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WITHDRAWAL SHEET

Ronald Reagan Library

Collection: KHACHIGIAN, KEN: Files

Archivist: ggc *dlb*

File Folder: Cabinet Meetings *[Notes] (Jan. 1981) (1 of 2)*
Box 4689

Date: 5/13/97 *redo 10/24/06*

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
1. Notes	handwritten notes by Ken Khachigian re Cabinet Meetings (3 pp)	2/13/81	P5
2. Notes	handwritten notes by Ken Khachigian re Cabinet Meetings (7 pp.)	2/4/81	P5, P1 B1
3. Memo	from L. Paul Bremer to Craig Fuller re Burden of Proof for Statutory Validity of Regulations (2 pp.)	2/3/81	P5
4. Memo	from James Edwards to Craig Fuller re Burden of Proof for Statutory Validity of Regulations (1p)	2/3/81	P5
5. Notes	handwritten notes by Ken Khachigian re Cabinet Meeting (4 pp.)	1/26/81	P5, P1 B1
6. Notes	handwritten notes by Ken Khachigian re Cabinet Meeting (7 pp.)	1/24/81	P5, P1 B1
7. Notes	handwritten notes by Ken Khachigian re Cabinet Meeting (7 pp.)	1/23/81	P5
① 8. Notes	handwritten notes by Ken Khachigian re Cabinet Meeting (12 pp) <i>partial p. 10 13.</i>	1/22/81	P5 B1 <i>CCB 11/29/00</i>

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

- P-1 National security classified information [(a)(1) of the PRA].
- P-2 Relating to appointment to Federal office [(a)(2) of the PRA].
- P-3 Release would violate a Federal statute [(a)(3) of the PRA].
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- P-6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA].

C. Closed in accordance with restrictions contained in donor's deed of gift.

Freedom of Information Act - [5 U.S.C. 552(b)]

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- F-9 Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA].

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Archivist: ggc *dlb*
redo
 Date: 5/13/97 *10/24/06*

File Folder: Cabinet Meetings (3 of 3) *Notes (Jan 1981) (10 of 2)*
~~box 4689~~
Box 1

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
<i>1.</i> Paper <i>2.</i>	re Synthetic Fuel Subsidies (3 pp.)	n.d.	<i>PS</i> <i>COB 11/23/00</i>

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WITHDRAWAL SHEET

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Archivist: ggc dlh

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redo
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Serry-

The attached are
notes taken by
Ken Khachigian during
the period of
Jan 1981 - April 1981,
at noted meetings.

Thanks,

Nance Roberts

1-22-81

Cabinet Meeting - Economic Policy Group

Report
from
Walter
Mondale
re:

35% of the people were fine
50% need some help
25% need a lot of help

Iran

lot of abuse. Fake firing squads
beat a fellow who tried to
escape

RR told men - we'll save you a
lot of trouble by wearing the
same wardrobe at each Cab.
meeting.

Fi. Smith

100's of law suits re: Iran -
any changes of policy affects what
we do - let us know

Jelly beans in glass jar - sitting
in front of Bush - passed down
the table, each got some + popped in mouth.

RR: re: Iran: We're studying matter &
we'll hold comment.

Om Smith - needs guidance because has to
act in response to what's happening

P-2

gray/blue
Rt in plaid sport coat - dark
blue trousers

Several Cab. Officers - munching
on jelly beans as meeting progresses.

Broch: Should express some indignation

Portraits

Coolidge - Ike on south
wall - Lincoln on north
wall.

Fr. Sault: Have to log in all
phone calls - try to stop when
they release this to the press.

P.: Decided to admit to stop it -
it was leading to "blossoming
of paperwork."

"We came here to do things
differently."

Jim Edwards - Energy Development
"produce; produce; produce."

- 1.) Oil - rep. of crude oil, prepare it.
- 2.) Move a little slower on nat. gas.
- 3.) Adjust fuel laws - let states
know what they should be.

P-3

move on NRE - license
5 or 6 waiting plants.

on coal - move fast
because it's biggest volume.
- safely & environmentally
sound, but do it.

Must notify on laws.

Foreign policy will help
our energy policy - energy
independence, 10-15 years
away, not 5.

allies are helping us a lot
w/:

- 1.) Synthetic fuel development
- 2.) more nat. defense, thus
they don't use as much capital
for defense

Iraq a little more imp. to
us than Iran. Must repair the
Iraqi pipeline after their
war.

move into nuclear
" " breeder reactors

P. 4

must move on nuclear
reprocessing - can save
1 million barrels a day.

