SYNTHETIC PROGRESS
The Fifth Annual Report of the Energy Security Corporation, July 15, 1984

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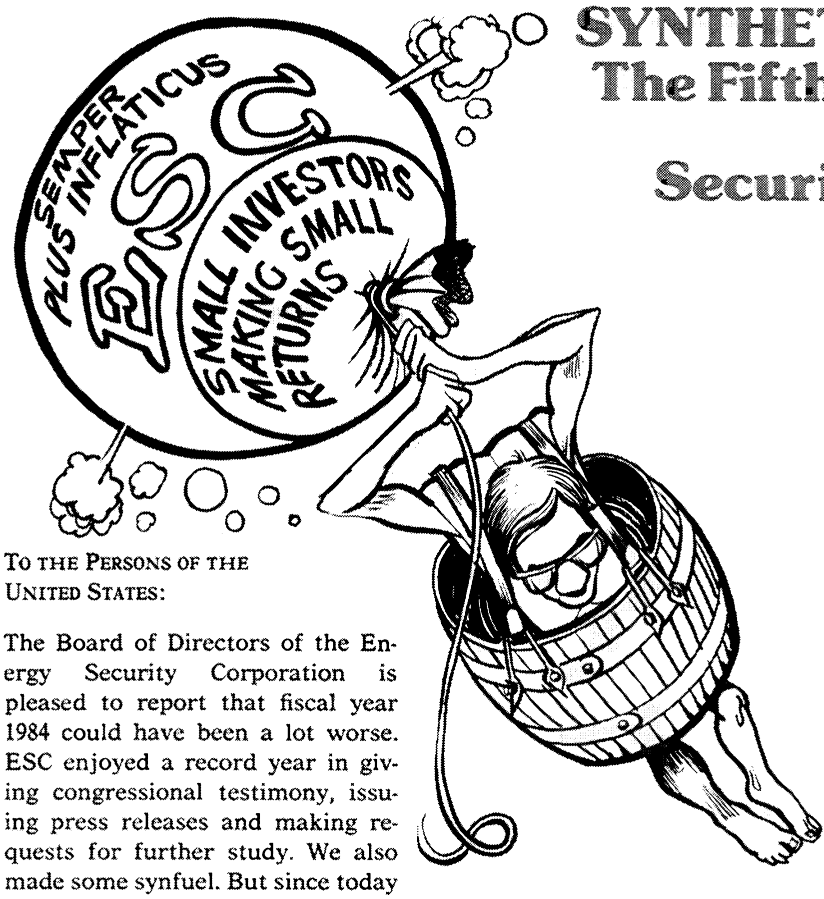

TO THE PERSONS OF THE UNITED STATES:

The Board of Directors of the Energy Security Corporation is pleased to report that fiscal year 1984 could have been a lot worse. ESC enjoyed a record year in giving congressional testimony, issuing press releases and making requests for further study. We also made some synfuel. But since today is your company's fifth anniversary, it seems appropriate to reflect on the hurdles we have surmounted. This will remind us how the philosophy of a common people's oil company—small investors making small returns—came to be.

ESC was conceived five years ago by President Carter. On that day, he declared it intolerable to pay $20 a barrel for oil. Then, unable to find oil for less, he boldly opted for second best. Synfuel could be made for $40 a barrel, which is different from $20. "If we can't pay less," said Carter, "we'll have to pay more." Thus was coined your company's motto, *Semper Plus Inflaticus*.

As you remember, most ESC capital was to have come from taxes on the profits that oil companies made by selling "old" oil as "new" oil—erroneously called a "windfall" tax. But ESC soon came to grips with a heady threat—"old" oil would someday be used up, and thus would end your company's liquidity. So in 1981, laws were passed to impose a true "windfall" tax directly on the oil companies' profits.

Complications, professors of economics were pleased to discover, were unavoidable. ESC quickly realized that funding could be guaranteed—and precious synfuel made—only if oil companies made baronial profits. Otherwise, there would be nothing to tax. The way to ensure this was, of course, to force oil companies to raise their prices.

You may recall that some controversy surrounded passage of the ESC-sponsored Energy Blackmail Act of 1982. Initially consumers were upset when ESC Price Police arrived at gas stations in their baking-soda-powered squad cars, busting discounters and posting weekly price increases as required by the act. They were further dismayed as mass transit subsidies were ended and assembly lines for fuel-efficient cars were closed down. (This fine-tuning of regulatory policy was necessary to keep gas demand high.) But, in time, the public understood that—since windfall profits financed ESC—common people had a vested interest in high prices. "Gas price extortion is good for everybody!" became one of the nice things you could say about America. The great economic experiment continued.

As you, the people, are well aware, ESC also raises capital by selling bonds in the small denominations that interest small investors. Common people drawn into energy investments for the first time were surprised to discover that pieces of other firms were available in small denominations as well. Gulf Oil's common stock was selling at $32, for instance, and Texaco's at $29. Management confesses that, at first, this revelation gave us pause. But transactions in the stock of oil companies proved hopelessly confusing to small investors. They might buy a share at $29 and soon discover it had gone up to $60—no longer the desired small denomination! Investing in ESC poses no such problem.

