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REPORT ON CRUDE OIL AND GASOLINE PRICE INCREASES OF NOVEMBER 1970: A BACKGROUND STUDY

A BACKGROUND STUDY

PREPARED FOR THE USE OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NOVEMBER 3, 1971

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LETTERS OF TRANSMITTAL

NOVEMBER 3, 1971.

To the Members of the Joint Economic Committee:

Transmitted herewith for the use of the members of the Joint Economic Committee and other Members of Congress is a background study entitled "Report on Crude Oil and Gasoline Price Increases of November 1970: A Background Study."

The analysis was prepared for the members of the Joint Economic Committee as background material for our forthcoming hearings on oil prices and supplies. The views expressed in the study do not necessarily represent the views of the members of the committee or of persons on the committee staff.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Joint Economic Committee.

NOVEMBER 2, 1971.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
Congress of the United States, Washington, D.C.

DEAR MR. CHAIRMAN: Transmitted herewith is a study prepared by Martin Lobel entitled "Report on Crude Oil and Gasoline Price Increases of November 1970: A Background Study." It is intended to serve as background information in connection with the committee's planned hearings on price and supply factors in respect to petroleum commodities. This study analyzes the report to the President by the Director of the Office of Emergency Preparedness of April 1971 which was submitted pursuant to the requirements of section 232 of the Trade Expansion Act of 1962 and section 6(a) of Presidential Proclamation 3279. For the convenience of the members, the report of the Director of the Office of Emergency Preparedness is reprinted in this volume as an appendix to the staff analysis.

Sincerely,

JOHN R. STARK,
Executive Director, Joint Economic Committee.

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REPORT ON CRUDE OIL AND GASOLINE PRICE INCREASES OF NOVEMBER 1970: A BACKGROUND STUDY

The report to President Nixon by the Director of the Office of Emergency Preparedness, General George A. Lincoln, entitled "Report on Crude Oil and Gasoline Price Increases of November 1970," fails to meet the fundamental requirements of section 232 of the Trade Expansion Act of 1962 and section 6(a) of Presidential Proclamation 3279 implementing it which states:

> The Director of Emergency Planning shall maintain a constant surveillance of imports of petroleum * * * in respect of the national security and, after consultation with the Secretaries of State, Defense, Treasury, the Interior, Commerce, and Labor, he shall inform the President of any circumstances which, in the Director's opinion, might indicate the need for further Presidential action under Section 2 of the Act of July 1, 1954, as amended. In the event prices of crude oil or its imports or derivatives should be increased * * * such surveillance shall include a determination as to whether such increase or increases are necessary to accomplish the national security objectives of the Act of July 1, 1954, as amended, and of this Proclamation.

Under this provision, the Director of the Office of Emergency Preparedness (OEP) must continually survey prices and, if oil prices increase, must:

(1) Determine whether the price increase is necessary for the national security as defined in section 232 of the Trade Expansion Act of 1962; and

(2) Must inform the President of any circumstances which in his opinion indicate the need for further Presidential action.

Coverage Deficient

The coverage of the OEP report is deficient in three regards: (1) Products covered, (2) time span covered, and (3) national security justification.

This *Report* only covers gasoline and crude oil, although the surveillance responsibility of the Director of the OEP under the statute and the proclamation embraces all oil products and derivatives. Had he exercised his responsibility, the Director would have discovered that, almost without exception, petroleum prices had increased. Even President Nixon's address of December 4, 1970, which referred to oil prices included jet fuel as well as crude oil and gasoline.

Secondly, because the surveillance responsibility is a continuing one, the Director should have instituted an investigation in early 1969 when the price of both crude oil and gasoline increased, rather than

limiting the investigation to crude oil and gasoline price increases after November 11, 1970. Between early 1969 and November 1970 there were increases in the price of almost all petroleum products. Thus, having neglected, in the first place, to make the necessary inquiry, OEP failed to take these price increases into account in its *Report.*

The third substantial shortcoming of the investigation is that it fails to relate its findings to the statutory basis for import controls as required by section 6(a) of the proclamation. Specifically, section 232 of the Trade Expansion Act of 1962 requires a determination that imports would threaten to endanger the national security, if there had not been a price increase.

National Security

Under the circumstances, the Director was required to certify whether the oil price increase was necessary to keep imports from increasing to such an extent that they threatened to endanger the national security. Section 232 of the Trade Expansion Act of 1962 requires an absolute finding to justify import controls. A finding that imports might possibly so increase is no basis for imposing import controls. This is why no other commodities have been subjected to import controls on the basis of national security. But this question was not considered.

Finding 4 of the *Report* states:

> No evidence has been offered to establish that the November price increases will lead to the maintenance of spare capacity for the production of crude oil or the maintenance of refinery capacity in the United States adequate to meet both defense and essential civilian needs in periods of disruption in normal patterns of world oil trade. *Consequently, these national security objectives have not entered into this analysis.* [Emphasis added.]

Despite the lack of national security analysis the *Report* invites additional price increases in its last finding:

> In the long run future crude oil price increases may be necessary if fuel supplies are to be developed consistent with our national security requirements. A series of governmental measures to achieve our national security objectives should be accelerated promptly in order to *minimize reliance on future price increases.* [Emphasis added.]

So, even though the Director did not consider it necessary to examine the national security grounds for the recent price increases, the *Report* states that future price increases will be necessary to secure the undefined national security. The possibility that governmental measures might prevent prices from increasing or that lower prices might be consistent with national security was never considered. While the *Report* makes repeated use of the *Cabinet Committee Task Force Report* of 1970, it does not mention the finding in that study that national security objectives could be met at prices below those of 1969—a basic finding of that committee on which the Director of OEP served and to which he did not take exception.

The national security justification for the price increases to which the *Report* addresses itself has not been demonstrated. The same would hold true if the increases of kerosene and distillate fuels had been evaluated. Under these conditions, OEP should have followed section 6(a) and informed the President of the circumstances which indicate the need for further Presidential action under section 232 of the Trade Expansion Act of 1962. As Chairman of the Oil Policy Committee, General Lincoln could have submitted specific recommendations to reduce oil prices. This point is discussed in greater detail below.

The failure of the OEP to examine the national security justifications for the past price increases and to translate them into a probable explanation for the recent price increase and a potential explanation for future price increases parallels its admission in the *Report* that OEP has no standards for measuring the relationship between oil imports and national security.

The *Report* (p. 10) lists "four clearly identifiable national security objectives of the Mandatory Oil Import Program * * *":

> (1) A satisfactory level of domestic reserves of crude oil, supplemented from secure foreign sources of supply;
>
> (2) Maintaining spare capacity to produce and deliver crude oil when international factors disrupt supplies from other sources;
>
> (3) Maintain refinery capacity in the United States adequate to meet both defense and essential civilian needs, in periods of disruption in normal patterns of world oil movement; and
>
> (4) Provide a healthy petroleum industry in the United States with a capacity to meet the nation's national security requirements.

These are not criteria. The *Report* fails to define—

"Satisfactory" domestic crude oil reserves;
Adequate productive or refinery capacity;
The Nation's security requirements; and
National security contingencies.

The last of the four listed national security objectives is the provision of a "healthy petroleum industry" to meet the Nation's security requirements. But, what is a "healthy petroleum industry"? A "healthy" industry is not likely to be one with a large measure of spare capacity. Although the *Report* recognizes elsewhere that other measures not related to the "health of the petroleum industry" may be required to meet national security objectives (p. 10 of the *Report*), it cannot evaluate them since apparently the OEP cannot specify the national security objectives secured by import controls.

The generalizations the OEP supplied are not sufficient criteria to adequately evaluate the effect of price increases and other changes in the oil environment. This is particularly true in evaluating programs, other than import controls, designed to protect our national security. Consequently, the failure to formulate testable criteria will impair the development of intelligent policies throughout the oil and energy area.

But its failure to develop adequate criteria has broader implications. It means that the United States does not know what goals to seek in fuel and energy negotiations with Canada, Venezuela, or within the Western Hemisphere as a whole.

Reserves

The *Report* does not establish criteria for determining how much oil is needed for national security—except "the more the better." Beyond this failure to quantify, is the inherent technical shortcoming of including only proven reserves and no other physical factors. The *Report* states (p. 25) :

> The trend in improved crude oil reserves is basic to considering the national security implications of these price increases. In terms of assured future supplies and financial net worth, the oil industry relies only on proved reserves in which enough drilling and testing have been done to define a measure of recoverable resources from each reservoir.

Obviously, crude reserves are a factor in the analysis of national security. Productive capacity and deliverability determine what can be realized from crude oil resources. But, that capability needs to be balanced against the expected *duration* of the emergency contingency to determine our national security needs with due regard to rationing. A cutoff of imports for 3 months is one matter, a cutoff for 1 year would be quite different.

Is OEP thinking of a World War II situation of 3 years duration? Or Arab oil denial of production for 6 months or 1 year? The Cabinet Committee Task Force estimated the effects of such cutoffs.

The relationship between proven reserves and productive capability has been undergoing a major change during the past 20 years as productive capacity has increased more rapidly than reserves. This change means that the industry has not had to spend as much as before in order to increase productive capacity. Had this change not been accomplished, the domestic cost of crude oil would have been far higher than it is. If proven reserves and productive capacity had increased proportionally with demand there would now be a very high level of unused capacity which would be considered "unhealthy." The *Report* observes but does not take account of the fact that proven reserves have not followed the pattern of expenditures for exploration and development. Had it done so, it would have gone beyond the consideration of proven reserves as a national security index.

An incidental reason cited in the *Report* for the concern about proven reserves is the statement that the oil industry relies only on proven reserves in terms of assured future supplies and financial net worth. Even if this were so, it is not necessarily relevant to our national security—unless, of course, one assumes what is good for the oil industry is good for the Nation. In any event, proven reserves are not recorded in the determination of corporate net worth. Perhaps, the Securities and Exchange Commission should require public filing of data detailing proven reserves. Then, we could intelligently analyze the data in *Report* annexes M, N, and O. As it is, the *Report* gives the impression that changes in reserves are reflected in company net worth.

They are not. Consequently, the income performance for oil companies is not directly comparable with manufacturing firms.

Yet the *Report* deviates from adherence to the proven reserves index when considering the results for 1970—it excludes the considerable proven reserves of North Slope Alaska because these will not be available until 1974 or 1975. The impact of the additional 9.6 billion barrels of North Slope proven reserves in the context of 29.6 billion barrels of reserves in the rest of the U.S., however, destroys whatever significance most of the old indicators had, even as rough first approximations. Although OEP is concerned on national security grounds that proven reserves at the end of 1966 to the end of 1970 (North Slope excluded) dropped from 31.5 billion barrels to 29.4 billion barrels (in the area also excluding California the reduction was from 26.8 to 25.4 billion barrels), it discounts entirely the addition of 9.6 billion barrels in the North Slope credited to 1970.

However, since the OEP has concentrated exclusively on proven resources, this analysis examines the data, most of which did not appear in the *Report*.

Table I casts significant light on the history of proven oil reserves recorded by the American Petroleum Institute. (The *Report* contains the gross additions to reserves for 1960–69 in its annex J. It does not include any of the other data covered by this table.)

Column 3 of table I lists gross additions to reserves (the sum of crude oil production (col. 1) of the year plus the net change in the reserves at the end of the year (col. 2)). The figures for 1970 are noteworthy in two respects: They show the gross addition of 9.6 billion barrels for the North Slope of Alaska and almost 3.1 billion barrels for the remainder of the United States.

We added nearly 12.1 billion barrels to our reserves in 1970, by far the largest increase shown in any year in the history of the United States.

Even if the North Slope reserves are excluded, the 3.1 billion barrel addition to proven reserves is the largest of the 1960–70 period. It may well be an important and favorable reversal from the 1968–69 showings. During 1965–67 the gross additions averaged about 3 billion barrels a year. Although in 1968 and 1969, these slumped to 2.45 billion barrels in 1968 and 2.12 billion in 1969, the gain in gross additions (North Slope excluded) during 1970 was large enough to more than overcome the decreases of these 2 years and was a larger annual increase than experienced during 1960–65.

Column 2 of table I lists the net changes in proven reserves at the end of each year. Again, 1970 saw an improvement compared with the previous 2 years even when the North Slope is excluded. At the end of 1968, proven reserves were 670 million barrels lower than at the end of 1969. In 1969, the reduction was almost 1.1 billion barrels. However, in 1970, the reduction for the year was 231 million barrels with the North Slope excluded. With the 9.6 billion barrel increase in 1970, the net change during 1970 came to an increase of almost 9.4 billion barrels.

Because of the difference between California and the rest of the United States, its proven reserve situation was compared separately from the rest of the country. Column 5 of table I shows proven reserves

for the United States; column 6, California reserves; column 7, United States minus California.

The California column is important because it demonstrates the reversability of proven reserve trends. Proven reserves in California decreased from a level of 3.9 billion barrels at the end of 1953 to 3.6 billion barrels at the end of 1961. But, by the end of 1966, they reached 4.6 billion barrels although they have since declined to approximately 4 billion barrels.

During the past 3 years, California, with less than 15 percent of total proven reserves at the end of 1967, accounted for over 38 percent of the reduction of proven reserves (North Slope excluded) through the end of 1970. Furthermore, while the United States as a whole with North Slope excluded showed a yearend proven reserves reduction of 231 million barrels, the United States excluding North Slope and California (col. 7, table I) showed a slight increase.

For the United States as a whole, there has been a distinct slowing in the reduction of yearend reserves. These reductions, with North Slope excluded, were 75 million barrels for 1967; 670 million for 1968; 1.1 billion for 1969; and 231 million for 1970. For the United States minus California and the North Slope the changes in proven reserves at the end of each year were: −68 million barrels for 1968; −978 million barrels for 1969; and +39 million barrels for 1970. This means that, in addition to the increased production of 1970, the increased proven reserves for 1970 (California and North Slope excluded) were 1,017 million barrels above the 1969 results. The performance of proven reserves has been far superior to that given in the *Report*.

Column 4 of table I is of particular significance because it records proven reserves in new field discoveries as distinguished from extension and revisions of old fields or new fields discovered in old areas. New field discoveries are the source of subsequent increases of proven reserves through extension and revisions. During 1970, new field discoveries were 253 million barrels outside of the North Slope and 9.6 billion barrels in the North Slope itself for a total of almost 9.9 billion barrels. Although the North Slope new reserves are well known, few people realize that new field discoveries outside of the North Slope area during 1970 were larger than those of any year since 1954. They were, for example, almost as large as the new field discoveries for 1968 and 1969 combined. This fact is even more amazing when we consider that during 1968–70 there were no Federal offshore lease sales in new areas.

The *Report* fails to take account of the impact of the North Slope discoveries on exploration and development in the rest of the United States. Given the timelag in the discovery and development of new oil fields, a discovery of the magnitude of the North Slope is a severe depressant on oil exploration activity elsewhere. While the *Report* dismisses the North Slope findings from its national security evaluation, the petroleum industry does take it into account. Given that the largest single oil discovery in American history will come to market in a few years, an interval substantially less than that needed to discover and develop new fields, the extent of added new field discoveries outside the North Slope should be regarded as phenomenal. If the

petroleum industry had not spent a large part of its resources on the North Slope, much of those resources might have been devoted to oil activities in the lower 48 and would have resulted in even larger oil reserves than were actually discovered.

The *Report* not only disregards North Slope proven reserves, but it also minimizes their future potential significance. After noting that the inclusion of the proven reserves on the North Slope increased the American Petroleum Institute (API) reserve estimate from 29.6 billion barrels for 1969 to 39 billion barrels for 1970, the *Report* stresses that "significant action will be required promptly if the decline in reserves is to be reversed before the Alaskan oil becomes available * * *."

The *Report* does not perform the calculations which show that there was a major reversal in the reserve picture for 1970. Instead, it relates (p. 27) that U.S. refineries refine at about 4 billion barrels of oil a year and that about 20 billion barrels would be required in the 4 or 5 years before the North Slope crude is deliverable. This 20 billion barrel figure is then cast in relation to the 31 billion barrels of reserves which had been proven in Texas to date, thereby suggesting that the U.S. requirements for the next 4 or 5 years are of such a scale that they require extraordinary efforts. In the first place, refineries are not using 4 billion barrels of domestic crude a year. Column 1 of table I shows crude oil production in the United States during 1970 was 3.3 billion barrels or 15 percent lower than the cited number. As far as the relationship between the production and U.S. reserves is concerned although output of crude oil in the years 1964 through 1970 (col. 1, table I) aggregated about 20.9 billion barrels, U.S. reserves (North Slope excluded) decreased less than 600 million barrels from about 31 billion barrels to 29.4 billion barrels. This was accomplished without a discovery on the scale of Texas or Louisiana, notwithstanding the suggestion contained in the *Report* that substantial finds would have to be made in order to realize such production.

Expenditures

Expenditures on leasing, exploration, and development is another area which the *Report* examines. Annex J of the *Report* combines gross additions of reserves from the API and expenditures as reported by the Independent Petroleum Association of America (IPAA). Although the latter figures are similar to those reported in the Joint Association Survey which is sponsored by the API, the IPAA and the Mid-Continental Oil and Gas Association, they differ and need to be reconciled. The *Report* ignores the fact that the expenditure figures cover both oil and gas. An examination of the drilling cost data published by the Joint Association Survey indicates that over 35 percent of the $2.6 million spent on drilling in 1969 went to gas wells. The Joint Association Survey separated the expenditures on successful oil and gas wells. Although no such split is made for dry holes, it is fair to assume that dry hole costs for oil and gas wells were in the same proportion as for successful wells. This ratio has varied over time. Table II shows that the cost of gas wells went from 41.2 percent of total costs of oil and gas in 1963 to 31 percent in 1968 and then increased to 35.2 percent of the

combined total in 1969. Furthermore, between 1968 and 1969 this calculation shows that expenditures on gas wells increased $169 million, from $750 million to $919 million while the outlay on oil wells increased only $33 million from $1,659 million to $1,692 million. Again, the *Report* ignores that expenditures in both the crude oil and natural gas industries are combined in its figures. Tangentially, it is not clear from its discussion of natural gas that outlay on natural gas wells increased nearly 23 percent between 1968 and 1969.

The expenditures on natural gas are not limited to drilling; they also apply to leasing. For example, the Offshore Louisiana wildcat sale of December 15, 1970, was for the most part a sale of gas potential. Successful bidders in the $851 million sale included gas companies. The Department of the Interior report submitted to the Council on Environmental Quality characterized the area in question as having significant gas potential. No doubt, oil companies as well as gas companies bid with an eye to gas. Eighty percent of the fields found in related areas have been gas fields. Again, these circumstances are ignored in the *Report*.

Whatever the intrinsic value of the analysis of expenditures and results contained in the *Report*, they are of little significance because of the failure to make even a modest delineation between oil and gas. This error is compounded in the statement in the *Report* "* * * that in the December 1970 Outer Continental Shelf sale, independent producers were major participants in two of the three tracts for which the highest per acre bids were made." However, as already indicated, this was largely a gas rather than oil matter.

Parenthetically, the *Report* (p. 39) observes:

> In addition, the use of drilling funds has provided a means to raise money for expensive exploration efforts. As a tool, these funds certainly provide an avenue for participation and management by skilled independents.

OEP's endorsement of drilling funds is welcome, but it is questionable how much of the funds actually raised go for exploration. According to Resource Programs Institute, public oil and gas drilling programs raised $188 million in 1968, $411 million in 1969, and $280 million in 1970. Since, as seen in table II, the JAS estimates that all the wells drilled in 1969 cost $2.6 billion, this indicates that almost 16 percent of the funds for drilling costs were raised in this special fund market not available to most industries.

Aside from the inaccurate use of trade association data, the Government's reliance on this data further hampers analysis of the Government's own programs. The United States subsidizes the oil industry by over $7 billion a year with tax and import programs, yet is dependent on the beneficiaries of these programs for the most rudimentary data needed to analyze these subsidies.

This need goes far beyond data collection. The lack of independent government projections of oil demand during 1970–71 is a prime source of our recent difficulties. Although much of the analysis made by the *Cabinet Task Force* is accurate, its reliance on an industry concensus demand projection is a serious flaw. Having erred on the low side, industry is now attempting to provide government with stepped-up

projections. Some months ago the Chairman of the Joint Economic Committee asked the Department of the Interior to provide the totals of the fuel and energy projections which it had made during the past several years. As yet, this information has not been provided. It is to be hoped that it will be provided soon.

Beyond the important issue of whether the Federal Government should rely on trade association tabulations is the matter of the technical quality of the data. Table III summarizes some of the features of the coverage of the Joint Association Survey for 1967–69 with greater detail shown for 1969.

It is noteworthy that the JAS sample was far from symmetrical with respect to its coverage of oil, gas, and exploration of wells. For 1969, it included 45 percent of oil wells, 40 percent of gas wells and only 31 percent of dry wells. In the aggregate, it covered 38.4 percent of wells. The differentials in the coverage by various categories resulted in a particularly significant disparity in its coverage of dry wells. Companies participating in the JAS sample had dry wells equal to 34.7 percent of their drilling. Of the wells drilled by others, dry holes represented 48 percent of their total. Thus, the proportion of drilling holes for those not covered in the sample was 38 percent higher than those of the sample itself.

Another difficulty in using the JAS data is its lack of consistency of coverage from year to year. As seen in the lower half of the table, the proportion of wells that were included in the sample went from 36.2 percent in 1967 to 32.5 percent in 1968 to 38.4 percent in 1969. The number of companies participating in the JAS survey decreased from 235 in 1967 to 146 in 1968, then rose to 369 in 1969. This lack of conformity of coverage is another reason why it is essential that the Federal Government obtain its own annual statistics on the expenditures of the petroleum industry.

The OEP has the responsibility of constantly surveiling petroleum imports. Yet it has based its "studies" upon data summaries provided by the oil industry. The OEP has failed to collect the data necessary to make rudimentary cost benefit analyses of oil price increases and of the $7 billion indirect subsidy of the oil industry. If higher prices and the subsidy are justified by national security needs, the OEP should be able to evaluate how changes in prices and the subsidy will affect national security. It has not and presently cannot do this. These figures should have been collected before the support program was begun. They are needed now to determine to what extent, if at all, these programs should be continued. Too much money—considerably more than $7 billion annually—is at stake for policies to be based on unreliable and inconsistent JAS data. To fulfill the law the OEP must collect this data and carry out the suggested analyses.

Paradoxically, it is sometimes argued that the Government should refrain from obtaining detailed expenditure and reserve information because of business confidentiality. There is adequate capability in the Government to protect business confidential information. The collection of this type of information by industry groups, rather than government, has at least three disadvantages: (1) It enables the major companies to pool their information, (2) it can subject small companies to severe disadvantages if their activities become known to

others, and (3) it deprives policymakers of significant body of information for analysis in making public policy—but, then, perhaps, that is the reason the industry associations are so anxious to collect this data for the Government.

It is obvious that government must collect the data necessary to measure activity in the oil industry in order to evaluate policies.

Existing government data is not good enough as is illustrated in annexes M, N, and O of the *Report.* That material relates to the financial performance of petroleum refining and all other manufacturing corporations as reported in the FTC–SEC *Quarterly Financial Report for Manufacturing Corporations.* Given the lack of corporate reporting by separate activities within each corporation, it is extremely doubtful that the direct type of analysis for groups as a whole for 1963–70 can yield reliable comparisons. Over this period, the so-called refining companies have used this tax free cash flow to diversify into other industries. In order to obtain the financial information needed for policy evaluation, the Oil Policy Committee should request the SEC to institute detailed data collection on activity lines separating petroleum production, refining and marketing from each other and from other activities. Still, some interesting information used to obtain financing has come to light. For example, the First National City Bank of New York reported that between 1958 and 1968, 31 oil companies added over 9 million barrels per day (b/d) to production and over 7 million b/d to their refinery runs.

Prices

Over the years, oil industry officials have argued that present prices should be sufficient to pay for future increased requirements as well as present production. The higher and firmer the growth rate, the greater the justification for the price increase. Most industries are satisfied to have assured growing markets and are content to have the consumer pay as he consumes, rather than finance company growth in advance. The *Report* does not reject the concept—instead, it is concerned that the advance payments might end up in foreign investments instead of domestic exploration and development (p. 37). Still, it quotes Chase Manhattan's study of 27 oil corporations which in 1959 met 91.3 percent of their capital needs from cash flow as compared with 76.4 percent in 1969. Although the *Report* is aware of the large investments made overseas, it does not pursue the consequences. The First National City Bank compares 1958 and 1968 debt factors for different components of the petroleum industry:

> * * * The five largest international companies based in the United States have, over the last 10 years, almost doubled the long-term component in their capitalization. By contrast, five large independent producing companies in the sample have cut their long-term debt component in half. This has reduced it to 8 percent, compared with 17 percent for the internationals * * *.
>
> The four large (domestic) refining companies in the sample have, on average, cut back their proportionate dependence on debt * * * starting from 46 percent in 1958 their present

> average (is) 34 percent. * * * The 17 (domestic) integrated companies * * * debt ratio of 24 percent has shown little change over the last 10 years.

Another indication of the lack of independent analytical capability is the *Report's* treatment of costs. On page 31 it records findings by the National Petroleum Council that the producing industry realized the following cost reductions between 1950 and 1965:

> (1) Improved drilling technology, 35¢ per barrel; (2) crude oil production methods, 32¢ a barrel; (3) better corrosion control, 9¢ per barrel; and (4) optimized well spacing, between 17½¢ and 35¢ per barrel.

These reductions add up to between 93.5 cents and $1.10 a barrel. But, rather than give attention to these reductions which might negate OEP's attempt to justify higher oil prices, OEP immediately turned to the Department of the Interior to refute these findings. In the only reference to the Department of the Interior, the *Report* relates the Department's "opinion that increases in costs together with increased difficulty of finding oil have more than offset any cost savings from greater efficiencies, the Department has recognized the difficulty in providing objective data to support such a conclusion."

This National Petroleum Council report was made in 1967. Yet, despite the enormous sums spent on the Office of Oil and Gas, which reports directly to the Assistant Secretary for Mineral Resources, the Department of the Interior, the core of the proposed Natural Resources Department, responded as if the crude oil cost question is new and surprising (*Report*, p. 32):

> Many variables affect the cost of oil; the technology of oil exploration and production is only one of these. The exact interplay between rising costs, increased efficiencies, technological and operating prices, the increasing difficulties of finding oil and randomness of new discoveries is difficult to assess and quantify for any short-term period.

Finally, after dismissing the evidence of lowered costs, the *Report* (p. 43) cites an unsubstantiated study by the Petroleum Industry Research Foundation, to justify increased crude oil prices:

> This recent study estimates that, at the price level prior to the recent price increase, the 10 percent dependence on Eastern Hemisphere oil will be exceeded by 1973, the dependence will reach 16.5 percent by 1975, and 22.8 percent by 1980.
>
> This recent study further estimates an immediate need for an increase of 73¢ a barrel above 1969 prices, or about $3.80 a barrel, to limit future dependence to 10 percent.

Although this point has not been discussed in detail, it must be stressed that a review of the *Task Force* report fails to reveal the grounds on which the determination was made that national security would be endangered if more than 10 percent of our oil requirement were met from the Eastern Hemisphere, an area which includes Indonesia, Iran, and Nigeria.

Oil prices cannot be adequately analyzed by considering only one

commodity or by considering very short-term changes to the exclusion of long-term averages. The weakness of using only isolated dates without reference to averages over time is illustrated by the first two paragraphs of the *Report* concerning gasoline price increases (p. 46):

> The 1969 price increase effort began on February 25 when Texaco increased domestic crude prices by 20¢ per barrel and dealer tank wagon prices by 0.6¢ per gallon * * *. An erratic pattern of price changes continued over an extended time. By the end of 1969, the structure of the gasoline marketing system had itself essentially eliminated the sought-after gasoline price increase, even though average crude oil prices for 1969 were 12¢ per barrel higher than for 1968.
>
> The 0.7¢ per gallon dealer tank wagon price increase started by Mobile in March 1970 did not hold either, except that the increase was dissipated in a much shorter period of time.

