United States Department of Energy

Office of the Secretary

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MEMORANDUM

To: Policy Group
Office of Secretary Les Singer

From: Les Singer, Secretary, DOE

Subject: Price Control Problems?

There seems to be a lot of concern about price controls. A group of reporters stopped me today to ask about J.R.'s Op-Ed piece in the oil industry's rag. They asked me if I knew how markets operated and if DOE would intentionally set prices so low that it would cause shortages in the gasoline market. I was able to make light of their questioning with a joke, but I must be prepared immediately for answering their questions.

I need a detailed memo that explains why J.R. would say that price ceilings "prevent the laws of supply and demand from operating." I need to understand what is so efficient about letting the market set the price of gasoline and why price ceilings might produce shortages and hurt some people.

Feel free to use some of those graphs you like if you want, but I also need you to explain the effects of markets and price controls in plain English

I can't leave the building until I am armed with this information. Actually, you can't leave either, seeing as there are six reporters sitting in our lobby. Please get the memo to me by the end of the day.

Attachment

Oil Express

A Trade Paper of the Oil, Gas, and Petroleum Industry

OPINION

The U.S. Department of Energy—headed by none other than that puppet-of-the-President, Les Singer— is now deciding how to implement price control legislation just passed by Congress and signed by the President. Implementing this legislation in the wrong way will destroy the capitalistic spirit in this country by preventing the laws of supply and demand from operating.

It is true that price controls would lower the price of gasoline. But they would also eliminate production of 90 percent of the world's gasoline. Consider how they resulted in rationing of goods during World War II and gas shortages in the 1970s.

What Mr. Singer may not realize is that price reflects the cost of getting gas to consumers. If oil producers do not get paid enough to cover their costs of production, they will not pump oil and no one will have gas.

Mr. Singer has talked about setting the price of gas at the alarmingly low rate of $1.50 a gallon. At this price, oil producers will not engage in horizontal drilling or inject carbon dioxide into the subsurface for additional oil production.

Although these techniques can cost twice as much as traditional wells, they produce far more oil. Without the use of these newer technologies, oil production will be cut back by about 35 percent.

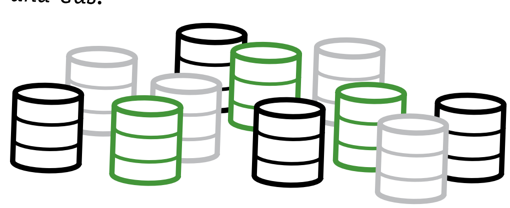
Our economy works because prices tell us what to buy and produce. In 1776, Adam Smith described how this mechanism produced *The Wealth of Nations*:

> *It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest... (Man is) led by an invisible hand to promote an end which was no part of his intention.*

Smith is saying that if you want to have gas in your car, you have to pay a price that will compensate the producer's efforts.

Only free markets can determine that price. Government bureaucrats cannot.

J.R. Ewing is President and CEO of Ewing Oil and Gas.



TRANSCRIPT OF FINAL VOICE MAIL FROM LES SINGER

(Total running time 2:15 minutes)

Voice of Secretary Les Singer

Bill, Les here. Thanks for your group's background work on markets. That really helped me sort through some issues about free markets and price-controlled markets. I guess price controls may be fair, but free markets are efficient. The old tradeoff between equity and efficiency is a real dilemma.

Anyway, now we've got to announce, quickly, our policy on price controls and allocating gas. I suggest that your group make this your number-one priority. We plan on explaining our policy to the general public in an Op-Ed piece, which will appear in several major newspapers and wire services next week, so please write it in that form.

Since the legislation only says that we must set a price ceiling on gas and determine the rules for its allocation, we have some leeway in what we can do. So you will need to decide whether we will have a policy that sets the price ceiling below market or above market level — and then decide how to determine who gets gas. That was sharp thinking when you pointed out to me that a price ceiling set above equilibrium lets the market determine price. I would not have thought of that!

Once the public sees the Op-Ed piece and accepts our decision, the DOE Implementation Group will determine the exact price and set the allocation plan into motion. Remember, we must gain public support with our Op-Ed piece, and this can only be done by showing that our policy is grounded in a clear understanding of how both unfettered and price-controlled markets work.

So, to sum things up, your job is to use the Op-Ed piece to persuade the public of the wisdom of our policy — regardless of whether we set the price of gasoline above or below equilibrium. You'll need to justify our policy decision, outline the plans for allocating gas, and identify winners and losers.

Because the President knows that I do not have a strong background in economics, he has requested that the Council of Economic Advisors approve the piece before it goes to print. Given this extra step in getting our policy out to the public, I will need to see your piece in two days. Just so you know, my head is on the block here, and if the Op-Ed piece does not convince the Council of our price control policy, I will have to take some of my staff down with me.