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EXECUTIVE SECRETARIAT
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9	Chm/NIC		✓		
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19	C/IPD/OIS				
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SUSPENSE ______________ Date

Remarks:

Executive Secretary
5/6/82
Date

3637 (10-81)

NSC review completed.

L118
ISSD #9

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NATIONAL SECURITY COUNCIL
WASHINGTON, D.C. 20506

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May 5, 1982

MEMORANDUM FOR L. PAUL BREMER III
Executive Secretary
Department of State

DAVID PICKFORD
Executive Secretary
Department of the Treasury

LTC. ROBERT P. MEEHAN
Assistant for Interagency Matters
Office of the Secretary of Defense

STEPHEN SHIPLEY
Executive Assistant to the Secretary
Department of Interior

JEAN JONES
Director, Executive Secretariat
Department of Commerce

WILLIAM V. VITALE
Director, Office of the Executive Secretariat
Department of Energy

WILLIAM SCHNEIDER
Associate Director for National Security
and International Affairs
Office of Management and Budget

THOMAS B. CORMACK
Executive Secretary
Central Intelligence Agency

ROGER PORTER
Special Assistant to the President
for Policy Development

JAMES BURNHAM
Special Assistant to the Chairman
Council of Economic Advisers

COL. CHARLES F. STEBBINS
Executive Assistant to the Chairman
Joint Chiefs of Staff

SHEILA DRYDEN
Special Assistant to the Director
Federal Emergency Management Agency

CONFIDENTIAL
Review 5/5/88

SUBJECT: Next Meeting of Overview Group for NSSD 9-82

The Overview Group for NSSD 9-82 will not meet as scheduled on May 7. To allow more time for work to progress, the next meeting of the Overview Group will take place on May 19 at 11:00 a.m. in the White House Situation Room. At that meeting, we will discuss the outlines of Parts i and II of the study and an initial draft of Part I.

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The CIA Working Group on the first two parts will meet several times between now and May 19. Contact [redacted] if you are not participating and feel you should be.

Attached for your information is a recent Wall Street Journal article on energy forecasting.

Michael O. Wheeler
Staff Secretary

Attachment

CONFIDENTIAL
Review on 5 May 1988

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The Wall Street Journal, Wednesday, May 5, 1982

More or Less Oil Will Go Up or Down Or Maybe It Won't

* * *

Energy Experts Are Gun-Shy After Forecasts, for Years, Haven't Turned Out Well

By GEORGE GETSCHOW
Staff Reporter of THE WALL STREET JOURNAL

John Lichtblau, an unabashed energy forecaster, is feeling a bit abashed these days. "The less you quote me the better," he says.

Mr. Lichtblau's sudden shyness is understandable. As head of the Petroleum Industry Research Foundation, he predicted gloom and doom in 1981. World oil demand would "likely accelerate," oil supplies from Eastern Europe and other non-OPEC countries would decline, and there would be a continuing drop in U.S. production. On all counts, just the opposite happened, and the world is awash in oil.

"If we had just applied Economics 101," Mr. Lichtblau says, "we would have come up with better results."

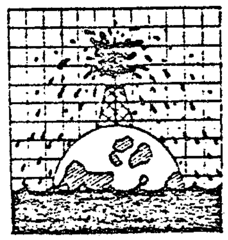
In making bum predictions, Mr. Lichtblau has a lot of company. "All forecasters, both in the government and in the private sector, have been awful at figuring out where the energy markets were headed the past few years," says Dennis O'Brien, who does his predicting as a deputy assistant secretary of the U.S. Department of Energy.

Just why their crystal balls failed them is the subject of intense soul-searching among the energy experts. They have huddled at various professional forums, broken down their elaborate energy models and tried to isolate flaws in them. Many forecasters have concluded that the errors weren't entirely of their own making.

Bad Data Blamed

Some blame "bad government data." Others blame war, weather and other "exogeneous factors," as they call them, that can't be cranked into their models. Still others blame "aberrant consumer behavior" in response to anticipated shortages and rising prices. But a good number of forecasters simply concede that they grossly overestimated energy demand and grossly underestimated energy savings from conservation and improvements in technology.