Annex K of the *Report*, a chart prepared and submitted by Texaco, indicates that *Platt's* low tank wagon price of gasoline for 1969 after February was about equal to the high of 1968. However, the *Report* fails to list the figures supporting this chart, perhaps because the actual figures show results totally at odds with the *Report's* price findings. *Platt's Oilgram Price Service* reported a February 1, 1970, average tank wagon price of 17.2 cents a gallon. The January through July 1, 1970, prices averaged 17.72 cents per gallon and the average through October 1 price being 17.66 cents a gallon.

Annual price changes are far more accurate indicators of trends than short-term price swings. The average *Oilgram* gasoline tank wagon price increased 0.6 cent a gallon or 25.2 cents a barrel between 1968 and 1969, while the average for crude oil increased 15 cents per barrel according to figures published by the Bureau of Mines. It is not clear why annex C of the *Report* records $3.06 as the Bureau's average for 1969. The Bureau's published reports list a price of $3.09.

Although the *Report* gives the impression that the refining industry absorbed a 12 cents (actually 15 cents) a barrel increase in the cost of crude oil, the actual increase in the wholesale price of gasoline itself was nearly 70 percent *higher* than the crude oil price increase. OEP was satisfied that several observations late in the year were at levels close to that of February, but it ignored the fact that the February 1, 1969, level from which the increase started was higher than 10 of the monthly 1968 figures.

The 1970 average tank wagon price was 52 cents or 21.8 cents per barrel higher than in 1969 while the annual average price of crude oil increased 4 cents a barrel according to the IPAA, not 10 cents per barrel as reported in annex C of the *Report*.

Platt's Oilgram reported an increase of 47 cents a barrel in the tank wagon price of gasoline during 1970 as compared with 1968 while the price of crude oil increased 19 cents a barrel (according to the IPAA). At the same time, there were substantial increases in the prices of all other petroleum products. Although 1971 has had some tank wagon prices lower than those of 1970, the averages clearly demonstrate that wholesale gasoline prices have increased more than crude oil. The failure of OEP to make an adequate analysis of prices is distressing in the light of its long standing price surveillance responsibility which

originated with the oil import control program. It is doubly difficult to explain that failure since the Director of OEP is Chairman of the Oil Policy Committee, an assignment for which Congress has provided a supplementary appropriation to increase OEP's capability in oil matters.

With respect to other product prices, if gasoline prices increased while others had unchanged or reduced prices, the per barrel increase of products in relation to crude oil would be reduced. The IPAA published wholesale prices covering four products: Gasoline, kerosene, distillate fuel, and residual fuel oil. Tank wagon prices for gasoline are widely accepted as more indicative of what refiners realize than the cargo prices used in the IPAA series. Therefore, the staff combined the *Platt's Oilgram* tank wagon price increase of 47 cents per barrel for gasoline with the other prices used by the IPAA. Between 1968 and 1970, the annual average increase for these products was: 0.84 cents per barrel for kerosene, 16.38 cents a barrel for distillates and 32.34 cents per barrel for residual fuel oil. Applying the weights used by the IPAA, the composite increase of wholesale petroleum products was 36.1 cents per barrel. Even though the IPAA gives too high a weight to residual fuel oil, this is offset because the figures understate the increase in distillate fuel prices. This increase of 36.1 cents per barrel of product in 1970 should be compared with the 19 cents a barrel price increase for crude oil.

This is a clear demonstration of the deficiencies in OEP's price study. The *Report* assumes that crude oil price increases lead product prices which have a hard time catching up.

This misconception about prices moved OEP to give special attention to the extent to which a refiner had to be integrated into production to break even when the crude oil increase is not accompanied by an increase in product prices. A sufficiently integrated refiner can increase income at the expense of the Treasury when crude oil prices increase even though product prices do not. An increase of 30 cents a barrel in the price of crude with product prices unchanged increases net income after taxes for a fully integrated refiner by 3.168 cents a barrel. Crude oil price increases for an integrated refiner shift income from refining to production where the effective tax rate is lower. With a tax rate of 48 percent and depletion allowance of 22 percent, the tax saving from such a shift equals 48 percent of 22 percent or 10.56 percent. Thus, 10.56 percent of any crude oil price increase is saved in taxes.

An increase in crude oil prices without an increase in product prices reduces Federal revenue. With crude oil production of 3.3 billion barrels at 30 cents a barrel, a crude oil price increase without an increase in product price costs the U.S. Treasury over $104 million.

How integrated does a company have to be in order to be able to break even on an increase of crude oil which is not reflected in increased product prices? The degree of integration involves the relationship between the amount of crude the refiner uses and his net crude oil production (gross production less the portion going to the land owner as a royalty). The arithmetic indicates that the integration needs to be 82 percent. Such is the combined effect of the tax saving on the integrated production and the increased cost, after taxes, of its pur-

chased oil. However, realistically, one must take account of the refiner's allocations of imported crude oil. Assuming that the foreign crude oil prices do not increase as a result of increased U.S. crude oil prices and do not share in the tax saving consequences of U.S. oil, the degree of integration necessary to break even applies to the company's crude oil use minus its crude oil allocations. If it is assumed that the company's crude oil allocations (refining both overseas and overland and petrochemical) equal 10 percent of refinery crude oil use, the degree of required domestic integration becomes 73.8 percent which is 82 percent of 90 percent. The 73.8 percent rather than the 82 percent factor which the *Report* uses is the true break-even level.

The *Report* (p. 31) relates that, according to the Petroleum Industry Foundation, only "Gulf and a few other integrated companies with crude self-sufficiency of more than 82 percent * * *" were sufficiently integrated to gain from price increases even if the value of refined products was unchanged. However, public information suggests that Cities Service, Getty, Gulf, Humble, Marathon, Skelly, and Tenneco meet the 82 percent overall criterion to which the Petroleum Industry Foundation refers. Since the break-even point is really 73.8 percent, Continental, Texaco, and Union Oil should be added to the list. Standard of California can also be included when account is taken of its combined U.S.-Canadian integration. (It should be kept in mind that the Canadian crude oil price increase followed the U.S. price increase.) Finally, if 36 percent of the crude oil price increase is carried through to the products, 50 percent integration in the United States is sufficient for the refiner to break even. All major, and nearly all medium-sized, refiners would benefit.

This discussion is essentially theoretical because wholesale product prices increase far more than crude oil prices. Those who enjoy a high degree of integration gained more after taxes than those with a lesser degree of integration. This illustrates the economic incongruity of having one tax rate on refining and another on oil production.

Without formally adopting its judgment, the *Report* (p. 31) apparently accepts the estimate by the Petroleum Industry Research Foundation that the cost of the 1969 revision in the depletion allowance to producers was "around 24 cents per barrel—almost exactly the crude price increase under investigation. If this is correct, it should be recognized that the crude oil price increases did rest on the net back to the independent oil producer * * *." The *Report* does not indicate that this estimate is based on the assumption that all tax effects are transmitted to oil—none to gas, and that it includes all tax consequences attributable to changes in depreciation—effects which, if subject to shifting, would be via product rather than crude oil prices.

Paramount is the issue of tax shifting and competitiveness. The *Report* fails to take account of the 1969 crude oil price increase when it discusses the tax revision. Specifically, because the Petroleum Industry Research Foundation paper considered that the price increase in 1969 was required to put that year's results on a par with 1968, it failed to mention that the 1969 price increase in all probability "took care" of that year's revenue revision.

Finally, the *Report* ignores that the Cabinet Task Force Report estimated (p. 241) that "the change in the depletion allowance in the bill

as enacted is equivalent to less than a 10 cent change in price." The Task Force Report had the benefit of specific review and endorsement by Treasury, but it is not clear that the OEP *Report* was similarly reviewed.

Any review of recent oil price history should also examine tanker rates. When spot tanker rates rose dramatically in mid-1970 the oil lobby insisted that these increases proved that the quota system could not be replaced by a tariff and that even more restrictive controls were required. OEP used this as an answer to inquiries regarding residual fuel oil prices and as a defense for the quota only position. The *Report* states (p. 20) that spot tanker rates more than doubled in a year's time. However, according to *Platt's Oilgram* the rate for moving crude from the Persian Gulf to the United Kingdom was 92 cents a barrel on June 8, 1971; $3.14 on November 11, 1970 (when the U.S. crude oil price increased), and $1.33 on February 2, 1970 (when the Report of the Cabinet Task Force on Oil Import Controls was signed). The spot rates from the Carribean to the United States east coast were 19 cents per barrel on June 8, 1971, 81 cents on November 11, 1970, and 42 cents on February 2, 1970. These reductions have received no attention in the New York Times (unlike the rate increase). The Government no longer refers to tanker rates. And prices do not seem to have been modified by these reductions. This will be among the matters on which the Joint Economic Committee will seek explanation.

State Prorationing

Without doubt, the most unclear portion of the *Report* concerns market demand prorationing—the system under which Texas and Louisiana maintain an equilibrium between the supply and demand for oil. The *Report* relates (p. 22):

> After a preliminary analysis, the Director of OEP concluded that any systematic analysis of the relationship between increased prices and their national security need was complicated by State control over oil production from Federal offshore lands over which the U.S. has exclusive jurisdiction by law. These controls could withhold from the market a portion of domestic oil production for which the Federal Government has the overriding responsibility for national security and ultimate management responsibility. Hence, the Director concluded that the Federal Government should assume regulatory responsibility over the production from Federal offshore lands in order to assure that this Federal area would make its maximum efficient contribution to meet longer range national security objectives and any claim of short-term supply deficits. As a corollary to this action, it was concluded that the price increase pressures would be restrained by this action.

In other words, OEP determined that market demand prorationing was in conflict with national security and recommended that the Federal Government discontinue its voluntary adherence to State production restrictions in Federal offshore areas. The OEP should have recommended termination or at least suspension of all such controls.

The increased production from the Federal area is offset by reductions in the State controlled areas even though the authority ultimately depends on the Connally Hot Oil Act which ought to be suspended by the President. The same force which permits crude oil prices to increase without market justification enables the States to thwart the decision to operate the Federal area in a manner more consistent with national security. State market demand prorationing is adverse to the national security.

Two features of the OEP statement on the assertion of Federal production authority on the offshore area are rather unusual. The analysis leading to the conclusion is characterized as "preliminary" and the advice to the President is described as following the consultation required by section 6(a) of Proclamation 3279. However, neither a followup to the preliminary analysis nor a written report has ever been mentioned or made public. But, section 6(a) of Proclamation 3279 applies only to "* * * circumstances which in the Director's opinion might indicate the need for further Presidential action under Section 2 of the act of July 1, 1954, as amended." The decision to discontinue voluntary adherence to State controls was not such an action. Nevertheless, since section 6(a) of the Proclamation was followed, it is only appropriate that the Director issue a public report on the results of that surveillance operation, as he did for the price study.

It should be emphasized that the price study which resulted in no action required a 70 page report, while the analysis and consultation which resulted in the Federal assertion of authority has not been explained publicly.

President Nixon's address of December 4, 1970, reads:

> I have today directed the Interior Department to assume complete regulating responsibility for conservation and production of oil and gas on *all* Federal offshore lands * * *. [Emphasis added.]

The expected increased output was in terms of all Federal offshore lands. It was only later that the distinction was made between the disputed and the undisputed Outer Continental Shelf lands. On January 21, 1971, the Director of OEP explained in a letter to the Chairman of the Joint Economic Committee:

> With regard to the disputed areas * * * the Master is now considering the positions of the Federal Government and the State of Louisiana concerning the exact location of the base line. Until the line proposed by the State has been submitted to the Master, final decision concerning Federal production controls in the disputed area has been delayed. The State has been required to submit its proposed line within the near future * * *.

Despite the passage of months, no action has been taken.

A related and more significant factor is that the OEP does not know how much spare productive crude oil capacity is in the undisputed offshore Federal oil and gas fields.

At a December 22, 1970, White House press briefing, the Director of OEP was asked about the extent of increased output to be expected from the release of Federal offshore areas from State control. He

referred the question to a Deputy Assistant Secretary of the Interior who said that the capacity of the wells and the available deliverability would be known by March. On January 21, 1971, the Director wrote the Chairman of the Committee that the short-term result—

> * * * may be an increase on the order of 50,000 b/d. I am told this magnitude should be considerably greater as soon as the Geological Survey has had time to evaluate the producing structures of this area.

On February 24, 1970, Hollis M. Dole, an Assistant Secretary of the Interior, wrote the Chairman that the spare capacity in the Federal undisputed area was 140,000 to 200,000 b/d and that the disputed area had 300,000–440,000 b/d for a total of as much as 440,000 b/d to 640,000 b/d. The initial information furnished the press was that the 1971 Presidential action would increase output by some 400,000 b/d.

The Chairman also inquired about the deliverability of that spare capacity. Secretary Dole's reply almost a year and a half ago was:

> The question of crude oil deliverability is *presently under study*. [Emphasis added.] It is expected that more accurate data will result from this review

The results are not even mentioned in the *Report* which was prepared after consultation with the Department of the Interior. The compilation and evaluation of such information is crucial if the Federal Government is to make policy in the national interest. The Office of Management and Budget has not required that Interior carry out that function even though a reading of the functions and programs of the Department suggest that these questions are under study and results will be forthcoming in the near future.

Instead, major assignments are turned over to the National Petroleum Council—the oil lobby which acts as an adviser to the overstaffed but underdeveloped Department of the Interior. With the National Petroleum Council in such a central position the oil industry continues to think for the Federal Government.

On February 5, 1971, Mr. Pecora, then Director of the Geological Survey, wrote the Chairman of the Committee that production increased 5,000 b/d in December, that it was expected to increase "* * * as much as 50,000 b/d over current rates" in coming months, and that a better estimate of the effect of the Presidential action would be available by mid-February.

Finally, the Chairman wrote to Mr. Pecora, now Under Secretary of Interior, to find out what the actual increase was. He replied that the results so far were far short of the 50,000 b/d. He stated:

> For the months of December 1970 through March 1971, actual increased oil and condensate production (sales) from the area in the Outer Continental Shelf off the Texas coast and the undisputed zone off Louisiana averaged 19,896 barrels per day. March sales averaged 478,025 barrels per day showing an increase of 30,015 barrels over last November's total of 448,010. February and March combined daily averages show an increase of 38,610 barrels, while February alone shows an increase of 47,205 barrels. Preliminary production estimates for April are given as a daily average of over

> 508,000 barrels of crude oil and condensate, thus the estimated increase for the month of April over last November's production is 60,000 barrels per day.

Notwithstanding all of the references to reserves and spare capacity, the Federal Government does not know the extent of spare capacity, not even in the undisputed Federal area where the Government has extensive records. If the Office of Emergency Preparedness has been told that the spare capacity in the undisputed area will turn out to be several times the initial estimate, the overall figure should be increased by an even larger factor after the data are evaluated.

The irony of the entire, expensive oil import quota program is that, although it is supposed to encourage the development of spare capacity, the Federal Government does not know how much spare capacity exists. We spend $5 billion a year on the oil import program but do not know whether it is working. The Office of Management and Budget refused to provide funds in the budget for the geologists who would be able to determine the maximum efficient production rate of oil wells on Federal lands.

Ending market demand prorationing, in addition to limiting unreasonable price increases, would encourage exploration and development. The *Report* states (p. 30):

> * * * the relaxation and liberalization of market demand prorationing in the past year have brought forth substantial amounts of lower unit cost oil. The probability that this trend will continue in prorationing should provide an incentive for greater investment in exploration and development.

Earlier (p. 28) the *Report* states: "* * * it is generally agreed that our burgeoning demand for petroleum will cause effective removal of prorationing limits by as early as 1973."

To repeat, given the desirable impact of the removal of market demand prorationing on exploration, and costs, and the finding that increased oil activities for the next few years are needed, one would reasonably expect OEP to recommend the elimination or at least the immediate suspension of the Connally Hot Oil Act. However, the *Report* makes no such recommendation. Section 4 provides that the act is to "be inoperative" if the President determines that there is a lack of supply-demand parity "resulting in an undue burden on or restriction of interstate commerce." The findings of the OEP Director with respect to the effect of market demand prorationing provide ample demonstration of the "undue burden on interstate commerce." The same conclusion follows from the statement in the *Report* (pp. 22–23):

> * * * it should be noted that state market demand prorationing tends to counteract the downward pressure of high inventories on crude prices.
>
> * * * gasoline stocks were higher at the end of 1970 than 1969 and were also higher at the end of October 1970 than for the comparable week in 1969. Total crude runs to stills from all products were only about 2.3% above the previous year. Therefore, one cannot infer that refinery runs were increasing rapidly which might call for a price increase to

> obtain a higher level of supporting stocks if crude oil production was not keeping pace with refinery operations.

Put another way, the price increases were possible only because of market demand prorationing. Under that circumstance, the President is required to suspend the Connally Hot Oil Act. On January 21, 1971, General Lincoln wrote to the Chairman of the Joint Economic Committee:

> * * * it is not at all clear that storage and transportation conditions would provide the legal basis for Presidential action (suspension of the Connally Hot Oil Act) at this time. However, this matter is under constant review by this office and other agencies with statutory responsibilities bearing on the oil industry * * *.

But the circumstances described in the *Report*, that increased crude oil prices are under economic pressures which should reduce rather than raise prices, are far more conclusive than any theoretical observations. In any event, the public is entitled to know the standards which OEP is applying in its "constant review" of whether the Connally Act should be suspended and to report on its findings.

Report's Alternatives

The most outstanding feature of the *Report* is the list of nine measures (p. 45) which "in addition to, or in lieu of, an increase in the price of crude oil" might be required in the long run. These include changes in leasing policy, tax policy, natural gas regulation, research on synthetics, and conservation. They do not include any suggestions regarding the oil import control program which is under the supervision of the Oil Policy Committee.

Leasing of Federal Oil Lands

The Oil and Gas Journal of September 19, 1970, reported that Joseph C. Swidler, chairman of the New York Public Service Commission, conferred with the Secretary of the Interior and recommended a seven point program related to Federal leasing policy including the two listed in the *Report*. The *Journal* then relates that Secretary Dole advised that "much geological and geophysical review would be necessary in the Department and other interested agencies before offering any acreage off the East Coast." This—even though Foster Associates had recommended such leasing in a 1969 study for Interior. Humble Oil announced, before the Secretary of the Interior officially did, that there would be east coast offshore crude oil production by 1976, a consideration not included in the *Report*.

Nor has the Department of the Interior made available its preliminary assessment of offshore northern Alaska (Cardova)—an area which is understood by some to be larger than North Slope, but which might interfere with the North Slope pricing expected by the oil industry.

Royalty bidding is not being considered despite its potential benefits, including the entry of smaller independents, supposedly because of the fire in Shell's offshore well. The rationale behind this argument is that

a small company could not have met the cost of fighting the fire. Therefore, measures such as roya'ty bidding which might open Federal leases to rather small companies are to be avoided.

Taxes

The *Report* demonstrates that good intentions can be thwarted by poor information. Its suggestion regarding the question of tax treatment of oil investment in secure as opposed to nonsecure areas does not even mention the foreign tax credit issue. So long as royalty and quasi-profit-sharing payments are treated as income taxes and therefore credits against U.S. tax liability, manipulations of overseas depletion allowances are meaningless.

It is also necessary to take into consideration the large price advantage of the domestic market compared to the foreign market. There is no evidence that a considerable increase in taxes on foreign production would cause investments to shift to the United States. The First National City Bank reports that since 1964 the rate of return for U.S. oil companies has been higher than for Eastern Hemisphere companies, a notable reversal from the 1959–63 experience during which the opposite was true. In 1959, U.S. oil companies had a 10 percent rate of return on net worth while the Eastern Hemisphere companies showed more than 14 percent. In 1969, U.S. oil companies realized 12.1 percent compared to 11.3 percent for Eastern Hemisphere companies.

Natural Gas

The *Report*'s four paragraph coverage of natural gas pricing (pp. 28–29) lists major analytical conclusions and resultant recommendations. Without supporting analysis, it condemns interruptable sales of natural gas, well head regulation of natural gas moving in interstate commerce, and concludes that "* * * a revised pricing policy for interstate sales of natural gas would also provide a basis for a more realistic sharing of the costs of exploration and development between the consumers of oil products and natural gas and restrain upward pressures on crude oil prices."

The justification for OEP's opposition to interruptable natural gas sales is not clear. Given the seasonality of heating demand and the high portion of fixed costs in production and pipelines, it appears economically sound to have lower priced interruptable or even seasonal rates. There is no reason to believe that the "cost-of-service" mode of regulating natural gas prices is inconsistent with a "realistic sharing" of costs between oil and natural gas. To the contrary, the costing approach of the FPC explicitly accounts for that distinction. The OEP offers no evidence to indicate that the Commission has not succeeded in this.

The *Report* recommends that steps be taken (p. 45) to "adjust natural gas regulation to avoid governmental underpricing of one fuel to the detriment of others." The *Report* is not concerned that the oil import control program causes oil to be priced higher. This artificially increased price of crude oil causes shifts in demand and the production pattern. The Office of Emergency Preparedness would resolve these consequences to the further disadvantage of consumers.

The *Report* quotes the Council of Economic Advisers in the relationship of prices and natural gas supply in a statement concluding: "The only satisfactory solution * * * is to allow the price, at least of new gas not previously committed, to approach the market-clearing level." Now, this is both complex and vague. Some light can be cast on the matter by the statement of Hendrik S. Houthakker, of the Council of Economic Advisers, on May 5, 1971, in an address in Honolulu, Hawaii:

> * * * If prices were to stay at the level of 1970 (in real terms) there could well be some decline in domestic gas production, lowering over all gas supply from about 22 quadrillion B.t.u.'s in 1970 to about 19 quadrillion B.t.u.'s in 1980 * * *. How much more gas could be made available by raising the well head price has been a subject of considerable controversy. An econometric study by Dr. Daniel Khassoom, *and some further calculations* [emphasis added] suggest that a 10 cents per thousand cubic feet wellhead price increase would nearly double the gas supply by 1980, to about 38 quadrillion B.t.u.'s * * *. If the projected increase in the natural gas supply resulting from a 10 cents price increase were realized, the total domestic energy supply would be 98 quadrillion B.t.u.'s, almost equal to the projected demand of 100 quadrillion B.t.u.'s. This does not mean, however, that we would not need any oil imports, because not all energy can be supplied in the form of natural gas, the nonsubstitutable oil demand has been estimated at about 19 million barrels a day (or 40 quadrillion B.t.u.'s) in 1980. With domestic oil production projected to be 13.6 million barrels a day, minimum import needs, excluding residual oil, would be about 5.4 million barrels a day, and *there would be a surplus of energy of nearly 10 quadrillion B.t.u.'s.* [Emphasis added.] I hardly need to repeat that there are great uncertainties in these estimates, and not only in the projected effect of a price increase on the supply of natural gas. What this particular calculation suggests is that *we may not need a very large* increase *in the wellhead price of natural gas; in fact an increase of 5–10 cents per thousand cubic feet might suffice to bring our projected energy supply and demand in rough balance* * * *. [Emphasis added.]

A price increase of 10 cents results in an increase of 19 quadrillion B.t.u.'s of natural gas in 1980 (from 19 to 38 quadrillion B.t.u.'s) which means a surplus of nearly 10 quadrillion B.t.u.'s. This would mean, according to the CEA member who has been directly involved, a 10-cent increase is about twice as large as needed to prevent surplus production of natural gas in 1980. It is reasonable to translate this into the conclusion that a price increase substantially less than 10 cents would be adequate.

Domestic Refining

The *Report* is concerned with the adequacy of domestic refinery capacity. The greatest lapse in this regard concerns residual fuel oil. Since 1967, the oil import proclamation has carried provisions for

placing the U.S. residual fuel oil production at parity with foreign imports. Interior held hearings, proposed rules have been published, but no affirmative action has been forthcoming from the administration. Instead, the one set of regulations—that on desulfurization of imported residual fuel oil—has been suspended. Regulations alone can yield dramatic improvement in this sector with no Presidential action required.

Canadian Oil

Restrictions on crude oil imports from Canada into districts I–IV should be lifted. With the exception of residual fuel, the importation of products has been severly restricted since the outset of the program. Yet, refinery capacity has hardly kept pace with requirements—marking a severe shortcoming of the program. But, the OEP *Report* does not have any suggestions on this account and does not even attempt to measure national security requirements with respect to refining, much less with regard to competition. During 1971, these crude oil imports have been averaging 200,000 b/d below pipeline capacity. Paradoxically, U.S. controls on Canadian imports were imposed in 1970–71 when the closing of Tapline and reduced production in Libya disturbed world markets. The "Rube Goldberg in oil" regulations have effectively sabotaged 200,000 b/d of oil from a secure source.

On December 4, 1970, the President announced that companies importing Canadian oil would be permitted to use their overseas allocations for the purchase of more crude oil from Canada. That was designed, according to the President, to "increase the supply of oil * * *." General Lincoln stated in his White House press conference on December 22, 1970, that "* * * making overseas tickets eligible against Canadian oil * * * may well result in the import of Canadian oil up to the capacity of the pipeline from Canada." The Cabinet-level Joint United States-Canadian Committee on Trade and Economic Affairs communique announced on November 25, 1970: "For 1971, it is expected that pipeline capacity would need to be fully used * * *." Finally, on January 21, 1971, General Lincoln wrote the Chairman of this Committee:

> Since pipeline movement in the United States * * * has been close to or at capacity in recent weeks, I have no present reason to believe our regulations will impede use of any Canadian oil for which there is an economic demand.

To date, not one barrel of 1971 overseas crude oil allocations has been used for Canadian oil imports. All the assurances were illusory.

The Chairman also questioned why holders of overseas tickets were only permitted to exchange up to two-thirds of their overseas tickets for Canadian oil. General Lincoln's response was that this was necessary to avoid the attempts by importers to bring in more oil than the line could carry. Therefore, the rule would avoid "pre-emption of these facilities by a few at the expense of others * * *." In other words, OEP regards the prorationing of the line as a justification for controlling imports. But this is far removed from national security and has in actuality operated to the detriment of national security.

The OEP steadfastly adheres to the Task Force concept that the United States might have to replace some of Canada's eastern im-

ports in an emergency and that consequently, there should be spare capacity from Canada to the north-central United States to offset the resultant movement from the Gulf Coast to Canada. Without going into the long-term merits of this position, it is obviously a consideration for the long-term, not applicable to the actual conditions of 1970–71. Specifically, the failure to use Canadian imports to capacity did nothing to augment U.S. or Canadian security in the interval. These are precisely the circumstances in which Canadian oil should have been used to capacity. In fact, despite the tanker shortage, eastern Canada did not look to the U.S. Gulf Coast for crude oil.

Carryover

A partial solution is to permit a full carryover of unused crude-oil allocations. Such a provision will dampen and reverse crude oil price increases which are not required for national security. In the 1967 Middle East conflict companies were permitted to carry over their unused allocations to 1968 and 1969. Half of the carryover was within the formula overall import level and half was above it. This was one of the contributing factors in keeping prices from rising. But, now it is necessary to roll prices back. Consequently, all of the carryover should be above the formula level.

Allocate

As a final step all of the imports provided for 1971 should be allocated. At the White House press conference of December 22, 1970, General Lincoln placed great emphasis on the 100,000 b/d increase of imports into districts I–IV. The acting Oil Import Administrator said that the supply-demand gap had increased 152,000 b/d in district V. In both areas substantial portions of the increases have not been allocated. Holding them back bolsters prices. The remedy is to allocate the entire authorized import level and provide for a full carryover to be extended for a 2-year period above formula levels as was pointed out by Chairman Proxmire in a speech on the Senate floor on September 20, 1971.

