EFFECTS OF IMMEDIATE DECONTROL

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On January 28, 1981, President Reagan announced the suspension of most price and allocation controls on domestic crude oil and of price controls on gasoline and propane. Under the Energy Policy and Conservation Act (EPCA), the President has the authority to take such action. This paper summarizes the budgetary and macroeconomic effects of the President's decision.

SUMMARY

Budget Effects. The immediate decontrol of crude oil prices will raise federal revenues in fiscal years 1981 and 1982 by a total of $7.9 billion. Most of these revenues will come from the windfall profits tax on crude oil. Immediate decontrol will raise federal outlays by $2.9 billion. Most of the outlays will go to increased costs of oil purchased for the Strategic Petroleum Reserve (SPR).

Price Effects. After September 1981, crude oil and product prices will be generally unaffected by the decision to decontrol crude oil immediately rather than gradually. Immediate decontrol will, however, affect product prices between now and October 1, 1981. It will raise product prices by approximately 9 cents per gallon within 30 days of implementation. Over the next eight months, the average price of a gallon of refined product will increase by approximately 5 cents relative to the phaseout of controls. By October, this difference will decline to zero.

Similarly, immediate decontrol will not affect the long-term level of the Consumer Price Index. The average increase of 5 cents per gallon of refined products over the next eight months corresponds to an increase of 0.4 percent in the CPI for fiscal year 1981. The increase of 9 cents per gallon estimated to occur in February corresponds to an increase in the CPI of 1.0 percent in that month. Since decontrol would have been completed by October 1, 1981 in either case, neither product prices nor the CPI are expected to be higher after that date as a result of immediate decontrol.

This analysis is based on the following assumptions:

- o An average decontrolled acquisition cost to U.S. refiners of \$42.00 per barrel in February and March of 1981, rising to \$44.50 in the second and third quarters of the year. This price assumption reflects no significant exports from Iraq or Iran, and a phased reduction of Saudi Arabian output beginning in the third quarter;
- o Full passthrough of increased crude oil costs to product prices;
- o Subsidies in the entitlements program (such as the small refiner bias) are not passed through to product prices, but are absorbed by their recipients; and
- o All of the subsidies found in the entitlements program (notably subsidization of Strategic Petroleum Reserve purchases) are con-

tinued under phased decontrol, even if the amount of money required to finance them exceeds the dollar value of price controls on oil.

To the extent that CBO's estimates differ from those of other analyses, such differences probably result from assumptions concerning world oil prices, passthrough of increased crude costs, and the volume of oil under price and allocation controls. This analysis uses estimates of volumes of oil taken from first purchasers' data, rather than the lower figures found in recent refiner receipts data.

BUDGETARY EFFECTS

Immediate decontrol of domestic crude oil prices will significantly increase both budgetary revenues and outlays in fiscal years 1981 and 1982. The net effect will be to decrease the fiscal year 1981 budget deficit by approximately $4.6 billion and the fiscal year 1982 deficit by approximately $0.4 billion. The budget for later years would not be affected. The assumptions and other calculations that affect these estimates are discussed below.

Revenue Effects

Immediate decontrol will result in an $11.7 billion increase in revenues to domestic oil producers in fiscal year 1981. Much of this increase, however, will be paid to the federal government in the form of increased windfall profits and corporate income taxes. Windfall profits tax liabilities will rise by $6.3 billion 1/, and oil producer liabilities under the corporate income tax will increase by $1.4 billion. However, due to collections lag, not all of this increase will occur in fiscal year 1981. Approximately $6.4 billion will be collected in fiscal year 1981, and approximately $1.3 billion will be collected in the first quarter of fiscal year 1982. Additional revenue will accrue to the government in the form of increased royalty payments on oil produced on federally owned land. CBO estimates that this will result in approximately a $0.2 billion increase in revenues. 2/ The primary assumption that affects these estimates is the price of decontrolled domestic crude oil.

1/ These are "gross" windfall profits tax estimates. The "net" effect, as defined for purposes of calculating the phaseout of the windfall tax, is estimated to be approximately $3.5 billion. The "gross" estimate is, however, the proper figure to measure the budgetary effect.

2/ These revenues will show up in the budget as increases in the "offsetting receipts" outlay function, rather than on the revenue side of the budget.

This revenue increase may be offset by a number of factors. There is a possibility of a decrease in revenue from industries other than oil. This would occur for one of two reasons. First, if the increased cost of oil to firms is not passed through to the consumers of those firms' goods, producers' profits will decline. This would result in a decrease in corporate profits tax receipts outside of the energy sector. Alternatively, if these costs are passed on to consumers, the transfer of revenue from consumers to producers and the ensuing rise in inflation could slow real economic growth and increase unemployment, resulting in a decline in revenues from all income taxes. Both of these effects are taken to be negligible.

