

Cutting Energy, Boosting Inflation

Texas Study Shreds Schlesinger's National Energy Plan

A recently completed study coauthored by the dean of the University of Texas Graduate School of Business confirms with hard figures that Energy Secretary James Schlesinger's energy program, far from redressing the nation's trade deficit and inflation problems, would significantly aggravate both.

The study, titled "Evaluation of the Conversion of U.S. Industry and the National Energy Plan," is no mere academic treatise. Senators Tower and Bentsen appeared last month in press conference with the study's coauthor, Dr. George Kozmetsky, by way of endorsement of its conclusions.

One of these conclusions was that cutting oil imports, a favorite Schlesinger cure-all, would likely be counter-productive to U.S. interests because the countries from whom we buy our imported oil use the dollars received to purchase U.S. goods. Reducing oil imports could likely mean reducing all kinds of exports.

The study is printed by the Institute for Constructive Capitalism, a body affiliated with the University of Texas Graduate School of Business in Austin, where Dr. Kozmetsky is the Dean. The study was funded in part by the Mobil Foundation, and Dr. Kozmetsky himself is a director of the Gulf Oil Company. His colleague and co-author, Hossein Askari, is also the author (with J. Creasey) of a study titled "Texas and the Middle East: a Case of Economic Interdependence" (Texas Business Review, September 1977).

The excerpts which follow are from the concluding section of Professors Kozmetsky and Askari's evaluation of the effects on U.S. industry of the Schlesinger energy plan.

We are convinced that vital national and international interests require all-out energy production and conservation in the United States. However, our study leads us to somewhat different conclusions than the National Energy Plan.

Our major points of consideration are simple. First, the transformation of U.S. industry from oil and gas to alternative fuel sources, such as coal, will place a substantial economic burden on the nation. We estimate that the direct investment cost to the private sector of such a conversion is on the order of \$220 billion; this sum is equivalent to about 1000 percent of the entire U.S. manufacturing sector's aggregate annual investment in machinery and equipment or to over 300 percent of net profit, after taxes, of all U.S. manufacturing. Furthermore, the \$220 billion makes no allowance for additional capital required for environmentally directed investments which alone could be in the order of \$50 billion; nor does it allow for increased operating costs of the new

facilities. These alone could add an additional cost of \$13.50 per short ton of low sulphur western coal.

We have not even included an estimate of the social capital requirements associated with the relocation of plants or expansion of newer energy resources required by federal, state and local governments. This required investment has far reaching implications for U.S. capital markets and the general availability of investment funds. This conversion cost has not been, until now, a part of the ongoing discussion of the NEP.

Second, the regional impact of such a transformation policy will be severely skewed. That is to say, the absolute impact will be greatest on the large industrial states — Texas, Pennsylvania, Ohio, New Jersey, Louisiana, Illinois, New York, California, Indiana, and Michigan — and on regions with heavy dependence on oil and gas — Texas, Louisiana, and Oklahoma. The replacement cost for Texas alone will be in the order of \$20 billion.

Third, certain industries will bear the brunt (70 percent) of the necessary conversion costs — chemical and allied products, primary metal industries, paper and allied products, petroleum and coal products, and stone, clay, and glass products. In short, besides the overall costs, large regional and industrial distortions will be also introduced into the U.S. economy.

Finally, and most fundamental to the National Energy Plan, we have serious reservations about conversion (from oil to coal — ed.) On the face of it, reduced oil imports would be expected to help our trade balance. However, to import less oil, the U.S. would have to divert more national resources to producing coal, building new electric power plants, and producing new machinery to replace machinery that is based on oil and gas. Economic resources are finite; thus, this transfer of resources must mean less input of capital and labor to other sectors of the U.S. economy. The prices of available capital and labor would rise due to increased demand. Some of the costs of the reduction in available capital and labor will be borne by the export sector.

The large investment requirement of conversion and increased operating costs will add to inflation in the industries most affected. Some of these industries also contribute to our current exports.

For example, in 1974 our exports of chemicals and allied products alone were \$8.8 billion while our total exports of all merchandise was \$97 billion; or this one industry was 9 percent of our total exports. Because of the increased cost of production prices will rise which will, in turn, reduce our exports. U.S. exports will therefore decline, causing further deterioration in our trade balance. In addition, if we buy less oil, income outside of

the United States will decline. This lower income will reduce the demand for U.S. exports, leading again to a deterioration in our trade balance. Finally, some of the capital equipment necessary for conversion may have to be imported. Thus, the net effect on our trade balance is unclear.

We see little incentive for industry to convert given the relative size of the investment requirement for conversion of \$220 billion in comparison to the penalty of a user tax, estimated to be \$90.5 billion. The end result in case of no conversion would be a general excise tax on industry at a time of high inflation and high unemployment. If anything, the private sector needs incentives for expansion rather than for contraction.

More fundamentally, international trade is based on the notion that a country should export the commodity

that it produces efficiently, relative to the rest of the world, and should import other commodities.

In the case of the United States, oil and gas prices are controlled; therefore, we do not know whether we could domestically produce all the needed oil and gas if our prices matched current OPEC prices. But let us, for the moment, assume that even with decontrol of oil and gas prices the U.S. would still import oil. Now why would the U.S. import oil? The answer is clear — only if the U.S. were not endowed with reserves of the same quality as the OPEC reserves and therefore could not produce new oil even at the cartel's prices.

International trade would, therefore, dictate that the U.S. should import oil and export other commodities which could be produced by employing the capital and labor that would have been used to produce high-cost domestic energy.