Oil *and* August 15th

By Philip K. Verleger, Jr.

An unintended consequence of the three days at Camp David: the complete reconstruction of the global petroleum system.

Jeffrey Garten's new book, *Three Days at Camp David: How a Secret Meeting in 1971 Transformed the Global Economy,* focuses on international finance. However, his insights about what was discussed and decided by President Richard Nixon and his advisers at that meeting also provide a clear explanation of what happened with oil in 1971, developments that eight years later would cause the 1979 Tokyo economic summit to limit its discussion almost entirely to that subject.

The key events for oil in the United States that followed President Nixon's August 15, 1971, speech to the nation were the ninety-day wage and price freeze and, as explained by Garten, Nixon's efforts to win the cooperation of the Democrats in Congress.

The 1971 wage and price freeze (phase I) was followed by three additional phases. In June 1973, Nixon instituted a second freeze, this one for sixty days. Then came a two-tiered system of price controls. The terms "old oil," oil from wells producing before 1973, and "new oil," oil from wells that had just begun to produce, entered the lexicon.

Old oil prices were frozen at about $3 per barrel and would remain near that level until 1981 even as world prices rose to more than $30. The architects of the price control program included an incentive to boost production, allowing any incremental output from old oil wells above 1973 levels to receive a higher price. Those writing the regulations, though, failed to recognize the laws of physics and geology, which cause output to decline over time. Thus, the perceived economic incentive was absent.

Garten's comment regarding President Nixon's desire to bring the Democrats with him in the program offers a hidden insight into the longer

---

Philip K. Verleger, Jr., is president of PKVerleger LLC.

THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
220 I Street, N.E., Suite 200
Washington, D.C. 20002
202-861-0791
www.international-economy.com
editor@international-economy.com

Aggressive moves by the United States would likely have restrained the rise in world prices.

consequence of the crude oil and other petroleum regulations: the Democrats were waiting for an opportunity to get oil. The Democrat-majority Congress elected in 1974 was determined to punish the oil industry for decades of perceived harm. Following the October 1973 oil price increase noted by Garten, the Democrats passed legislation to extend limits on oil price increases, constrained the ability of refiners and other processors to raise margins, and prevented firms from changing historical contractual relationships. The legislative actions were justified as being necessary to dampen price rises to consumers and prevent large firms, principally the multinational oil companies, from using their market power to destroy smaller competitors.

No doubt some actions would have been taken after the 1973 price surges. However, their impact would likely have been far less draconian if price controls had not been in place.

The impact of the regulatory program on the U.S. petroleum sector was notable. While world oil prices increased from $2.24 per barrel in 1971 to $36.83 in 1980, a rise of 31 percent per year, the price for old oil rose only to $6.24 from $5 in 1974. It is not a surprise to note that U.S. production declined from 9.2 million barrels per day to 6.8 million barrel per day between 1971 and 1980.

The limits on retail prices also discouraged conservation. Consumers paid $0.33 per gallon for gasoline in 1971 and $0.85 in 1978. Prices jumped to $1.30 per gallon in 1981 with decontrol. U.S. consumption rose from 15.2 million barrels per day to 18.8 million barrels per day in 1978 before declining to 17 million barrels per day in 1981.

The decline in consumption of 1.8 million barrels per day from 1978 to 1981 was caused in part by the sharp price increase and in part by the severe recession. I would attribute probably half the decline to the higher prices.

Consumption would have been lower in 1980 had prices not been controlled. U.S. oil production would have been higher, possibly as much as one million barrels per day. The combined impact of reduced use and increased production would have lowered the volume of U.S. imports. Net imports of petroleum rose from 3.7 million barrels per day to 6.3 million barrels per day between 1971 and 2000.

The cost of these imports rose from approximately $3 billion in 1971 to $93 billion in 1980. Absent price controls, the cost would have increased to $60 billion in 1980 if global oil prices had been unaffected by U.S. actions. Aggressive moves by the United States would likely have restrained the rise in world prices. I estimate that the U.S. merchandise trade deficit in petroleum would have been less than $50 billion in 1980 had the controls program not been implemented.

There is an irony here. Garten reports that the goal behind the U.S. actions on August 15, 1971, was a reduction in the U.S. merchandise trade balance of $13 billion. The price controls on oil, though, had the long-term effect of boosting the merchandise balance by between $30 billion and $50 billion.

U.S. energy policies and particularly the subsidization of oil imports were the primary topics of the June 1979 G-7 economic summit held in Tokyo. President Carter was reportedly angered by French President Valéry Giscard d'Estaing, who, when asked about U.S. effort to conserve energy, replied, "They haven't started."

The French were especially miffed at a U.S. Department of Energy program that offered subsidies for distillate fuel oil imports weeks before the meeting. Global supplies were tight, and the Department of Energy's $5-per-barrel bounty

Continued on page 73

French Barb

President Carter was reportedly angered by French President Valéry Giscard d'Estaing, who, when asked about U.S. effort to conserve energy, replied, "They haven't started."

—P. Verleger

KEYSTONE PRESS / ALAMY STOCK PHOTO

U.S. President **Jimmy Carter** *and French President* **Valéry Giscard d'Estaing,** *1978.*

Continued from page 27

for imports drove up the global price of distillate and crude oil. Weeks earlier, the *New York Times* reported that Giscard had publicly criticized the Department of Energy plan to his cabinet.

At the time, U.S. officials were engaged in a desperate effort to prevent Japan and European nations from calling a special meeting through the International Energy Agency to examine U.S. regulations. The *New York Times* reported that the Japanese government called the U.S. actions "regrettable," while the IEA's chairman claimed the U.S. measures were "tantamount to snatching money out of Europe's currency reserves." The *New York Times* authors added

> *European officials complain that the Carter Administration is effectively enlarging the price control shield that already protects United States consumers against world oil prices and that, other countries argue, encourages Americans to use more than their fair share of the world's limited energy resources.*

Eighteen months later, President Ronald Reagan ended the price control program begun by President Nixon nine years before. By then, however, substantial damage had been done to markets and to international relations.

U.S. production declined from 9.2 million barrels per day to 6.8 million barrel per day between 1971 and 1980.

One of the unintended consequences of the three days at Camp David, then, was the utter and complete reconstruction of the global petroleum system for the sole purpose of protecting the U.S. consumers. These include the destruction of trust among U.S. allies. While Garten is correct to praise the primary achievements of the weekend, the benefits must be tempered by the costs to the energy system. ◆