Outlay Effects

Immediate decontrol will increase outlays mandated by higher fuel costs and their effects. CBO has prepared estimates of three of the largest effects of immediate decontrol on the outlay side of the budget--increases in outlays for the Strategic Petroleum Reserve, the Department of Defense and other fuel procurement, and inflation-indexed federal programs.

The largest of the offsets is increased outlays for the Strategic Petroleum Reserve. If current policy concerning the rate of SPR fill is followed, approximately $1.9 billion in increased outlays will result. As with revenue collections, all of this increase will not occur in fiscal year 1981--$0.3 billion is estimated to occur in fiscal year 1982.

This increase in outlays occurs because of the termination of the benefit the SPR receives under the entitlements program. Under a continued phaseout, the SPR would have been able to purchase price-controlled lower-tier oil. The immediate budget effect of decontrol is that the SPR will have to pay approximately $30 dollars or more per barrel more for its purchases.

The most important assumptions underlying this estimate are a presumed decontrol oil price path, the assumed "fill rate" for the SPR, and the presumed continuation of SPR subsidies under phased decontrol. CBO's estimates assume that the fill rate proposed in President Carter's fiscal year 1982 budget (an average of 200,000 barrels per day for fiscal year 1981) would be achieved.

Other outlays will rise due to fuel costs to the federal government. The largest federal consumer of fuel is the Department of Defense. CBO estimates that the Defense Department would have to spend $0.3 billion more under immediate decontrol than it would have if controls were phased out. Of this amount, $0.1 billion will occur in fiscal year 1982. Increased fuel costs to the remainder of the federal government are estimated to be approximately $0.2 billion, of which $0.1 will fall in fiscal year 1982.

The final estimated impact of immediate decontrol on the outlay side of the budget is the effect on inflation-indexed federal programs. CBO estimates that federal outlays will have to increase by approximately $0.5 billion because of the increase in the CPI resulting from immediate decontrol. Of this rise, $0.4 billion will fall in fiscal year 1982.

The Deficit Effect

CBO estimates that immediate decontrol will reduce the federal deficit by approximately $4.6 billion in fiscal year 1981 and by $0.4 billion in fiscal year 1982 (see Table 1). These estimates given are approximate; as mentioned above, there are other, probably smaller, offsets that have not been estimated.

TABLE 1. MAJOR BUDGET EFFECTS OF IMMEDIATE DECONTROL (By fiscal years, in billions of dollars)

	1981	1982	Total
Increased Revenues			
Gross Excise (windfall profits) Tax Payments	5.8	0.5	6.3
Additional Oil Producer Income Tax Payments	0.6	0.8	1.4
Royalty Payments a/	0.2	0	0.2
Total Revenues	(+6.6)	(+1.3)	(+7.9)
Increased Outlays			
Strategic Petroleum Reserve	1.6	0.3	1.9
Department of Defense Fuel Costs	0.2	0.1	0.3
Non-Defense Fuel Costs	0.1	0.1	0.2
Inflation Indexed Federal Programs	0.1	0.4	0.5
Total Outlays	(-2.0)	(-0.9)	(-2.9)
ESTIMATED NET BUDGET EFFECTS	(4,6)	(0.4)	(5.0)

a/ Will appear in budget in offsetting receipts function.

PRICE EFFECTS

After September 1981, crude oil and product prices will be generally unaffected by the decision to decontrol crude oil immediately rather than gradually. Immediate decontrol will, however, affect product prices between now and October 1, 1981. It will raise product prices by approximately 9 cents per gallon within 30 days of implementation. Over the next eight months, the average price of a gallon of refined product will increase by approximately 5 cents relative to the phaseout of controls. By October, this difference will decline to zero.

Similarly, immediate decontrol will not affect the long-term level of the Consumer Price Index. The average increase of 5 cents per gallon of refined products over the next eight months corresponds to an increase of 0.4 percent in the CPI for fiscal year 1981. The increase of 9 cents per gallon estimated to occur in February corresponds to an increase in the CPI of 1.0 percent in that month. Since decontrol would have been completed by October 1, 1981 in either case, neither product prices nor the CPI are expected to be higher after that date as a result of immediate decontrol.

These results should be interpreted in light of the assumptions stated above. The results would be lower if prices are lower than assumed, if higher crude costs are not fully passed on to consumers, or if the volume of oil under controls is lower than CBO assumes. The impacts will be larger than estimated here if prices rise unexpectedly, or if some of the entitlement program subsidies are passed on to consumers. The impacts toward the latter part of 1981 could also be larger if the entitlement program subsidies were not fully funded under phased decontrol.