Joint Economic Committee
Senator Charles E. Schumer, Chairman
Representative Carolyn B. Maloney, Vice Chair

SHOULD WE BEGIN TO EXAMINE THE RASH OF OIL COMPANY MERGERS IN THE LAST 20 YEARS? CONSOLIDATION RAISES SERIOUS ECONOMIC, CONSUMER, AND ENERGY SECURITY QUESTIONS

Has U.S. Policy on Oil Company Mergers Hurt Refining Capacity, Alternative Energy Development and Raised Gas Prices for Consumers?

Congressional Joint Economic Cmte Begins Overdue Debate on Consolidation in U.S. Oil Industry and its Impact on Consumers and Energy Security

Senator Charles E. Schumer

Joint Economic Committee Hearing: Opening Statement

May 23, 2007

Thank you all for coming to today's critical hearing on the state of competition in the market for U.S. petroleum. We have a lot of business to cover today, so I am going to ask that Ranking Member Saxton and Vice Chairman Maloney offer their opening statements, and our fellow Members to please submit their opening statements for the record so we can get right to it.

After a wave of mergers in the industry over the past two decades, we have an elite group of five very large, integrated oil companies dominating our domestic petroleum market, and there has been very little analysis on the impact of those mergers.

The looming question hanging over us that we will strive to answer today is whether the lack of competition in this market is harming consumers: Should we begin a serious exploration of whether or not to undo some of these mergers?

To answer this question, we need to explore three areas—price-manipulation, refining capacity, and barriers to entry for renewable energy alternatives:

1. PRICES: Are oil companies exploiting their market control prices? If this market is, as some say it is, an oligopoly, then the oil companies don't have to meet behind closed doors to set the price of oil—one company can take the lead, and the rest can all wink at each

other. Economists call this “price leadership,” and the more concentrated the oligopoly, the more market power they have to set prices above competitive levels.

2. REFINING CAPACITY: Are oil companies strategically under-investing in refinery capacity and maintenance in order to constrict supply, drive up prices and maximize profits?

3. BARRIERS FOR RENEWABLES: And third, are oil companies using their market power to block the availability of alternative energy choices, such as E85, at the pump?

The goal of this hearing is to examine in depth whether the oil industry’s market structure is to blame for the sky-high gas prices, lack of adequate refining capacity, and lack of alternative fuels at the pump that are harming consumers today.

And frankly I can’t imagine a more appropriate time to have this hearing –the national average gasoline price reached $3.22 a gallon last week—the highest level on record.

We are here today because the American people suspect that the high prices they are paying at the pump go straight to oil companies’ profits. They’re concerned that these profits are not going towards renewable energy alternatives or curbing the cost of gasoline at the pump.

We are here today because, in the words of Teddy Roosevelt, “We demand that big business give people a square deal.” A square deal means passing along efficiencies achieved through mergers to consumers, investing in new production and refinery capacity, and ensuring reliability of supply so that gas prices don’t shoot up by over $1 a gallon in a matter of months. Today, American families are getting a raw deal, while oil companies make out like the robber barons of Roosevelt’s time.

And finally, we are here today because competition in the petroleum industry is critically important to the health of the economy of this nation—an economy that has been dragging its feet in recent months. And the federal government has an important role to play in ensuring that this market is competitive.

Scanning the landscape of the U.S. petroleum market, it isn’t clear that we have anything that can remotely be called competition:

Since the late 1990’s—mergers between the giant oil companies, like Exxon and Mobil in 1999, Chevron and Texaco in 2001 and Conoco and Phillips in 2002—have left us with only 5 major domestic oil companies controlling the majority of our domestic refining capacity.

In 1993, the largest five oil refiners controlled one-third of the U.S. market, while the largest 10 had 56 percent. By 2005, the largest five controlled 55 percent of the market, and the largest 10 refiners dominate the market with over 80 percent market share.
Despite ever-increasing petroleum prices, our major oil companies don’t feel they need to compete to create new domestic gasoline supply. All things being equal, high gas prices should be an incentive for increased refining capacity. But we haven’t had a new refinery built in 30 years, forcing refineries to operate longer and harder, and at capacity levels that are overtaxing the system.

