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- Welcome once again as MIT professor Paul Samuelson discusses the current economic scene. This series is produced by Instructional Dynamics Incorporated. Professor Samuelson, as we move into the winter heating season when there's an increased demand for petroleum products and natural gas, the question has to arise once again, where are we in terms of an energy policy?

- Well, to discuss that issue, let me first describe two unhedged views on oil policy that are really diametrically opposed to each other. The first view, perhaps associated with Republicans more than Democrats and in part with the administration, but still not completely typical of anybody I would think, but certain economists, would go as follows. You begin with the axiom, the only good price control program is a repealed price control program. The sooner we phase out all controls the better, according to this view. The same would apply actually to President Ford's tariff on oil imports. According to people of this way of thinking, there is no real long run oil emergency. Provided we let prices rise and fall with supply and demand, there's just nothing wrong with the US importing half or more of its oil by the 1880s, if that's the way the cookie of supply and demand crumbles. Furthermore, provided we let the different kinds of energy, natural gas, coal, oil, gasoline, fissionable uranium, et cetera, let them in effect be auctioned off at their market worths, the problem will take care of itself. Any rise in price that occurs under this scenario is what ought to occur, given the scarcities of the situation. People of this persuasion, I think, tend to go on to argue that the temporary monopoly of OPEC, like any temporary monopoly, is going to disintegrate anyway. And having free pricing of energy domestically is likely, this school thinks, to be the most efficient way of hastening that day of disintegration of the OPEC oligopoly. Well, that's one view. By contrast, let me try to describe in an unhedged way, still another view. Perhaps one associated with many of the Democratic Congressmen. According to this view, if you decontrol oil, and if you try very hard in this immediate short run to promote US independence from imports, that that will do more of what it's already been doing. Namely, increasing the rate of inflation in the cost of living. That acceleration of inflation from energy will go farther, will be aggravated if decontrol is allowed to take place suddenly. And if the higher prices for fuel will withdraw purchasing power from our consumers and thereby slow down recovery, first place some extra revenues may go abroad and come back only slowly into the purchasing power stream at home. Secondly, some part of the domestic purchasing power will go as rents to oil producers and oil companies, and although they will ultimately be recycled, there is no Say's law, no valid Say's law according to this view, which says that they'll be recycled at the same rate. To put things in the language of monetary theorists, the velocity of circulation of money is effected by the qualitative composition of pricing and countenancing complete and sudden decontrol will have a adverse effect upon the recovery. People of this viewpoint tend generally to think of the recovery as in jeopardy anyway, as not being too strong. That will be another story to discuss, whether our current recovery is all that fragile and is such a tender beast that it will be killed off by a shock of this sort. But let me go on with this second view. Since the wage rates tend to rise when consumer prices rise, you can see this, for example, in the escalated contracts, but you also see it in the course of collective bargaining. There'll be a further increase in costs and prices induced by the decontrol of oil resulting in an increase in energy prices. All this will be further aggravated by induced increases in airline costs and fares and rises in prices of all those goods whose production depends on energy and which themselves are raw material cost components for production of other goods. Moreover, these days, this school argues, there's not only a pass-through of higher energy costs, but that there's also evidence of a markup, some kind of a percentage markup, on each such increment of costs. So, the increase in the price of energy cascades through the system, not in an uncontrolled way but in an amplified way. Moreover, just to go on with this, if government policy on decontrol and on insulating us from oil imports does substantially worsen the rate of inflation, how we will be doing in the Consumer Price Index in the next two or three quarters or in the overall GNP deflator, then this school is afraid that Federal Reserve and administration policy formulators will feel forced into tightening the screws of monetary and fiscal policies. Tightening the screws on what already threatens to be a drawn out and weak economic recovery. So, being stampeded into the wrong activistic energy policy will thus, according to people of this persuasion, help to keep the unemployment rate high in the remaining years of this decade and will thereby put an intolerable load on the unskilled earners and on the minority workers, those parts of the labor force that are most subject to unemployment, youth and so forth. Now, I've stated two