A SIX-POINT STRATEGY FOR ENJOYING LOW OIL PRICES WHILE ENHANCING U.S. ENERGY SECURITY

Most Americans probably only dimly recall what life was like before OPEC's extortionist oil prices. Now at last, the U.S. is experiencing relief as the OPEC oil cartel crumbles. Consumers are enjoying the plunging prices at the gas pump and business is welcoming a reduction in one of its basic costs. So dramatic and pervasive are the benefits of the oil price fall that forecasters are raising their estimates of economic growth for 1986 by as much as 1.5 percentage points.

Regrettably, of course, every silver lining has a cloud. Low oil prices help the national economy in the aggregate, but inflict severe pain on U.S. oil producing regions. Experts caution that a continuation of current prices, now about $14 per barrel, for an extended period could threaten the nation's energy industry and energy security. Exploration for new U.S. oil supplies has ground to a halt. In addition, imports from Saudi Arabia have climbed from 27,000 barrels per day in September 1985 to 664,000 barrels in January 1986. Aggressive Saudi Arabian price cutting could wipe out permanently a significant proportion of domestic U.S. oil production capability if low Saudi prices force American drillers to abandon their so-called "stripper" wells (those producing less than 10 barrels per day) and other high-cost wells. This could leave the U.S. increasingly dependent on OPEC. But while U.S. domestic sources of oil must be preserved, many proposed "solutions" would undermine the benefits from low oil prices, and do little to help the U.S. domestic energy industry.

Calls for an oil import tax are one example of grievously flawed policy. A tax would shatter Ronald Reagan's pledge not to raise taxes and would send a shock wave through the economy, slowing growth. And with the production costs lower than those in the U.S., OPEC producers could absorb an import fee and still undersell U.S. producers.

Yet actions could be taken to enhance U.S. energy security by removing federal barriers preventing the U.S. energy industry from responding to the new era of lower and fluctuating world prices. Among them:

1) Waive regulations that lead to early abandonment of marginal wells. State and federal regulations now require a producer who ceases production for more than 60 days to relinquish his lease to the well and "reclaim" the well. This forces the owner to plug the well with concrete, often making it very uneconomic to restart the well, since a new hole must be drilled, should oil prices start to climb. Texas and Oklahoma already have modified some of their rules. Other states and the federal government should follow suit. This would allow marginal producers to halt production only as long as the price of oil remains below their production costs, without having to abandon their wells. This would give the U.S. a reserve of wells that could be reactivated if world conditions change.

2) Abolish the Windfall Profits Tax on oil. At current prices, at any rate, the U.S. Treasury will collect no revenue from this tax. Even so, producers bear an enormous cost for the paperwork required by the tax law--as much as $1 per barrel for a small producer.

3) Restore the depletion allowance to its pre-1969 level. It is among the most important capital formation tools the oil industry ever had and would spur new drilling.

4) Eliminate the minimum tax on so-called intangible drilling costs. This would provide more incentives for domestic exploration.

5) Decontrol natural gas prices. This would improve the revenue available to producers from oil well by-products, giving an additional encouragement to drill for oil.

6) Lift the restriction on purchases of domestic oil for the Strategic Petroleum Reserve. Allowing domestic producers to bid on SPR purchases would help to enhance their cash flow.

Collapsing world oil prices do carry the risk that the U.S. could again become vulnerable to the OPEC cartel. These dangers cannot be averted by oil import taxes or jawboning the sheiks to raise their prices. To confront the danger effectively, the White House and Congress should take steps to encourage exploration and forestall the premature abandonment of marginal wells. So doing would allow the American consumer to enjoy the benefits of low energy prices without flirting with either renewed dependency on the Middle East or sending the economies of oil producing states into a permanent tailspin.

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For further information:

Monetary Perspective (Drexel Burnham Lambert, Inc.), February 24, 1986.

"Repeal of Windfall Profits Tax on Oil Urged by Baker," The Wall Street Journal, April 7, 1986.