Such a provision would make for more efficient use of transportation and petroleum resources. So far as national security is concerned, it is difficult to understand why such a carryover would not be consistent with national security. Accordingly, this study concludes with a request that the OEP Director provide for a full carryover of unused 1970 and 1971 allocations to 1972 and that the entire proclamation authorized 1971 imports be allocated. If the OEP is not ready to recommend those actions, it at least should undertake an investigation to determine whether such action would be consistent with national security.

TABLE I.—CRUDE OIL OUTPUT AND PROVED RESERVES: THE UNITED STATES, NORTH-SLOPE ALASKA, AND CALIFORNIA

[Million barrels]

		Reserves					
		Additions			Dec. 31		
	Output	Net	Gross	New field discoveries	United States	California	United States-California
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1953	2,312	984	3,296	344	28,945	3,919	25,026
1954	2,257	616	2,873	308	29,561	3,889	25,672
1955	2,419	451	2,870	220	30,012	3,801	26,211
1956	2,552	422	2,974	235	30,435	3,771	26,664
1957	2,559	−134	2,425	207	30,300	3,760	26,540
1958	2,373	236	2,609	151	30,536	3,866	26,670
1959	2,483	1,183	3,666	166	31,719	3,763	27,956
1960	2,471	−106	2,365	141	31,613	3,659	27,954
1961	2,512	145	2,657	107	31,759	3,615	28,144
1962	2,550	−369	2,181	92	31,389	3,648	27,741
1963	2,593	−419	2,174	97	30,970	3,600	27,370
1964	2,644	21	2,665	127	30,991	4,125	26,866
1965	2,686	362	3,048	237	31,352	4,568	26,784
1966	2,864	100	2,964	160	31,452	4,608	26,844
1967	3,038	−75	2,963	125	31,377	4,693	26,738
1968	3,124	−670	2,454	166	30,707	4,341	26,366
1969	3,195	−1,075	2,120	96	29,631	4,243	25,388
1970							
N. slope Alaska		9,600	9,600	9,600	9,600		9,600
Other	3,319	−231	3,088	253	29,401	3,984	25,417
Total	3,319	9,369	12,688	9,853	39,001	3,984	35,017

Note: Proved reserves at end of year minus reserves at beginning of year equals net additions to reserves. Net additions plus production during year equals gross additions to reserves.

Source: American Petroleum Institute.

TABLE II.—DRILLING COSTS: OIL WELLS, GAS WELLS, AND DRY HOLES

[In millions]

	1963	1966	1967	1968	1969
1. Oil	$1,071	$986	$995	$1,098	$1,117
2. Gas	441	543	502	494	606
3. Oil and gas	1,152	1,529	1,497	1,592	1,722
4. Gas as percent of O. & G	41.2	35.5	33.5	31.0	35.2
5. Dry holes	$790	$832	$802	$826	$888
6. Dry holes assigned to gas	325	295	269	256	313
7. Total gas (2 plus 6)	766	838	771	750	919
8. Total oil	1,537	1,523	1,528	1,659	1,692
9. Aggregate	2,303	2,361	2,299	2,409	2,611

Source: Joint Association Survey of Industry Drilling Costs, various issues.

Table III.—JOINT ASSOCIATION SURVEY (JAS) OF DRILLING

[Number of wells]

1969	Sample	Others	Total	Sample as percent of total
Oil wells	5,820	7,095	12,195	45.1
Gas wells	1,575	2,352	3,927	40.1
Dry holes	3,932	8,707	12,639	31.1
Total	11,327	18,154	29,481	38.4
Dry holes as percent of total	34.7	48	42.9	

JAS SAMPLE, 1967-69

	Number of wells	Percent of all wells	Number of companies in sample
1967	11,424	36.2	235
1968	9,603	32.5	146
1969	11,327	38.4	369

Sources: Joint Association Survey of Industry Drilling Costs (sec. 1), American Petroleum Institute, the Independent Petroleum Association of America, and the Mid-Continental Oil and Gas Association.

APPENDIX

REPORT
on
CRUDE OIL AND GASOLINE PRICE INCREASES
of
NOVEMBER 1970

★★ OFFICE OF ★★
EMERGENCY
PREPAREDNESS

EXECUTIVE OFFICE OF THE PRESIDENT

April 1971

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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF EMERGENCY PREPAREDNESS
WASHINGTON, D.C. 20504

OFFICE OF THE DIRECTOR

April 15, 1971

The President
The White House
Washington, D.C.

Dear Mr. President:

I enclose a study prepared in my office concerning the price increases in crude oil and gasoline initiated on November 11, 1970. Judging that the increases announced on that date by a major company did herald industrywide increases, I initiated the action required of me by Section 6(a) of Presidential Proclamation 3279, which established the Mandatory Oil Import Program, to determine whether such increases are necessary to accomplish the national security objectives of the controlling legislation and of the proclamation.

In the context of the pertinent statute and Proclamation 3279, national security is not the same as the popular conception of national defense. Direct defense requirements for petroleum products are relatively small when measured against our national consumption. We are here concerned with the essential role of petroleum in our economy and our way of life, and the measures necessary to assure an adequate and secure supply in all contingencies, whether or not of military origin.

This investigation has included consultation with the Secretaries of State, Defense, Treasury, the Interior, Commerce, and Labor as required by Section 6(a) of Presidential Proclamation 3279, as amended, in addition to the Chairman of the Council of Economic Advisers and the Attorney General. Also, I have considered comments from the industry and other interested parties (a total of 57) submitted in response to an invitation for comment published in the Federal Register. Although I have given substantial weight to the views of the agency heads mentioned above, each does not necessarily agree with all of my findings and conclusions.

As the discussion in the enclosed report indicates, there are not, in my judgment, reliable indices on which to base a determination concerning the price of gasoline, particularly over a short period. The gasoline market is highly competitive in many places as to price and subject to varying degrees of discounting, although the vigor of this competition is not sustained everywhere. The last two Inflation Alerts issued by the Council of Economic Advisers have reported substantial erosion of the attempted increase in gasoline prices. If the market does stabilize at a higher price, the increase undoubtedly can be ascribed in major part to any increases in crude oil price which the industry may succeed in sustaining over time. Hence, I do not attempt to reach a determination on the matter of the price of gasoline apart from the question whether the crude price increase is necessary.

I consider that the current 25¢ per barrel increase in the price of crude oil should be the subject of two determinations: the first in the light of short-term considerations; the second in light of the longer-term considerations of petroleum supply and overall energy security.

I conclude that the November price increases were not required to meet any national security objectives arising out of the present short-run disruptions in the international flow of oil. Supply was meeting market demand at the previous price. It does not, therefore, appear that a crude oil price rise was needed to meet short-term requirements. The ultimate conclusion, however, must rest on long-term national security effects.

The state of the art of the analysis required is such that there is unlikely to be certainty in an appraisal, within a few months of the price change, of the long-term effect on national security purposes of the comparatively small (less than 10 percent) incremental price increase being investigated. As the Task Force study indicated, professional judgments differ widely concerning the elasticity of supply, i.e. the extent to which the discovery of new reserves is responsive to price increases over time.

The study does clearly show the need for new and accelerated actions to support our petroleum security in the future in order to minimize reliance upon even higher prices to assure needed supplies. Indeed, our study does not conclusively show that the recent price increase, without other accompanying measures, would be necessarily effective. Nor do we yet know whether these other measures will be instituted on a timely basis.

The suggestion may be made that the crude oil price increases should be checked or thwarted through increasing supply by increasing import quotas. The enclosed study shows, however, that supply measured by inventories and refinery runs was meeting demand at the prices prevailing before November 11 and the supply situation has not materially changed since. Also, the unusual present international oil situation currently results in quantities of crude oil imports from overseas which are below the level of quotas already permitted. Those levels will, however, almost certainly need to be progressively increased in future years to assure adequate supply.

The defenders of the price increase have clearly established in their submissions the need for immediate actions to guard our longer-term energy security. In my judgment, it has not been established that price increases alone will achieve our national security objectives, even though they certainly will provide a measure of incentive toward that end. For example, development of the great supply potential of the North Slope of Alaska is currently insensitive to price at present levels, because the North Slope discovery is of such magnitude that the unit costs of production will be low and its unavailability to the market is not a matter of price. On the other hand, revisions and extensions of existing fields and the extent of other exploration efforts may well turn on this marginal increase in crude prices.

The enclosed study concludes that programs and policies other than price increases need to be pressed. Whether further price increases in the longer-term will be needed is an open question which will depend, in large part, on the timely adoption of programs and policies which will encourage the necessary investments to meet our fuel and energy problems. If we do not press forward on other energy supply policies, there will be an increasing tendency to rely on further price increases. This we should not encourage.

We are traditionally concerned about the price of energy fuels. We are concerned over the quality of our environment. We are also concerned about the adequacy and security of the supply of our energy fuels. The quality of life of our country, as well as much of our country's strength, turns on that adequacy and security.

The lead times in developing energy supplies are long. Time is running out for providing the energy supply assurance needed for the latter half of this decade and beginning of the next. We have recently placed greatly increased stress on our environmental programs. Along with improving the quality of life, the effects sometimes include delaying friction with essential energy programs, and also increased cost of energy to the consumer.

The situation argues for accepting and pressing those helpful actions which can be gotten underway promptly. If further progress had been made in the past decade on energy programs which we now see as needed, the recent price increase might be clearly unnecessary.

The courses of action are generally beyond the boundaries of the oil import program for which I have the policy responsibility. That program can no longer be relied on as the exclusive means to assure adequate secure petroleum supply. The Energy Committee of your Domestic Council is preparing recommendations for you in the energy field. I have provided, as an input to that Committee's studies, my conclusions developed in connection with this price study as to energy actions needed.

I recommend that you refer this letter and the enclosed study to the Energy Committee of the Domestic Council.

Because the assurance of adequate secure petroleum supplies in the future is an urgent matter, and there are inevitable uncertainties about the timing and effects of other programs which may be instituted, I cannot confidently conclude that the November crude oil price increase was unnecessary.

Respectfully,

G. A. Lincoln

G. A. Lincoln
Director

Enclosure

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INTRODUCTION

On November 11, 1970, the Gulf Oil Company increased its purchase price of domestic crude oil by $0.25 per barrel and, on the following day, increased gasoline prices to its dealers by 0.7¢ per gallon. Judging that the action of the Gulf Oil Company heralded general price increases by the industry, the Director of the Office of Emergency Preparedness announced on November 12 that he would proceed according to Section 6(a) of Presidential Proclamation 3279, as amended:1/

> The Director of the Office of Emergency Planning shall maintain a constant surveillance of imports of petroleum and its primary derivatives in respect of the national security and, after consultation with the Secretaries of State, Defense, Treasury, the Interior, Commerce, and Labor, he shall inform the President of any circumstances which, in the Director's opinion might indicate the need for further Presidential action under Section 2 of the Act of July 1, 1954, as amended. In the event prices of crude oil or its products or derivatives should be increased after the effective date of this proclamation, such surveillance shall include a determination as to whether such increase or increases are necessary to accomplish the national security objectives of the Act of July 1, 1954, as amended, and of this proclamation.

A notice (Annex A) inviting comment on the necessity of the price increases to national security was published in the Federal Register on November 17, 1970. In addition, letters requesting specific comment were sent to the principal companies announcing crude oil or gasoline price increases. A total of some 57 responses have been submitted from a wide spectrum of the oil industry, Congressmen, State officials, consumer associations, independent oil experts, and the general public. These have been carefully examined and analyzed.

1/ No similar formal action has been taken since the issuance of the Proclamation in 1959.

The Director of OEP asked each department head specified in Proclamation 3279, as well as the Attorney General and the Chairman of the Council of Economic Advisers, to designate an official for consultation as the investigation progressed.

National Security Criteria

Presidential Proclamation 3279 charges the Director, in conducting this review of crude oil and gasoline prices, to determine whether they are necessary to accomplish the national security objectives of the Mandatory Oil Import Program and Section 232 of the Trade Expansion Act of 1962 (19 USC 1351).

The most authoritative definitions of these national security objectives are to be found in the legislation and Proclamation and the most recent analysis is in the Cabinet Task Force Report of February, 1970. While, as the Cabinet Task Force Report notes, objective standards to be used in appraising the threat to national security are not stated with precision, a study of the above documents establishes the following criteria rather clearly:

a. The need to guarantee supplies sufficient to meet the need of U.S. military forces and defense industries;

b. The need for sufficient supply of crude oil and its derivatives to meet essential civilian demands and sustain economic growth;

c. The need to foster exploration and development so as to ensure against a depletion of reserves to an extent which would jeopardize the capability of the petroleum industry to meet future demands, without undue reliance on foreign sources of questionable reliability.

The Trade Expansion Act of 1962 directs that the national security criteria must include consideration of industry growth requirements and the investment, exploration and development necessary to assure that growth insofar as they affect the capacity of the United States to meet national security requirements.

In announcing the institution of the Mandatory Oil Import Program on March 10, 1959, President Eisenhower stated:

> The new program is designed to insure a stable, healthy industry in the United States capable of exploring for and developing new hemisphere reserves to replace those being depleted. The basis of the new program, like that for the voluntary program, is the certified requirements of our national security which make it necessary that we preserve to the greatest extent possible a vigorous, healthy petroleum industry in the United States.
>
> In addition to serving our own direct security interests, the new program will also help prevent severe dislocations in our own country as well as in oil industries elsewhere which also have an important bearing on our own security. Petroleum, wherever it may be produced in the free world, is important to the security, not only of ourselves, but also of the free people of the world everywhere.

Proclamation 3279 also explicitly recognizes the need:

> "...to avoid discouragement of and decrease in domestic oil production, exploration and development to the detriment of the national security."

The Cabinet Task Force Report of 1970 generally reaffirmed these national security objectives. The majority report added a new feature by calling for a limitation of dependence on the Eastern Hemisphere, recommending that such imports be limited to 10% of domestic demand, a figure brought into question by recent disruptions of much lesser amounts than this (p. 135). The Secretary of Defense, in his statement of supplementary views, said (p. 132):

> "...it is extremely important that the program be carefully administered and security considerations be paramount. As a member of the Interdepartmental Policy Panel the Secretary of Defense would consider the following to be essential:
>
> a. That domestic exploration be maintained at approximately current rates and that no reduction in reserves be allowed."

In the same vein, the Secretary of Treasury said (p. 131):

> "Our domestic industry will be expected and encouraged to continue to expand its output and to explore for and develop new sources of crude oil and substitutes; the revised oil import control system should be so managed as to work toward this goal."

In the context of the authorizing legislation and Proclamation 3279, national security is not limited to current national defense requirements nor to future mobilization needs. Rather, it relates directly to the indispensability of petroleum to our economy and our way of life.

The essential national security objectives of the Mandatory Oil Import Program certainly include:

(1) a satisfactory level of domestic reserves of crude oil, supplemented from other secure sources of supply;

(2) maintaining spare capacity to produce and deliver crude oil when international factors disrupt supplies from other sources;

(3) maintaining refinery capacity in the United States adequate to meet both defense and essential civilian needs in periods of disruption in normal patterns of world oil movement; and

(4) providing a healthy petroleum industry in the United States with the capacity to meet the nation's national defense and essential civilian needs at all times.

In applying the above standards of national security objectives, the markets for crude oil and gasoline, while closely related in several ways, are sufficiently different in their structure and past price behavior as to necessitate separation of these two portions of this price investigation for much of the analysis and findings.

The present world supply situation is that type of situation which the oil import program is designed to protect against -- and hence is not, standing alone, an argument

for raising prices of domestic crude oil or controlled refined products. Rather, domestic crude oil and product prices have, in the past, been higher than world prices in order that this insurance would exist and additional costs resulting from a tight world supply situation could be avoided to the fullest extent possible. It should be recorded that no one gave the tight world situation as the reason for the announced higher prices in responding to our requests for comments, even though the landed cost of crude oil carried in spot tankers was almost certainly higher than the price of domestic crude oil.

PUBLIC AND INDUSTRY COMMENTS

Since the essential charge of the Presidential Proclamation 3279 is a determination whether price increases are "necessary" to national security objectives it seems reasonable that the initial burden of justifying price increases on national security grounds rests with the industry. Accordingly, the following is a summary of industry submissions which endeavor to prove the necessity of the price increases to national security.

A total of 57 submissions were received either in response to the notice in the Federal Register of November 16, 1970, inviting comments on the recent oil and gasoline price increases, or to the letters sent to those companies which raised their prices. (A list of respondents is given as Annex B).

In this summary, the emphasis has been placed upon the logic of the arguments, and the numerical data offered in support of the arguments have been omitted. These data, where vital, have been verified as within a tolerable range of acceptability.

Although some respondents presented their case in greater length and detail than others, and the statistics cited vary somewhat among the individual statements, the general rationale of those supporting the price increases is similar. These arguments will be separately summarized for the dealer tank wagon gasoline price and the crude oil price under review here.

The Proponents' Argument - Gasoline Prices

Most of the respondents in rationalizing the gasoline price increase cite the fact that gasoline service station prices

(usually less taxes) have not risen as fast as the Consumer Price Index to support their contention that gasoline prices have not been a cause of inflation.

The refiners also cite rising refinery and marketing costs in support of higher gasoline prices. Increased taxes, higher wages, higher equipment and construction costs, and costs associated with new lead-free gasoline are all cited by various respondents as components of their overall cost problems. These are often said to be increasing faster than gasoline prices, putting the refiners and marketers in a "cost-price squeeze." Many net buyers of crude oil also cite the need to raise product prices to cover the higher costs resulting from the crude oil price increase.

The gasoline price increase is said to be linked to the national security by the general argument that the higher price is necessary to maintain a healthy industry.

The Proponents' Argument - Crude Oil Prices

The principal argument for the increase in the price of crude is that it is required in order to provide the necessary capital and the incentive for exploration and production which is needed if the U.S. crude oil reserve position and producing capability are to be maintained at the level required for national security. The individual considerations used to support this line of argument include the following:

a. The reserve position and producing capacity of the domestic producing industry are not being maintained. If present trends continue, the U.S. will have become increasingly dependent on Eastern Hemisphere petroleum supplies, even with the introduction of Alaskan North Slope production, a dependence which will tend to threaten our national security.

b. Declining trends in basic activities such as geophysical crew activity, exploration, leasing, well drilling, and total well completions indicate a lack of incentives to find and develop sufficient U.S. oil reserves and production capacity.

c. Petroleum prices have been relatively stable for more than a decade. Crude oil prices, prior to the increase, have risen much less than the Wholesale Commodity Price Index.

d. The petroleum industry's aggregate costs have been rising more rapidly than its prices. Taxes have been increasing, and, especially, the Tax Reform Act of 1969 sharply increased the industry's tax bill. As "easier" prospects are being used up, exploration for oil must be conducted in more remote, more costly areas. The percent of new-field wildcats discovering significant quantities of oil and gas is decreasing. Wages are up in all sectors of the industry, and material costs are also rising. Large sums are being spent by the industry for protection of the environment. Interest costs are also higher, and this is particularly significant to the petroleum industry because of its capital intensity and its growing need to supplement internally generated funds.

e. The profitability and investment return for the petroleum industry have been declining and are said to be unfavorable compared to other industries. These trends, together with currently higher borrowing rates, make financing of large present and future capital requirements, exceedingly difficult.

Two companies reported that they had reduced their exploration expenses sharply in 1970 compared to those in 1969.

Higher prices will contribute to greater domestic petroleum supplies by: (1) prolonging the effective life of marginal wells which otherwise would be abandoned, (2) increasing the number of economically acceptable secondary recovery projects, (3) increasing incentives for exploration for new reserves, and (4) improving the industry's financial capability to undertake these expanded efforts.

A considerable number of companies that followed price increases initiated by others stated that they were obliged to do so to maintain their crude supplies in a competitive market. A number of those refiners who on balance are substantial buyers of crude oil supported the increases as necessary to maintain local crude oil production at levels required by their own refinery operations. Whether or not advantaged by the price increase, practically all industry respondents supported it as needed for national security reasons.

Although the investigation does not deal with natural gas prices, some respondents note that "unrealistically low"

natural gas prices contribute to the profit squeeze. They also relate this to incentives for exploration and development of crude oil reserves because oil and gas are so closely linked in exploration.

One respondent, a regional producers' association, took a different view in support of higher prices. On the basis of experience in their area, they concluded that the major companies no longer find it profitable to commit a substantial part of their exploration budgets to prospecting for reserves onshore in the lower forty-eight states. They claim that these major companies, as net crude oil purchasers, have incentives to hold prices down. They further state the recent price increase is insufficient to make a meaningful change in exploration programs.

Adverse Comments

There is much less uniformity in those responses that opposed the price increases.

Senator McIntyre, Congressman Conte and their associates urge a thorough and incisive investigation of price increases (including increases in price of No. 2 and No. 6 oils), with the burden of proof to rest on the major oil companies. They also urge interim action to roll back recent price increases with consideration to be given to decontrol of imports from Canada, No. 2 fuel oil to the East Coast, and residual fuel into Districts II through IV; a relaxation of imports from the Western Hemisphere; removal of crude oil production on Federal lands from state prorationing controls, and the suspension of the Connally "Hot Oil" Act. They suggest examination of seventeen specific questions, appended to their statement, relating principally to the structure of and cost price relationships within the oil industry.

The New England Council claims that a disproportionate share of the cost of import restrictions falls on the New England area; criticizes failure to implement Cabinet Task Force findings and move toward freer imports; and asks analyses of recent increases in prices of No. 2 and No. 6 oils. Senator Prouty also makes this latter request and asks consideration of a "uniform national pricing structure."

Independent marketers and refiners cite an uneven impact of price increases on various sectors of the petroleum industry, despite appearance of comparable increases in crude

oil and gasoline prices. Their arguments are based on institutional characteristics of the industry (percentage depletion, oil import allocations, integration) and upon concern that crude oil price increases will hold, but that gasoline price increases will not, thereby squeezing the profitability of nonintegrated refiners. Professor Allvine of Northwestern University, who has been involved in a study of competition in the gasoline-oil industry, also contends that the oil import program has worked to increase the vertical integration in the domestic oil industry, but he does not compare the scale of integration and competition in the United States with that in other countries.

Two oil companies indicate that they followed crude oil price increases reluctantly in order to protect their crude oil supplies. One believes that the crude price rise may have been too much and claims a more urgent need for higher natural gas prices. The other attributes the present sellers' market in crude oil to adherence to the 12.2 percent formula in setting oil import quotas; mandatory controls of imports from Canada; the postponement of Outer Continental Shelf lease sales; and delays in access to Alaskan North Slope production.

One respondent, the Air Transport Association, proposed a price freeze at November 1, 1970, levels. A.T.A.'s major thesis, however, is the financial plight of domestic airlines and their need for Federal financial support in the interest of national security.

The American Paper Institute does not articulate a position, but merely states their interest as a major user. They include a survey of their membership on "Fuel and Energy Problems in the Pulp and Paper Industry," which cites an interest not only in prices but in assured availability of fuel.

FINDINGS AND CONCLUSIONS

-FINDINGS-

1. The Mandatory Oil Import Program permits (with exceptions, e.g. residual oil in District I) a continuing price structure for crude oil and its derivatives which is insulated over time from the full effects of competition from imported oil.

2. There are four clearly identifiable national security objectives of the Mandatory Oil Import Program which can serve as criteria in determining whether price increases are justified as necessary to the achievement of national security objectives:

(1) A satisfactory level of domestic reserves of crude oil, supplemented from secure foreign sources of supply;

(2) Maintaining spare capacity to produce and deliver crude oil when international factors disrupt supplies from other sources;

(3) Maintain refinery capacity in the United States adequate to meet both defense and essential civilian needs, in periods of disruption in normal patterns of world oil movement; and

(4) Provide a healthy petroleum industry in the United States with a capacity to meet the nation's national security requirements.

3. No national security justification for gasoline price increases has been offered other than their possible relationship to the health of the petroleum industry which is also essential to evaluation of the crude oil increase. Competition in the market place may not sustain the attempted increase in gasoline prices. Under these circumstances no finding on gasoline prices has been made apart from that on crude oil prices.

4. No evidence has been offered to establish that the November price increases will lead to the maintenance of spare capacity for the production of crude oil or the maintenance of refinery capacity in the United States adequate to meet both defense and essential civilian needs in periods of disruption in normal patterns of world oil trade. Consequently, these national security objectives have not entered into this analysis.

5. From the initiation of the oil import program in 1959 until 1969, the price of crude oil remained almost constant. Although there have been two price increases since December 1968, crude oil prices have increased only 11.6% over the life of the oil import program while wholesale prices for all commodities have increased 17.8%.

6. Domestic crude oil proven reserves (excluding Alaskan North Slope oil) have declined markedly since 1968, and the average ratio of reserves to consumption has been declining for over a decade. North Slope Alaska discoveries, not being deliverable to date, are not included as proven reserves in this report.

7. When measured by indices such as drilling rigs in operation, wells drilled, wells completed, geophysical expenditures and acreage under lease, there has been a declining trend in exploration and development effort in the U.S. for more than a decade. There has not been a proportional fall in proven reserves, but in view of our rapidly increasing demand for petroleum, our proven reserve situation is unsatisfactory when measured in national security terms.

8. In the past year there has been a disruption in world oil movement which has been met in the United States by increases in the production of domestic crude oil (utilization of spare production capacity) and imports of Canadian oil. Higher prices were not necessary to bring forth this domestic production and the larger volume of Canadian imports flowing at the time of the price increase.

9. The major portion of spare production capacity has been in Texas and Louisiana. The use of this spare production has not been at an increased unit cost since it has come primarily from efficient wells for which production allowables have been increased under state procedures.

10. From 1952 through 1969 exploration and development expenditures in the U.S. have remained almost constant, if bonus payments to State and Federal governments for search rights are excluded, while our consumption of petroleum has steadily increased.

11. For various reasons leasing and development on the Outer Continental Shelf have been severely curtailed since May of 1968 and development in Alaska also has been stalled, even though these areas have been demonstrated as having the greatest promise of large-scale exploration success and hence for substantial additions to reserves.

12. Industry off-peak pricing practices and federal regulatory policies in relation to well-head pricing of natural gas have limited revenues from natural gas sales

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so that incentive has been lacking for an exploration and development effort for natural gas in proportion to the percentage of the energy demand which needs to be supplied by natural gas. Natural gas has not been carrying its reasonable share of exploration and development costs and incentives therefor.

13. While the costs of exploration and development activity and income taxes on the oil industry have increased, these costs do not materially affect exploration activity where there are favorable probabilities of large-scale, giant field production and low average unit costs per barrel produced, e.g. the high probability formations in Alaska and offshore. These costs do, however, undoubtedly have some adverse effect over time on secondary development of already proven reserves and exploration in areas favorable to discoveries of lesser pools of crude oil.

14. In view of the large capital requirements of the petroleum industry, both in the United States and overseas, for production, transportation, refining and marketing purposes to meet the burgeoning worldwide demand for petroleum products, it follows that:

(a) it is unrealistic to expect these requirements to be met from the industry's cash flow alone;

(b) a substantial share of the industry's capital needs will have to be obtained through equity and debt measures attractive to outside capital;

(c) the anticipated return will need to be adequate, in comparison with other investment choices, to attract equity and debt capital to the domestic oil industry; and

(d) increased cash flow resulting from the November price increases will be reflected to some degree in increased exploration and development effort which would not occur otherwise and which is essential to our national security objectives.

15. The net earnings and cash flow position of the petroleum industry have been and are favorable when compared with other manufacturing industries, and, therefore, in the short run should provide no obstacle to exploration and development

investment. However, it is also clear that incentives must be adequate to attract substantial amounts of new equity and debt capital for the industry's investment needs over the next decade.

16. A crude oil price increase alone will not assure the independent segment of the industry a larger and more active role in the domestic exploration and development activity needed to find and develop larger crude oil reserves. Leasing policy changes and/or the utilization of innovative financing arrangements by independents will be necessary if this segment of the industry is to share largely in the future activity.

