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HEADLINE: API-COMMISSIONED STUDY BATTERS BTU TAX; API WARNS OF ECONOMIC IMPACTS,
URGES MORE SPENDING CUTS

BODY:

Oil and gas producers continue to make their case against the Administration's Btu energy tax proposal. A study by DRI/McGraw-Hill, commissioned by the American Petroleum Institute, concluded that the proposed tax would reduce the U.S. gross domestic product by $73 billion and eliminate almost 400,000 jobs from 1994 to 1998, absent any easing of Federal Reserve monetary policy. The study was done by W. David Montgomery, director of energy and environment at DRI/McGraw-Hill, former assistant director for natural resources and commerce at the Congressional Budget Office, and former director of integrated modeling and data collection at EIA. Montgomery presented the study results at a press conference on May 14.

Just the day before, the House Ways and Means Committee made final adjustments to the Administration's national tax reform package, including the energy tax provisions. The committee approved the entire package, largely intact, by a 24-14 party line vote. The President has requested Congress to approve a net $273 billion tax increase over five years, with $72.8 billion coming from proposed Btu tax revenues. The increase must be voted upon by the full House, tentatively on May 26 or 27, and if approved will then be taken up by the Senate Finance Committee, where its fate in uncertain.

The President's 1994-1998 overall economic program, called "A Vision of Change for America," includes the tax reform package, a short-term stimulus package (now withdrawn), and an investment package. The DRI/McGraw Hill study analyzed the impact of five alternative scenarios on the U.S economy and energy markets: the President's overall economic program; the Btu tax in isolation; the President's program without the Btu tax; the President's program with more spending cuts in lieu of the Btu tax; and the President's program with a value-added tax in lieu of the Btu tax. A table of 1998 impacts on energy prices and demand under each scenario, excerpted from the study, follows this article. The VAT scenario is based on the European experience, and the spending cuts are derived from the CBO report, "Reducing the Deficit: Spending and Revenue

Options." Following are five major conclusions of the study:

(1) Without offsetting monetary stimulus, the President's overall program would reduce GPD by nearly $140 billion (1987 dollars) and eliminate about 800,000 jobs;

(2) The Btu tax would contribute only $66 to $68 billion or 18% of net deficit reduction, but trigger virtually all of the extra inflation;

(3) Removing the Btu tax would cut the projected GPD loss to about $65 billion and cut job losses by about 50%;

(4) Replacing the Btu tax with more spending cuts or a value-added tax (raising the same amount of revenue) would reduce GPD and job losses and encourage business investments and exports;

(5) The Btu tax would reduce energy demand by about 2% and burden oil more than natural gas, coal, or electricity -- with utility coal prices rising in line with residual fuel oil prices and at a faster rate than gas prices.

According to the study, both a Btu tax and a VAT would raise prices and therefore be inflationary. By comparison, spending cuts would be deflationary and ease interest rates, spurring stronger investment and export demand. After spending cuts, the next best deficit reduction alternative is the VAT. Replacing the Btu tax with a VAT would lower the GDP loss from $73 billion to $55 billion, or 25%. Any form of deficit reduction must be offset by lower interest rates to avoid negative economic impacts, says the study. "But alternative ways of reducing the deficit show lower economic costs, by every measure, than does the Btu tax."

The VAT's trade effects are also better than those of the Btu tax. The VAT would shift some of the revenue burden to foreign firms because it would be collected on imports and rebated on exports. Conversely, the Btu tax would tax the energy content of exports and not tax the energy content of imports. Plus, it would apply to petroleum imports but exempt coal exports.

Finally, although arguing that spending cuts would be best for the economy overall, the study acknowledges they would be less effective than either a Btu tax or a VAT in reducing energy demand.

API executive vice president William F. O'Keefe stated: "[W]e support the President's commitment to reduce the deficit and to promote more robust rates of economic growth . . . but believe the Btu tax is not consistent with those [objectives]." API favors removing the tax and replacing it with additional spending cuts.

The study, "Comparison of the Economic Impact of the Clinton Administration's Proposed Btu Tax and Alternatives," is available from API at (202) 682-8112. .[TABLE OMITTED]