Take spent rods - ~~for reuse~~
take out good fuel & ~~take~~
~~we~~ make bad stuff better
for waste.

We have technology to handle
barical - just need political
courage to do it.

Fuel Rods - 50% of the
energy is left in them.

Can reduce size of waste to
1/10 of what it was by
reprocessing.

P: What's wrong w/ White Sands
testing area?

Edwards: Granite is safest &
most stable - inert

Defense waste - get handle on this
There's a lot of it - get it into
classified.

Stoche: Will private industry do it?
or must govt. pay for it?

p. 5

J.E.: - France has stolen our
leadership in nuclear.

Stroeman:

"I just want to save money."

P: On coal - Is diff.
in strip-mining laws -
the one b/t State &
Fed. law.

Flying in west Va - when
you see strip mines - "like
a purple on an elephant"

Is it right that Fed. law says
you must replace & reclaim
coal of same contours?

How do this, once you've taken
out coal? You've got to dig
a hole ~~everywhere~~ else to fill
old hole!

Stroeman:

Focus on crude oil price
decontrol. Whether P. to
sign an Exec. order on this.

World markets seem stable enough
to handle immediate decontrol -
w/ w/i next 10 days.

P. 6

Iran + Iraq still exporting
some despite war.

Thus, no rapid drawdown in
crude oil levels.

No great surge in crude
oil prices.

Can control immediate
price run-up would be, at
pump, 10¢ a gallon tops,
maybe less.

Get 200 - 300 thousand
more barrels a day of
oil.

Also get favorable response
from allies on this, because
commitment would be fore.

So: recommend you do what
you pledged in campaign.

6 - 8 - 10¢ increase -
But that will happen anyway.

- good for fiscal policy & revenues.
- good for other reasons.

Edwards: in complete agreement, but
must draft carefully.

p. 7

Would end entitlement programs. Cut out many bureaucrats at DOE.

State: We might get 5/9 from allies for doing this

Regan: might raise CPI .3 to .4 (one-shot thing).
won't affect home heating oil.
Might be a howl from home, though.

Cautions oil cos. not to raise prices or gouge.

Stoehman: won't happen because mkt. is so competitive.

P: "The only Q. I have is whether I do it today."
Then maybe tell oil companies to show restraint.

Watt: Don't start jaw boxing -
Don't use up your goodwill. Let the market work.

Regan: considers the bill b/c of constituents' hurt.

p. 8

Edwards: Maybe announce it now & ~~let~~
it take place in March —
giving certain plants time
to get through their 6-month
orders w/ end in March.

Stecher: Do it after very careful
study of entitlement program.

P: "We want to announce the
decision as soon as possible."
"You made my day."

Stecher:

Nat Gas policy Act - Byzantine

26 categories of nat. gas
all phase out at diff. times.

Phase it out as quickly as possible
to speed up drilling rate.

We can find as much nat. gas
as we are using each year.
High response w/ new drilling.

2 issues:

1.) Can do many things w/
FERC in DOE - existing
powers.

2.) Can change the statute
also - but not much
support for this on hill

we can
do this
rapidly.

P-9

move
quickly

2 holes at FERC -
get 2 new appointees
so we can get it going.

Finding so much gas,
before long Much administrative
potential to be lost.

P: The Washhutes shall hear the
word to move quickly

P: I want to tell your honor story
In Indian, Fan Buea
found hot gas worth \$10,000
per day - only one pipeline
to Indianapolis - interstate
But Feds objected -
DOE ruled that weren't sure
it was same molecule with ~~ended~~
~~they~~ up in other end of
pipeline. Delayed 2 years -
Then EPA stalled a
new pipeline that was
necessary. Found that
there was no shellfish or
whatever to protect in river

have not lost from Team - K. - Ok.
But even taxpayer is sending it
deep breath for one who's coming.

Change Policy: Require that TVA market its own bonds in the public utility bond market.

Bring 40-year (over 40) w/
90-day Trenches.

TV4: Sticky initially
They became all free w/ w/
cuttic bands.

See English - & the law
Reading they're out of order.