17. While it may be assumed that crude oil price increases at the present time in the long run would encourage some future expansion in exploration and development effort, there are a number of governmental programs and policies which could be instituted or modified and which would also contribute to our national security objectives.

18. To most refiners, increased crude oil prices represent a net cost inverse to the degree that they own or control their own crude oil production. Those refiners with lesser crude oil self-sufficiency therefore are pressed to maintain higher product prices to the consumer.

19. In the long run future crude oil price increases may be necessary if fuel supplies are to be developed consistent with our national security requirements. A series of governmental measures to achieve our national security objectives should be accelerated promptly in order to minimize reliance on future price increases.

-CONCLUSIONS-

1. The petroleum industry has not adequately justified crude oil and gasoline price increases at this time on short run national security grounds.

2. Reluctantly, it is concluded that because of the urgent need to encourage exploration for and development of crude oil reserves in the long run, the November price increase for crude oil of approximately eight percent may be justified because of sound national security considerations.

3. Crude oil price increases will be an inadequate instrument for the achievement of our national security objectives. Other measures should be considered and pressed to execution at this time which contribute to achieving national security objectives without further price increases. Among these would be accelerated offshore leasing and realistic pricing of natural gas more nearly approaching its market value in relation to alternative fuels.

STRUCTURE OF THE U.S. PETROLEUM INDUSTRY

A brief review of the structure of our domestic petroleum industry is believed useful before attempting to evaluate the implications of the recent price increases. Undoubtedly, the following description over-simplifies this most complex subject, but it has been reviewed by persons whose knowledge and industry association should assure reasonable accuracy.

Refining

As of January 1, 1970, the petroleum refining industry was made up of 129 companies in the United States which owned or controlled 262 refineries. The ninety-one leading companies in petroleum production and refining had a net worth of more than $50 billion at the beginning of 1969. In terms of net worth this industry greatly exceeds that of any other, including such giants as electric generation, natural gas distribution, telephone and telegraph companies, railroads, steel, and the automobile industry. The rank of this industry in the manufacturing spectrum is not surprising since oil and gas provide three-fourths of the energy fuels used in the United States.

Refining companies have processing capacities ranging from a few hundred barrels of crude oil per day up to more than 1 million barrels per day. The largest single refinery has a daily capacity between 400,000 and 500,000 barrels per day.

Twenty-one of these companies have refinery capacities of 100,000 B/D (barrels per day) or more.1/ Of these, 4 exceed 900,000 B/D, 6 exceed 800,000, 8 exceed 600,000,

1/ Domestic refinery capacities are as reported by NPRA for January 1, 1970, excluding Puerto Rico. Since then about 6% or 700,000 B/D have been added, but information is lacking with reference to its distribution among companies or size classes.

and 16 exceed 200,000 B/D. It should be noted, however, that all of the larger companies operate some refineries with relatively small capacities. Among the operations of the eight largest refining companies there are 15 refineries out of 70 with less than 33,000 B/D capacity, 9 of which are 20,000 B/D or less.

On the other hand, there are 21 refineries with over 20,000 B/D capacity owned by corporations whose total capacity is less than 100,000 B/D but more than 30,000 and 9 more by companies with total capacities of less than 30,000 B/D. The largest company, measured by total refining capacity, has only 6 refineries. The next largest has 12.

The largest oil company in the U.S. has less than 10% of the nation's refining capacity. The 8 largest companies have about 58% of the nation's refining capacity, the 15 largest have about 78% and the top 21 have about 85% of the total.

Refining capacity is not the only criterion to apply in evaluating financial or competitive strength in the oil industry. From the refining capability perspective this industry is not as concentrated as a number of other industries. It is characterized, however, by a high degree of integration both backward into exploration and production of its raw materials - crude oil, condensates and natural gas - and forward into marketing at many levels of distribution.

Five of the 8 largest U.S. oil corporations are also major producers and refiners of oil in other nations as well. They, together with two foreign corporations (British Petroleum and Royal Dutch Shell), constitute the so-called "Seven Sisters" in the world oil picture. These seven corporations control 58% of the giant oil fields of the Free World and 79% of the ultimate reserves. (Oil & Gas Journal, February 22, 1971, p. 109). The five U.S. companies (Jersey, Gulf, Texaco, Standard of California and Mobil) produce over half of the production and almost half of the refinery runs in the Free World outside of the United States.

Eighteen other integrated U.S. corporations together control more domestic production than the five international majors mentioned above, and most of these others have some foreign production and refining capacity. However, in the aggregate, their total foreign production is 13% of that of the 5 major internationals. Their foreign refinery inputs are barely 6% of those of the 5.

At the other end of the scale, the majority of the 129 refining companies have very little or no domestic or foreign crude production capacity, and their integration, if any, is forward into transportation and marketing at the wholesale and retail levels.

Crude Oil Production

Estimates have indicated that there are 10-12,000 oil producers in the United States. This number includes all persons or corporations having an operating interest in oil producing properties. A large proportion of the total production from these lands is committed by lease or contract to refining corporations. Nevertheless, about 30% of total domestic production is sold by independent producers. Consequently, there is an active market for crude oil in the United States and market prices are generally known and published.

It should be noted that oil is where you find it, and other business considerations than oil location have often dictated the location of refineries. Consequently, many of the largest integrated companies are sellers of their own crude oil production from some areas and buyers for their refineries located in other areas. Crude oil exchange agreements are not at all unusual in this industry. These sales and exchanges have also contributed to make an active domestic market for crude petroleum.

Open pricing of crude petroleum is not a characteristic of the world oil trade. Published quotations of posted or tax reference prices for foreign crude oil are not measures of actual transactions. Most producers of foreign crudes are integrated companies which ship and use their own production. One major international company recently stated that it refined 2/3 of its foreign production and the rest was sold under a long-term contract. Transaction prices are not often published when they do occur, and the only open pricing is that demonstrated by published bids for relatively atypical small amounts sold to government-owned companies in a very few locations.

Very few refining companies in the United States are net sellers of domestic crude oil. Of 23 integrated U.S. corporations analyzed in 1969, only 4 were in that position. These were Getty, Tenneco, Skelly (affiliate of Getty) and Pennzoil, of which only Getty ranks among the 21 companies having a refinery capacity above 100,000 B/D.

While industry-wide data are not available on the domestic crude self-sufficiency of refiners, sufficient data are available to conclude that only 2 of the 8 largest refiners exceed 80% net crude oil sufficiency in the United States, 2 approximate 50% and 4 between 60 and 80% self-sufficiency. On the other hand, it appears that at least 2 of the 21 largest refiners have a net domestic crude oil sufficiency of less than 20%.

Posted crude oil prices for various fields are bid prices offered by buyers to potential sellers. This is vastly different from posted product prices which are sellers' published offering prices to potential buyers.

It is also clear that an increase in crude prices, even after taking into account the resulting larger tax allowances for depletion on their own production, reflects an increased net cost to nearly all refiners, even the largest integrated refiners.1/ The cost impact on each refiner will vary inversely to its relative self-sufficiency in the production of crude oil. On the other hand, the independent producers who produce about 30 percent of domestic crude oil, do gross the complete extent of a price increase for crude oil.

Transportation

The movement of crude oil and products overland within the United States is primarily by pipeline. Most pipelines are owned by a single oil company or a group of such companies. Generally, these pipelines are owned by corporations falling within the 21 largest refining corporations. Most are common carriers, however, under either state or Federal law.

Substantial amounts of domestic crude oil and products also move by barge and tanker. The largest water movement is between the Gulf Coast and the Atlantic Coast, nearly all of it in tankers owned or chartered by refining companies situated in the Gulf Coast area. As a general practice, buyers of crude oil or products do not own or charter tankers for movement of the crude oil or products they purchase.

Smaller volumes of crude oil are shipped by tanker from Alaska to the West Coast. The tankers moving crude oil from Alaska to the West Coast are owned or chartered, in nearly all cases, by the very few companies controlling production

1/ Study of Petroleum Industry Research Foundation, December, 1970.

in Alaska. There is very little movement overland either into or out of the states west of the Rockies.

Those companies having substantial crude oil positions overseas own or charter nearly all the tankers moving crude oil or products into the United States.

Marketing

Nearly all refining companies have integrated forward at least to the wholesale level. Some, including the eight largest, are engaging in the retail sale of some products in some areas, particularly fuel oils. Some, including only one of the eight largest, operate service stations in some areas. In the case of this one major, it has ten dealer-operated stations for each company-operated station. There is no uniform pattern, and the degree of forward integration tends to vary widely from area to area even for a single refiner.

No more than 8 refiners approach nationwide marketing activity, of which 7 are among the 8 largest.1/ However, regional as well as local marketing is quite common among refining companies, at least those above 10,000 B/D capacity. In fact, because of refinery-to-market transportation advantages, regional marketers are often in a very favorable competitive position.

Branded products generally sell at higher wholesale prices than unbranded products. Independent jobbers, wholesalers and retailers often sell at lower prices than those marketing branded products. When the spread between branded and unbranded products tends to cause marked shifts in market positions, discounts are often offered off posted prices for branded products. In the case of gasoline marketing, these are generally termed temporary dealer allowances. The common practice of allowing discounts adds to the difficulty of determining a representative wholesale price for gasoline and to the development of dependable price series.

By no means all unbranded products are sold by "independent" or smaller refiners. Major refiners at times and in varying degrees manufacture products in excess of their own marketing requirements in some areas and sell the excess as unbranded products on the basis of covering their incremental costs. In addition, refiners find it advantageous to buy products from other refiners in some areas for sale under

1/ Humble, Texaco, Shell, Mobil, ARCO, Gulf, Indiana, Phillips.

their own brands, and in many instances product exchange agreements are utilized. Processing agreements may be used under which one refiner manufactures products for another. Consequently, when the consumer purchases branded gasoline, it is by no means to be concluded that the gasoline he purchases was refined in a refinery of the company owning the brand name. Those companies maintaining or approaching a nationwide marketing effort often must either purchase or exchange products in order to market in some of the areas in which they are active.

In most of the important marketing areas of the United States there are integrated companies engaging in competition with jobbers and retailers to whom they supply one or more products.

EVALUATION

To determine whether these announced price increases are "necessary" to national security, there are two time frames to be considered, short-term considerations and long-term considerations. A negative conclusion as to one time frame would be overcome by an affirmative conclusion as to the other.

From the initiation of the oil import program in 1959 until 1969, crude oil prices remained almost constant, and Platt's Oilgram price index (using 1957-1959 as a base) for crude oil was at 99.7 in December 1968. The combined effect of the 1969 increase and the one under review here has been to move this index up to 111.6, or about 11.9%, in December 1970. Using the same base period, the BLS wholesale price index for all commodities moved from 109.8 in December 1968 to 117.8 in December 1970, or about 7.3%.

A table of average crude oil prices by year is set forth in Annex C. While these petroleum prices have not reached the index price of all commodities, it is obvious that their recent rate of increase has been faster. Consequently, their movement has been one of the factors in our current inflation problems, as indicated in the recent inflation alerts issued by the Council of Economic Advisers. Based on 1970 crude oil production, the price effect would aggregate almost $800 million per year if fully passed through to the consumer.

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-CRUDE OIL PRICE INCREASE-

-Short-Term Considerations-

The Suez Canal has been closed since the Israeli-Arab War of 1967. In May of 1970, the flow of Saudi Arabian oil to the Mediterranean through the Tapline across Syria to Lebanon was interrupted. In addition, production in Libya was substantially reduced by governmental edict. All these factors combined to reduce sharply the amount of short haul oil available to meet European demand. Replacement of this oil had to come from the Persian Gulf by tanker around the Cape of Good Hope. To accomplish this movement, at least four times as much tanker capacity is needed (Petroleum Press Service, January 1971, p.2). Spot tanker rates more than doubled in a year's time, and the London Tanker Brokers' Average Freight Rate Assessments Index, which more nearly reflects term charter costs, indicated an average increase of 40% in ocean freight rates for crude oil between May of 1970 and January 15, 1971. All these factors were accentuated by a growth rate in the demand for fuel oils in Japan and Europe over double that in the United States.

The shortage of tankers and rapid growth in demand elsewhere have had a direct impact on the United States. Actual imports of crude oil from all sources dropped 7.5% or 106,000 barrels per day in 1970 from the 1969 level. In supply and demand terms this reduction is perhaps more significantly measured by the fact that actual imports of overseas oil in 1970 were approximately 185,000 barrels per day less than the refinery allocations under the Mandatory Oil Import Program. This shortfall was offset in part by an increase in imports from Canada of 100,000 B/D over 1969.

While crude oil imports declined during 1970, residual fuel oil imports increased over 330,000 B/D. Practically all of these imports were used in the Atlantic Coast states which are over 90% dependent on imported residual fuel oil.

As previously discussed, there is not an open world market system for crude oil. The situation at the time of the price increase, and previously, does suggest, however, a conclusion that the marginal delivered cost to the U.S. importer of much foreign crude oil was above the price of domestic crude oil. For instance, 16% of the overseas quota allocation for 1970 was not used by importers; it does seem that if enough tankerage had been available at a cost

making imports economic, these quota allocations would have been used. As other facts pertinent to the world price situation, the East Coast of the United States, where residual fuel oil imports have not been limited by the import program and which is therefore exposed to the world price for this product, experienced an increase of 50% or more in that price. Also, the price of No. 2 oil landed from Venezuela was generally close to that of domestic oil.

In the absence of controls on imports, the international dislocation might well have caused an increase in the price of domestic oil to the price at the margin of foreign oil delivered to the U.S. East Coast. The recent dramatic increase in residual fuel oil prices (along the Atlantic Coast) underlines this point.

At the present time, then, the U.S. oil industry has been faced with a tight world transportation supply. It is noteworthy that the effect of the oil import program can be judged to have served the country well in the recent world oil transportation shortage, since petroleum supply in the U.S. has continued to be adequate. Furthermore, the estimate is that, even with a further disruption of the Eastern Hemisphere supply situation, the U.S. petroleum situation should be manageable.

It is clear that price increases were not necessary in order to bring out alternative sources of supply to meet the demand during the present disruptions in normal supply movements of imported oil. Consequently, this short run situation did not necessitate crude oil price increases and further long run analysis is required.

During 1970 domestic production of crude increased 420,000 B/D over the year, or 4.8%, to meet the gap. This increased production came primarily from Texas and Louisiana, with smaller increases in production from Wyoming and Alaska. Except for marginal wells (stripper and secondary recovery wells), Texas and Louisiana apply market demand prorationing to oil fields in those states under which production from the more efficient reservoirs is restricted to meet estimated demand. Between October of 1969 and November 1970, Texas increased permissible production from these fields from 53.7% of maximum allowables to 87.3%. In the same period Louisiana went from 44% to 75%.

After a preliminary analysis, the Director of OEP concluded that any systematic analysis of the relationship between increased prices and their national security need was complicated by State control over oil production from Federal offshore lands over which the U.S. has exclusive jurisdiction by law. These controls could withhold from the market a portion of domestic oil production for which the Federal government had the overriding responsibility for national security and ultimate management responsibility. Hence, the Director concluded that the Federal government should assume regulatory responsibility over the production from Federal offshore lands in order to assure that this Federal area would make its maximum efficient contribution to meet longer range national security objectives and any claim of short-term supply deficits. As a corollary to this action, it was concluded that price increase pressures would be restrained by this action.

As part of his preliminary analysis, the Director of OEP noted further that existing overseas allocations for oil imports were not fully used due to the disruption in the world oil situation. On the other hand, production and pipeline capacity was available to switch, if the market forces so determined, some of these unfilled overseas allocations to imports from Canada.

After the consultation required by Section 6(a) of Presidential Proclamation 3279, the Director advised the President of the above situation. On December 4, 1970, the President placed oil and gas production on Federal offshore lands under Federal regulatory control. He also made users of imported Canadian oil who hold offshore allocations eligible to exchange those allocations for additional Canadian crude oil.

One measure of the supply/demand balance at any given time is the size of the inventory. At the end of 1970 total stocks of crude oil in storage were 33 million barrels above those at the end of 1969 or about 3.4% higher. During the four weeks ending October 30, 1970 - just prior to the initial price increase announcements - crude oil stocks increased each week. However, it should be noted that state market demand prorationing tends to counteract the downward pressure of high inventories on crude prices.

It should also be noted that gasoline stocks were higher at the end of 1970 than 1969 and were also higher at the end of

October 1970 than for the comparable week in 1969. Total crude runs to stills from all products were only about 2.3% above the previous year. Therefore, one cannot infer that refinery runs were increasing rapidly which might call for a price increase to obtain a higher level of supporting stocks if crude oil production was not keeping pace with refinery operations.

Some of the written submissions suggest that a higher price for crude oil will extend the production life of stripper wells, thus increasing the short-term supply. It is undoubtedly true that some of these wells which shut down when the revenue from their production no longer covers out-of-pocket costs would continue to produce for a time. (See Annex D for stripper well trends). Taking only short-term considerations into account, it seems clear that a higher price for crude oil would not bring forth significant production from this type of well.

It is quite true that secondary recovery projects, in which reservoir production is stimulated by such methods as water flooding or the injection of steam or gas, lead to greater production than natural or primary production alone. Additional investments are required for secondary recovery, and they will not be undertaken unless the additional production will provide an adequate return on this investment. Current nationwide information is not available on secondary production, but Annex E points up the fact that secondary production is expected to become a larger part of total production in the years to come.

However, it should be noted that the Department of the Interior has informally advised that it requires about 12 months lead time for additional production to be obtained even in the case of relatively shallow and uncomplicated secondary recovery projects. Therefore, it is most doubtful whether the additional revenue from the announced price increases will stimulate additional production to assist in meeting our short-term requirements arising from the current disruptions in world oil patterns.

Many responses cited the need for higher earnings in terms of the current health of the industry. This aspect of the analysis will be undertaken as part of the long-term considerations discussed subsequently in this paper.

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-Long-Term Considerations-

The price of crude oil varies by the characteristics and location of the production from a particular field. Refinery design, refinery location and refinery markets are among the factors affecting the crude oil market. Hence, there is no single existing quotation which can be taken as the price of crude oil and the most valid single figure has to be derived from a weighted average - a considerable statistical task. The most widely accepted average is that provided by the Bureau of Mines for each year, as set forth in Annex C for the years 1955-1970.

There is no direct proportional relationship between the price of crude oil and the price of any product to the consumer. Residual oil has in the past, for instance, sold at a lower unit price than the price of crude oil. One factor in this price has been the interfuel competition with natural gas and coal, a type of competition which affects gasoline prices very little. Hence, refineries have pressed to maximize production of gasoline and distillates, with consequent frequent inventory surpluses, and to minimize production of resiudal oil. The alternative fuel costs resulting from increased interruptions in natural gas supply and of changing environmental standards now adds to the complexity of any price analysis. There may be under way, over the mid-term and longer term future, a transition in the relationship of the pricing of the various products from a barrel of crude oil, and also a transition in the optimum economic mix of refinery production from a barrel of crude oil. Such transitions make reliable economic analysis difficult at this time.

A purpose may be served in having a look at the measure of what the United States might be willing to pay for energy security -- if the need were proven by a sobering experience. Practically all our energy supply is now secure except oil. Oil provides about 43% of total U.S. energy. The production (and import) cost of oil is about 16-18 billion dollars a year at current prices at the well head and port -- or less than 2% of our trillion dollar economy. This cost is less than a quarter of the annual budget of the Department of Defense. The total portion of the petroleum industry in the Gross National Product is on the order of $30 billion a year, with the major part of the costs being downstream from the provision of the raw material. The cost of crude oil at the well head represents an average of only 8.13¢ per gallon of gasoline.

Viewing this basic raw material cost of energy fuel of less than 2% of our GNP in the perspective of its essentiality to our way of life and also to our security, a moderate increase in cost could certainly be sustained if that increase were needed to preserve that security. On the other hand, there should be no need to sustain an increase in cost, if that security can be attained at a lower cost. To the extent available, alternative courses should be adopted which will achieve these security objectives without greater cost to the consumer.

Recent world events have demonstrated a substantial upward shift in the cost of foreign oil. However, the recent revisions in payments to foreign governments have increased the cost of foreign oil 40¢/80¢ per barrel, thus narrowing the spread between domestic and foreign crude oil costs. Historically, the long-range trend in the cost of foreign oil has been downward, but there is no present evidence upon which to assume this trend will re-occur.

The submissions in support of crude oil and gasoline price increases are directed primarily to the national security objectives of maintaining adequate crude oil reserves and a healthy petroleum industry. Even though considerations of providing excess production capacity and adequate refinery capability also must enter into long-term analysis to some degree, the submissions did not offer any substantial comment with respect to these factors.

On the other hand, submissions in opposition tended to discount heavily, if not reject, the national security findings accepted by four national administrations. Some, however, did contend that the price increases under study were not necessary to achieve the national security objectives stated above. Others limited their objections to a statement of their views concerning the adverse competitive effects within the industry which could flow from these price increases.

Proved Crude Oil Reserves

The trend in proved crude oil reserves is basic to considering the national security implications of these price increases. In terms of assured future supplies and financial net worth, the oil industry relies only on proved reserves in which enough drilling and testing have been done to define a measure of recoverable resources from each reservoir. These proved reserves are to be distinguished from

those inferred from discovery wells alone or estimated to be available in favorable geological formations. A recent National Petroleum Council report estimated that 55% of the oil and 60% of the natural gas in the United States remain to be found. These estimates constitute inferred and ultimate resources which are not included in proved reserve calculations.

From 1952 to 1957 the U.S. proved reserves steadily increased (with only one annual exception) from 27.5 billion barrels to nearly 32 billion. After 1957 these reserves varied within a narrow range which did not fall below 31 billion barrels until 1969. However, in each of the last three years (1968, 1969 and 1970) the nation's total crude oil proved reserves have declined. The extent of the decline is from 31.4 billion barrels to 29.4 billion barrels, excluding the North Slope of Alaska. (See Annex F). In other words, gross additions to these reserves from exploration and development have not been sufficient to meet our domestic production withdrawals. However, these reserves make no allowance for discoveries on the North Slope of Alaska which are not included for the purposes of this study because they are not presently deliverable. The American Petroleum Institute now reports the proved reserves of the Alaskan North Slope to be 9.6 billion barrels, but in view of the present uncertainty whether or when these resources will be marketable, they certainly are not available to meet our national security objectives.

Proponents of the recent crude oil price increase have expressed alarm that the ratio of proved reserves to current consumption has fallen drastically since 1955. In that year our domestic proved reserves of 29-1/2 billion barrels were 9-1/2 times our current consumption at the time. In 1969 that ratio was slightly under 6 to 1. (See Annex G). Under normal economic conditions it is not to be expected that crude oil reserves will reach a life index equal to that of the early 1950's in the face of our increasing demand for energy in all forms.

Optimistic estimates have put the reserves found thus far on the Alaskan North Slope at 20 billion barrels. Other estimates are 10-15 billion barrels. If these potential proven reserves in Alaska could now be included in the calculations the result would be a heartening leap in the current total. In fact, inclusion of 9.6 billion barrels of

North Slope oil by the American Petroleum Institute lifted its reserve calculations from 29.6 billion for 1969 to 39.0 billion for 1970. But, by the time that deliverability of this large increment is arranged (1974 or 1975 at the earliest) there will be a large drawdown of current reserves and an increase in the rate of annual consumption. Significant action will be required promptly if the decline in reserves is to be reversed before the Alaskan oil becomes available, and a continuing input of reserves is needed after that time since even 20 billion barrels is only the current rate of production of U.S. refineries for about five years. It may be noted for comparison that the total reserves ever proven in Texas have been about 31 billion barrels and 11 billion in Louisiana, including offshore.

The foregoing analysis is admittedly somewhat discouraging and leads to the obvious question as to what else, in addition to proven reserves of oil, can be done to provide energy security. Should these be the only areas of security emphasis and the oil import program the only program recognizing our national security energy needs?

There are other recognized courses of action. Policies which increase gas production (related to oil production) will tend to decrease demand for oil. Assurance of foreign oil from more secure sources will contribute to alleviating the problem - but there is not that much secure foreign oil in sight. Development of shale oil and acceptable utilization of coal (stack technology and gasification) will help. But these resources are available only for the latter part of the decade and, only then, if technology and development are pressed immediately. At best they initially will only supplement production from proven petroleum reserves. Research and development effort will be required now from government, producers and industrial consumers such as utilities if these potential sources are to be effectively utilized under sound economic principles.

It does seem necessary from the national security standpoint to maintain and strive to increase our proven crude oil reserves. However, any significant long run improvement in their life index almost certainly turns on developing a capability to produce synthetic equivalents for oil and natural gas from our vast reserves of oil shale and coal.

For the longer term, the principal issue is whether the recently increased price, or a higher price, or even a lower

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price, is necessary to maintain an adequate level of proven reserves and the needed accompanying production industry. The incentive factors involved include the cost/price relationship. But those incentive factors also include other government programs such as the leasing of government-owned land, environmental protection requirements, and realistic regulatory pricing of natural gas, which have not been systematically introduced into the equation of an adequate and secure petroleum supply.

Exploration and Development Expenditures

The available data confirm a declining trend in domestic exploration and development effort when measured by all the usual indices, such as geophysical expenditures, acreage under lease, rotary rigs in operation, wells drilled and wells completed.

With respect to total investments in exploration and development (excluding lease acquisition costs) the average annual investment since 1952 through 1969 has been $3.7 billion, and the annual investment has never varied more than 5.3% below or 8% above that average. (See Annexes H and I). Including lease acquisition costs distorts any such comparison since they include the sporadic wide swings occurring when bonus lease sales occur on the Outer Continental Shelf or in Alaska. Bonus payments also distort these investment data as a measure of effort since they do not cover any of the labor or capital equipment costs of exploration and development.

Undoubtedly, the rate of exploration and development expenditures has been affected to some degree by uncertainties in government policy trends in relation to such matters as environmental regulations, import controls and tax treatment at Federal and state levels.

As we note subsequently, the relaxation and liberalization of market demand prorationing in the past year have brought forth substantial amounts of lower unit cost oil. The probability that this trend will continue in prorationing should provide an incentive for greater investment in exploration and development.

Natural Gas Pricing

Prior to World War II natural gas was viewed in most oil-producing areas in the United States as a waste product and

large quantities were typically flared. After 1945 major pipelines moved natural gas to populous areas where this desirable and clean fuel found a ready market. Large quantities have been sold on an off-peak interruptible basis for industrial and boiler fuel purposes at prices which have discouraged the use of coal and residual fuel oil. In addition, well head prices for natural gas shipped in interstate commerce have been regulated on a cost-of-service basis by the Federal Power Commission since 1954.

Since about 1/4 of our natural gas supply is produced in association with oil and exploration for oil often leads to discoveries of natural gas, potential revenues from natural gas are important in exploration and development investment decisions. The average addition of gas reserves found with the addition of each barrel of added oil reserves has ranged from 1,074 cubic feet in 1967 down to 717 cubic feet in 1969. Intrastate prices for natural gas, which are not regulated by the Federal Power Commission, are higher than the regulated interstate prices. The Council of Economic Advisers has reported:

> Not only have prices been too low for desired consumption to be met, but they appear also to have retarded development of new gas supplies. The only satisfactory solution of this problem is to allow the price, at least of new gas not previously committed, to approach the market-clearing level.

As the Council observed, the competition of new supplies of natural gas would tend to reduce prices for consumers of other fuels. In our view, a revised pricing policy for interstate sales of natural gas also would provide a basis for more realistic sharing of the costs of exploration and development between the consumers of oil products and natural gas and restrain upward pressures on crude oil prices.

Cost Trends

The industry submissions in defense of their price increases have highlighted the increase in their costs and the decline in their profits and have stated that the industry is caught in a cost-price squeeze. But these claims need to be evaluated against the background of general economic events and a more complete picture of cost-price relationships than the submissions generally included.

