10 million barrels a day—is 30 percent below the industry projections made in 1970, despite inflation-adjusted price increases far beyond predictions of ten years ago. America's dependence on imported oil has nearly doubled, to 43.2 percent of total consumption.

The call for an end to government



intervention was met with an unprecedented barrage of new regulations. The task force had worried about the "hazards of fallible judgment" in federal attempts to allocate import rights among some 130 refiners. Within three years government bureaucrats would be allocating—and pricing—gasoline for 225,000 retail service stations.

Oil policy in the 1970s meant not only price controls that encouraged foreign production, but also an oil allocation program that subsidized imports and inefficient refineries, gave most refineries no incentive to seek secure supplies, and put gasoline where the people weren't. "With any regulatory program, you'll have some people advantaged, others disadvantaged," said Alan T. Lockard, manager of the allocation program for the Department of Energy. "I say to you or anybody else who complains: You give me another system. The more you tinker with it, the more you try to fine-tune it, the worse it gets."

The record shows that the oil industry has been strong enough to use government programs to further its own commercial interests. The largest oil firms are still among the nation's corporate giants. But the industry has not been so strong as to prevent the government from incessant meddling in day-to-day operations and investment decisions. The consequences of that uneasy relationship—measured in fuel shortages, exorbitant prices, and loss of popular faith in both government and industry—have already proved traumatic. They are likely to get worse.

Federal regulation of the industry has increased American dependence on foreign oil. And more than any other single factor, these programs made gasoline-line chaos out of the slight shortfall in world oil supplies in early 1979. They have made a sham of the notion of free enterprise in oil.

The dismal history begins in 1971 with price controls, a short-term government effort to combat inflation that remained in effect for crude oil and petroleum products long after being dismantled for the rest of the economy. The controls made importing foreign oil more profitable than domestic production and discouraged critically needed investment in refinery modernization. In the wake of price controls numerous regulatory amendments were passed that were supposed to promote competition. Instead they subsidized oil imports and funneled crude oil to inefficient refineries lacking the equipment necessary to make products like gasoline that were most in demand. Allocation regulations, also imposed as a short-term expedient, distorted the market in times of surplus and created havoc during the 1979 shortage.

That litany is not just the industry line. Consider William C. Lane Jr., director of the DOE's Office of Competition and a man who shares the concerns of many critics about the implications for competition in an industry dominated by a handful of giant companies.

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"Everybody," he says, "from the Senate antitrust subcommittee to the Federal Trade Commission to the Department of Justice to the House antitrust subcommittee who has looked at this issue from the competitive point of view has said that pricing-allocation regulations don't work in this industry. Period."

Government regulation of the oil industry was not unique to the 1970s, but that decade brought the practice to a peak. State agencies had restricted production for forty years and the Mandatory Oil Import Control Program had held imports to 12 percent of domestic production since 1959. Of the later program, the Nixon task force charged in 1970 that "the present system has spawned a host of special arrangements and exceptions for purposes essentially unrelated to the national security, has imposed high costs and inefficiencies on consumers and the economy, and has led to undue government intervention in the market and consequent competitive distortions."

The recommendations of the task force were ignored as the Nixon administration moved toward wage and price controls in the summer of 1971. Between 1973 and 1975, when controls were ending for the rest of the economy, they continued for "old" oil produced from existing fields. Passage of the Energy Policy and Conservation Act in 1975 extended these controls to new oil as well. Price controls on petroleum products also had their origin in the 1971 program, with subsequent adjustments establishing the "base" as the price in effect on May 15, 1973. "If a guy was in a price war on that particular day," a DOE regulator said, "he was theoretically locked into it ever since." As the system of price controls evolved, refiners could pass through only documented increases in raw material and operating costs. Despite inflation, profit margins were essentially frozen at their 1973 level. If a company had invested to expand or improve its refinery, price increases could reflect only the direct costs of the investment; no additional profit was allowed.

These controls discouraged refinery investment at a time when it was critically needed to cope with dramatic shifts in the qualities of crude oil available—due in part to OPEC machinations, and in part to new supplies opening up—and the types of products required. On the supply side, refineries had to adjust to an increasing proportion of "heavy" crude oils that required more sophisticated equipment for processing into gasoline, heating oil, and aviation fuel. The proportion of sour—or high-sulfur—crudes also has increased, requiring more elaborate refining to meet environmental standards. On the demand side, while total gasoline usage is expected to peak in the early 1980s, the mix of gasolines required will change as leaded grades are phased out. As an additive to raise the octane rating of gasoline, lead is a substitute for more extensive processing at the refinery. If demand for unleaded gasoline is to be met, according to industry and DOE reports, substantial investments in refinery equipment must be made.