8 Johnson

P: n: Hill. "We ~~the~~ then we
 cannot with the (being a necessity)
 poor."

19

p 11

of the happiest meetings I ^{to}
had. It's only just
the way I thought it
would."

laughter & some applause -

per Jim Edwards 1-22-81
Secy DOE

- Cost out Fed. employees -
over their lives

- # of autos

- # of other things

- whether what we're doing -
trading off one capital
worker or auto worker
for 1 permanent -

cost of inflation
putting all the other
out of work -

- productive use
vs. hoarding

so Storchman re: speed

CABINET MEETING PARTICIPANTS

January 22, 1981 -- 10:30 a.m.

James Edwards
James Watt
Donald Regan
Edwin Meese
David Stockman
Myer Rashish for Alexander Haig
Other Cabinet members optional

Jim Baker
Mike Deaver
Richard Allen
Martin Anderson
Max Friedersdorf
James Brady
Richard Darman
Craig Fuller
David Gergen
Dan Murphy

FOR PRESENTATIONS

Ed Harper
Glenn Schleede
Fred Khedouri

Distribution:

Ed Meese
Jim Baker
Mike Deaver

Dick Darman
David Fischer
Helene von Damm

THE WHITE HOUSE

WASHINGTON

CABINET MEETING AGENDA

January 22, 1981 -- 10:30 a.m.

Economic Policy Group

- | | |
|---|----------------|
| 1. Overview of Energy Situation | James Edwards |
| 2. Oil and Gas Decontrol Issues | David Stockman |
| a. Accelerated Decontrol of
U.S. Crude Oil | |
| b. DOE Price and Allocation
Controls on Petroleum Products | |
| c. Increasing Domestic Natural
Gas Production | |
| 3. Energy Budget Issues | David Stockman |
| a. Federal Spending on Energy Programs | |
| b. Tennessee Valley Authority
Loan Activities | |
| c. Strategic Petroleum Reserve | |
| d. Synthetic Fuels Subsidies | |
| e. Outer Continental Shelf Leasing
Acceleration | |

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	-- Accelerated Decontrol of U.S. Crude Oil	1
	-- DOE Price and Allocation Controls on Petroleum Products	2
	-- Increasing Domestic Natural Gas Production	3
II.	Energy Budget Issues	
	-- Federal Spending on Energy Programs	4
	-- Tennessee Valley Authority Loan Activities	5
	-- Strategic Petroleum Reserve	6
	-- Synthetic Fuels Subsidies	7
	-- Outer Continental Shelf Leasing Acceleration	8



Crude Oil Price Decontrol

Issue: Should the President decontrol crude oil prices as quickly as possible or should crude oil price controls continue to be phased out through September 30, 1981, in accordance with Carter policy?

Background: The following is a brief description of current status of crude oil price controls:

- o Only 15 percent of the 14 million barrels of crude oil refined in the U.S. each day will remain under controls as of February 1 (see attached table). Thus the controls have relatively little effect on gasoline prices.
- o The remaining controlled crude oil is sold to domestic refiners at an average cost of \$15/barrel. This is less than half the price paid for imported oil (\$35/barrel and rising), and discourages domestic oil production.
- o Aggravating this situation is a regulatory apparatus (the "crude oil entitlements program" administered by the Department of Energy) that requires refiners which use price controlled domestic oil to pay their competitors who use high cost imported oil a subsidy so that all domestic refineries on average pay \$30/barrel for their crude oil. This is a clear oil import subsidy.
- o Further complicating this picture is the fact that the entitlements program, originally designed to equalize crude oil costs for refiners, has been used to subsidize various favored interests, including so-called "small refineries." Many of these refineries are high cost, inefficient operations that depend on the subsidy program for their continued existence.

Current Decontrol Policy: According to the schedule established by the Carter Administration, price controls on crude (and product) and the import subsidy policy which goes with them will be phased out by September 1981. Regardless of whether decontrol takes place now or in September, it inevitably creates "winners" and "losers".

- o "Winners" will include domestic crude oil producers, royalty holders, the balance of payments and tax collectors at the State and Federal level. Federal tax collections will increase due to the "windfall profit" tax as well as the normal tax system.
- o "Losers" will include OPEC producers and refiners now receiving subsidies.