Wage rates, drilling costs, and other elements of fixed and variable production costs have indeed been rising as claimed. But the part each of these costs plays in unit costs of production and refining is not discussed. Production costs cannot be totally disaggregated from refining industry costs since 70% of the crude oil produced is owned or controlled by refiners. According to the 1967 Census of Manufacturers, total payroll for all employees in petroleum refining (SIC 291) amounted to only 4.8 percent of total value of shipments. According to the Department of Labor, average hourly earnings in the oil refining industry advanced by 6.8 percent from September 1969 to September 1970, but output per man hour went up by 7.4 percent from 1968 to 1969 which would appear to more than offset the labor cost increase in calculating the unit cost. True, there was an industry-wide increase in labor costs in December 1970, but there is no evidence available to indicate any change in productivity trends.

Equivalent productivity data is not available for the production segment of the industry, but the wage bill is also only a small segment of costs in this part of the industry which is also capital intensive. And since State prorationing allowables have increased over the period, tending to increase the proportion of total output which comes from the more efficient, lower unit cost wells, it is entirely possible that these increases also have been offset. As noted previously, Texas and Louisiana allowables were increased substantially in 1970. In one year's time the actual lower cost production from Texas was increased almost 500,000 barrels per day, while in Louisiana it increased over 400,000 barrels per day. Even under normal world oil transportation conditions, it seems generally accepted that, given current trends in import levels, market demand prorationing will no longer be applied by 1973 or 1974 so as to have any significant effect on supply. The producers in those states will then have the full benefit of lower unit cost production. However, whether we have excess production capacity in future years will be affected primarily by the level of imports permitted under government policy and not by state prorationing in Louisiana and Texas.

Two additional cost elements, however, are not as easy to discount. These are the so-called "tax cost" of the reduction in the depletion allowance to producers and the added

costs of pollution control measures to producers and refiners. Both of these are new cost elements. They almost certainly have contributed to the fact that oil profits did not go up generally with the increase in demand which occurred even though this has been a period of economic slowdown.

The American Petroleum Institute did not provide a submission for this investigation. Their annual report does estimate that the 1969 Federal tax law added $700 million a year to the industry's tax bills and that the industry's annual rate of expenditures in 1970 for environmental protection was $559 million.

The Petroleum Industry Research Foundation estimates the cost of the revision in the depletion allowance to producers as around 24¢ per barrel -- almost exactly the crude price increase under investigation. If this is correct, it should be recognized that the crude oil price increases did restore the netback to the independent oil producer which he had prior to the Tax Reform Act of 1969. The Foundation also reports that, in the case of Gulf and the few other integrated companies with crude self-sufficiency of more than 82%, their depletion allowance benefit could be used to offset any additional cost in their refining operations for the oil they purchase from others. As to these few highly integrated companies, the crude price increase imposes no net cost on them even if competition erodes their efforts to increase the prices of gasoline and other products.

In evaluating the effects of cost trends it is necessary to consider productivity improvements arising from technological changes and greater efficiencies in exploration and development. According to a National Petroleum Council study prepared in 1967, the producing industry effected sizable cost reductions between 1950 and 1965, as follows: (1) improved drilling technology, 35¢ per barrel; (2) crude oil production methods, 32¢ per barrel; (3) better corrosion control, 9¢ per barrel; and (4) optimized well spacing, between 17-1/2¢ and 35¢ per barrel.

While the Department of the Interior is of the opinion that increases in costs together with the increased difficulty of finding oil have more than offset any cost savings from greater efficiencies, the Department has recognized the difficulty in providing objective data to support such a conclusion. The Department has advised us that:

> Many variables affect the cost of oil; the technology of oil exploration and production is only one of these. The exact interplay between rising costs, increased efficiencies, technological and operating prices, the increasing difficulties of finding oil and randomness of new discoveries is difficult to assess and quantify for any short-term period.

Annex J sets forth the ratio of annual exploration and development costs per barrel of new reserves added for ten years, 1960-1969. Inasmuch as current reserve additions arise largely from past expenditures, and current expenditures are made in part to provide future reserves, this ratio must be used with considerable reservation. However, these data do tend to establish that annual variations cannot be relied upon as a firm basis for concluding that industry-wide exploration and development cost trends would warrant a crude oil price increase at this time.

There is considerable room for doubt whether cost trends in drilling are nearly as important as the industry's judgment of the probabilities of successful discoveries. When opportunities have been made available to obtain wildcat drilling rights on the Outer Continental Shelf and in the Alaskan North Slope areas, exploration expenses have bulged materially because of large bonus bids. These payments, of course, did not pay for one foot of drilling costs. Thus, in 1967, 19.7% of the industry's total exploration expense was in lease acquisition costs; in 1968, 31% and in 1969, 23.8%. In contrast, from 1952 to 1960, these costs never exceeded 13% of total exploration costs.

Another indicator that success probability weighs heavily in industry exploration activity was demonstrated in the recent Louisiana offshore sale in December 1970. The high bids accepted by the Federal government amounted to almost $846 million. The total of the unsuccessful bids was over $2 billion. In other words, after the sale there remained over $2 billion, most of which presumably was available for exploration in favorable areas. In 1969 the State of Alaska sold leases in the North Slope area for which cash bonuses aggregating some $900 million were paid.

The 1969 Alaska sale is particularly significant. Operations on the North Slope were known to be extremely costly and

transportation expense largely an unknown element. Nevertheless, the industry paid out over 1/6 of its total exploration and development expense that year just for the right to drill and produce in that area. It seems apparent that the probabilities of large-scale production and low average unit costs per barrel produced are an incentive more than offsetting the obvious cost disadvantages of operations in that area. An official of one of the companies with a major interest in the North Slope has stated that the oil industry's total investment may well reach $10 billion and, even at that cost, North Slope oil will be economically attractive. The average flow rate per well is expected to be 10,000 B/D.

From May 21, 1968, until December 15, 1970, there were no exploration leases on the Outer Continental Shelf offered for sale by the Federal government. This was a period of almost 30 months in which the only leases available in these favorable areas were in small drainage pockets for which $125 million were paid. During the same period and continuing even now, Federal leases are not available in Alaska pending settlement of certain native claims.

Less than 5% of the world's producing fields account for more than 85% of the world's oil. When both oil and gas are considered, giant fields with over 500 million barrels of oil or gas equivalent account for over 80% of the world's hydrocarbons. Within the United States the two areas with known prospects for giant field discoveries are off the coast of the Gulf of Mexico and California, and in Alaska. Quite naturally these areas attract large amounts of capital for exploration and development, yet these are the very areas in which there have been major obstacles to Federal leasing and development for several years. It may then be questioned whether the decline in proved crude oil reserves would have been as steep in 1969 and 1970 if the Federal government had followed a different leasing policy after May of 1968.

Investment Requirements

The recent boost in crude oil prices has been consistently defended as necessary to provide funds for exploration and development, thus to assist in reversing the decline in proved crude oil reserves. As noted previously, some of the submissions supporting the increase have said it was not enough to assure the desired result, but that it is an important step in that direction.

There are three sources of funds for investment in the petroleum industry. They are (1) retained net earnings; (2) return of capital, which includes the proceeds obtained by the industry as a result of depreciation and percentage depletion allowances on crude oil production; and (3) capital raised through equity participation or through debt transactions.

A series of charts are attached which establish quite clearly that the petroleum refining industry over time has had a favorable profit experience compared to other industries. Profit rates after taxes for the refining industry exceeded the average for all other manufacturing industry in four of the seven years from 1963 to 1969, inclusive. While the total cash flow of the petroleum refining industry in relation to stockholders' equity exceeded that of the average for all other manufacturing industries in only two of these seven years, the available data indicate clearly that the oil refining industry has not been disadvantaged on balance. See Annex M.

The analysis that follows is based on data contained in the Federal Trade Commission--Securities and Exchange Commission, Quarterly Financial Report for Manufacturing Corporations. In order to sharpen the comparison, the petroleum refining data as published has been subtracted from the published data for all manufacturing to create a series for all manufacturing except petroleum refining.

Since the availability of financing for investment is affected by capital recovery as well as retained earnings, cash flow series have been calculated by adding the published data for retained profits to that for depreciation and depletion. The final adjustment to the published data was necessitated by a lack of the most recent data. Since only three quarters of data were available for 1970, annual rates are calculated by multiplying the three quarter totals by four-thirds, i.e. assuming that the fourth quarter results would be the average of the first three quarters.

Annex M gives the resulting time series for profits after taxes and cash flow for both petroleum refining and all other manufacturing. These are listed both in millions of dollars and in percentages of stockholders equity.

Annex N shows graphically the relative growth patterns in terms of the actual dollar values. Because of the differences

in scale, however, the relative heights of the lines for the two sets of curves should be disregarded - only the patterns of growth and the spreads between profits and cash flow within each set of curves are comparable.

Annex O displays cash flow and profits for these industries in terms of percentages of stockholders equity. The data are all strictly comparable on this graph, but the truncated scale may tend to exaggerate the size of the changes.

Petroleum, both in terms of profits and cash flow, appears to be much more stable than manufacturing industries in general. The data and graphs do indicate a drop in the petroleum refining profits, as claimed, but not a worsening of the position vis-a-vis all other manufacturing industries.

Of course the fact that petroleum refining profits and cash flow have not suffered as large a decline today as other industries is not necessarily proof that they are adequate to meet the needs of sustaining the level of domestic reserves.

One factor that bears heavily on this question is the extent to which these resources are indeed applied to domestic investment in production capability and exploration. While the data are not strictly comparable to that of the FTC-SEC, the Chase Manhattan Bank reports on Capital Investments of the World Petroleum Industry can help to throw some light on the question.

According to the Chase data, American companies have allocated their capital expenditures in recent years as follows:

	1968	1969
United States	$7,745 million - 64.6%	$7,495 million - 62.4%
Production[1]	(4,625 million - 38.6%)	(4,415 million - 36.8%)
Other[2]	(3,120 million - 26.0%)	(3,080 million - 25.6%)
Free Foreign	4,240 million - 35.4%	4,510 million - 37.6%
TOTAL	$11,985 million - 100%	$12,005 million - 100%

1. Both crude oil and natural gas, including natural gasoline plants.

2. Pipelines, marine (tankers), refineries, chemical plants, marketing, etc.

The Chase Manhattan 1969 survey of petroleum capital investments also reveals that 81% of the worldwide spending in the search for new petroleum reserves came from American companies. In this connection, it should be noted that the same rate for depletion is allowed under U.S. income tax laws for foreign production as for domestic production. Consequently, it can be said that our income tax laws, including credits for foreign tax payments and equal depletion allowances, are essentially neutral and provide no differential incentive favoring exploration for domestic reserves. In effect, this means that the Mandatory Oil Import Program is not reinforced by our tax policy in achieving national security objectives.

While 4th quarter and year-end data are not yet available on the same basis as the first three quarters of 1970, the Wall Street Journal for February 5, 1971, surveys 4th quarter profits for 422 business concerns from more than 21 different industries. Nineteen petroleum companies were included. This summary indicated a 10% improvement over the 4th quarter in 1969 for the oil companies included. Only five of the other 20 industries were reported as having improved profits for that quarter over the previous year. Our own review of published earnings results for 23 of the companies included in the Chase Manhattan financial analysis for 1969 indicates that 11 reported increased net profits for the year and 12 reported declines, but none reported losses. Of 17 of these companies for which 4th quarter results have appeared in the press, only 3 reported a decline for 1970 over 1969. These data indicate that the industry's performance for the year actually was more favorable than that reflected in the annexes attached.

A similar survey by Business Week (February 13, 1971) for 250 corporations in 25 different categories of industry confirmed this conclusion. The oil industry, represented by 26 corporations, was one of 13 categories of corporations reporting improved 4th quarter earnings over 1969. The profit margin of oil for the quarter ranked exactly in the middle of the 13 categories showing improvement.

On February 8, 1971, the Oil and Gas Journal reported on oil industry profits for 23 corporations, including all five of the major internationals. For the 23 as a group, 1970 annual profits were only a shade less than 1969, with 10 reporting increases and 13 decreases. For the 4th quarter,

only 6 of the 23 reported declines. Of perhaps even greater significance is the fact that only one of the 5 major internationals reported lower earnings for the year 1970 than for 1969, and their 4th quarter results were much more favorable than the other companies as a group. The one exception emphasized an unfavorable tanker position. Since these five major internationals received over 63% of the total profits of the 23 corporations included in the survey and there have been widespread reports of favorable foreign results in 1970, it can be questioned whether additional profits from price increases in the U.S. will in fact lead to more domestic exploration and development in the face of attractive opportunities for overseas investments by the industry.

The point is made in several submissions that the industry historically has relied heavily on cash flow (retained earnings and return of capital) to finance its investment requirements, but in recent years it has had to rely more heavily on borrowed money and equity issues. This trend is confirmed by the 1969 Chase Manhattan financial study of 27 corporations. In 1959, they met 91.3% of their capital needs from cash flow, whereas in 1969, 76.4% was obtained from these sources.

Nevertheless, one should not assume that this trend is precisely related to exploration and development trends in the United States. From these same capital sources must come the funds invested by American companies overseas as well as home. Furthermore, the capital requirements of the industry also include funds for transportation, refining and marketing facilities, as well as exploration and development. Merely adding to the industry's cash flow by a domestic crude price increase does not assure, in itself, that more would be invested in domestic exploration and development.

In view of the readily apparent need of the industry for vast sums of money for investment in the years to come, in order to meet world demand growth, more and more reliance on new equity and debt capital must be expected. One major company has recognized this and in the last year has raised about $1 billion in new money.

For the Chase Manhattan group, the proportion of its total investment in the United States has declined from 79% in 1959 to 72.8% in 1969. This reflects in part the phenomenal industry growth elsewhere, particularly in Europe. Almost half of the Chase Group's capital investment

worldwide in 1969 were for purposes other than production of raw materials. A recent Oil and Gas Journal (February 22, 1971) projected that refining capacity in Europe will be expanded at the rate of 1.4 million B/D for each of the next 5 years. The U.S. Department of Commerce has estimated that U.S. overseas oil investment will jump 13% in 1971.

Insofar as interest costs on borrowed money may be concerned, the petroleum industry certainly is not disadvantaged in relation to other industries. Nor are the recent high levels of interest costs to be considered as immutable. Interest rates for substantial borrowers have been dropping rapidly in the past six months.

Surplus Production Capacity

While provision for surplus production capacity is an essential consideration in analyzing any oil program for national security purposes, the submissions made no substantive contribution that would connect the price increases to this objective. The Department of the Interior has estimated that there remains today a surplus capacity of one million barrels per day, deliverable within a reasonably short time. Of this amount, 225,000 B/D are attributed to Elk Hills Naval Petroleum Reserve No. 1 and the remainder to Texas and Louisiana. The latter capacity is surplus in the sense that state prorationing has limited production below the Maximum Efficient Rate for many fields in those states. It has been held in surplus for reasons other than national security, and it is generally agreed that our burgeoning demand for petroleum will cause effective removal of prorationing limits by as early as 1973. However, substantially higher import levels could be expected to result in excess domestic production capacity. The national security benefits from this surplus capacity in previous crises have been merely by-products of other restraints such as import policies and state market demand prorationing.

Merely providing more funds to the industry through higher crude oil and product prices will not assure a desirable level of surplus capacity for national security protection. Even if the funds so raised are expended in exploration and development, that would not guarantee excess producing capacity available on short notice. Unless market demand conditions warrant development drilling, there will be a

tendency to restrict such development to that necessary to define a newly discovered reservoir and thus prove its crude oil reserves. Further development would then be staged as the market for the oil would justify.

If the Federal government is to carry out its national security responsibility properly, it would seem that incentives must be tailored to fit the desired level of excess production capacity. An increase in crude oil and product prices as the sole incentive is obviously poorly suited to that purpose.

The Independents' Role

In the past independent producers have participated substantially in expenditures for exploration and development of oil and gas resources. From 1946 through 1955 the Chase Manhattan group (which includes some large independent producers and all the major refiners) averaged $1.4 billion per year while all others, including literally thousands of independents, averaged $1.3 billion.

After 1955, however, this relative situation changed materially. By 1969 the Chase Manhattan group had increased its annual expenditures for exploration and development by 50%, but the other elements of the industry were expending 45% less than their 1956 level of investment.

There is little evidence that crude oil prices were a substantial factor in this change. As noted previously, exploration emphasis has shifted materially to the Outer Continental Shelf and to Alaska where there were favorable prospects for giant fields and where leases are issued on the basis of competitive cash bonus bidding. As noted previously, these lease acquisition costs have become a major portion of exploration investment and no doubt have hindered participation by many independents. It is heartening, however, to note that in the December 1970 Outer Continental Shelf sale, independent producers were major participants in two of the three tracts for which the highest per acre bids were made. In addition, the use of drilling funds has provided a means to raise money for expensive exploration efforts. As a tool, these funds certainly provide an avenue for participation and management by skilled independents.

In the long run it appears that it may be necessary to rely significantly on the independent to take the wildcat

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risks necessary to explore those areas which are favorable prospects but are not likely to yield giant fields. In addition, leasing policy which did not turn so heavily on large advance bonuses would provide him more opportunity to participate in highly desirable areas such as the Outer Continental Shelf.

Integrated companies have become progressively more self-sufficient in crude production. See Oil and Gas Journal, January 18, 1971, pp. 22-24. An increase in crude oil prices generally will tend to accentuate that trend. It is apparent that the more costly purchased crude becomes, the greater the incentive for integrated companies to expand their own exploration effort (in competition with the independent) and thus reduce their purchases of crude oil in the open market.

Here again it seems that a desirable objective - significant participation by independent producers - may require tailored incentives and will not necessarily be achieved by a crude oil price increase alone.

Summary Long-Term Observations

Exploration and development for oil are assumed in the submissions, sometimes explicitly, sometimes implicitly, to be directly related to the price of crude oil. There is, however, a very wide difference in professional judgment on the long-range relationship of crude oil prices to production levels. (See Annex P on the elasticity of supply). The submissions from the producers, however, generally show an attitude that the recent price rise, while welcomed, is not enough in their opinion.

As stated earlier, the prices for domestic crude oil vary widely. Gravity, sulfur and metallic content and location all materially affect the pricing of crude oil. This is well illustrated by the average prices of the 5 types of crude oil used by the Bureau of Labor statistics in its monthly wholesale price index. For the month of January, these prices varied from $2.97 per barrel for Wyoming sour crude to $3.765 for upper Texas Coast sweet crude. Some specialized crudes command even higher prices in the marketplace.

Adequacy of exploration, by implication in most of the submissions, is measured in terms of geophysical operations,

leasing, active drilling rigs, and feet of drilling. These physical indicators of exploration activity have all been declining over the past decade. Another measure of adequacy mentioned is the dollar investment in exploration and development. That rate of investment, excluding bonus payments, has remained fairly steady for at least ten years at about 3.7 billion dollars.

The only available estimates of oil industry investment needs in the future are from private sources. The Chase Manhattan Bank estimates that approximately $7.25 billion (including lease acquisition) per year is required over the decade of the seventies. This estimate seems to assume a continuing and increasing reliance on petroleum as an energy source. Such a level of investment, or for that matter even the recent level, turns on a combination of anticipated success in exploration, anticipated price of oil, availability of capital for this purpose, and the rate of development of alternative energy sources.

Generally, emphasis has been placed on the price of crude oil, both as an incentive to explore and as a provider of capital. But it does seem unlikely that price alone will bring about almost double the rate of capital investment from earnings of the oil industry--when that investment has remained about constant for at least ten years, even in those few instances in which there have been changes in crude oil prices. See Annexes C and I. Hence, attention in this analysis needs to be paid to the general problem of provision of capital and to probability of success in drilling. For, referring to the last point, the real test of adequacy in exploration is in the addition to reserves, and not in dollars spent, feet drilled, or any other measures.

Capital tends to move where investment is judged to be most remunerative. This principle applies to oil company earnings, which may move to coal, refineries, pipelines, motels, or some other investment, either here or abroad, rather than to domestic exploration and development. The same principle applies to bank investments or any other sources of capital for exploration. Hence, to maintain exploration and development, we have to premise an anticipated longer-run earnings situation for the oil industry comparable to anticipated earnings for other major capital investment. Whether some additional increment is needed because of the risk element is arguable, and difficult to analyze because of such compensating aspects as tax treatment. But certainly

the maintenance of a healthy industry, assuring adequate exploration and development, requires an assurance of earnings in equilibrium with that for other major industry. Otherwise, capital will not be provided to do the needed long-run job.

Parenthetically, critics of the oil industry have pointed to its earnings. That earnings rate is substantially the same as that for all other manufacturing and we should not premise that it be less. See Annexes N and O. Otherwise, we may be creating a situation unattractive to capital and inhibiting a development essential to national security.

Furthermore, if an increased rate of investment is needed, it may be argued that some incentive beyond that for other industry is warranted. The choice among incentives is not limited to oil prices alone. Incentives could be governmental assistance of some type (such as pilot plants for synthetic fuel), a more favorable leasing policy, more return for natural gas, or some other provision or combination of provisions. For instance, as noted above, the U.S. depletion allowance tax policy applies equally whether the oil produced is domestic or produced in an insecure foreign source. About half of the exploration capital of major U.S. companies is invested abroad. Since the U.S. crude price is higher than overseas crude costs and imports into the United States are limited by quotas, the reasons for this export of available capital must lie outside the domestic crude oil price structure.

As mentioned above, the future level of investment turns primarily on anticipated success in exploration, anticipated price and availability of capital--and the objective is addition to reserves. Oil companies often stress need for assurances as to long-term policy as much as they stress price. The flow of exploration capital abroad must be primarily due to anticipated success in exploration in relationship to costs and profit margins realizable in foreign markets.

We have mentioned above the demonstrated willingness of U.S. capital to make large bonus payments for leases believed favorable to the discovery of large fields. With that commitment to leases goes an implicit commitment to invest in exploration in order to recover the initial lease acquisition costs. But recent leasing and other government policies have not encouraged exploration and development of the more promising areas (offshore and Alaska).

Certainly, there are conflicts among public policy objectives, e.g. maximum income from bonuses, maximum environmental protection and perhaps others. But the tradeoff for each increment in achieving adequate reserves may, in the long run, have to be increased prices. But the incentive of price alone is unlikely to provide those reserves. For instance, as noted before, Alaska is a striking example of a situation where development of reserves is currently not price sensitive because of the temporary overriding effect of other factors. A coordinated family of actions is needed.

As noted before, several respondents have indicated that the November price increase is not adequate. None attempted to estimate the increase considered adequate. Such an estimate is obviously difficult, involving as it does, estimates of U.S. demand and domestic supply at different price levels and a judgment as to the amount of dependency which threatens to impair the national security. The Cabinet Task Force study (completed in late 1969) did make such an estimate concluding that a dependency on the Eastern Hemisphere for more than 10 percent of consumption should be avoided, and further concluding that such dependency could be avoided with a U.S. crude price of no more than $3 a barrel and perhaps less than $2.50 a barrel.

While not a submission for this investigation, there is a recent study taking sharp exception with the Cabinet Task Force study estimates.1/ This recent study estimates that, at the price level prior to the recent price increase, the 10 percent dependence on Eastern Hemisphere oil will be exceeded by 1973, the dependence will reach 16.5 percent by 1975, and 22.8 percent by 1980. This recent study further estimates an immediate need for an increase of 73¢ a barrel above 1969 prices, or about $3.80 a barrel, to limit future dependence to 10 percent. The impact of possible program and policy options without price increases was not considered in this study, however.

Thus far, the discussion has not dealt directly with synthetics (oil shale, coal gasification and liquefaction, and perhaps tar sands). The available forecasts are that within ten years or so the United States may need these sources for any semblance of supply security unless there is a large input from the current unproven but promising locations.

1/ Oil Imports and the National Interest, Petroleum Industry Research Foundation, Inc., March 1971.

The United States cannot safely wait too long to move on the synthetics. The incentives could be a combination of leasing policy and price. For the latter, it has been argued that national security purposes call for a price increase sometime in the future to generate production of synthetics. The usual price mentioned by oil company executives is around $3.75-$4.00 a barrel. As noted previously, the best grades of crude oil currently attract prices approaching that level already. But members of the industry often add that if the government would permit a prototype operation, the necessary incentive price might be less.

Again, government as of now but not for too long, has a choice in the matter of synthetics. The options include: (1) inaction which will result in an undesirable degree of dependency on foreign oil sources; (2) complete reliance on the market in response to price increases; (3) governmental actions favorable to exploration and development, or (4) direct government assistance as it chose to do in the case of atomic energy (which will not provide more than 7-10% of energy by 1980, whereas oil and gas will probably be providing ten times that amount); or some combination of the foregoing.

On the matter of price, it has been customary to cite the lower price of foreign oil when criticizing the domestic price of crude oil as being too high. It is a fact that the cost of foreign oil did fall fairly steadily from 1960, when the landed cost in OECD countries was about $2.65 a barrel, to 1969 when the landed cost was about $2.20 a barrel. Recent OPEC negotiations have, however, resulted in a 42¢ per barrel average increase as of June 1 for 1971 and a contract provision for escalation over the next five years. Hence, it appears that the price of foreign oil in the longer term may well continue to increase, contrary to past history and the views of some authorities who believe that producer countries will not act together in the long term. While the cost of foreign oil at the well-head is unlikely to increase to the level of U.S. domestic crude prices, this foreign trend is a factor affecting the U.S. oil situation, including the allocation of U.S. exploration capital.

The possible avenues in the longer term, in addition to, or in lieu of, an increase in price of crude oil, include:

a. Acceleration of offshore leasing in all promising locations, including even previously unexplored areas such as offshore New England.

b. Resolution of the problems inhibiting exploration and production in Alaska.

c. Some shift to royalty leasing on a selective basis to generate exploration in previously untested areas.

d. Consideration of the tax treatment of oil to determine whether a difference should be established between exploration and development in secure areas as compared to insecure areas.

e. Systematic and timely balancing of environmental security and energy security objectives.

f. Updating of our traditional Naval Petroleum Reserve policies.

g. Steps to adjust natural gas regulation to avoid governmental underpricing of one fuel to the detriment of others.

h. Timely action on synthetics from coal, oil shale and tar sands.

i. Measures to reduce wasteful consumption.

As a concluding summary statement, referring back to the comment on cost of petroleum as compared to our total Gross National Product, the increase in the price of crude oil, in the longer term, may become necessary to achieve our critical national objectives. On the other hand, it does seem clear that price alone is most unlikely to do the job, and further increases may not be necessary if supporting programs are wisely pressed on a timely basis. In fact, it may well be hypothesized that even the increase reviewed here would be clearly unnecessary if these actions had been examined thoroughly and those most feasible had been vigorously implemented over the past decade.

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-GASOLINE PRICE INCREASE-

To obtain greater realization of profits through increasing the wholesale price of gasoline is difficult because of the competitive, volatile, and complex structure of the gasoline market. Earlier attempts -- February 1969 and May 1970 -- to raise dealer tank wagon prices were substantially negated by competition within the industry itself. See Annex K.

The 1969 price increase effort began on February 25 when Texaco increased domestic crude prices by 20¢ per barrel and dealer tank wagon prices by 0.6¢ per gallon. Industry reaction was mixed. That time the higher gasoline prices received a greater immediate industry response while the crude increase picked up support more slowly. An erratic pattern of price changes continued over an extended time. By the end of 1969, the structure of the gasoline marketing system had itself essentially eliminated the sought-after gasoline price increase, even though average crude oil prices for 1969 were 12¢ per barrel higher than for 1968.

The 0.7¢ per gallon dealer tank wagon price increase started by Mobil in March 1970 did not hold either, except that the increase was dissipated in a much shorter period of time.