If price controls are set up for the long term, they must allow for inflation—or people go bankrupt.

UNTIL THE ADVENT OF price controls the oil industry was making the required investment, according to Joe Moore, president of Bonner & Moore Associates, a Houston consulting firm that has specialized in studies on the lead phaseout. "Once the controls were put on," he said, "the industry stopped doing what it was supposed to do." The companies simply couldn't see any way to recover the hundreds of millions of dollars they would have to invest to alter their refineries. The result, Moore said, was a shortage of unleaded grades that forced several major companies into product allocation in late 1978—well before the shutdown of Iranian production.

"The system," says Edwin Mampe, the DOE's director of price regulations, "wasn't set up to deal with inflation. If price controls are set up for the long term, they've got to be adequate to handle inflation. Otherwise, you bankrupt people."

Price controls also gave an extraordinary cost advantage to refineries with access to domestic crude oil. In its attempt to redress that imbalance, the federal government ended up subsidizing oil imports and inefficient refineries.

By August 1974, independent refiners who did not have access to price-controlled domestic crude were paying as much as $7 a barrel more than their competitors for oil. Recognizing that this was a "peculiar form of competition," as one DOE official put it, the government instituted a program called "entitlements" to equalize crude-oil costs for all refiners. Under that program refiners having more than the national average of price-controlled oil write checks each month to refiners having less than the national average. The checks can be large: Standard Oil of Indiana, with its heavy proportion of domestic production, had by the end of 1979 paid out well over a billion dollars to its competitors. The entitlements program, says Edd Grigsby, a Phillips Petroleum specialist on government regulations, is "the heart of the current energy policy, which is to subsidize imports and penalize those companies that elected to spend money in years past to develop domestic sources of oil."

Entitlements are based on average oil prices, but foreign oil prices are far from uniform. The major oil companies, because they have been doing business overseas longer, have access to oil purchased on long-term contracts at cheaper prices. The independents, having originally concentrated on domestic oil, must buy their foreign oil on the higher-priced spot market. Obviously this gives the major oil companies a big advantage in collecting entitlements money. At the height of last year's gasoline crunch, for example, the weighted-average cost of all imports was $23.09 a barrel, and that was the figure used in computing entitlements. Yet the actual prices paid for foreign oil ranged from $18.00 to $45.00.

In terms of competition, this price disparity meant that some refiners and marketers started out with wholesale prices double those of their competitors. "It's a situation with enormous competitive implications, not only for refiners but for everybody in the industry down to the dealers," said John Dansby of Ashland Oil. "In theory the market sets a price and everybody charges that, so you've got customers competing on an equal basis. You don't have that here: Union Oil's independent dealers are trying to compete with Exxon's independent dealers, but with wholesale prices that differ by an enormous amount."

Union, a company that uses a large proportion of domestic oil in its refineries, got hit harder than most by federal energy policy. Although the initial price controls gave Union a competitive advantage, the entitlements program took it away. "The problem is that the government makes us share our domestic crude-oil cost advantage with these big rascals, yet refuses to force them to share their foreign cost advantage with us," said Union vice president William Cole. By the third quarter of last year Union, scrounging for oil on the foreign spot market, was paying $10 a barrel more than the industry average, while at the same time the four largest American oil firms—Exxon, Mobil, Texaco, and Standard Oil of California—were reaping an annual windfall of $7 billion by purchasing much cheaper Saudi Arabian oil.

Despite claims by other companies that Union's predicament was the result of bad business judgment, the firm sought and won temporary relief from the DOE. Under the December order, the agency required the other fourteen largest refiners to sell Union crude oil at their own average acquisition cost plus a surcharge of no more than $1.50 a barrel. Among the companies forced to supply Union were several that had themselves experienced serious difficulties in securing adequate supplies of crude oil at reasonable prices. Some, like Phillips, had already cut back deliveries to their own customers to 70 percent of past purchases. Others, like Marathon, had paid exorbitant spot-market prices to maintain full supplies for their customers, only to find—after the DOE order—that they had to sell some of their oil to Union at much less than they paid for it.

"We may be next in line to do what Union did," said Norman Potter of Cities Service, which had also been running its refineries substantially below capacity because of inability to acquire foreign oil at less than spot-market prices. "I'm not surprised at anything DOE does anymore," Potter said. "They've ordered us to supply Union but that just makes our problems worse. They put out one fire but at the same time they ignite another one."