Potential Change: President Reagan has authority to accelerate the Carter decontrol schedule by Executive Order. Accelerated crude decontrol would have the following advantages:

- (1) Price controls on domestic oil are one of the glaring defects of current energy policy. Terminating them will encourage efficient energy production and conservation.

- (2) Domestic supply of crude may increase by an estimated 350,000 barrels per day of controlled oil that would otherwise be lawfully withheld from the market in anticipation of additional profits of \$20 to \$25 per barrel that can be realized after decontrol in September.
- (3) Immediate decontrol will produce an estimated \$4.2 billion in additional Federal revenues during 1981 from higher Windfall Profits and income tax collections. This increase may be partially offset by up to \$1.5 billion in higher outlays for the Strategic Petroleum Reserve, however, because the SPR is at present receiving subsidies through the price control system.
- (4) Inflation as measured by the Consumer Price Index could increase by up to 0.8 percent in February. This may be a high estimate, however, because current market conditions may not permit refiners to pass through higher crude costs to consumers. More significantly, this inflationary effect will take place regardless of whether decontrol occurs immediately or in September; immediate decontrol simply shifts it to earlier in the year.
- (5) Capital and foreign exchange markets will be bolstered by the policy; to the extent these markets have anticipated prompt decontrol, postponing this decision will have a negative effect.
- (6) Prompt decontrol would avoid the necessity for large, integrated refiners to pay higher than world crude prices, which will occur in April through the entitlements program, in order to continue subsidizing small refiners and the strategic petroleum reserve.
- (7) Adjustment to decontrol by marginal economic refiners is inevitable. Whether these adjustments begin in February or October makes little difference. A number of these refiners are direct products of the regulatory program; their investors have reportedly recouped their investments in little more than a year. Accelerated decontrol avoids a difficult battle on the issue which the beneficiaries of controls expected to wage during the next nine months.

Possible Reactions: If world crude prices climb this spring as expected, Congressional critics will blame higher domestic product prices on the decontrol decision. Current beneficiaries of the entitlement subsidy are likely to charge that the Administration is assisting "big oil" in extinguishing competition from "small oil." Congressional delegations from "small refinery states" (Kansas, Texas and Louisiana) in particular will press hard for tax relief to protect their constituents. In addition, accelerated decontrol combined with a tight oil market could cause temporary shortages and particularly high prices in certain regions. Major suppliers of these regions (for example, Ashland Oil in Kentucky) have not sought low cost crude supplies and have depended instead on government assistance in obtaining their crude oil.

Percentage of Oil Supply Remaining Under Controls
(Carter Policy)

<u>Month</u>	<u>Percent of U.S. Production under Controls</u>	<u>Percentage of U.S. supply (including imports) Under Controls</u>
February	25.5	15.6
March	22.0	13.6
April	18.9	11.6
May	15.4	9.4
June	12.1	8.3
July	9.0	5.5
August	5.6	3.4
September	2.2	1.3
October	0	0

Petroleum Product Price Decontrol

Issue: Should the President remove price and allocation controls on gasoline and propane immediately?

Current program: The gasoline lines which have plagued the country periodically since 1974 are the result of price controls on petroleum products enacted in that year and the allocation formulas which accompanied them.

- o Under normal market conditions, when petroleum is relatively plentiful, refiners, jobbers and retailers are free to buy and sell as if the industry were uncontrolled.

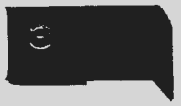
- o But when supplies get tight, suppliers are required to allocate uncontrolled products (gasoline and propane) according to an historically-based system.

- o The historically-based system is likely to have no relationship to market demand at the time supplies grow tight. The predictable result is product shortages in some areas, while products are plentiful in others.

As long as price and allocation rules apply to gasoline and propane, the country has what might be called a "negative preparedness strategy" -- minor turbulence in markets is amplified by the controls, making shortages inevitable as long as controls are in effect.

Proposed change: The President would eliminate gasoline and propane price and allocation controls by Executive Order as soon as possible. This would remove the risk that tight petroleum markets this spring would result in gasoline lines or propane shortages. If markets are tight, higher prices will result, but this will have the beneficial effect of compelling users to economize and allowing distributors to move supplies to areas where they are most needed, unencumbered by historic (and irrelevant) regulations. Timing here is important, since products should be decontrolled before markets tighten and the spring driving season arrives. Propane should be decontrolled simultaneously, to end the allocation system and to allow farm interests (major propane users) to prepare for the fall crop drying season. Decontrol will also stimulate needed investments in the nation's refineries.

