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TIME TO DECONTROL NATURAL GAS PRICES

When President Reagan moved to lift federal price controls from crude oil and refined products in January 1981, critics claimed that sharp increases in the cost of home heating oil and gasoline would soon follow. Although these increases failed to materialize, much the same group of critics now claims that the President's plan to remove federal price ceilings on natural gas will boost prices and hurt the consumer. The critics are just as wrong now as they were in 1981. When the Senate acts on the plan this week, it should ignore the doomsayers and look at the facts.

The roots of the current problem go back to the Supreme Court's 1954 decision in Phillips v. Wisconsin, which extended the Federal Power Commission's (FPC) regulatory jurisdiction to include the wellhead price of natural gas sold across state lines. As a result of Phillips, a dual market for natural gas was established: gas sold between states ("interstate gas") was subject to federal price ceilings, while that produced and consumed in a single state ("intrastate gas") was not. Not surprisingly, gas supplies on the price-controlled interstate market dwindled over time, while a surplus appeared on the intrastate market.

It became clear to Congress during the winter of 1976-1977 that controls were a bad mistake. Unusually cold weather led to an unexpectedly high demand in the northeast and midwest states, which are supplied mainly from interstate pipelines. Because controls had stifled the interstate market, gas companies had to cut deliveries to business customers to meet the demand for home heating. The plant closings that followed threw hundreds of thousands of people out of work and imposed widespread economic hardship. To prevent the crisis from deepening, Congress passed a stopgap measure partially lifting controls so that intrastate gas could be sold on the interstate market, and thereby gained a temporary respite from the disruption.

Congress finally began to address the long-term problems resulting from controls with the Natural Gas Policy Act of 1978 (NGPA). Although called a "decontrol bill," the measure actually extended the scope of FPC authority to include the regulation of intrastate gas sales, in exchange for some limited relief from interstate controls. A complex system of more than 30 classification categories was established for gas wells. Every category except so-called deep gas was subjected to a price ceiling below market levels. The price of gas from wells discovered after the enactment of the NGPA could be raised gradually until it reached rough equivalency with the world price of oil.

In designing the mechanism by which the rise would take place, however, Congress chose to use a fictitious "target" price for the estimated cost of a barrel of crude oil in 1985 rather than the actual market price at any given moment. The result: instead of narrowing the gap between the wellhead price of conventional natural gas and the world price of crude oil, the NGPA served to widen it, since partial decontrol allowed producers of deep gas to charge prices far above the level a fully decontrolled market would have allowed.

This price disparity had predictable results: it encouraged overdevelopment of the highly expensive deep gas, while retarding the development of less costly conventional gas supplies.

There is now widespread agreement among energy experts that the removal of price controls would lower prices to the consumer by stimulating the production of less expensive gas. In a Heritage Foundation study published earlier this year, it was calculated that retaining the current system of price controls would impose $157 billion in direct and indirect costs on the U.S. gas consumer over the next six years. Another study, just released by the Natural Gas Supply Association, indicates that within a year of decontrol consumers' gas bills would drop between 5 and 20 percent, realizing a saving of at least $108.30 a year for an average family using natural gas for heating.

These and other similar studies echo the experience of oil decontrol. Since 1981, decontrol has coincided with a decline in the pump price of gasoline of approximately 10 percent, despite the addition of between 10 and 14 cents in new state and federal taxes. Over the same period, "controlled" gas prices rose by 31 percent.

Removing natural gas price controls would unleash new supplies and drive down the price, just as decontrol did for oil. Although only five years ago some observers argued that the U.S. was running out of conventional gas supplies, there is now general agreement that adequate supplies exist--if sufficient incentives are forthcoming to extract them. If controls remain in place, however, half of all conventional gas reserves may be left in the ground, according to a study by Shell Oil. Another study, undertaken at the Graduate School of Management of the University of Dallas, indicates that full decontrol would not merely reverse the trend over many decades toward declining U.S. reserves, but would bring about a substantial surplus of supply.

In short, there is no rational argument for continuing the controls that have so long hindered America's ability to produce adequate supplies of natural gas. Only one conclusion can be drawn from the experience with oil decontrol and the projections for gas: decontrol of natural gas prices would bring enormous benefits to the American consumer.

Milton R. Copulos
Policy Analyst

For further information:
Milton R. Copulos, "Natural Gas Deregulation, Giving the Consumer a Choice," Heritage Foundation Backgrounder No. 250, March 1, 1983.
"Inflammatory Rhetoric," Reason Magazine, August 1983.
Gas Price Reductions Under S. 1715, Natural Gas Supply Association, 1730 Rhode Island Avenue, N.W., Washington, D.C., 20036.
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