The original entitlements program was biased in favor of those refineries having a capacity of less than 175,000 barrels a day. The intent was to promote competition by giving a cost advantage to small refineries that did not have the economies of scale enjoyed by their giant competitors.

With the help of Joseph Califano, a Washington attorney who became Carter's secretary of health, education, and welfare, a group of small western refineries persuaded Congress to exempt entirely from the entitlements program small refiners with access to domestic crude. The first four months of the exemption produced a $164 million windfall for the fifty-six refineries affected. With that record as evidence, the Federal Energy Administration—which had opposed the exemption all along—struck the best deal it could with Congress, spreading the total benefit of the exemption to all small refiners, not just those with domestic crude oil.

Under the revised program instituted in April 1976, small refiners saved an average of $2 for every barrel processed. Over the next three years, forty inefficient refineries—"bias babies"—opened. Almost none had the equipment necessary to produce gasoline. According to conservative government estimates, this bias toward small refineries cost the country at least 50,000 barrels of gasoline a day during the 1979 shortage. "People here knew what the likely results [of the bias] would be," said Douglas McIver, director of the entitlements program. "It was totally predictable."

The entitlements program and the small-refiner bias were both offshoots of the allocation program that began as a federal response to spot shortages in the summer of 1973 and was codified into law by the Emergency Petroleum Allocation Act later that year. Other parts of the program, also intended to promote competition, had equally unintended effects.

The mandatory crude-oil buy/sell program, for example, originally was intended to assure equal access to crude-oil supplies during the Arab embargo of 1973–74. It forced the fifteen largest refiners to make crude oil available at their own acquisition costs to small refiners whose supplies had been cut off. Use of the program declined after the embargo, as the independent refiners bought cheaper oil available on the foreign spot market. But when spot prices shot up again in late 1978, the independents demanded and won a share of the major refiners' oil.

From the perspective of major oil companies, the program was an invitation to disaster: It encouraged independents to seek the cheapest source of crude, no matter how insecure. "The buy/sell program gave small refiners no incentive to look for secure supplies," said Roy Murdock of Mobil, "so when things got tight, they lost a great deal more crude than they should have." A Mobil study found that small refiners, representing 25 percent of the industry, accounted for half of the 1979 gasoline shortage.

A gasoline allocation system that imposed 1972 supplier/purchaser relationships on an industry undergoing a transformation to self-service operations brought further distortions. For most of the time there was a surplus of gasoline and the main effect of the regulations was to give a windfall to jobbers, the middlemen of the industry who function, in effect, as wholesalers. As described by Alan Lockard, the DOE official responsible for allocations, the program undercut the large refiners' control over their own marketing by assigning new service stations to jobbers who in turn got allocations from the refiners. "The jobbers loved it," he said. "The system let people double, quadruple, quintuple their volume with the refiner-suppliers standing by helpless."

"Some people who figured out the system are now huge marketers," said Edd Grigsby of Phillips. "They're the true entrepreneurs."

'I'm not surprised at anything DOE does any more. They put out one fire at the same time they ignite another.'

CONSIDER, FOR EXAMPLE, Marine Petroleum, a St. Louis–based wholesale gasoline firm that exploited murky regulations on price and allocation to divert supplies from St. Louis to other, more lucrative markets, and in the process disrupted the local market and drove several independent retailers out of business. Beginning in March 1979, at least thirty service stations in the St. Louis area were shut down for as long as ten months because their supplier, Marine, was charging them up to fifty cents a gallon more than other wholesale suppliers. Yet during the same period, when Marine's prices were among the highest posted anywhere in the country, the firm was purchasing a substantial portion of its supplies from major oil companies whose prices were among the lowest in the industry.

If that sounds inconsistent, blame the federal regulations. "The DOE regulations are so complicated that you can twist them around," said Charles Marshall, general manager of the Texas Discount Gas Company, a cut-rate marketer forced to shut down nine of its fourteen St. Louis stations because of the noncompetitive prices charged by Marine. "It's just like reading the Bible," Marshall said of the federal regulations. "Anything you want to do, you can find something in the Bible to back you up."

In the jargon of the trade, Marine is a "reseller," buying finished petroleum products for resale to retailers and other wholesale customers. There are two sets of federal regulations governing resellers that Marine was apparently able to twist to its advantage.