Small denomination bonds have proved vital to your company because, we soon found out, no one

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was interested in large paper. After extensive polling, ESC market analysts discovered that poor people fail to buy $1,000 bonds, not because the denomination is inconvenient, but because they lack money. Wealthy people, on the other hand, were found to have the money. They, however, believe that better rates than the ESC bonds' taxable 5 percent (so successful with U.S. savings bonds) are available. ESC assures you that, if all corporations were run by the government, this inequity would quickly be corrected.

With this background in mind, management is pleased to transmit a summary of operating results for fiscal year 1984. ESC had revenues of $16.1 billion. Of this, $7.3 billion came from the sale of 500,000 barrels of synfuel and $8.8 billion from windfall profits taxes. Revenues were a hefty 83 percent higher than 1983 revenues of $8.8 billion. The reason is that, for the first time, ESC actually sold some synfuel.

Expenses were $16.1 billion. The chief outlay was $7.3 billion for the purchase of synfuel. Another $7 billion was invested in new projects, while $1.8 billion went to administration, press releases, and fighting lawsuits against other government agencies.

This left net income of zilch. Under some accounting schemes, not all of the $7 billion invested would have been considered expense. Instead, an amount to be "depreciated" each year would have been arrived at by dividing the total by some number of years—say, twenty. ESC would then have shown a "paper"—or windfall—profit. But the Internal Revenue Service advised us that all synfuel investments must be depreciated through the little-used "straight down" method. Since IRS considers the return potential of synfuel to be zero, each dollar is fully depreciated the instant it is committed.

Careful students of economics may note that figures for synfuel sales and purchases were, in a manner of speaking, identical. This is because ESC itself bought all the fuel it produced in 1984. Management admits this to be a setback. Built into the country's energy-wasteful system are insidious prejudices against the sale of a $40 substitute for a $20 commodity. This anomaly should soon correct itself. Perhaps we will be favored by some positive turn of events, like another oil embargo or a series of supertanker disasters. Until then, ESC is confident that it, itself, represents an unlimited market for its own product.

Many synfuel projects, like coal gasification or alcohol distillation, actually consume more energy than they produce. It can plainly be seen that the more synfuel ESC makes, the more it must buy: it will never be possible for ESC to keep pace with its own demands. Truly, no company restrained by conventional economics could offer its investors such a secure market.

In the event, however, that surplus synfuel should become available, ESC has important plans. As announced last month, it has made a tender offer to acquire the Strategic Petroleum Reserve, the government program to store oil in salt domes against the prospect of shortages. Merger with SPR would be a somewhat complicated transaction involving treasury notes, bonds, stocks, and indebentured servants; ESC has retained the entire faculty of the Wharton School of Business as placement counsel in this affair. If the deal goes through, it would achieve for your company the ideal vertical integration—taking fuel out of the ground and immediately putting it back in.

In other matters, ESC is pleased to announce a technological breakthrough. A drawback to making synfuel from coal or oil shale is that the process requires oceans of water. Yet shale reserves are located in arid states where water is already scarce. Thus scientists were delighted to discover that the atmospheric "greenhouse effect," caused by burning coal, is melting the polar ice caps. Management need not detail the beneficial effects this will have on fresh water supplies. And this abundant new water source will be enjoyed in coastal towns the world over.

Far from being discouraged by near-term realism, ESC has set ambitious goals for 1985. We will invest $10 billion in new synfuel projects. Left to its own devices, this money would be lost in a dizzying series of "multiplications." Half would go to buy oil at $20, enter OPEC pockets, then come back to the United States as investments in shoe factories or other goods. Soon it would be reinvested in something else; and on and on, with bewildering ramifications. The other half—money unspent if $20 oil were bought instead of $40 synfuel—*would never be used for energy purchases at all.* Consumers might spend it on outdoor carpeting, stereo headphones, or even food.

One can easily see how this aimless scattering of funds throughout society does little to create a sense of energy crisis. Quite otherwise with ESC projects, however. They send jobs and factories—real resources—deep into the desert where they can be watched. And from where they are unlikely to escape.

In sum, 1984 has been a year for your company. But ESC's true contributions lie beyond its synthetic progress. By selling 5 percent bonds to average Americans once content to enjoy their hard-earned money, we have taught them a valuable lesson. More important still, we have jacked up gas prices to create windfall profits; which finance ESC; which pays the bond interest for the little people who pay the high prices. This proves that social progress and profiteering *can* go hand-in-hand.

But most important of all, this arrangement—by seeing to it that every American, rich or poor, is ripping off every other American—has restored confidence in our system. That would have made President Carter proud.

Alfredo D. Darke,
Chairman of the Board