FOR THE SAKE OF THE CONSUMER:

DEREGULATE NATURAL GAS

This winter's unprecedented rise in natural gas prices--as much as 60 percent in some cases--was a painful demonstration of the inability of the Natural Gas Policy Act (NGPA) to protect consumers. Although the NGPA was enacted expressly to protect the gas-consuming public from steep price increases, while the restoration of some semblance of a free market in gas took place, it has had exactly the opposite effect. The NGPA has created a series of perverse incentives which not only block the entry of new, low-cost supplies into the gas market, but elicit new gas production from the costliest possible sources. While some of the consequences of this already are being felt, even more severe economic repercussions could occur in the future if federal gas price ceilings are not lifted, as the Administration has requested from Congress.

A continuation of NGPA controls through 1988, as advocated by some Members of Congress, would result in natural gas consumers paying $153.7 billion more for their gas over six years than they would have in the absence of controls. This would add $887.80 to the average homeowner's natural gas bill over the same period. In addition, there would be indirect costs through higher prices for food, petrochemicals, medicines and a host of other gas-dependent commodities; these would come to nearly $3,300 for an average homeowner, raising the total cost of controls to $4,160 for a family of four. These costs would be reflected in a general rise in the price of goods where gas is a factor, and in annual increases in gas heating bills of as much as 24 percent.

Paradoxically, the failure of NGPA seems only to fuel efforts aimed at extending NGPA's price ceilings beyond their 1985 expiration date. This would be a drastic mistake. Extending controls would push prices to levels above those that would occur if the market were to be completely deregulated. The reason: a number of flaws inherent in the NGPA.

The most basic flaw in the NGPA's structure is that the price categories established for various types of natural gas wells create enormous disincentives to search out new supplies of low-cost gas, while at the same time creating enormous incentives to develop high-cost sources of supply. Most conventional gas is limited to at best modest price increases. At the same time, gas from "deep" wells (those drilled to depths of more than 15,000 feet) may be sold at any price the market

will bear. Pipelines purchasing gas are able to pay above-market prices for deep gas, and by mixing it with low-cost conventional gas, keep prices at about market levels. Yet as the low-cost gas is consumed and not replaced by new conventional sources (because conventional gas regulations eliminate incentive to do so), an increasing proportion of total supplies is gas from high-cost sources. This naturally raises prices for the consumer.

The high cost of drilling for deep gas has limited available supplies. As a result, some pipelines have had to import gas from Canada, Mexico and even Algeria to meet customers' demands. Since supplies from foreign countries are not subject to federal regulation, these may be sold well above the cost of conventional--but regulated--domestic gas. Mixing this high-cost gas with existing low-cost gas initially produced a price acceptable to consumers. As with deep gas, though, the eventual depletion of low-cost supplies due to regulatory disincentives will lead to spiraling prices for consumers.

Another problem caused by NGPA rules is that as prices rise, due to the depletion of low-cost supplies, industrial consumers are prompted to switch to alternate fuels. This decreases the total volume of gas moved through interstate pipelines and results in a smaller pool of gas over which to spread the fixed costs on which pipeline transportation charges are based. The result: the lower volume results in a higher transportation charge to the consumer. According to a recent study by the First Boston group, industrial users have already reduced their gas consumption by 515 Billion Cubic Feet per year and could reduce it by another 1.3 Trillion Cubic Feet in the near future. This could increase pipeline transportation charges to consumers by as much as 16 percent.

Many gas pipelines have attempted to take advantage of regulatory loopholes by establishing subsidiaries to produce high-cost gas. They then sign "sweetheart" contracts with their own subsidiaries agreeing to purchase large volumes of this gas, at prices substantially above the market. It is perhaps the ultimate irony that the system of regulations enacted to "protect" the consumer has enabled pipelines to engage in such monopolistic practices. If consumers were allowed to contract directly with producers, the pipelines' monopoly control would be broken.

The regulations enacted under the NGPA clearly have worked against, not for, the interests of the gas consumer. They have increased prices, not lowered them. Extending the regulations will make a bad situation worse, penalizing the residential consumer the most. Large industrial customers can, and will, switch to cheaper alternatives, something that is prohibitively costly for the average homeowner. If controls are extended, that homeowner will suffer nearly $900 in direct costs, and nearly $3,300 in indirect costs. This is a high and unnecessary price to pay. For those truly interested in the plight of the consumer, there is only one way to restrain natural gas prices: Deregulation.

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For additional information see:

"Natural Gas Deregulation: Giving the Consumer a Choice," Heritage Foundation Backgrounder #250, March 1, 1983.
"Natural Gas Controls Are No Bargain," Consumer's Research Magazine, March 1983.
Natural Gas: Options and Opportunities, A Special Report, The Oil Daily, 1983.
"Declining U.S. Gas Demand," First Boston Research, February 24, 1983.