The first set consisted of price-control regulations. These put a ceiling on the wholesale price Marine can legally charge; it was supposed to be no more than the price on May 15, 1973, plus any subsequent documented cost increases. The regulations also said, however, that if for some reason Marine is unable to charge its ceiling price it may "bank" these unrecouped costs and at some later date it can charge more than the ceiling price in order to recover the money.

The second set of regulations, governing allocations, was supposed to freeze supplier/purchaser relationships at 1978 levels. The regulations set up as a base period November 1977 to October 1978; they guaranteed Marine an allocation from all the refining companies that sold it gasoline during the base-period months. Similarly, all the retailers who *bought* gasoline from Marine during the base-period months were guaranteed a continued allocation from Marine.

But for much of 1979, an allocation from Marine meant nothing more than the right to buy gasoline from a company whose wholesale prices were often higher than what retailers were charging at the pump. What Marine apparently did was to use its "bank" of unrecovered costs to drive prices out of reach of its retailers. When the retailers refused to buy this high-priced gasoline, it became "surplus product" and federal regulations permitted Marine to dispose of it as the company pleased.

That meant Marine could go sell the gasoline on the more lucrative spot market—and it did, while its St. Louis–area customers slowly strangled in red tape. It takes anywhere from four to eight months for retailers to petition DOE for a new supplier. Meanwhile they can't obtain gasoline.

Marine could expedite the process by signing a release that would allow its retailers to look for another supplier, but if Marine signs such a release, it would also have to give up part of the allocation it receives from the refineries. Obviously Marine officials would never agree to that. Marine's customers believe the release requirement puts them at the mercy of their supplier, and several DOE officials agree. "I'm with you all the way," said one. "Don't ask me to explain the rationale behind that rule."

BY THE SPRING OF 1979 even Jimmy Carter, who had campaigned against decontrol, was saying that regulations hadn't worked in the oil industry. In March his administration implemented the gasoline "tilt" rule that permitted an increase in the price oil firms could charge dealers, and in April he announced a two-year phased decontrol of crude oil. At the same time, however, the President unveiled an energy plan that promised to enmesh the federal government in the oil business more deeply than ever before: It included a windfall profits tax, an energy security fund, and an energy mobilization board.

When Carter announced the phased decontrol he told the nation that "the most effective action we can take to encourage both conservation and production here at home is to stop rewarding those who import foreign oil and to stop encouraging waste by holding down the price of American oil." But what the President gives he can also take away: Carter followed his announcement with a pledge to tax away half the revenues that decontrol would bring to the oil industry.

What emerged from Congress this March—after nearly a year of exquisite wrangling over special treatment for this or that special interest—was a fitting monument to Washington's continued infatuation with the regulatory approach to energy. Just as the discredited price controls established three tiers of oil and a separate exempt class, so does the windfall profits tax. Just as price controls made foreign production more profitable than domestic, so will the windfall profits tax. It is not even clear that the tax will produce the magic $227 billion that Carter and Congress are counting on to finance a massive synfuels program, low-income assistance grants, mass-transit expansion, income tax reductions, and you-name-it over the next ten years.

Reaping that $227 billion depends on the precarious assumptions that world oil prices will increase annually at the rate of inflation plus 2 percent, and that decontrol really will produce a windfall revenue. Not counting taxes, Americans have been paying the same for gasoline, home heating oil, and other petroleum products as consumers in Europe and Japan. If world prices will ultimately determine the U.S. price, decontrol will produce no windfall: Revenue gains by domestic producers will be offset by losses at the refining level. Taking the industry as a whole, it is quite possible that the windfall tax will be paid out of existing revenues.

Although it would seem logical for federal policy to encourage domestic production while reducing demand for OPEC oil, the windfall profits tax could well have the opposite effect because it makes nontaxed foreign oil cheaper to a refiner than taxed domestic oil. And although inspired largely by anger over the profits of Big Oil, the tax will not touch the foreign earnings that have been at the heart of those profits for many international oil giants—and it will no doubt extend the market distortions begun with price controls.

So, after ten years in this Byzantine maze of price controls, allocation systems, entitlements programs, and ever-increasing armies of federal bureaucrats, where do we find ourselves? The answer seems to be, right back where we started. While testifying before a Senate subcommittee on energy regulation, Hazel R. Rollins, head of DOE's Economic Regulatory Administration, was asked what would happen if all federal regulation of gasoline ended.