Possible reaction: Gasoline marketers and their trade associations would strongly object on the grounds that continued controls protect them from predatory action by the major oil companies. Marketers are going through an inevitable winnowing out process as motorists use less gasoline and increasingly favor non-traditional "gas-and-go" outlets. Reaction from these sectors could be greatly reduced by a voluntary commitment from major refiners to proceed very slowly over the next year in renegotiating contracts with dealers and wholesalers, however.



SUBJECT: Increasing Domestic Natural Gas Production

Current Situation:

The Natural Gas Policy Act of 1978 (NGPA) was intended to provide for the gradual decontrol of domestic natural gas prices between now and 1985. But within months after its adoption, the 1978 law became obsolete. The rapid oil price increases accompanying the Iranian revolution caused the regulated price for natural gas to once again fall far behind the price of imported oil. As a consequence, we are losing potential gas supplies that could be used to efficiently replace oil imports.

Administrative Actions to Increase Gas Supplies:

The Federal Energy Regulatory Commission can take a number of steps to encourage additional drilling and production of natural gas. The NGPA gives the Commission broad discretion to provide more incentive for domestic natural gas under three provisions:

- Most significant is the FERC's authority to establish special incentive prices for gas that is expensive to produce. Although FERC has already adopted rules that provide higher prices for four types of costly production, existing law would permit the Commission to extend this provision much more widely.
- FERC also has the authority to raise the controlled price that applies to so-called "old" interstate gas production, which is gas from fields put into production before November 1978 that was sold across state lines. By raising this price, FERC could generate additional cash flow within the industry that could be used to finance drilling and exploration.
- FERC has authority to raise the controlled price for gas sold under expiring intrastrate contracts. This would also have the beneficial effects on industry cash flow described above.

Proposed Action:

Because the Federal Energy Regulatory Commission has a high degree of statutory independence from Presidential direction, ordering the Commission to provide higher natural gas prices would create a serious risk of legal challenge to the Commission's action.

However, the Secretary of Energy does have the authority to participate as a party in FERC rate proceedings. Thus, the President could direct the Secretary to petition the FERC for higher natural gas rates.



Federal Energy Spending
(Millions of Dollars)

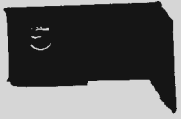
	<u>1972</u>	<u>1976</u>	<u>1980</u>	<u>1982</u>
<u>Direct Outlays (Net)</u>				
Energy Supply	1,107	2,508	4,574	6,234
Energy Conservation	0	51	568	1,067
Emergency energy preparedness	0	65	342	3,412
Information, policy, regulation, administrative expenses	<u>163</u>	<u>503</u>	<u>829</u>	<u>1,260</u>
Total	1,270	3,127	6,313	11,973

Energy Tax Expenditures and Loan Activity
(Millions of Dollars)

	<u>1980</u>	<u>1981</u>	<u>1982</u>
<u>Tax Expenditures</u>			
Expensing of exploration and development costs	2,195	2,760	2,950
Excess of percentage over cost depletion	1,965	2,675	2,825
Residential conservation and solar credits	485	540	615
Business conservation and alternative energy credits	340	540	685
Excise tax exemption for gasohol <u>1/</u>	50	121	189
Credit and excise tax exemption for buses <u>1/</u>	43	55	55
Other	<u>85</u>	<u>115</u>	<u>165</u>
Total	5,163	6,806	7,484
<u>Loan Activity 2/</u>			
Synthetic Fuels Corporation	0	6,000	2,000
Biomass energy development	0	1,761	50
Geothermal energy development	<u>82</u>	<u>228</u>	<u>228</u>
Total	82	7,989	2,278

1/ These result in revenue losses even though they are not tax expenditures.

2/ Includes guaranteed and direct loans (net) made through "on budget" Federal accounts. Excludes "off budget" activities such as REA and TVA.



AGENCY: Tennessee Valley Authority

SUBJECT: TVA Loan Activities

<u>POTENTIAL REDUCTIONS</u>	<u>(\$ in millions)</u>				
	1981	1982	1983	1984	1985
Budget Authority <u>1/</u>	--	-762	-997	-1,097	-1,125
Outlays <u>1/</u>	--	-762	-997	-1,097	-1,125

PROGRAM:

TVA through loan guarantees for the Seven States Corporation and direct loans in its nuclear construction program anticipates borrowing in excess of \$9.0 billion by the end of 1985. Over \$8.0 billion is for nuclear plant construction and current plans are to finance the borrowing through use of the Federal Financing Bank.