quite opposed viewpoints. Let me try to judge where there is strength in each view and also what the effect would be of various compromises between these different views. Notice that neither school that I've been describing is very gung-ho on project independence. So, maybe I oughta complete the triangle by putting Dr. Kissenger, Secretary of State, and his erstwhile assistant Mr. Enders into a third corner. Those who think that the main problem is to show the rest of the world that the US can't be bullied by an oil boycott. That we mean business and are going to make ourselves independent of foreign supplies of oils. More realistically, this view would have to go in the form that the trend of our dependence of our increasing dependence, which has been rather clear in the past data, that trend must be changed by activistic action. This third corner school, if I were going to describe it in the same detail that I've described the first two corners, I would have to say, is a great believer in organizing all of the consuming countries into an oligopsony. You fight oligopoly by oligopsony. A monopoly of a few sellers is to be checked by the countervailing power of the monopoly of a few buyers. And so, Dr. Kissenger is to get together with the Japanese and the Germans and the French and form a tight little buying cartel. Then, in good Yankee fashion, there's to be hard horse trading and dickering at some international conference, and armed with our cohesiveness, we will then be able to hack out and agree upon a pricing program, which does what? If it brings down the price that we pay for imported oil, it doesn't play into the hands of project independence. So, I guess the utopian version of this would be that such limited energy, as we continue to import, should be imported at very low prices compared to what OPEC, by its unilateral monopoly, will do, but we don't allow the sweet tooth of the American users for energy to be satiated by oil at cheap prices. Well, the administration's views and programs say as you would determine it from monitoring the speeches of President Ford, would be somewhere between the first corner view that I stated and the third corner view that I stated and I guess a number of the Democratic Congressmen who've been resisting President Ford's suggestions on compromise in oil would be at the second corner. Well, what are we to think? First, I would like to emphasize that we must keep a sense of quantitative balance as to how important the issues are between these different schools. Is it the case? Because if it were the case that the present system is intolerably inefficient and the present system puts an intolerable burden on the incentives to look for oil in North America. Then the first view, whatever you may think of its aesthetic and philosophical importance, would take on a enhanced practical importance. Well, as far as I can tell from studying what there is that is known about the present control system, there is no intolerable depressant of incentives under the present system. If you have old oil, and if you can squeeze an increment out of your old oil well which puts the increment above your quota of old oil, then you have something which is called released oil and you don't have to sell that released oil at the controlled price of five and a half dollars a barrel for old oil. You don't even, in effect, sell it at the price of internationally imported oil, let's say $11.50 or $13.50. You in fact sell it at something like $18 because you get a chit, an entitlement with that released oil and in consequence, there is a tremendous incentive to generate, at the present time, released oil. And if you're a believer, as most of the people in the first philosophical camp that I've described would be, in the efficacy of incentives, in getting people to do things, then you must be a believer under the present system in the strong substitution effects which are in the present pricing arrangements. Now, what's important about that is that to the degree that this is true, that there is even under the present system an artificial incentive to generate released oil, we cannot look for any kind of a miracle on that happy morn when all controls are swept away in the fashion that Erhard, as the Chancellor under Occupied Germany, disregarding the American generals instructions, swept away all price controls and then suddenly, as story goes, it's a little bit overdrawn, but it's a good story. We oughta tell it. Suddenly goods became available on the market, flowers flourished and so forth. Well, I don't think you can look for that. Now, if time permitted, I would have to give all of the various qualifications. For example, let's suppose you have old oil and you've been draining off a depletable, limited supply of your reserves so that by no superhuman effort can you ever get back to your quota level. Therefore you have no chance of ever getting into the released oil category. Still, as a nation, if we are interested in promoting project independence, we would like to generate a little bit more old oil than is now motivated by the price under control of $5.50. Well, you would have no motivation to do that because that's all you get on the old oil is $5.50. So, there are places in which there is a disincentive under the present control system. As I've mentioned on these tapes before, there