"I think we would see . . . very little happening in terms of price increases," Rollins replied. "Allocation of supplies would take place in a way that would satisfy more consumers." But she added that deregulation is impossible because the American public would feel insecure. That, then, is the legacy of a decade of active federal intervention in the energy marketplace: increased dependence on foreign oil, an allocation system that puts energy where it isn't needed, and a public addiction to the destructive, expensive, and useless regulatory bureaucracy that created most of the problems in the first place. ❏

By the spring of 1979 even Carter, who campaigned against decontrol, admitted regulation hadn't worked.

***THE SECOND COMING*, by Walker Percy. Farrar, Straus & Giroux, 360 pp., $12.95.**

Seeing and believing

JOHN GORDON

IN THE FOURTH CENTURY, as historians tell us, the church father Julius Africanus conflated two scriptural texts in order to determine the life expectancy of Creation. The first, "A thousand years in Thy sight are but as yesterday," was taken to reveal that one of God's days lasts a thousand human years. The second, from the opening verses of Genesis, was taken to reveal that the Creation had taken six God-days to complete, followed by a day of rest. Ergo, six thousand years of Creation, then the millennium. Put this deduction together with Bishop Ussher's famous computation of 4004 B.C. as the beginning of time, add certain questionable prophecies from the Book of Revelations, the spread of nuclear weaponry, and the general worldwide perception that everything is going to hell, and the upshot is that from now until 1996, just six thousand years after the Beginning, we can expect a steady proliferation of impresarios of Armageddon.

The sense of impending apocalypse is nothing new to Walker Percy, convert to Catholicism and student of philosophy, whose novels have all worked to turn his readers' thoughts to what the church calls the four last things: death, judgment, hell, and heaven. Now, with his fifth novel, *The Second Coming*, he reintroduces his protagonist from *The Last Gentleman*, Will Barrett, into a world quite conceivably on the edge:

> "As anyone can plainly see, [says a preacher in *The Second Coming*,] all the signs of Armageddon are present." And in a droning voice he listed them, including the return of the Jews to Israel. On a beautiful Sunday morning in the mountains of North Carolina no one in the congregation paid the slightest attention—except Will Barrett, who, head slightly cocked to favor his good ear, had listened to every word.

Barrett is about fifty years old, recently retired after a successful career as a lawyer, enormously rich in consequence of an inheritance from his late wife, a

woman whose idea of slumming was to leave the Rolls in the garage and take the Mercedes. He is in firm possession of everything one could ask for, except for either of two opposed states between which he oscillates throughout the novel—love and oblivion. They are the last things of his day of judgment.

He is denied oblivion because of a cerebral dysfunction that causes him to remember with complete clarity the kinds of moments most people must suppress as one of the conditions of sanity. He reexperiences, repeatedly, an adolescent access of longing compared to which everything he has coveted and achieved in his life has been second-rate—and the time in a swamp when his father, soon to commit suicide, wheeled a shotgun around in his direction and pulled the trigger. Like the less satisfactory "lapsometer" of *Love in the Ruins*, Will Barrett's brain disorder is Walker Percy's faintly science fictionish device for inducing in his protagonist the range of states, most of them with German names, characteristic of the romantic temperament as it has been represented since Goethe. It allows Barrett to be a seer of the things that almost everybody else is too busy or oblivious or stoned or stupid to see. Afflicted by moments of truth-seeing, Barrett intermittently picks up his father's old shotgun and contemplates following him (one of the book's several "second comings") into the oblivion from which his dubious gift of total recall otherwise disqualifies him.

Denied oblivion by a physiological aberration, he is at the same time denied love by the numbing mundanity of his cossetted, air-conditioned, death-in-life life, "deep in the woods, socking little balls around the mountains, rattling ice in Tanqueray, riding $35,000 German cars, watching Billy Graham and the Steelers and M*A*S*H* on a 45-inch Jap TV." He inhabits the same American wasteland ruefully viewed in Walker Percy's earlier novels, a landscape in which no love exists because there is nothing and no one worth loving. Enter Allison, an escaped mental patient, amnesiac from shock treatments. She is not of this world. Like her near-namesake and possible inspiration of *Through the Looking-Glass*, who finds a brief peace in the Forest of No Names, Allison has a Martian's-eye view of the idioms of her contemporaries:

> Sitting down again, knapsack beside her, she reflected that people asked questions and answered them differently from her. She took words seriously to mean more or less what they said, but other people seemed to use words as signals in another code they had agreed upon. For example, the woman's questions and commands were evidently not to be considered as questions

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