It is not yet clear whether the industry's previous inability to maintain higher gasoline prices will be repeated in the current gasoline price increase cycle. Gulf Oil Company triggered the current attempted increase by increasing its gasoline dealer tank wagon price by 0.7¢ a gallon concurrently with its increase in the price offered for domestic crude. Also announced was a 0.55¢ increase per gallon to jobbers, suggesting a 1.0¢ retail increase at the pump.

According to the trade publications, there also followed a widespread effort on the part of the majors to withdraw outstanding dealer competitive allowances. Such a withdrawal could have resulted in a net increase at the pump of 2¢ to 9¢ depending on local market situations, and in one week the Council of Economic Advisers reported that gasoline prices went up 16%. In other words the effort was to increase gasoline pump prices substantially more than 1¢ above the previously prevailing retail prices.

It is difficult to establish a single definitive measure of national gasoline price levels at given points in time because of the differences in competitive conditions among

local markets and the lack of comprehensive statistical measures of gasoline prices. Several measures of price changes in the period November 1, 1970 to February 1, 1971 are available. These measures should be viewed in the light of both their statistical adequacy and the markets which they describe.

According to Platt's Oilgram of February 2, 1971, the retail market consists essentially of four categories, each of which seeks a different level of profit per gallon according to their sources of supply, services rendered, and method of operation. These several categories enhance competition and tend to dampen or overcome attempts to increase the price of gasoline at the pump.

a. Unbranded, self-serve operators who seem to be satisfied with a profit margin of 5¢ per gallon.

b. The private brand operators -- the so-called SIGMA group, or Society of Independent Gasoline Marketers of America -- who aim for a profit margin of 7¢ to 8¢ a gallon.

c. The branded independent operators who normally price at 1¢ above the SIGMA group.

d. Major brand operators who tend to seek a price level 2¢ above the branded independent operators.

Both Platt's Oilgram and the Oil and Gas Journal depend primarily on company-supplied information for their price surveys. For a given market area, there may be a range of prices prevailing for the same brand of gasoline. In addition, none of the existing measures of prices are scientifically weighted by volume of sales; consequently, the reported national price levels are simple arithmetic averages of data from all cities sampled. In the Oilgram report, for example, Los Angeles is given the same weight as Portland, Maine, even though Los Angeles obviously consumes a far greater volume of gasoline. Finally, the geographic distribution of selected cities is probably not a representative sample of the United States as a whole. The Oil and Gas Journal, for example, lists only eight cities on the East Coast between Maryland and Maine, while showing nine in the state of Texas.

Recognizing the above shortcomings in popular statistical measures, there follows a summary of national "average" prices for the period November 1, 1970 to January 1, 1971. The prices are in cents and do not include local sales taxes.

Platt's Oilgram--55 Selected Cities
(Major brand, regular)

	Nov 1, '70	Dec 1, '70	Jan 1, '71	Net Change Nov-Jan
Dealer Tankwagon (ex tax)	17.40	19.03	18.38	+0.98
Service Station (ex tax)	23.71	26.50	25.61	+1.90
Tax (Incl 4¢ Federal)	11.14	11.14	11.14	0.0
Service Station (incl tax)	34.85	37.64	36.75	+1.90

Oil and Gas Journal--52 Selected Cities
(Major brand, regular)

	1970		1971		Net Change
	Nov 3	Dec 1	Jan 5	Feb 23	Nov-Feb
Service Station (ex tax)	23.35	25.85	24.67	22.54	-0.81
Pump Price	34.26	36.76	35.56	33.43	-0.83

A comparison between the service station (ex tax) prices of these two indices illustrates the difficulty in determining what the price of gasoline actually is. However, the Bureau of Labor Statistics survey of retail gasoline prices in 10 major cities, which reports a high-low range, reveals that the January low prices in those cities were above November lows in only 3 of the 10 cities.

As a cross-check against the above reported averages, we have also examined price levels for jobber unbranded regular gasoline in 10 markets on a day-to-day basis from October 1, 1970

through February 26, 1971, as reported in The Oil Daily. These prices have a marked effect on competitive prices as indicated in the earlier discussion of the petroleum industry. These wholesale data are summarized in Annex L for the Williams Brothers Pipeline Terminal, Oklahoma Northern Movement, and five of eight cities examined (the three cities excluded--Bay City, Evansville, and Detroit--have patterns almost identical to that shown for Indianapolis).

Although the sample of jobber prices reported by The Oil Daily is admittedly small and is somewhat regional in nature, the relative stability of these jobber prices in the face of the attempted price increases and volatile swings in other parts of the market is significant.

Of the eight cities surveyed, there were no changes in jobber prices until December 1, 1970 when increases in two cities in the amounts of 0.50 and 0.25¢ were posted. Milwaukee remained constant throughout the period while the remaining five cities showed the first increase on February 2, 1971. The patterns in Williams Brothers Pipeline Terminal and Oklahoma Northern Movement were somewhat more active, with each showing a decrease of 0.25¢ on October 13 followed by a return to the starting price of 12.25¢, a series of adjustments, and a net change from the starting price of -0.50¢. Over the total period the net change ranged from -0.50¢ to +0.75¢ and the average change for the ten markets was +0.31¢.

The resistance of unbranded jobber prices to upward price announcements is a source of pressure on branded suppliers to grant larger dealer competitive allowances in order to meet the unbranded competition and avert a significant market shift. Evidence to date indicates that the competitive pressure within the market--and particularly that caused by unbranded gasoline prices--may have created a market atmosphere in which the gasoline price increase sought by the industry in November cannot survive in the short term.

The temporary dealer allowance is a discount or price support offered to the dealer or jobber in order to support a particular pump price and thereby meet the competition. Such allowances have played a significant role ever since the mid-fifties.

The January 1971 National Petroleum News indicates that refiners report a major growth in allowances with 1970 totals about double those for 1969. In any event, temporary competitive allowances are not only a major factor in meeting

competition but also represent a significant drain from refinery profits. National Petroleum News also cites a major company which estimates its total competitive dealer allowances in 1970 as approximately $100 million at an average cost per gallon of 2¢.

Confidential data have also been made available to us by one integrated company with a high degree of crude sufficiency. These data, although not necessarily typical of the industry as a whole, tend to confirm both the magnitude of competitive allowances and the widespread reports in trade publications of continued discounting from posted dealer tankwagon prices since November 11 when the current round of price increases was announced.

(a) For the first eleven months of 1970 this company granted over $8 million in allowances at an average rate of approximately 1.3¢ per gallon. Individual allowances in local areas have ranged as high as 12¢ per gallon for short periods of time.

(b) Total temporary allowances per year have multiplied by 4-1/2 times what they were in 1965 and the allowance cost per gallon by 3-1/2 times.

(c) The netback to the company per gallon of gasoline increased approximately 0.3¢ from November to December 1970. However, its average netback was less than one mill per gallon higher for the year 1970 than 1969.

There is support for a judgment that dealer allowances are an important factor in any effort to determine the price of gasoline and its trends. A survey of quoted prices is not alone sufficient. But dealer allowances are not readily susceptible to incorporation in the data base of a price index or even of a price survey such as those undertaken by the trade press.

At least two companies have recently announced new pricing policies apparently intended to eliminate temporary competitive allowances. Phillips announced that it was discontinuing temporary competitive allowances indefinitely for jobbers and dealers in southern Idaho, western Wyoming, eastern Nevada and all of Utah. This was followed in December by termination of minimum margin assurances to jobbers and

dealers in Arkansas, Louisiana, and Texas. National Petroleum News, January 1971, reports the Phillips rationale for these actions as an effort to "lessen the impact of destructive price wars on Phillips' dealers, jobbers, and Phillips itself." With respect to the discontinuance of the assured margins, a Phillips spokesman is reported as saying, "We believe price supports at downstops during gasoline-price wars have outlived their usefulness, and indeed oftentimes contribute to depressing prices to unrealistic levels."

According to Platt's Oilgram, the Continental Oil Company, on January 21, 1971, discontinued the granting of temporary competitive allowances and concurrently announced a reduction of 1.2¢ per gallon for its normal dealer tank wagon price and 0.6¢ per gallon for its normal jobber price. The CONOCO philosophy, as cited in Platt's Oilgram, is: "The pricing of petroleum products inevitably must undergo drastic change in the 1970's. This change will be either evolutionary or revolutionary -- i.e., it will be change which is intelligently, deliberately 'managed' by oil suppliers themselves, or it will be revolutionary change imposed on the industry by the government."

Recent reports have indicated that neither Phillips nor Continental succeeded in its effort to reduce the practice of discounting.

It is apparent that for the majority of refining companies, including some major companies such as Mobil and Standard Oil of Indiana, the November increase in crude prices represents an additional cost, unless they are able to pass this higher cost through to the consumer in the form of higher product prices, including those of gasoline. The level of this additional cost, of course, varies inversely with respect to the degree of crude self-sufficiency of the refiner in question. Those refiners having little or no crude production are therefore under pressure to maintain higher product prices, including the price of gasoline, as a result of crude oil price increases. In the longer term this pressure may well suffice, in conjunction with other market conditions, to establish gasoline prices at levels higher than those in effect prior to the price increase initiated by Gulf Oil Company on November 11, 1970, particularly since these less crude-sufficient refiners are often very competitive in their pricing practices and contribute to the volatility of gasoline prices.

OFFICE OF EMERGENCY PREPAREDNESS

Notice of Investigation of Recently Announced Increases in Prices of Crude Oil and Gasoline

Section 6 of Proclamation No. 3279, as amended, requires the Director of the Office of Emergency Preparedness to maintain constant surveillance of imports of petroleum and its primary derivatives in respect to the national security and to inform the President of any circumstances which, in the opinion of the Director, might indicate the need for further Presidential action under Section 232 of the Trade Expansion Act of 1962. That section also provides that in the event prices of crude oil or its products or derivatives should be increased after the effective date of that Proclamation "...such surveillance shall include a determination as to whether such increase or increases are necessary to accomplish national security objectives...."

Notice is hereby given that the Office of Emergency Preparedness, with the assistance of the Department of Justice and the several Departments referred to in Section 6 of Proclamation No. 3279, as amended, will conduct an investigation of increases in prices of crude oil and gasoline

ANNEX A

recently announced by certain producers and refiners of petroleum. Interested parties may file information or comments concerning the subject matter of this investigation until December 1, 1970. All such information and comments should be submitted in writing, and 25 copies of each such submission should be provided. All such submissions should be addressed to:

Director
Office of Emergency Preparedness
Washington, D. C. 20504

Information which would disclose confidential business data or operations within the meaning of section 1905 of Title 18 of the United States Code or section 552(b)(4) of Title 5 of the United States Code, will be accorded confidential treatment if submitted in confidence. All information submitted in confidence must be on separate pages marked "Business Confidential." All information and comments submitted pursuant to this Notice, except "Business Confidential" information submitted in accordance with the preceding sentence, will be available for inspection or copying. A list of persons submitting information pursuant to this Notice will be maintained and will be available for inspection and copying.

SIGNED

G. A. Lincoln
Director

Dated: November 16, 1970.

LIST OF RESPONDENTS (57)

Respondents Favoring Petroleum Price Increases (42)

Major Integrated Oil Companies (15)

Atlantic Richfield Company
Cities Service Company
Continental Oil Company
Getty Oil Company
Gulf Oil Company
Humble Oil and Refining Company (Standard Oil Co., N.J.)
Mobil Oil Corporation
Phillips Petroleum Company
Shell Oil Company
Skelly Oil Company
Standard Oil Company (California)
Standard Oil Company (Indiana)
Standard Oil Company (Ohio)
Sun Oil Company
Texaco, Incorporated

Independent Producers (4)

Alvin C. Hope
Herman G. Kaiser
L.V.O. Corporation
Waverly Oil Works Company

Independent Refiners (6)

American Petrofina, Inc.
Champlin Petroleum Company
Clark Oil and Refining Company
Diamond Shamrock Oil and Gas Company
Kerr-McGee Corporation
Marathon Oil Company

Independent Marketers (2)

Oskey Gasoline and Oil Company, Inc.
Rock Island Oil Company

Producers and Professional Associations (13)

American Association of Petroleum Geologists (AAPG)
American Association of Oilwell Drilling Contractors
California Independent Producers and Royalty Owners Association

ANNEX B

Producers and Professional Associations (13) (con't)

Independent Petroleum Association of America (IPAA)
Kansas Independent Oil and Gas Association
North Texas Oil and Gas Association
Ohio Oil and Gas Association
Panhandle Producers and Royalty Owners Association
Permian Basin Petroleum Association
Petroleum Industry Research Foundation, Inc. (PIRINC)
Rocky Mountain Oil and Gas Association
Texas Independent Producers and Royalty Owners Association
West Central Texas Oil and Gas Association

Congressional (2)

Senator John G. Tower
Senator Bob Dole

Other (1)

W. L. Pennington, Consulting Geologist

Respondents Opposed to Petroleum Price Increase (11)

Oil Refiners/Marketers (2)

Ashland Oil, Inc.
Martin Oil Service, Inc.

Associations (4)

Air Transport Association
Independent Terminal Operators Association
New England Council for Economic Development
Society of Independent Gasoline Marketers of America (SIGMA)*

Congressional (3)

Representative Silvio Conte and 43 others.
Senator Thomas McIntyre
Senator Winston Prouty

Others (2)

Fred C. Allvine, Assistant Professor of Marketing,
Northwestern University
Theodore R. Brooks, Oil Editor

---

* Letter submitted by Hogan & Hartson.

Respondents Expressing Reservations About Price Increases (3)

Oil Companies (2)

Union Oil Company
Murphy Oil Company

Associations (1)

American Paper Institute

AVERAGE CRUDE OIL PRICES AT WELL
(Per Barrel)

	Current $
1955	2.77
1956	2.79
1957	3.09
1958	3.01
1959	2.90
1960	2.88
1961	2.89
1962	2.90
1963	2.89
1964	2.88
1965	2.86
1966	2.88
1967	2.91
1968	2.94
1969	3.06
1970	3.16

Source: U.S. Bureau of Mines.

ANNEX C

U. S. CRUDE OIL PRODUCTION

(Thousand Barrels Daily)

	From Stripper Wells	Total U. S. Production	Percent from Stripper Wells
1959	1,462	6,828	21.4%
1960	1,577	6,720	23.5%
1961	1,622	7,035	23.1%
1962	1,587	7,158	22.2%
1963	1,521	7,324	20.8%
1964	1,461	7,420	19.7%
1965	1,614	7,559	21.3%
1966	1,329	8,072	16.5%
1967	1,369	8,513	16.1%
1968	1,326	8,757	15.1%
1969	1,246	8,882	14.0%
1970*	1,225	9,179	13.3%

* Estimated (Oil and Gas Journal, January 25, 1971, p. 132)

Source: National Stripper Well Surveys (1959-1969)

ANNEX D

ESTIMATED GROWTH IN SECONDARY VS. PRIMARY PRODUCTION
(Based on Continuation of Present Import Program)

Year	Primary	Secondary	Total Crude	Lease Condensate	Total Crude & Condensate
			Thousand Barrels Daily		
1950	4442	898	5340	111	5451
1953	5242	1113	6355	156	6511
1955	5294	1359	6653	172	6825
1957	5550	1468	7018	210	7228
1959	5267	1563	6831	266	7097
1961	4867	2009	6876	323	7199
1962	4830	2192	7022	341	7363
1963	4764	2357	7121	310	7431
1965	4854	2534	7388	433	7821
1970	5093	3160	8253	579	8832
1975	5407	3908	9315	716	10031
1980	5790	4608	10398	892	11290
			Percent of Total		
1950	81.5	16.5	98.0	2.0	100.0
1953	76.5	17.1	97.6	2.4	100.0
1955	77.6	19.9	97.5	2.5	100.0
1957	76.8	20.3	97.1	2.9	100.0
1959	74.2	22.0	97.2	3.8	100.0
1961	67.6	27.9	95.5	4.5	100.0
1962	65.6	29.8	95.4	4.6	100.0
1963	64.1	31.7	95.8	4.2	100.0
1965	62.1	32.4	94.5	5.5	100.0
1970	57.7	35.8	93.5	6.5	100.0
1975	53.9	39.0	92.9	7.1	100.0
1980	51.3	40.8	92.1	7.9	100.0

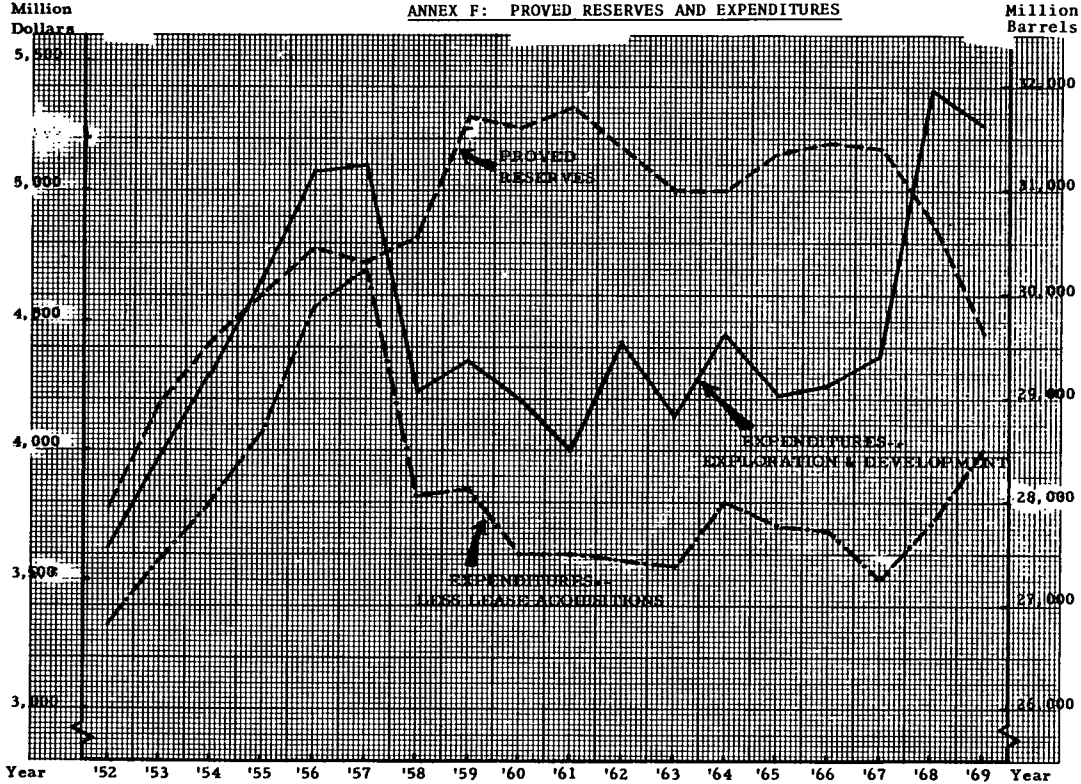
Source: 1950-1963 derived from state totals by Bureau of Mines (Dallas) November 1964; figures for national totals differ slightly from those reported in Bureau of Mines annual yearbooks.

1964-80 projected by Bureau of Mines (Dallas)

"An Appraisal of the Petroleum Industry of the United States", January 1965., U.S. Department of the Interior.

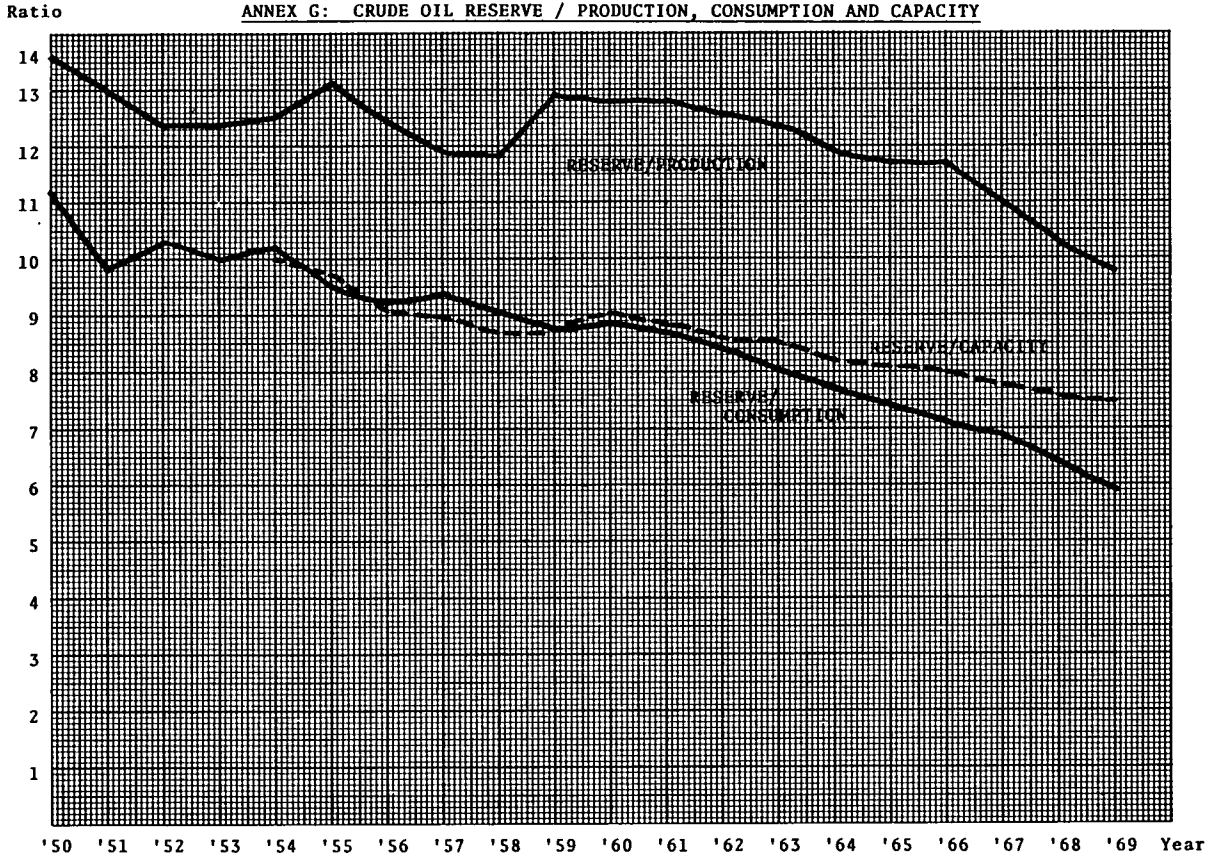
ANNEX E

ANNEX F: PROVED RESERVES AND EXPENDITURES



SOURCE: IPAA (Natural Gas Plants Excluded) (Alaska North Slope reserves not included.)
Proved Reserves are as of the end of the year for which they are posted.
Since data are published as of January 1, this means the data are posted for the year before that indicated by their published year.

ANNEX G: CRUDE OIL RESERVE / PRODUCTION, CONSUMPTION AND CAPACITY



EXPLORATION AND DEVELOPMENT EXPENSE
UNITED STATES

(1) Year	(2) Lease Acquisitions	(3) Producing Wells	(4) Dry Holes	(5) Geological & Geophysical Expense	(6) Lease Rentals	(7) Total	(8) Total Less Col.2	(9) Lease Acquisition as % of total cost
			(Million Dollars)					
1952	300	1,950	875	350	150	3,625	3,325	8.3%
1953	400	2,100	900	400	175	3,975	3,575	10.0%
1954	500	2,250	950	425	175	4,300	3,800	11.6%
1955	600	2,450	1,000	450	175	4,675	4,075	12.8%
1956	525	2,650	1,200	500	200	5,075	4,550	10.2%
1957	400	2,625	1,375	500	200	5,100	4,700	7.8%
1958	400	2,275	900	475	175	4,225	3,825	9.5%
1959	500 (1)	2,250	950	475	175	4,350	3,850	11.5%
1960	600 (1)	2,125	850	460	165	4,200	3,600	16.7%
1961	400	2,175	825	450	150	4,000	3,600	10.0%
1962	850 (1)	2,200	800	425	150	4,425	3,575	20.1%
1963	575	2,125	825	440	160	4,125	3,550	13.9%
1964	650 (1)	2,225	925	490	160	4,450	3,800	14.6%
1965	500 (1)	2,200	900	450	160	4,210	3,710	11.9%
1966	560 (1)	2,115	925	500	150	4,250	3,690	13.2%
1967	860 (1)	2,040	850	475	140	4,365	3,505	19.7%
1968	1,675 (1)	2,150	850	575	140	5,390	3,715	31.0%
1969	1,250 (2)	2,325	950	575	150	5,250	4,000	23.8%

(1) Includes acquisition of offshore leases:

1959 - $135 million
1960 - $285 million
1962 - $550 million
1964 - $175 million
1965 - $100 million
1966 - $260 million
1967 - $560 million
1968 - $1,375 million
1969 - $125 million

(2) Includes Alaska - North Slope - $900 million

NOTE: The above figures exclude natural gasoline plants

SOURCE: IPAA

ANNEX H

SOURCE: Independent Petroleum Association of America (Alaska North Slope reserves not included.)

Changes are from end of previous year to end of year posted.

Since data are published as of January 1, this means the changes are calculated by subtracting the posted years figure from that for the next year.

ANNEX J

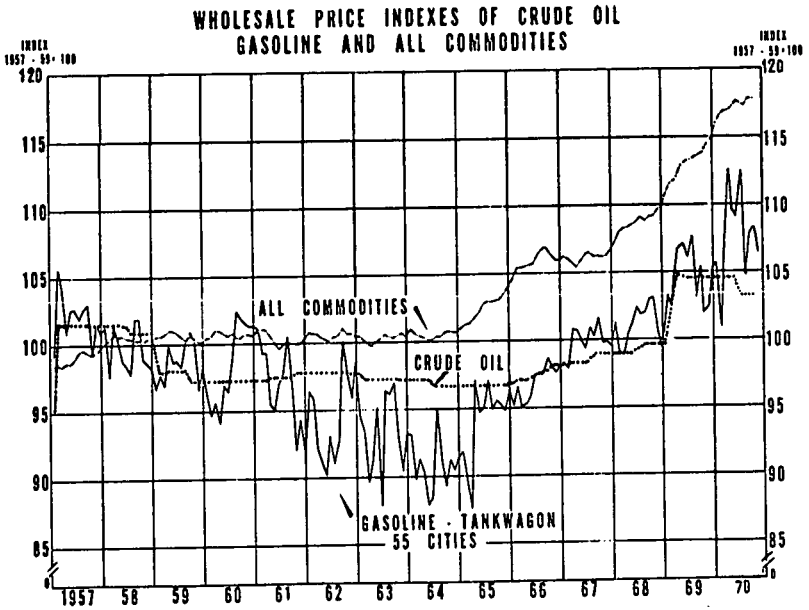
GROSS ADDITIONS TO RESERVES AND EXPLORATION AND DEVELOPMENT COSTS

(1)	(2)	(3)	(4)	(5)		
Year	Gross Additions to Reserves (million barrels)	Exploration and Development Costs* (million dollars)	Lease Acquisitions (million dollars)	E and D Cost Less Lease Acquisitions (million dollars)	Expenditure Per Barrel (dollars) With Lease Acq. (3)/(2)	Without Lease Acq. (5)/(2)
1960	2,365	4,200	600	3,600	1.78	1.52
1961	2,658	4,000	400	3,600	1.50	1.35
1962	2,181	4,425	850	3,575	2.03	1.64
1963	2,174	4,125	575	3,550	1.90	1.63
1964	2,665	4,450	650	3,800	1.67	1.43
1965	3,048	4,210	500	3,710	1.38	1.22
1966	2,964	4,250	560	3,690	1.43	1.24
1967	2,962	4,365	860	3,505	1.47	1.18
1968	2,455	5,390	1,675	3,715	2.20	1.51
1969	2,120	5,250	1,250	4,000	2.48	1.89
	1960-64 Avg.	-	-	-	1.76	1.51
	1965-69 Avg.	-	-	-	1.73	1.37
	1960-69 Avg.	-	-	-	1.75	1.44

* Excluding natural gasoline plants.