The oil companies tell us that instead of building new refineries, they are focused on upgrading existing refineries to keep up with increasing demand. Yet it isn't clear how much they are really investing in their existing refining plants when "unexpected" refinery accidents and unplanned maintenance closings have become a regular occurrence, choking off supply and causing steep price surges at the pump in recent months.

The rust and neglect has crept into the pipelines as well. Just yesterday, BP announced that it would shut down 100,000 barrels a day in capacity "for a few days" because of a pipeline leak. Just the latest in a series of missteps for BP in their production and distribution systems.

Meanwhile, even as oil prices are dropping, gas prices are going through the roof! Right now, crude oil prices are lower than they were last year at the onset of the summer driving season. But gas prices this morning, at $3.21 a gallon, are 34 cents higher than they were a year ago. The Department of Energy is predicting that crude oil prices will average about $66 a barrel this summer, versus $70 a barrel last summer. But the agency is predicting that gasoline will average about $2.95 a gallon this summer, up from an average of $2.84 last summer.

As a result, with capacity as tight as it is, and the spread between oil and gas prices widening, refining profit margins are at historical highs – ConocoPhillips, the largest U.S. oil refiner, posted its biggest quarterly profit since its merger in 2002. ExxonMobil, the second-largest U.S. refiner, just reported its highest first-quarter refining earnings in 13 years, and Valero, #3, nearly tripled its profits during the first quarter of this year.

I don't understand how an industry that makes tens of billions per year can still have rusty refining plants that constantly break down. I don't know of any other business where the ratio of profits to infrastructure breakdowns is as high. And I don't know any other industry where an equipment break down in one company benefits every other company by raising prices.

On the surface, it seems that Big Oil is pumping cash rather than petrol, strengthening profits rather than fixing rusty pipes, and they're using their dominant market positions to buy back their own stock rather than meet the growing demand for fuel in this country.

Here's just one example. ExxonMobil—the world's most profitable company—dolled out $29 billion (or 60% of its cash flow)—on stock buybacks last year alone. This was more than any other company in the S&P 500. And this was $9 billion much more than Exxon invested back into its business. Meanwhile, according to news reports, Exxon's overall production as "barely budged" since its 1999 merger.

ExxonMobil is not alone. Overall, the oil industry spent $52.4 billion on buybacks last year, nearly double the amount in 2005. And like ExxonMobil, production levels at the rest of the Big 5 have been flat.

If there was more competition in this market, wouldn't these companies be investing in new production rather than sending their oligopolistic profits back to shareholders? Wouldn't they have the incentive to take more risks in and innovate to get ahead on the renewable energy curve?

This is a long overdue debate, and my instinct tells me that a reconsideration of oil company mergers in the last two decades may be in order.

When markets have been distorted from lack of competition in the past, the federal government has taken action. Standard Oil, U.S. Steel, and AT&T come to mind.

It's no coincidence that I again quote Teddy Roosevelt, a great New Yorker, who had a lot to do with restoring competition in markets that had been lost, once said "Rhetoric is a poor substitute for action, and we have trusted only to rhetoric. If we are really to be a great nation, we must not merely talk; we must act big."

It's time to consider acting big.

We're looking forward to learning from our witnesses today more about what is going on in the market so we can best figure out how to proceed from here. I will first introduce our witnesses before we proceed to my colleagues opening statements.

On our first panel we welcome:

Mr. Thomas McCool from the Government Accountability Office, who is the Director of their Center for Economics in the Applied Research and Methods Group. He has been at GAO for 20 years.

Dr. Michael Salinger is the Director of the Federal Trade Commission's Bureau of Economics. He previously taught at the business schools at Columbia and MIT, and is currently on leave from Boston University.

On our second panel we today we will have:

Dr. Diana Moss who is the Vice President of the American Antitrust Institute. She is an economist, and has expertise in antitrust issues across a wide range of industries, including: electricity, oil and gas, appliances, and agricultural biotechnology.

Mr. Dennis DeCota, who is the Executive Director of the California Service Station and Automotive Repair Association. In addition, Mr. DeCota is himself a service-station owner.

Ms. Samantha Slater is the Director of Congressional and Regulatory Affairs at the Renewable Fuels Association.

Dr. James Smith is the Chair of Oil and Gas Management at Southern Methodist University in Dallas, Texas, and specializes in both economics and energy. Dr. Smith is an expert energy economics and policy.

Now let's get down to business.