- Based on the transition team studies, the following points are noted:
 - ° TVA's estimate of a regional economic growth is 3.3% annually for the next decade.
 - ° Based on more recent historical performance a rate of slightly over 2.0% is more likely;
 - ° TVA's peak demand, the capacity for which a system is designed, has not grown over the last 3 years;
 - ° TVA is conducting a substantial energy conservation effort and is further encouraging this effort by increasing its electricity rates;
 - ° Overly optimistic demand forecasting, a conservation effort and increasing electricity rates suggest that TVA's ambitious construction program will create an excess of electric generating capacity by 1990;
 - ° The major factor in rate increases is the rising cost in interest payments to fund the nuclear construction program.
 - ° TVA should consider a further slowdown in its construction program (four units have already been deferred);

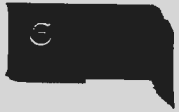
1/ Annual savings estimates are not yet available from TVA. Figures represent rough OMB staff estimates for deferral of 3 nuclear units and elimination of TVA financing through the FFB.

- Compared to independently owned utilities TVA enjoys substantial financial leverage in the market.
 - The advantage of FFB financing is estimated at 1% per year over the private sector markets;
 - TVA borrowings while not backed by the government are perceived to be and therefore command a favorable loan rate (the bond rating is Triple A);
 - Bondholder exemption from State and local taxes are a sweetener giving TVA an additional advantage; and
 - The overall borrowing advantage accruing to TVA is estimated to be between \$100 and 180 million annually.
- The current practice of funding TVA borrowing through FFB has disadvantages:
 - It transfers TVA debt to a more favored financial status;
 - Provides an interest subsidy to TVA ratepayers, one they should not enjoy;
 - In essence, TVA finances 30-40 year capital assets with 90-180 day Treasury paper; and
 - Encourages TVA management to remain committed to an ambitious construction program, which otherwise would be subjected to more severe tests of viability by higher interest rates.

POTENTIAL CHANGES

TVA construction activities and thus financing requirements may be slowed as a policy of the Administration, Congress and TVA management. Short of this, FFB financing could be curtailed on the following basis:

- TVA growth/demand projections are overly optimistic; a 2.0 to 2.5% annual growth rate is more probable;
- Three nuclear plants, Phipps Bend and Yellow Creek and possibly Hartsville A-2, may be deferred because of ample capacity represented by conservation activities, lower than anticipated growth and other new plants coming on-line through the 1980s;
- Forcing TVA to seek financing from the private sector, (eliminate the FFB advantage) will create more incentive to cut construction costs and serve to slow the rate of construction thereby reducing government outlays; and
- FFB financing requirements, i.e., Treasury borrowing, would be reduced thereby creating the perception of diminished government borrowing activity even though TVA would still be active in the credit markets, but to a lesser degree it would be hoped.



SUBJECT: Strategic Petroleum Reserve

POTENTIAL REDUCTIONS:

	Fiscal Year				
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
Budget Authority	5,200	1,350	2,100	1,600	1,100
Outlays	560	1,139	1,625	1,588	931

CURRENT PROGRAM:

The Department of Energy currently purchases oil on the open market and stockpiles it as a reserve against a cutoff of foreign supplies. The present rate of purchases is in the range of 100,000 barrels per day, and prevailing world prices are in the range of \$35-40 per barrel. Until final implementation of oil decontrol, government oil purchase costs will be partially offset by an "entitlement payment" from domestic refineries. This program is our most important short-term insurance against further Persian Gulf oil supply interruptions. Unfortunately, the Carter Administration permitted the fill rate to fall 40 percent behind schedule as of January 30, 1980. World market conditions permitting the Reagan Administration must move aggressively to reach 500 million minimum target.

POTENTIAL CHANGE:

Unlike most goods purchased by the Federal Government for current consumption, the oil reserve will be stockpiled for use only in an emergency, at which point it would be purchased by U.S. producers for domestic refinery operations. Hence, at some point, the government will be repaid the cost of the stockpiled oil -- at substantially higher unit prices.