are stories told, anecdotes, some of them are good anecdotes, but it's surprising to me how few they are and how hard they are to authenticate, that there is some hoarding of old oil going on. Well now, to the degree that there is hoarding of old oil going on, of course that's like money in the bank for the future as part of project independence. But for somebody who's concerned that the monopoly power right now of OPEC as it weighs whether in the next month or so to raise the price of oil, as OPEC says, to compensate it for the increase in industrial prices by 10% or by 15%, whether it's to be $1.50 a barrel or whether it's to be $3.50 a barrel or whether nominally it's to be no increase at all. There is still another possibility, by the way, which ought to be taken very seriously. Namely that there is in a nominal increase of 10% of $1.50 or even of $3.50, but the discounting from list which has been only very minor up until now, becomes major. Well, if you wanted to reduce our demand so as to embarrass OPEC with a lot of unsellable oil by some of its cartel members at the pegged price, then this hoarding of old old oil as I'll call it, as against new old oil, would be something which ought to be held against the controls. Take still another aspect of the control program. One of the bad things about controls, particularly if you start controlling supply and demand prices, and oil is not a supply and demand price simply. But if you start controlling the price of lumber or the price of meat when these are supply and demand prices and lumber moves off to a different auction market, the effect of a control program is often to dry up supplies completely in particular places. And where I live, New England, would be a great target for such a disappearance of supply. However, that is not the way the present controls work. I don't want to give the impression that somebody in Washington cleverly contrived all of these gimmicks and gadgets which turn out, even though very few people outside the industry and outside the bureaucracy and very few in the bureaucracy understand this. It was done the way the British Empire was formed, in a fit of absent mindedness. Nobody quite realized how it was working out but it's worked out pretty well as I want to go on to describe on the import side. Well, on the import side, if oil brought into the US costs $13, that is, the barge captain plus the Arabian company collect $13.50 for oil delivered in the Boston or New York port, I don't think that that's what the cost is to the oil company who brings it in or the ultimate cost, to the public utility in New England. New England is at a natural disadvantage. It should have thought twice before locating itself in the far corner of the country. Although, we have to remember that somebody has to be in each corner if the country is by nature rectangular in shape. However, the other side of this chit which the producer of released oil gets per barrel and which sweetens up his return, is the fact that there is kind of a negative chit which reduces the price to the importers. So, under the present system, there is very elaborate way de facto of taxing the oil rents of all the things which have become more valuable in Kansas and Oklahoma and in Texas and elsewhere. And a very elaborate control of average cost pricing and average profit pricing compensated, though, by marginal effects which are really quite tolerable. So, the present system is not like some price control systems. Perhaps the German one in 1948 before the Erhard miracle was perhaps an intolerable one, made especially intolerable by the propensity of the German people to obey the law. A French system could never become as malignant as a Scandinavian or German system because of the rampant feeling of individualism on the part of all the French citizenry who prefer to go through the red light pedestrian rather than otherwise in contrast to well-behaved Danes. So it's a tolerable system. The second thing is to debunk the fears of the second school of thought that if we instantly decontrol oil or if we decontrol it too fast that we go right back to the Great Depression or right back the the recession we've been in or go very definitely into an anemic and abortive recovery. Well, let's just look to see what difference it makes and I just happen to have received in yesterday's mail, so it's a convenient thing to refer to, the new Wharton School computer forecasts for the American economy in the next two years, from the middle of 1975 to the middle of 1977. And one of the advantages of a structural model like the Wharton model which brings it in contrast with a very simplified monetarist model or reduced form model or even a simple kind of model of the Neo-Keynesian, Raymond Fair type, is that you can run through different solutions and so I'm going to first look at their control solution, their single best guess as to what's going to happen. That's the first thing. Then I'm going to look through an alternative scenario with instant oil price decontrol. These runs were made on September 2nd, 1975. Since that time, of course, there have been a little revised production index data and I would say that the recovery from September 2nd, that's the day after Labor Day, until the time that I'm now speaking, has gone a little bit better than they could have known about in September 