Source: Gross additions to reserves - API
Other - IPAA

ANNEX K



Source: Gasoline-Platt's Oilgram Price Service
All Commodities-Department of Labor

Prepared and submitted by Texaco.

ANNEX L

JOBBER, UNBRANDED, REGULAR GASOLINE PRICES[1/]

Date	Williams Bros. PL Terminal[2/]	Chicago	St. Louis	Minneapolis/ St. Paul	Milwaukee	India-napolis[3/]	Oklahoma, Northern Movement
Oct 1, 1970	12.25	12.50	12.75	14.00	13.35	13.00	12.25
Dec 1, 1970	13.00	13.00	13.00	14.00	13.35	13.00	12.50
Jan 6, 1971	13.00	13.00	13.00	14.00	13.35	13.00	13.00
Jan 27, 1971	12.50	13.00	13.00	14.00	13.35	13.00	12.50
Feb 2, 1971	12.00	13.00	13.50	14.50	13.35	13.75	12.00
Feb 10, 1971	12.50	13.00	13.50	14.05	13.35	13.75	12.50
Feb 22, 1971	12.25	13.00	13.50	14.05	13.35	13.75	12.25
Feb 26, 1971	11.75	13.00	13.50	14.05	13.35	13.75	11.75
Net Change	-0.50	+0.50	+0.75	+0.05	0.00	+0.75	-0.50

1/ Prices shown are the lower ends of a 0.25¢ price range which applies in each case. The dates selected after October 1 are dates on which changes in cities are recorded.

2/ Midwest prices for delivery from Williams Brothers' Pipeline terminal points plus pipeline tariffs from origin.

3/ Evansville, Detroit, and Bay City are not shown since their patterns are almost identical to that shown for Indianapolis.

ANNEX M:

Profits and Cash Flow--Millions of Dollars and (% of Stockholders Equity)

Year	All Manufacturing Except Petroleum		Petroleum Refining	
	Profits 1/	Cash Flow 2/	Profits 1/	Cash Flow 2/
1963	15,652 (9.92)	18,587 (11.78)	3,831 (11.08)	4,582 (13.25)
1964	19,116 (11.40)	22,084 (13.22)	4,094 (11.23)	4,759 (13.05)
1965	23,079 (12.84)	26,133 (14.58)	4,442 (11.42)	5,131 (13.20)
1966	25,982 (13.32)	29,726 (15.24)	5,055 (12.11)	5,826 (13.96)
1967	23,511 (11.24)	28,961 (13.84)	5,497 (12.18)	6,314 (13.99)
1968	26,275 (11.67)	32,354 (14.37)	5,794 (12.05)	6,716 (13.97)
1969	27,364 (11.14)	34,214 (13.92)	5,884 (11.45)	6,836 (13.30)
1970 3/	23,430 (9.17)	31,242 (12.23	5,680 (10.53)	6,865 (12.72)

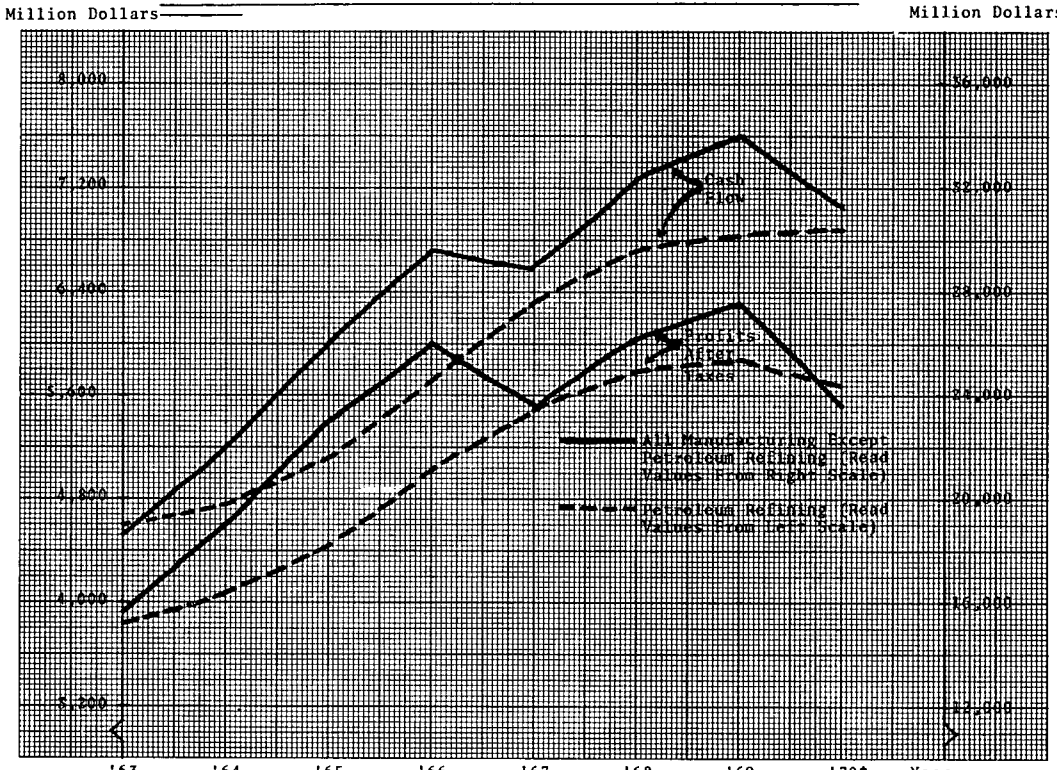
1/ Profits after taxes.

2/ Retained earnings plus depreciation and depletion.

3/ First three quarters raised to reflect annual rate.

Source: FTC-SEC, Quarterly Financial Report for Manufacturing Corporations.

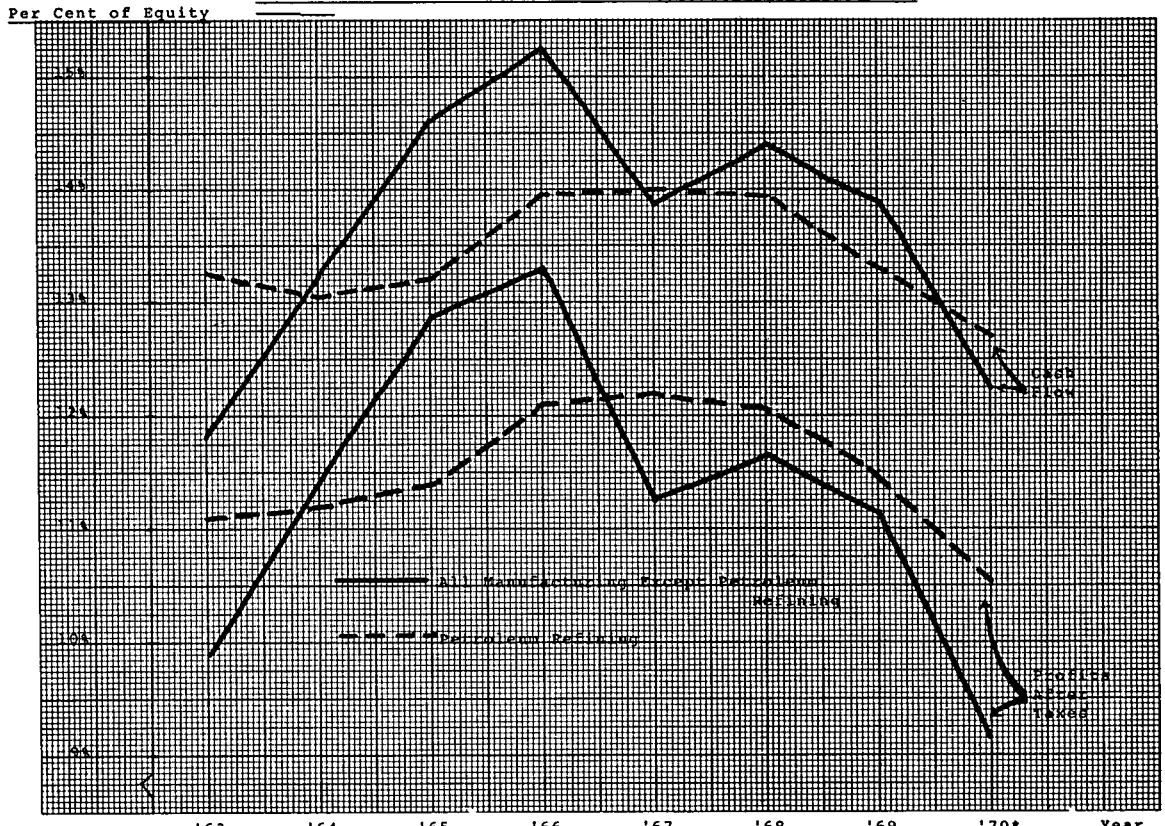
ANNEX N: COMPARISON OF PROFITS AND CASH FLOW IN MILLIONS OF DOLLARS



SOURCE: FTC-SEC Quarterly Financial Reports for Manufacturing Corporations

(* 1st 3 quarters at annual rates)

ANNEX O: COMPARISON OF PROFITS AND CASH FLOW AS % OF EQUITY

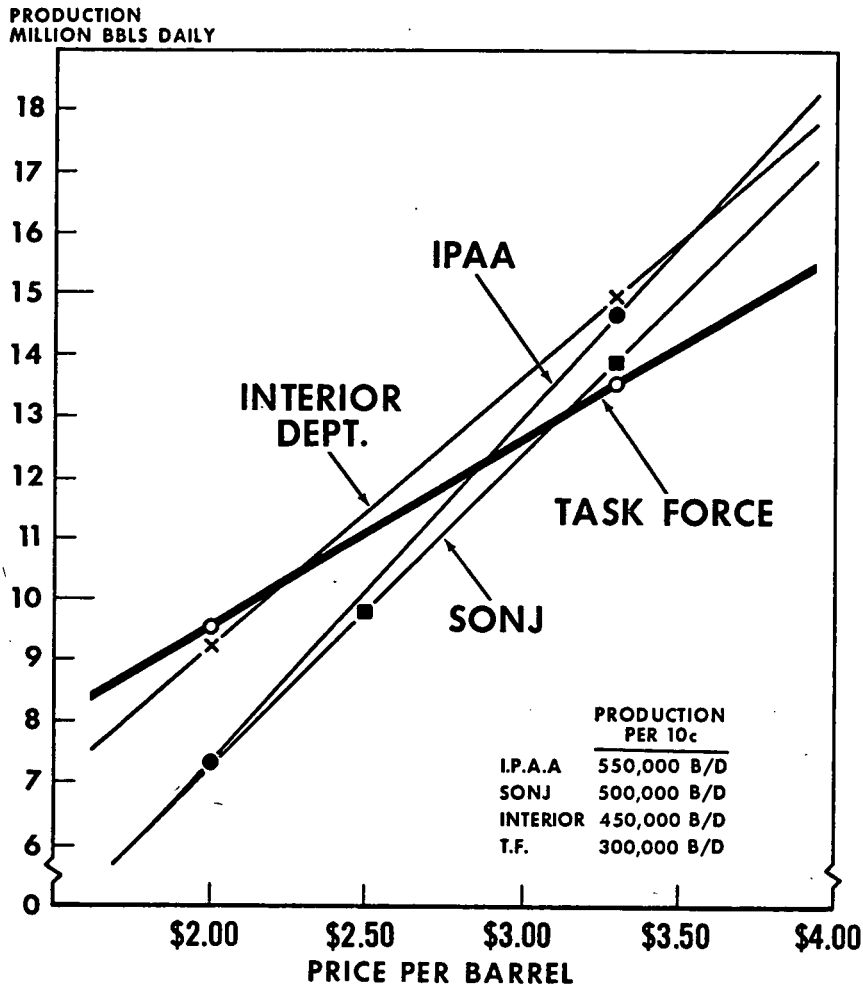


SOURCE: FTC-SEC Quarterly Financial Reports for Manufacturing Corporations

(* 1st 3 quarters at annual rates)

ANNEX P

ESTIMATES OF U.S. PRODUCTION OF PETROLEUM LIQUIDS IN 1980 AT VARIOUS PRICES



NOTE: All estimates made prior to, and not taking into consideration, 1969 changes in tax laws.

Prepared by the Independent Petroleum Association of America June 1970

○

528

92d Congress
1st Session

JOINT COMMITTEE PRINT

RESTORATION OF EFFECTIVE SOVEREIGNTY TO SOLVE SOCIAL PROBLEMS

REPORT

OF THE

SUBCOMMITTEE ON URBAN AFFAIRS

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

TOGETHER WITH

MINORITY VIEWS

DECEMBER 6, 1971

Printed for the use of the Joint Economic Committee

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LETTERS OF TRANSMITTAL

NOVEMBER 30, 1971.

To the Members of the Joint Economic Committee:

Transmitted herewith for your consideration and use and for the use of other Members of Congress, the Executive Branch of the Government, and the general public is a report of the Subcommittee on Urban Affairs entitled "Restoration of Effective Sovereignty To Solve Social Problems."

Sincerely,

WILLIAM PROXMIRE,
Chairman, Joint Economic Committee.

NOVEMBER 24, 1971.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
U.S. Congress, Washington, D.C.

DEAR MR. CHAIRMAN: Transmitted herewith is a report by the Subcommittee on Urban Affairs entitled "Restoration of Effective Sovereignty To Solve Social Problems."

This report is based, in part, on the extensive studies and hearings of the Subcommittee over the past four years, as well as on the many studies, hearings, and reports by the full Committee and its other Subcommittees over the past twenty-five years. It attempts to outline some pressing problems facing our government and to suggest partial solutions through changes in the institutional structure of government. It is hoped that the publication of this report will produce a public dialog that will lead eventually to the solution of the problems outlined either along the lines suggested in the report or along other lines developed during future discussion.

I wish to express the appreciation of the Subcommittee, to the various public officials, and to those private experts who appeared as witnesses or contributed papers during the Subcommittee's work of the last four years.

Sincerely,

RICHARD BOLLING,
Chairman, Subcommittee on Urban Affairs.

CONTENTS

RESTORATION OF EFFECTIVE SOVEREIGNTY TO SOLVE SOCIAL PROBLEMS

INTRODUCTION

Increasingly over recent years investigations by the Subcommittee on Urban Affairs have suggested that, in the long run, solutions to the many problems pressing in on government and private officials can only be found if the institutional structure of government is drastically improved. This became particularly obvious in the hearings held by the subcommittee in October 1970 and in May 1971. In order to promote a productive dialog concerning these longer term reforms which would make possible the effective exercise of political power to solve our social problems, a draft report was formulated and circulated to the subcommittee members on September 13, 1971. Four Democrats, including the chairman, agreed to support the report with minor perfecting alterations. By October two additional Democrats decided they could not participate in view of other obligations, and a fifth disagreed with a vital section of the report. A meeting of the subcommittee was called on October 27, but a quorum could not be mustered. A subsequent poll of the subcommittee by mail produced additional footnotes and supplementary views and the report enclosed herewith includes them. The publication, it is hoped, will produce the public dialog that will lead eventually to the solution of problems either along the line suggested within the various statements or along other lines as further debate may dictate.

THE PROBLEM [1]

The United States is a nation dedicated to peace, full employment, stable prices, decent housing for all, equal opportunity, civil rights, speedy and just legal proceedings—in a word, to what is generally called the good society. Now after almost 200 years the public descriptions of this society include the stark specter of war, high unemployment, rapid inflation, civil disturbance and disunity, housing shortages (not merely for the poor but also for the middle classes), balance-of-payments crisis, a lack of educational opportunities despite the most expensive educational system in human history, hunger, discrimination, one of the world's highest crime rates, cities decaying, ineffectiveness of the legal system, and an increasingly urban environment in which the quality of public services does not match the promise of the richest country the world has ever known.

Why is it, when for the first time a nation has achieved sufficient wealth and current income to solve age-old problems caused by scarcity, that failure seems to characterize our every social endeavor? Part of the answer, of course, is that we have not failed as badly as the daily prophets of doom would have us believe. This country has brought a higher level of material well being and greater opportunity in every direction to more people than any other society in history. It has provided for the world's most widely diverse and heterogeneous population on a scale unparalleled for both quality and quantity. After investigation, we believe much of the answer to this paradox is to be found in the fact that the political processes and institutions have not changed as rapidly as problems and conditions. The result is that sovereign power invested in government by the people is no longer exercised effectively. The people gave such power to government to solve those problems which are beyond the power of individuals in their private capacities. What has gone wrong is that power, knowledge, and responsibility are no longer in appropriate hands.

The top policymaking level in Washington has become so bogged down in administrative detail and responsibility so disorganized that for decades policies have been neither consistent nor coordinated. Execution of policies by the administrative apparatus has been adversely affected because the administration has been concentrated in Washington far from where the people, their problems and their aspirations can be known and dealt with rationally. Information has simply not filtered up from tne bottom to Washington, nor orders flowed back to local communities with the necessary speed, efficiency, and effectiveness. The organization of government has not kept pace in

[1] Due to the pressure of other duties Senators Proxmire and Ribicoff were unable to participate in the hearings and deliberations pertaining to this report; and therefore, they reserve judgment on its conclusions and recommendations.

many other ways. The same programs turn up in many different bureaus and departments. The requirement at the grassroots is for coordination between water supplies, sanitation, roads, highways, housing, education, and other services of government, but from locality to Washington these are divided between a morass of bureaus and agencies to which the individual or the local group must appeal in an endless series of paper shuffling processes. Local government officials face the same senseless complexity. The result is a despairing search for political messiahs and magic nostrums like revenue sharing.

These difficulties are best illustrated by the morass of different programs and administrative channels through which the people must find their way up the Federal bureaucracy if they are to make any progress in solving local problems. At the present time, 70,000 or more State and local governments can find financial and technical aid through at least 400 programs operated by the Federal Government on almost every subject of public interest. Even the simplest effort of local agencies and officials to work out a coordinated program to solve a local problem means running the gauntlet of numerous Federal bureaucracies all the way to some cabinet official who can render a final decision on one program while they must find their way to a decision for necessary related programs in other agencies or departments. It is no wonder that the process brings dissatisfaction and demands for reform.

What is wrong is that the processes of government have not been kept consistent with our fundamental aspirations and political principles. Decentralization has been swept aside in favor of centralization but the whole process has become so cumbersome and time consuming that decisions are late when they come at all, and then they are likely to be uncoordinated and inconsistent. What is necessary is a restoration of effective decentralized government that is administered as close to the people served as possible but in accord with broad national decisions as to priorities between alternative social programs.

How can we now restore effectiveness to the exercise of sovereign power to solve the problems of an increasingly urban and extremely heterogeneous population? It is that question that this report attempts to answer.

Our confidence that we can offer some helpful recommendations grows out of 25 years of studies, hearings, and reports by the Joint Economic Committee and its subcommittees concerning almost every conceivable aspect of economic activity and policymaking—public and private. We draw particularly on the studies and hearings of this Subcommittee on Urban Affairs over the past 4 years as follows:

"A Directory of Urban Research Study Centers." Materials prepared by the staff for the Subcommittee on Urban Affairs, August 1967.

"Urban America: Goals and Problems." Materials compiled and prepared for the Subcommittee on Urban Affairs, August 1967.

"Urban America: Goals and Problems." Hearings before the Subcommittee on Urban Affairs, September 27, 28; October 2, 3, and 4, 1967.

"Industrialized Housing." Compendium prepared for the Subcommittee on Urban Affairs, April 16, 1969.

69-723 O—71——2

"Industrialized Housing." Hearings before the Subcommittee on Urban Affairs.
Part 1. July 9, 1969.
Part 2. July 23 and 24, 1969.
"Housing Development and Urban Planning: The Policies and Programs of Four Countries." Report of the Subcommittee on Urban Affairs, March 24, 1970.
"Regional Planning Issues." Hearings before the Subcommittee on Urban Affairs.
Part 1. October 31, 14, and 15, 1970.
Part 2. Invited comments.
Part 3. May 11, 12, 13, and 18, 1971.
Part 4. May 19, 20, 25, 26.

The Employment Act and Political Power Failure

For over a quarter of a century the Federal Government has been committed by section 2 of the Employment Act of 1946 to:

> * * * the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power (15 U.S.C. 1021).

In present-day parlance this declaration commits the Government to create an economic climate in which, by cooperation with other levels of government and the private sector, there should be maintained full employment without inflation in a free, dynamic, and growing economy. It implies effective coordination of public and private policies. It places responsibility on both the public and private sectors for achieving the stated objectives. Contrast these high aspirations with the economic record of this last quarter of a century. The Nation has continued to experience both recurring recessions and inflation, until in recent years we have suffered from simultaneous inflation, high unemployment, and serious balance-of-payments deficits. We have experienced all of the old pre-1946 ills with about the same frequency and in recent years achieved the worst of all possible combinations.

The first and foremost source of political power failure, indicated earlier in this report, has been the concentration of decisionmaking in Washington divorced in time and space from the people and their State and local governments which are affected by Washington's decisions. There are four additional sources of policy failure which have to be recognized.

The first is that public policies have generally assumed that the "melting pot" really works; indeed, it works so effectively that the population has become uniform in tastes, culture, religious values, political outlook, social norms, and so forth. In fact, however, even modest-size metropolitan areas in this country have a population more diverse, more heterogeneous than the continent of Europe. Families in any individual community will come from almost every cultural background and race imaginable. They have many common aspirations for personal freedom and advancement, but it is beyond controversy that they have important differences of view on many of the details of their social, economic, and political lives. Nor can their religious differences be ignored. But in fact we ignore all differences. Policy and administration assume for example that if we have a national highway building program then the same program is desirable in every community in the Nation. What nonsense!

We assume that since better housing and improved community facilities are desirable then these are desirable everywhere in the same pattern. Architects and urban planners fail to take local divergencies sufficiently into consideration when applying national programs to individual localities. Testimony before this committee, as well as others, have vividly portrayed the consequences, if riots and other distressing social events have not.

Where urban renewal and a highway program combine to cut into pieces and destroy an existing community, the effects of the improved transportation, better housing and new community facilities fail to compensate for the destruction of community institutions that previously were an important part of the lives of the inhabitants. How many people have their lives blighted, their mental health impaired, their economic status reduced in the name of urban renewal or transportation improvement? Do we really have to pay this price to carry out national social policies?

If we would but drop the assumption that everyone has the same identical values, identical needs, identical religious convictions and design and coordinate policies so as to help people lead the kinds of lives they want to lead, we would approach the ideal of Government that our forefathers tried to create.

A second prominent source of the breakdown in our increasingly urbanized society and of the failure of sovereign authority to solve social problems is the maldistribution of population that results in high population density in urban areas using only a small fraction of the Nation's land area. A rapid inflow of rural population into the cities has required people to make adjustments—not only in economic activities, but in their entire way of life. Thus the sharp shift from less dense rural and smalltown areas to the highly dense urban metropolitan regions has had profound effects upon the mental and physical health of the Nation. Such a rise in density requires changes in social structure and organization, in political institutions, raises great issues of both public and private administration and creates new constraints on design of physical facilities.

Our failure to recognize problems created by the rapid shift of population, particularly in such a heterogeneous nation as ours, has

been disastrous. Similar tendencies around the world have been described by one of our witnesses as follows:

> The implosion of the world population into cities everywhere is creating a series of destructive behavioral sinks more lethal than the hydrogen bomb. Man is faced with a chain reaction and practically no knowledge of the structure of the cultural atoms producing it.

Third, through every phase of hearings by this subcommittee and other studies of the Joint Economic Committee there has been repeated evidence that a prime cause of financial and administrative breakdowns at all levels of government is the damage to financial planning caused by inflation on the one hand, and by recession and unemployment on the other. For example, changes in the cost of providing government services have gone up over the last 40 or 50 years 1½ to 2 percent for each 1 percent rise in the general price level (as measured by the GNP deflator). There have been periods also when the costs of government lagged behind the general price level and caught up later with a rush. On the revenue side of government budgets at the State and local level, receipts barely keep pace with the rise in the general price level, except where tax rates have been steadily raised or new taxes introduced. In some cases, for example the property tax, receipts not only rise less rapidly, but with a considerable lag. In consequence, inflation increases the cost of government faster than revenue, unless State and local governments regularly raise tax rates or add new taxes. The same effect wipes out the so-called fiscal dividend at the Federal level whenever inflation is more than nominal.

The consequence of inflation and recessions are financial difficulties for State and local governments on such a scale that Federal grants have increased from only about $1 billion per year in 1946 to between $25 to $30 billion in recent quarters, even without general revenue sharing. The trend is toward an ever increasing share of State and local spending being funded out of Federal taxes. Yet the sums are still inadequate in the face of mounting pressures from continued inflation and recession. No solution can be offered for this problem which does not reduce the freedom of elected State and local government officials to set their own priorities unless we achieve a better national record for controlling inflation and unemployment.

The Employment Act objectives must be achieved, not merely recited as a political litany. The breadth and complexity of the task was widely recognized 25 years ago, when in one of the first reports it issued, the Joint Economic Committee unanimously characterized its task as follows:

> The basic problem which this committee has to consider is the method of preventing depressions so that substantially full employment may be continuously maintained. No problem before the American people is more vital to our welfare, to the very existence of our way of life, and to the peace of the world. It is the most complex and difficult of all the long-range domestic problems we have to face. It involves a study of price levels and wage levels and their relation to

each other, a study of methods of preventing monopoly control in industry and labor from distorting prices and wages, a study of spending for consumption and for capital investment, a study of individual and corporate savings, and a study of many other economic forces bearing on a stable economy.

Fourth, the economics of public spending are such that experts repeatedly stress the need for increased long-range planning of Government programs, particularly at the local level. It must be obvious that if plans are to be made for public facilities and programs that stretch over a number of years, and if these programs are to involve Federal funding in part, then they cannot succeed as long as the Federal Government programs do not make possible multiyear commitments of funds for a variety of programs that make up a single plan from the standpoint of the local area.

In summary, if the failures of political power are to be remedied and effective popular government sustained over the long run then:

Measures must be taken to insure consistency between national and local priorities as determined by elected representatives at each level of government and; to this end we must improve the flow of information to and from the policymaking center in Washington, while at the same time pushing administrative authority out of Washington into the various regions of the country closer to the people served.

If this decentralization is to work better in the future than it has in the past, national policies must be better coordinated in order to end both recessions and inflation; long-range planning must be promoted along with the long-range commitments under Federal programs that will enable State and local governments to function efficiently in adapting national policies to local differences in values, preferences and priorities.

An Action Program

As a nation, we need an action program to restore full effectiveness to the exercise by government of the sovereign powers entrusted to it by the people. This is necessary to insure both that the power is used effectively and that the people are protected against arbitrary or improper use of that power for purposes other than to provide the services to our diverse population which that population cannot provide for itself as individuals or private groups. This action program should be designed to achieve the following objectives:

1. The creation and coordination of national policy must be centralized at the highest level, in the President, the Cabinet and the Congress to insure that it is under effective control of elected officials, but at the same time administration must be decentralized so that decisions within the policy guidelines are made close to the people where administrators can know how to adapt national programs to local needs.
2. Cabinet responsibility for all operations of the departments must be restored.

3. Flexibility in the funding of programs must be provided so that the fundamental policy objectives stated by the Congress in basic legislation and in presidentially approved regulations under such law can be carried out at the local level, with enough flexibility to adjust programs sensitively to local requirements and priorities, locally determined by locally elected officials.

4. The organization of Congress and of the executive branch must be brought into agreement so that in each House the committee structure agrees with the organization of the executive branch, so that each executive agency can be truly held responsible for following congressional policy guidelines.

5. The departments of Government must be made more nearly to coincide with the functions that are to be performed rather than organized as in the past along the lines of economic or social interest groups or sectors.