Under these circumstances, it is not necessary to acquire oil through appropriations for purchases. A special government security could be created, backed by the full faith and credit of the U.S. and tied to the value of oil at the redemption date. These "oil bonds" could be marketed to the public, and the proceeds used to both redeem the current government investment in the reserve (roughly valued at \$4.2 billion by the end of FY 1981) and probably provide sufficient funds to maintain -- or even increase -- the present fill rate.

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Fiscal Year				
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>

Budget Authority

Outlays

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The value of the bonds would be determined by the investing public. The budget estimates above assume the bonds sell at a price equal to the cost of buying oil. They could sell for more, producing larger budget savings. They could sell for less, but if that happened, the shortfall should be covered by receipts from bonds on oil already stored.

Because the value of the underlying collateral would rise, and because redemption would only occur 10 or 20 years in the future when both nominal and real prices are certain to be substantially higher, these oil-backed securities would have a value as long-term investments solely for capital gains, and could probably be marketed on a no- or low-interest basis. While there would be sales commissions and other costs associated with the securities, these would be minimal when compared to the on-budget outlay savings that would be created.

The savings estimates above assume that the fill rate would average 200,000 and 230,000 barrels per day in FY 1981 and FY 1982, and that the world price of oil would rise to \$57 by FY 1984. A faster fill rate for the program on a faster price run-up would imply even greater savings from this proposal, under the assumption that the Government would otherwise continue to make the same level of purchases on-budget at the prevailing price.

PROBABLE REACTION:

There appears to be no major opposition to a proposal of this sort. While there are many who in general object to the placement of the economic value of a public asset in private hands, the ability to continue this vital program without heavy on-budget obligations should mitigate against this objection. To the extent that the Federal Government retained control over the disposition of the reserve, this objection could be easily overcome. Members of Congress may object that the proposal removes control over the program from the appropriation process and endorses a new form of federal financing at a time when other programs are being directed to reduce their borrowing outside the budget. But these are risks which, in our view, are worth taking.

SUBJECT: Synthetic Fuels Subsidies

POTENTIAL REDUCTIONS:

	Fiscal Year (\$ in millions)				
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
Budget Authority	5,736	922	1,285	788	326
Outlays	368	712	1,085	1,132	1,113

CURRENT PROGRAM:

Government support for synthetic fuels has evolved from a research and demonstration program which would provide limited data on synthetic fuel production capability to a massive subsidy program intended to build production capacity. There are currently three related programs to develop synthetic fuels.

DOE fossil RD&D program provides direct assistance for synfuels R&D and for construction and operation of major pilot and demonstration plants (FY 1982 BA \$1.2 billion). Under a related program TVA has proposed a \$3 billion medium Btu coal gasification plant that would be built solely with Federal funds. Over \$200 million has been appropriated for this project. The Carter budget requests no funds in FY 1982 and proposes to rescind \$177 million in FY 1981 and prior year funds for the TVA project.

DOE also has \$5.5 billion in appropriations under the interim Alternative Fuels Program for feasibility studies, cooperative agreements, price supports, purchase commitments and loan guarantees to subsidize construction of commercial synfuel facilities.

The Synthetic Fuels Corporation (SFC) has appropriations of \$12.2 billion available to encourage synfuels commercialization through price supports, purchase commitments, loans, loan guarantees, joint ventures and government-owned facilities.

POTENTIAL CHANGES:

In order to minimize the budgetary impacts of Federal support for development of synthetic fuels new policies must be adopted to increase the private sector's contribution to the existing technology demonstrations, to support a more limited program to demonstrate technical feasibility of synfuel production and, over the longer run, to reduce the need for Federal involvement.

Recommended changes are:

- (1) Support the Carter budget request to rescind funds for the TVA gasification project and propose rescissions for five DOE supported demonstration projects (SRC I & II, two high Btu gasification plants and the Memphis medium Btu gasification plant). None of these projects are under construction although final designs are underway for all five and some site preparation work has begun for three.
- (2) Transfer to the SFC the responsibility to select and fund all major synfuel construction projects including the above technical demos, using the SFC's authority (and \$12.212 billion) to fund (with minimum of 40 percent private cost sharing) joint ventures for synfuel modules.
- (3) Declare the SFC to be operational thereby stopping DOE obligating further funds under the Alternative Fuels program (including \$2 billion under the Non-Nuclear R&D Act, \$3 billion under the Defense Production Act and \$300 for feasibility studies and cooperative agreements) and propose a rescission for \$5.3 billion.
- (4) Focus the DOE fossil R&D program on performing advanced research, supporting process development research and continue through FY 1983 testing programs on existing coal liquefaction pilot plants.