2nd. Well, for one thing, the first 10 days of auto sales have been strong and so forth and so forth. Well, the first thing I looked at was to see what happens to the rate of real growth in the next four quarters, for the middle of '75 to the middle of '76. And the Wharton School model is a less exuberant model than many and it shows, under its control solution without instant oil decontrol, a 5 1/3% rate of growth in the current quarter, that's the third quarter of the year, the one that's soon coming to an end. 8% rate of growth in the fourth quarter of the year. That's the strongest it's gonna show for a long, long time. Then, about 4.5% rate of growth in the first half of '76. The average for the year I make out to be the average of four and a half and six and a half, which would be just 5.5%. That would be a disappointing recovery but remember that Wharton is a little bit on the pessimistic side in comparison with Alan Greenspan or in comparison with Arthur Burns. I ought to mention for the record that Congressional committees kept badgering Dr. Arthur Burns to give his forecast of what was going to happen based upon his announced program of monetary growth and finally, after many hours of badgering the poor bull, the toreadors and picadors all poking at him, he said, all right, you've forced it out of me, I'm gonna give my opinion but I wanna tell you it's only personal opinion. It's not that of the official Open Market Committee or the Federal Reserve or the staff. He said, in my view, and he stated his words very carefully, the present program of 5.5% to 7.5% range for the aggregate monetary target from the second quarter of '75 to the second quarter of '76 is fully compatible with an 8% real growth rate. Now, if that means anything, and maybe it doesn't, I read that, I wrote down in my little black book that Arthur Burns thinks that the real growth is gonna be fully up to first year recovery and it's gonna be 8%. Alan Greenspan more recently has made an announcement for which he was much criticized by a lot of private economists and you can be sure the university economists won't be very late in joining in, saying we were gonna grow by 7%. Well, this Wharton growth is about six and a half, six and a third percent. Now, let's deal with instant oil price decontrol. So magic is the one month effect that it reduces even the current quarter from five and a third percent to four and a third, by a full percent. Of course that's only a quarter of a percent in the quarter because these are annual rates. It reduces by a full percent the booming, exuberant fourth quarter. That goes down from 8% to 7% and reduces by a full, well, I'd say a full percent down to something like 3 3/4% instead of 4 1/2%. Well, I guess that's by 3/4 of a percent. What's gonna happen in the first half of 1976? Well, I think that that would be regrettable if the first year's recovery were not at least 7%. That's been the target that I testified before Congress on. But it would be even more regrettable if something which was going to be about 6 1/3 or 6 1/2% were reduced almost by a full percent to 5%. However, what does it mean in terms of the unemployment rate in the election quarter? It's not as bad as you might think. Instead of having 7.9% in the fourth quarter, as under the control solution without complete oil decontrol, you have 8.1. You might say that these are within the degree of accuracy of the numbers. Well, that is true but I think that the spread would be around 7.9 if this forecast is right or around 8.1 and that is a significant difference. I may say that these numbers look a little bit high to me because we're now getting some rethinking on how high unemployment ever reached at its peak. We've had some revisions of the establishment data which I disagreed with the census. The census data of unemployment was showing rather lower than even the Washington officials has expected but the establishment data didn't bear that out. But they've now revised their establishment data and by August, the data are beginning to agree, so that I think that unemployment is not going to go back to 9%. Earlier, as you know, I thought it would go to 9 1/3% and it's about 8.4% and I think it is on its way down very soon. So, these numbers are high but what I want you to learn from them is the difference of about two or three tenths of a percent on the unemployment rate. Now, for somebody who's unemployed, this will seem very callous of me to disregard, because this means some hundreds of thousands of people, and I apologize for my beastliness. But keeping this in perspective, it is not the end of the world if one view prevails and the other view is correct. I myself think that there's a powerful case having discussed all that I've said to you for going slow on solving our long run problem when we're still in the acute phase of stagflation. So, I have no trouble in finding a compromise between the two main schools that I have outlined for you. I think the art of economic policy and also the art of political economy, of keeping our legislative system from getting polarized is to find that compromise and I don't think for all the noise it's all that hard to find it.

- If you have any comments or questions for Professor Samuelson, address them to Instructional Dynamics Incorporated, 450 East Ohio Street, Chicago, Illinois, 60611.