In any case, "the whole profession is now in a state of uproar," says Rep. Albert Gore Jr., Democrat of Tennessee, who conducted a congressional investigation of the profession last year because "billions and billions of dollars" in private and federal funds "are gambled on the basis of forecasts." Today, he says, forecasters are changing their assumptions.



"Conventional wisdom changes faster than we'd like to admit," says James Sweeney, the director of Stanford University's energy-modeling forum. "Only recently, the general consensus was that demand and prices would keep going up. Now the consensus is that they'll keep going down, at least for a while."

That isn't to say, of course, that the current consensus is correct. Because soothsayers share the same statistical techniques, economic theory and data, "they also tend to share the same ignorance," says Stephen McNees, an economist at the Federal Reserve Bank of Boston. "So they're either going to be all right as a group or all wrong as a group."

Influenced by the Present

Moreover, many forecasters try to divine the future merely by extrapolating the past, so their long-range forecasts are heavily influenced by present-day reality. "When the (energy) market's going up, they think it's going up forever; when it's going down, they think it's going down forever," says Arnold Safer, who considers himself a "maverick" energy forecaster. In the fall of 1980, when prices were rising, one forecaster predicted \$100-a-barrel oil before 1985. Now that they are falling, he is predicting \$15-a-barrel oil before 1985.

Throughout history, it seems, oil forecasters have suffered similar shortsightedness. They have bounced back and forth between predictions of impending glut and impending shortage, and in almost every instance their forecasts have been wrong one way or another. So if history is any guide, it should teach one important lesson about forecasting: "The only way to be sure where the market is headed is to go in just the opposite direction," says James Tanner, the editor of Petroleum Information International, a weekly energy publication.

The first gloom-and-doom forecaster was David White, onetime chief geologist of the U.S. Geological Survey. During World War I—a time when consumption was rising, domestic production was leveling off, reserves were dwindling and doubts were developing over future oil supplies from Mexico (then the U.S.'s biggest supplier)—Mr. White predicted that the peak of U.S. oil production would soon be reached. Even more alarming was his dire prediction in 1918 that the U.S. had only 6.7 billion barrels of recoverable oil left in the ground.

But the arrival of peace and oil gushers in Oklahoma and East Texas ended the crisis and created the nation's first "glut." By 1930, the U.S. had produced another 6.7 billion barrels of oil and the consensus among forecasters was that the surplus was here to stay.

World War II resurrected the prediction that "oil is in short supply." But as the war waned and new supplies were tapped in the U.S. and the Middle East, forecasters found it fashionable to talk about "a long era of cheap energy" and began issuing "plentiful supply" forecasts again. The Arab oil embargo of 1973-74 abruptly ended the euphoria.

One famous forecast was the Central Intelligence Agency's 1977 prediction that oil output in the Soviet Union, the world's largest producer, would soon peak, then decline sharply and turn the Soviet into a huge net importer by 1985. The prediction sparked world-wide anxiety that the Russians would be forced to march into the Middle East and thereby send oil prices soaring.

Prediction Revised

Walter McDonald, a private energy consultant who was then the head of the CIA research team, says that the agency later revised its forecast, but not because the original one was wrong. Thanks to the original forecast, he argues, "the Soviets invested an incredible amount of money to find new supplies," thereby averting the anticipated crisis. Several consumer groups, however, charged the CIA with deliberate deception aimed at drumming up support for President Carter's energy program.

Whatever the case, the forecasting profession will probably never be the same. The CIA forecast "ended the era of fabulous forecasts and made those who practice the profession somewhat cautious," says Mr. O'Brien of the Department of Energy. Mr. McDonald puts it more bluntly: "Forecasters are scared to death to make specific forecasts anymore."

So they hedge a lot. For example, Sherman Clark, a forecaster in Brookfield Center, Conn., who has been "burned badly" by making specific projections on oil prices, now makes three "different-case forecasts" and assigns probabilities to each one. His current five-year price forecast ranges from \$15 to \$150 a barrel and "the probability that the price could be anywhere in that range is about equal," he says.