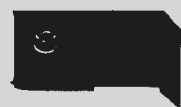
The basic rationale is to support a limited number (5-8) of first-of-a-kind operating plants to demonstrate technical, economic and environmental problems and costs, to rely primarily on the private sector and to minimize the net expenditure of Federal funds. In short, government would aid demonstration of synfuels capability but not subsidize building significant capacity. This action would save \$9.1 billion in budget authority through FY 1985 and reduce credit market impact of \$6 billion of federally guaranteed loans.

It is also recommended that in the longer term energy price decontrol and reduced regulation and taxes be linked to the implementation of this synfuels policy.

PROBABLE REACTIONS:

The proposed actions would be strongly opposed by project sponsors and the array of business and labor interests that would benefit from government-subsidized construction program (architect engineers, constructors, suppliers, labor unions, and development interests in areas where plants are to be built). Also, the popular perception that synfuels are a way of reducing dependence on imported oil and holding down OPEC prices would produce negative public and media reaction. Congresssional delegations from West Virginia, Kentucky, Ohio, Alabama and Illinois would be affected.

Synfuels programs have been most strongly supported by key Democrats on Senate Energy and Appropriations Committees and on House Banking, Energy and Commerce and Science and Technology Committees -- particularly from States in which plants would be built. Bipartisan support for programs overwhelmed the Congressional opposition from conservation members and environmentalists.



SUBJECT: Outer Continental Shelf Leasing Acceleration

POTENTIAL OUTLAY REDUCTIONS:

\$ in millions

	Fiscal Year				
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
Increased Revenues:					
Shortening sale preparation period approach	-	-800 (loss) to 800	0 to 800	0 to 800	0 to 800
Changing leasing strategies to add sales approach	-	-	1,250	2,600	3,500

CURRENT PROGRAM:

The federal government leases the rights to oil and gas on the outer continental shelf. Leases are sold at auction to the highest bidder for each tract. Bids include substantial bonus payments and a percentage royalty on oil and gas extracted. The outer continental shelf (OCS) program is expected to yield \$7.8 billion to the federal government in fiscal year 1981 and \$9.9 billion annually in fiscal years 1982 through 1985.

POTENTIAL CHANGES:

Significant increases in receipts (and earlier exploration) could be achieved by accelerating the leasing program and including more sales within the 5-year schedule. Schedule revision requires an administrative process taking 9-12 months. Both approaches below require schedule revision. Two broad approaches are:

- Shortening the sale preparation time period (now 40-45 months for frontier Alaska areas) by: (1) limiting Environmental Impact Statements (EIS's) to existing information rather than new research, and (2) limiting EIS's to analysis of exploratory impacts only rather than also including the impacts of development.

Both of these changes are likely to increase substantially the risk of successful litigation delaying or preventing sales. Past litigation has frequently delayed the program and prevented achievement of leasing objectives.

- Changing leasing program strategies to add more sales by: (1) revising the schedule to include all OCS areas with any petroleum promise, (2) offering leases in all promising subareas in each of the large Alaskan frontier areas within a year of the next sale in each such frontier area rather than at intervals of 2-4 years, and (3) leasing in all areas where current exploration technology is adequately safe, even though adequate development technology is not yet available.

The current schedule excludes the promising Bristol Basin, Alaska, the Blake Plateau, and several low promise areas. It also avoids leasing in sea ice areas and deep waters where exploration is feasible with current technology, but where development is not--following rather than encouraging the technology. Sales in an area are now held at 2-4 year intervals to take advantage of information from exploration in tracts sold earlier. However, most Alaska OCS areas are so large that several sales could be held within a year in different parts of the area without significant loss of information value.

PROBABLE REACTION:

Outcries against OCS leasing acceleration would come from environmentalists, the fishing industry, and community groups proximate to off-shore areas. Since the proposed changes are administrative, rather than legislative, however, public opposition will not prove as formidable a barrier as it might if legislation were needed. All actions involve some risks of successful anti-leasing litigation.