6. The organizational structure, powers, and relative ranks of officials in each department at each level of administrative responsibility must be brought into agreement so that cooperation laterally between agencies and departments is facilitated.

7. Modern government in our dense, urban society requires creation of an intervenor or troubleshooter for each 5,000 to 10,000 people to replace functionally the old-time local party officials who provided an outlet for popular grievances by intervening laterally into the political mechanisms to redress grievances caused by inevitable administrative error.

From colonial times there has been a continuous struggle between the advocates of ever greater centralization of government power over policies, programs, and administration on the one hand and the equally vigorous advocates of maximum decentralization of political power to lower levels, principally to States and localities. This has been healthy, for the contest between States rights and federalism has forced compromises that maintained a viable balance between central power exercised to achieve great national purposes and decentralized power that adapts policies and programs to local and even individual needs and preferences. Only such compromises could have preserved and strengthened individual rights and freedom in a nation so heterogeneous and yet provided national uniformities so necessary to rapid economic development.

Yet, the struggle has also produced unfortunate results as well, particularly at the national level. To limit Presidential power, Congress has specifically lodged authority in subordinate officials below Cabinet rank and split authority over related programs between numerous departments, agencies, and bureaus. At the same time, the need to enable the President to exercise responsible authority over the departments has led to creation of an ever-expanding Presidential or Executive Office, of which the Office of Management and Budget is perhaps the best illustration of centralist tendencies. The result of these conflicting tendencies seems like an almost impenetrable maze from the viewpoint of States, localities, and individuals.

To bring order out of this administrative and policymaking chaos, numerous commissions and experts have recommended reforms.

Studies by the JEC, particularly by this subcommittee, cause us to recommend the following changes to promote the objectives outlined above and to improve economic policymaking and execution:

1. Congress should undertake an immediate review of Federal statutes and enact appropriate legislation to strip subordinate officials of statutory authority and place these powers uniformly either in the President or in Cabinet officers, as deemed most desirable. In this way the Congress can effectively hold the President and the Cabinet responsible for efficient, effective, and economical execution of the policies established by the Congress.

2. Congress should require by law that all departments dealing with domestic programs and functions be organized on a common pattern of centralized policymaking and decentralized administration. This will necessitate:

***a.* Establishing common administrative regions for administration of programs along the lines of the present 10 administrative regions established by Executive order in 1969.**

***b.* Providing the same rank and powers to the regional administrator in each region for each department or agency so as to facilitate cooperation and coordination between the officials of different agencies in each region.**

3. Congress should enact legislation revising the structural organization of the departments of the executive branch of the Government so that departmental jurisdiction coincides with related functions to be performed and subjects to be dealt with. The subcommittee takes no position as to whether the recent proposals by the President satisfies this requirement.

It is clear that many of the ills brought to the attention of the subcommittee and other committees of Congress in recent years, in part, have had their origins in the fact that functions have been divided between different agencies and departments, resulting in inconsistency of policy and administration. For example, income maintenance programs have been divided up among almost every department and agency in government with the unintended result of providing incentives for uneconomic shifts between industries, occupations, and regions. How many of our present urban problems may be due to unintended combinations of policies that have pushed and pulled rural populations into cities for which they were not equipped, and where jobs and satisfactory housing were not available.

A National Planning System

One of the most important sources of influence by Government on the structure and economic development of the Nation is through the investments which it makes in the development of human and physical resources. Such investments require the formulation and execution of long-term plans which in our heterogeneous and necessarily decentralized society involve cooperation between Federal, State, and local governments as well as consistency of government plans with those for private investment. To facilitate this long-term planning process and

insure that policy remains the prerogative of elected officials at all levels of government, the subcommittee recommends:

1. The creation of a National Resources Planning Commission to be appointed by the President with the advice and consent of the Senate having representatives from business, labor, agriculture, consumers, and the general public, along with the Chairman of the Council of Economic Advisers and the Director of the Office of Management and Budget. It shall be the duty of this Commission to prepare plans for the development of physical and human resources for a 10-year period, setting priorities between various categories of investment for the Nation as a whole and preparing criteria by which the national totals are to serve as guides to allocation between regions and localities. The Commission shall report annually to the Congress, and its plans, when approved or revised by Congress, shall become a binding guide to Federal agencies over investment programs coming under the Commission's planning jurisdiction.

2. The Council of Economic Advisers shall prepare a long-term, 10-year full employment projection of the economy and shall update this annually. These projections will form the basis for the National Resources Planning Commission's development plan. The Council's determination of the total of government investment spending that is consistent with full employment without inflation shall be binding on the Planning Commission. The CEA projections and investment recommendations should be submitted to the Congress at the same time as the Planning Commission submits its report to Congress annually.

3. Congress should provide by general statute that in the funding of all programs involving Federal grants-in-aid to State and local governments or subsidy to private interests to encourage a particular development, a fixed percentage of each category of funds shall be transferable within any one region with the consent of the President if, and only if, such flexible transfer of funds shall be essential to enable a State, a local government or a group of such entities to carry out a local plan involving more than one type of assistance from the Federal Government: Provided that such plan has been developed with the approval of the elected officials of the appropriate local government bodies and there has been provision for due notice and hearing for interested citizens.

4. Congress should provide for the establishment in each administrative region of an agent of the President, reporting to the President through an official of the Office of Management and Budget. It shall be the duty of each regional representative of the President to assist regional administrators of agencies in coordinating their efforts of assistance to State and local governments; to decide on behalf of the President when shifting of funds between programs is essential to the execution of congressional intent and substantive law; to report regularly through the Office of Management and Budget to the National Resources Planning Commission the long-range plans being formulated in each region for resource development over the coming decade; and to report through the Office of Management and Budget to

the President those instances of unintended inconsistency which develop between programs and policies in the course of local execution of national policies.

5. Congress should provide that decisions of regional officials on specific grants or combination of grants shall be final unless appealed to the President or an appropriate Cabinet-level official, as the case may be, by one third or more of the elected officials of the State and local government units affected by the decision in that region.

6. Congress should provide for the establishment of regional councils of elected officials of State and local governments, including the Governors plus proportionate numbers of elected officials of local units. These regional councils shall provide a vehicle for the interchange of views and information between the Federal regional administrators and State and local officials. It shall also be a means for the appeals to the President provided for under item 5 above.

A People's Intervenor [2]

In an earlier day when mistakes of government administration were made—for example, the garbage didn't get collected—the individual appealed to the local ward leader or precinct captain who knew how to cut through the administrative redtape to reach someone who could straighten out the difficulty and who was subject to dismissal if the difficulty wasn't straightened out. This method, of what has been called lateral intervention, performed an important function in making government tolerable and effective. Unfortunately it also led to corruption which in turn resulted in the destruction of the apparatus.

While no one can blame the reformers for their zeal in destroying a source of corruption, we all must remember that the survival of a political and social system depends, in part, on success in providing an effective grievance machinery like the old precinct organization. Experience indicates that few people can perform this function for more than 5,000 or 10,000 of their neighbors. Experience also indicates that this Intervenor must be someone enjoying the confidence and support of those whose complaints he seeks to settle amiably and speedily. The lack of such machinery was suggested in this subcommittee's deliberation as a major source of present-day difficulty, particularly in the impersonal environment of urban life. It contributes to a feeling of private citizens that the Government is too impersonal and too separated from their lives; indeed, that nobody cares about their individual problems. For this reason the subcommittee recommends:

1. Provision should be made now for the modern professional equivalent of the old-time local political leader in the form of a paid Intervenor, elected by popular vote in a general election every 2 years.

2. Such Intervenor should be federally supported for both pay and office expenses.

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[2] Representative Griffiths: "I totally disagree with this section on the Intervenor Concept. I regard this as wholly impractical."

3. The Intervenor should have defined patterns of access to the processes of government from local to national levels so that he can act effectively as a spokesman for the complaints or suggestions, as the case may be, of his constituency.

4. Provision should be made for a national office in Washington to provide those services needed to enable the local Intervenor to reach the appropriate Washington officials in individual cases and to act as a conduit of communication between members of the two Houses of Congress and these local Intervenors, where necessary.

A Summary Comment

Some observers may find the package of reforms proposed in this report to be too sweeping in their impact on the Federal structure and in reemphasizing decentralization. To these, the subcommittee reemphasizes an old truth: Stable and good government springs from effective exercise of sovereign power granted by the people governed. Whenever and wherever government functions become too divorced from popular support, as at present, restoration of effective sovereignty requires returning power exercise to closer integration with the popular will. In an extremely heterogeneous nation like the United States, this means combining national policymaking and resource development planning with localized, flexible adaptation to local and even individual preferences.

We, as a nation, cannot expect to solve problems of local government merely by revenue sharing, or by changing boundaries of metropolitan regions, or by other superficial tinkering. In the end, political power must be reorganized so reasonable men can function effectively in the public service. In a closely related context, one of our recent witnesses before the subcommittee, Robert Wood, former Under Secretary of Housing and Urban Development and now president of the University of Massachusetts, summed this point as follows:

> One can debate the appropriate boundary lines of a metropolitan region or interstate region with a fixation approaching debates over angels on pinheads and one can opt for community control or shared power or expert dominance in the consultative pattern. But until planning decisions can alter resource allocation or management decisions, questions of size and participation are not very important.

MINORITY VIEWS

The criticisms of American government contained in the Majority Report remind us of the famous quote about democracy attributed to the late Winston Churchill:

> Indeed it has been said that democracy is the worst form of government except all those other forms that have been tried from time to time (speech in the House of Commons on the Parliament Bill, November 11, 1947).

Our system has resulted in many inequities, inefficiencies and outright failures. This has disillusioned many people about "the system." Unlike some who would criticize without seeking an alternative, this Subcommittee has explored some innovative ideas well worth consideration in an effort to make government more responsive and effective by decentralizing its planning, policy-making, administration and tax resources. **Unfortunately, the Majority Report does not discuss the most viable current recommendations in this area: revenue sharing, federal Executive Branch reorganization and the Ash Council's suggestions for regulatory reform. These Presidential initiatives are more likely to bring real results than this interesting but academic and limited study.**

The predicates of the Report are the same as those on which revenue sharing has been based. While we are a melting pot nation and to some extent share common problems, we are still diverse and are likely to remain so—and should be permitted to. Our mobility and changing life-styles have produced inequities of resource distribution, including population, which make flawless planning from the top down impossible. The matter of federal fiscal mismanagement in recent years could be a whole study in itself; such mismanagement requires that we rethink our tax structure. At present it is clear that Congress finds it easier to distribute federal taxes (and debt) than it does to impose the taxes necessary to meet planned (let alone emergency) obligations. We also have the problem of balancing resources at the federal and the state-local levels. Revenue sharing attempts to address the problem of evening out the long-range flow of federal assistance and restoring maximum local flexibility both in the establishment of local priorities and arriving at unencumbered local decisions as to how such funds should be spent. Revenue sharing provides the cushion between federal and local priorities which detailed categorical grant-in-aid programs never can offer.

The heart of the Report is the section entitled "An Action Program." This section lists a number of objectives, and recommendations in furtherance of those objectives, which are designed to "restore full effectiveness to the exercise by government of the sovereign powers entrusted to it by the people." We agree with a number of these objectives and recommendations and disagree with others.

Objectives 1, 2, 5 and 6 all deal with the need to reorganize the federal Executive Branch both centrally and locally and to rationalize both its policymaking and its relations with state and local government. We have no argument with the general propositions contained in these objectives. **However, as stated above, the Report fails to deal at all with the most important current proposal in this field, namely, President Nixon's comprehensive plan for reorganizing a major part of the federal Executive Branch. In our opinion President Nixon's plan could do a great deal to help us reach the goals included in the objectives listed above.**

Objective 3 in the Report aims at flexibility in federal funding of programs which are applied at the state and local level. Again, we have no argument with the Objective. **However, here too the Report fails to deal with the major proposal which would help us achieve the Objective, that is, the President's special and general revenue sharing program acting in combination with certain categorical grants.**

Objective 4, aimed at Congressional reorganization, is up to the Congress, which has had the same party leadership with only two brief interruptions for the past 40 years. We applaud the suggestion and support it, however. In fairness it must be observed that the failure to accomplish such Congressional reform is not willful any more than the Congress has been willful in its scattergun distribution of authority for duplicative programs through various departments and dissimilar administrative levels. Such patchwork is the result of legislative inadvertence rather than purposeful organizational judgment. Had more judgment been exercised or more oversight been given after legislative enactment, such errors might have been avoided. There is a clear need for Congressional reorganization to make the legislative function more nearly match up with administrative responsibility because both must necessarily be involved with policy.

We disagree with Objective 7 of the report, which deals with creation of an Intervenor, or troubleshooter, for every five to ten thousand people. The Congress and the Executive Branch cannot abdicate their responsibility for proper administration or oversight to a formalized ombudsman without losing some of the "flavor" of both jobs. This middleman Intervenor would become exactly that, a middleman further removing government from the people. The suggestion is that pride in efficient and effective governmental service is not in and of itself a sufficient spur to elected federal officials without focused outside pressure. The suggestion would institutionalize the complaint that "you can't fight city hall"—or at least the individual citizen can't. More than that, the ombudsman role itself is one which Members of Congress have been obliged to undertake as the Congress has enlarged the role of government in all our lives. Eschewing that role would cut a vital link in the chain of government. Whether it is at the federal, state or local level, legislators should know how their enactments impact on their constituents in actual administrative practice. How better are they informed and encouraged to correct the law or exercise their oversight of its execution?

We support the Committee's Recommendations 1, 2a and b, and 3, which deal with Executive Branch reorganization, and are pleased that the majority has noted in Recommendation 3 that the President's reorganization recommendations might satisfy some of the Subcommittee's requirements. However, we have some doubts that the

adoption of the Subcommittee's recommendations will result in the correction of conflicting policies and laws such as those which the Subcommittee cites. It is not within the province of the administrator to choose unilaterally the laws which he will execute and those he will ignore. The law itself is too often in conflict. It is only the Congress which can bring order out of conflicting or overlapping law.

We see no objection to the establishment of a National Resource Planning Commission (recommendation 1 under "A National Planning System") except that it strikes us as duplicative of the Domestic Council established by President Nixon and made up of his cabinet secretaries in the domestic fields. The suggestion may have some merit as long as its recommendations are optional guides and as long as those who bear the responsibility for implementation of programs have the good sense to apply the recommendations with the flexibility that changing circumstances always require. Also, planning and administration of plans cannot be effective if they are too far divorced from each other in responsibility. Finally, Congress cannot abdicate its discriminating study of plans; no Commission's plan should become binding—nor even become a "binding guideline"—without positive Congressional action.

Recommendation 2 under "A National Planning System" is, unfortunately, too utopian. Economic projections of any accuracy over a one or two-year period, much less a ten-year period, are difficult enough.

In Recommendation 3 the Subcommittee shies away from endorsing revenue sharing, although it comes very close. It seeks the local flexibility which revenue sharing will provide. It should also seek the economy and efficiency of eliminating the improductive paperwork burden of making application grants and having them corrected and approved in accordance with federal or regional views rather than local needs.

Recommendation 4 proposes that Congress provide for the establishment in each administrative region of an agent of the President who would report to the President through an official of the Office of Management and Budget. The creation of these regional "czars" with the broad authority outlined in the recommendation would of course result in the governmental efficiencies which generally result from increased centralization of power. However, we believe that the disadvantages of having such regional Presidential representatives might well outweigh the supposed advantages. Certainly such officials would completely short circuit the normal chain of command in the various departments of the Executive Branch. Much greater power would accrue to the Office of Management and Budget. Prior to any such increased centralization of power, both in the regions and in Washington, careful studies would have to be made regarding the effects of such increased centralization. If the recommendation is to be implemented at all, it should be undertaken experimentally and evaluated with care before it is formalized.

We are opposed to the procedure outlined in Recommendation 5, which is concerned with appeals from decisions of regional officials on grants. The requirement of a "one-third of local elected officials" quorum for an appeal could be unnecessarily restrictive of the appellate process. In fact, the present grant appeal process works in many departments substantially as the Subcommittee has suggested, but

without the formality proposed. A better method would be to have fewer appeals of regional decisions reversed by department heads, but this may be accomplished more easily through better local decisions—or even more efficiently through revenue sharing, which would eliminate the regional review and, thereby, the necessity for appeals and other reviews. This would be real decentralization.

The regional councils proposed in Recommendation 6 could be useful for planning regional policy. However, if these councils are to have no specific powers of their own regarding such planning, they will only be governmental window dressing and their establishment as such will not be worth the effort. We oppose the use of such councils as a means of either appeals to or formal contacts with the federal government. The formalization of groups to make recommendations, appeals or any other contact between local and state officials and federal officials seems to us undesirable. Officials at all levels of government should seek freer and more informal contacts with each other to accomplish their mutual goals. Without that effort, additional formal organizations will not be of any help.

The final recommendations in the report concern the Intervenor, discussed earlier in connection with Objective 7. As stated above, we oppose the establishment of such a governmental middle man. In addition to believing that citizens' Intervenors at the federal level should be Members of Congress, in our opinion the whole system of Intervenors as proposed in the Report is governmentally unworkable. If there were to be an Intervenor for every five to ten thousand Americans, as proposed, we would need approximately twenty to forty thousand Intervenors, all of whom would undoubtedly be accompanied by staff and other perquisites of office. All of these elected officials would be elected every two years. The financial and governmental costs of such a system would be staggering. Not only would we face the financial costs of paying all of these officials and their staffs, and providing for office expenses and election machinery, but we would be faced with at least twenty thousand additional officials intervening laterally at all levels of the federal government. Although the federal government is inefficient and cumbersome in many respects under our present system, it is difficult to believe that the addition of twenty to forty thousand more persons "intervening" in its workings would make a significant contribution to increased efficiency. Indeed, such Intervenors might have the undesirable effect of greatly increased politicization of the federal civil service. **This final recommendation of the Report seems to epitomize the Report's general thrust, that is, that the solution to many of our governmental problems consists of more government and more governmental officials, accompanied by certain reorganizations. Although reorganization can make a large and highly constructive contribution to increasing our governmental efficiency, unfortunately the hard solutions to many of our problems do not lie merely along the simple path of more elected officials.** We need instead to make our present officials more responsive and responsible to those who elect them—particularly when it comes to overseeing those who are not elected but who administer programs passed by the elected representatives.

Senators
CHARLES H. PERCY

Representatives
WILLIAM B. WIDNALL
CLARENCE J. BROWN

Views of Representative Ben B. Blackburn

I object strongly to the distressing picture painted of American society and government. In two hundred years, the United States has achieved a standard of living higher than any other country in the world. Problems exist with regard to education, hunger, discrimination, crime, cities and housing, but it should be emphasized that in most instances, we have made substantial gains over the two hundred years in improving the lot of every American.

I readily admit that there is a serious problem in a "big government" such as ours in that the Federal bureaucracy is not responsive to the public and that it is often difficult for the individual citizen or local government to deal with the bureaucracy for services. Furthermore, I recognize that geographical differences make for different problems and different solutions. But I do not feel that the recommendations in this report will solve the problems discussed.

Administration has been centralized, as the report states, but the report implies that in the past the state and local governments handled the problems now handled by the central government. Isn't it true, however, that the Federal government, in some cases, rather than assuming functions of the states, has assumed authority in fields in which the states never acted? In other words, did the FHA take away a state function? Did the Department of Agriculture take away from the states the privilege of issuing food stamps? The answer is no. The Federal government has tackled problems which the states and units of local government had neither the expertise nor the finances to undertake.

It should be kept in mind that our governmental system as conceived is basically a partnership of two fundamental units: (1) A federal government with representatives of all of the states, and (2) all of the states individually. The problem is that in recent decades one unit has assumed additional authority and the balance has been disturbed; the Federal government has usurped some of the authority of the states. Of course, certain conditions have forced the Federal government to assume additional authority. Emergencies such as world wars and great economic crises coupled with the vast resources available to the Federal government to deal with the crises, have forced it into areas which were not envisioned when our system of government was formulated.

From the hearings, some have reached the conclusion that the Federal government should be decentralized by giving power to regional authorities. The report presented by the majority is attacking the problem of the growth of the Federal government; however, I feel that the attack is misdirected. It seems much more logical that we should take a hard look at giving power back to the states where it rightfully belongs. Reason dictates that if we wish to make government more responsive to the will of the people by keeping it close to

the people, we should work through the states and local units of government. Rather than decentralizing the Federal government, it seems obvious that the Federal government with its vast resources and expertise should assist the states and local communities to assume those functions which they can handle most effectively.

The problem has not gone unrecognized. In 1968, Richard Nixon said:

> We are going to reverse the flow of power to the Federal Government in Washington, and channel more power back to the states and localities. Tax sharing; bloc grants; decentralization; local option; community participation; this is the direction I believe America is about to choose.

More attention should be devoted to the President's Special Revenue Sharing Plan and his suggestions for reorganization. Under the Special Revenue Sharing Plan, great emphasis is placed upon the need for modernizations of state and local governments. For the states and localities to participate they must bring their governments into the twentieth century. If properly constituted, state and local governments can work in an effective partnership with the Federal government to solve our social problems. I realize that this is a very expensive undertaking and should be encouraged by the Federal government. Further, I recognize that this might mean that several states may have to completely redraft constitutions and that the charters of various units of local governments must be changed. The President's plan assists and encourages the states in this endeavor.

The President's Special Revenue Sharing Plan for Community Development states the following:

> * * * the Federal aid system has not given sufficient recognition to the need to work through and to strengthen elected officials of State and local general-purpose governments and regional combinations thereof; * * *.

Moreover, states should be encouraged to re-examine their tax structures. We all agree that it would be more desirable for the states to be able to tax their own citizens in order to provide needed services instead of relying on the Federal government. However, new modes of taxation also require a complete reorganization of government. All of us would agree that the property tax and the sales tax should be re-examined. Furthermore, in the past few years, several suggestions have been made for the imposition of other forms of taxation which would produce greater revenue and at the same time remove the heavy burden of taxation from any particular segment of the population. The President in his Revenue Sharing proposal also endorses this concept and he states:

> It is therefore the purpose of this title to strengthen general purpose units of government and regional combinations thereof at the State and local levels to enable them to use their own and shared revenues more effectively to cope with complex problems in a manner responsive to the economic and social needs and desires of all affected citizens. To pro-

> mote this purpose Federal assistance will be provided to States and localities undertaking planning and management programs which lead to more effective resource allocation.

Secondly, in order for the shared revenue to be supplied to the states, the whole federal establishment should be reorganized. Since 1930 we have seen the Federal government grow in all directions. The addition of new programs has never been uniform or done in a manner to keep different agencies from overlapping. In 1930, the Federal government employed 600,000 people. Today it employs 3 million. The number of federal grant-in-aid programs which directly affect our urban areas has increased from two dozen to over 500. We find that the existing departments and agencies have been expanded in a piece-meal and haphazard way. Indiscriminate new and special purpose agencies were created to fill an occasional gap, but, unfortunately, this often resulted in competition with existing agencies. Within the past few years, the Congress has established programs in agencies with the main purpose of bypassing the existing political structure such as the state governor or the city mayor: the Community Action Program of the Office of Economic Opportunity is an excellent example. I would like to point out that local housing authorities and urban renewal agencies have been created by the Congress to bypass the local officials. Again, people who are not directly responsive to the electorate are receiving federal funds to carry out certain programs. I believe that in a representative government the people should have the right to control the programs which could affect their daily lives.

Let me cite one example of the fragmented domestic programs which the Congress has created over the years. There are now divided among seven different agencies four major federal programs of assistance for water and sewer facilities and eight smaller programs. The major programs are (1) The Department of Housing and Urban Development's basic water and sewer facility grant, (2) the Farmers Home Administration's rural water and waste disposal facilities grant, (3) the Economic Development Administration's Public Facilities Program, and (4) the Environmental Protection Agency's Waste Treatment and Collection Facilities Program. Other agencies which have jurisdiction in this area are the Departments of HEW, Interior and Defense. Many communities are eligible for grants-in-aid under two or more agencies with multiple applications for a single project. Definitely, our wisest course would be to try to eliminate this needless overlapping.

I believe that a single federal department should be created to administer the major federal programs of assistance for physical and institutional development of our communities. Such a Department is being proposed by the President as the Department of Community Development. According to HUD Secretary Romney, the work of the Department would be twofold:

> First, the Department should strengthen the institutional capacity of State and local governments to work with private business enterprises and civic organizations in solving community problems and meeting community needs. Second, the Department would assist State and local

governments and the private sector in carrying out urban and rural development, transportation, and housing programs. Within the Department, different program activities would be grouped according to their general purpose.

If we combine the President's revenue sharing program which would provide for grants for the specific project areas such as housing, urban renewal, etc., and the provision for reorganization of the Executive, we have created an effective delivery system for federal assistance. However, the President's program allows the local communities and states to decide which way to administer a program and where the money is needed most. If these plans are adopted by the Congress, I believe that the power of the people to govern and decide what action should be taken in their own behalf will see a new and positive beginning.

Views of Senator Jacob K. Javits

The Majority Report, and the Minority Views submitted by my Republican colleagues, point out all too well the complexities of dealing with so broad a subject as urban planning within the confines of an average Committee Report. The Majority Report, for example, points out correctly that governmental red tape can hinder the success of urban planning and affect the responsiveness of government to the wishes of its constituency. The Minority Report pinpoints some of the failings of the Majority Views, such as the very innovative and progressive steps being taken by the Nixon Administration in the fields of government reorganization.

Neither Report, however, more than goes once lightly over the major issues. For example, I believe it is essential that we confront in detail what has happened to the nation and the Federal Government in the past forty years. From 1930 to 1970, our population rose from 123 million to 205 million Americans. The gross national product rose from $85 billion to $977 billion. The federal budget for domestic programs rose from $2.7 billion to $116.3 billion. Federal grant-in-aid programs rose from 24 to 550, and the number of government civilian employees rose from 600,000 to 2.9 million.

In the face of this rapid growth, there is a deeply felt frustration among the American people that the pervasive institutions—governmental and corporate—which dominate their lives are unresponsive and unaccountable. This feeling reaches across all segments of the population—rich and poor, black and white, farmer and worker. As citizens, taxpayers and consumers, our people want realistic, disciplined and intelligent solutions to the governmental problems facing them every day in the localities in which they live.

The problems stem from the fragile nature of modern society, which has become so complex and interconnected. Sanitation, transportation, public safety, education, housing—even clean water, utility power supplies, and telephones appear to be failing. Industrial and municipal pollution is a ubiquitous problem. The liabilities of our cities, counties and metropolitan areas to provide services to their citizens on an unprecedented scale have combined with other factors to hinder attempts to reserve the process of deterioration of local urban areas.

The number of people receiving public assistance in New York City has reached over 1.1 million people. Economic factors, including the loss of industry and manufacturing jobs, and the relationship of the poor and the disadvantages to the economy are intrinsically complex. There are political, economic and moral dimensions to these problems which have defined the skill and good will of many committed and experienced students of the urban crisis.

If we accept the hypothesis that the Federal government will supply a large portion of the funds—through a general sharing of revenue—to solve the urban and metropolitan financial problem, we must consider also how that money should be spent and to what extent federal, state, local and county governments have the present capacity to govern so as to use their resources effectively.

Recent events in New York as well as elsewhere have shown me that the real issues are these. These are the problems that affect the daily lives of the Americans who must live and who must satisfy their livelihoods in our urban communities, be those communities planned or unplanned. I do not believe that either the report or the hearings, which were not cited except in general terms in the Majority Views, have addressed these issues, although they have tried hard to make the best of the limitations at hand. In short, these problems are ones which deserve a more thorough set of hearings, using, perhaps, some of the sociological findings developed in the compendium published by the Subcommittee.

I commend the Subcommittee Chairman for using the very capable resources of the Joint Economic Committee to discuss these important issues and I believe that the complexity of the subject compels a more thorough treatment, both in the way of hearings and in the way of an ultimate report.

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