Companies Hedge

Oil companies are also hedging their bets much more these days. Standard Oil of California's chief economist, William Hermann, says, "In the past we gave our best guess. Now we plot different price paths and explain what we think will happen within those paths." This change is understandable when you consider the difference between the company's 1978 and 1982 forecasts for world energy consumption in the year 2000. The latest one is lower by the equivalent of 137 billion barrels of oil, or about five-sixths of Saudi Arabia's total proven oil reserves.

Exxon Corp. also has looked bad at times. An Exxon forecast released in December 1979 assumed that oil prices, then about $18 a barrel, would rise to $25 a barrel in 1985. But only a month after the report came out, oil was already selling at $26 a barrel. "We looked pretty stupid on that one," an Exxon man says.

Some forecasters are considering issuing new forecasts more often. "Rather than sticking with one forecast and trying to justify it, I think it would make a lot more sense if every six months or so, one would make a new forecast as conditions change," says Mr. Lichtblau of the Petroleum Industry Research Foundation. Meanwhile, at various speaking engagements, Mr. Lichtblau has started citing government energy forecasts instead of his own. "This way if the forecast is wrong, people can blame them, not me," he says. "I don't want to stick my neck out."

Like Mr. Lichtblau, "most prominent forecasters are afraid to strike out on their own these days" with a truly original forecast, says Mr. McNees, the Federal Reserve Bank economist, who has studied their recent predictions. Faced with so much uncertainty, "they've clustered together like a herd of sheep," he says, making it hard to distinguish one forecast from another.

There are differences, however. Before a group of oilmen in Denver recently, Fred Singer, an energy forecaster who contends that the glut is price-induced and that prices could fall to $25 a barrel next year, debated Ragaei El Mallakh, an energy forecaster who says that the glut is recession-induced and that oil prices could begin climbing again once the recession subsides.

Although neither forecaster clearly dominated the debate ("I don't think either one of them has the faintest idea what's going to happen," says Glenn Anderson, a Denver oilman), Mr. El Mallakh admits that Mr. Singer's prediction gets a lot more attention than his. "He tells the public what they want to hear, namely, 'We can live without the foreigners,'" says Mr. El Mallakh, who is an Egyptian. "But I can't get my message across because people don't want to hear anything about oil shortages anymore."

Mr. Singer's predictions, in fact, frequently appear in guest columns on The Wall Street Journal's editorial page. But Mr. El Mallakh says, "I've submitted guest editorials to major publications (including this one) and I'm always turned down."

Because of this what-expert-gets-heard factor, some forecasters argue that expectations of gluts or shortages are more "media events" than reality. "At any point in time," says Mr. Safer, the self-styled maverick forecaster, "there are people predicting scarcity and people predicting gluts and, ultimately, the press decides who are the experts. Even The Wall Street Journal is guilty of it."

The Journal certainly quotes "experts" a lot, and these "experts" have sometimes been dead wrong. Two years ago, for example, coal analyst John Kawa was quoted in a Journal article as saying that "we're headed for a shortage of coal in the East" and that by 1983 prices could almost quadruple. Today, with coal demand and prices in the doldrums, Mr. Kawa freely admits that he has been "consistently wrong" in making energy forecasts. But that doesn't seem to bother him much.

As a securities analyst, "you make or break yourself on earnings projections," he says. "Energy forecasts are just a sidelight."

FROM:	TO:	ER NO.
NSC	EXSEC	82-4961
		DATE 3 MAY 82
	L-118 & NSSD 9-82	CLASS. CONF.

SUB:

MINUTES OF THE OVERVIEW GROUP MEETING APRIL 29, 1982 RE: NSSD 9-82, the next OVERVIEW MEETING WILL BE HELD ON 7 MAY 82.

6 MAY SUSPENSE

4MAY 82; ORUG TO ES.
4MAY82: CYS TO CHM/NIC,DDI,AND ER FILE FM ES. & OGI

1

SUSPENSE DATE : 6 May

ACTION OFFICE(S) : NIC

FIRST REMINDER SENT :

SUSPENSE DATE EXTENDED TO:

SECOND REMINDER SENT :

DATE OFFICE CALLED & CURRENT STATUS :

DATE COMPLETED :

25X1

ER: Action transferred to DDI. [redacted] will attend mtg. Action complete. 5/7

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