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INDEPENDENT PETROLEUM ASSOCIATION
OF AMERICA

file

May 23, 1974

Mr. Dan Jones 466-8240
Executive Vice President
INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA
1101 16th Street, N. W.
Washington, D. C.

Mr. Jones telephoned - requested an appointment with Mr. Staggers for President John Miller and several others either Wednesday, May 29, 1974 or Thursday, May 30, 1974.

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Statement by C. John Miller, President
Independent Petroleum Association of America

Before the
Senate Committee on Interior and Insular Affairs
February 1, 1974, Washington, D. C.

My name is C. John Miller. I am a partner in Miller Brothers at Allegan, Michigan, an independent oil and natural gas exploration and producing organization. I appear here as president of the Independent Petroleum Association of America (IPAA) a national organization of domestic independent oil and gas producers and explorers with some 4,000 members in every producing area of the United States.

We welcome and appreciate the opportunity to express the viewpoint of the independent segment of the domestic petroleum producing industry on the bill (S. 2885) to establish ceiling prices on petroleum. For reasons set forth in my testimony, we do not believe that passage of the bill would be in the best interests of the consuming public or the national economy.

Much of the public attention on oil prices, oil profits and oil taxes during recent weeks and months has centered on a handful of large international oil companies. This has obscured and overlooked the fact that some 10,000 small businessmen -- the independent producers -- are responsible for 75 to 80 percent of the exploratory, or "wildcat," drilling directed at finding new reserves of oil and natural gas in the United States. The attached chart "Percent of U. S. Production by Medium and Small Companies, 1971" provides further evidence of the importance of these units in domestic crude oil production. Excluding the eight largest companies, the medium and small oil producing companies control a far greater percent of total U. S. production than do their counterparts in other industries: 57 percent for crude oil vs. 35 percent for steel mills; 13 percent for aircraft; 11 percent for tires and tubes; 3 percent for motor vehicles and zero for cigarettes.

The United States became the largest oil and gas producing and consuming country primarily because of this multiplicity of effort by thousands of independent explorers. It is important, therefore, in considering policies as to prices, profits and taxes to recognize the vital role of independent producers.

The evidence now is persuasive that government's policies since the mid-1950's, directed at holding crude oil and natural gas prices unrealistically low, have been the primary influence in discouraging exploration and development, bringing on worsening shortages of natural gas and unnecessary dependence on remote and vulnerable foreign oil supplies.

Government economic policies such as federal price regulation of natural gas and direct and indirect crude oil price controls, had several predictable results. They caused a prolonged flight of capital from domestic exploration. The ranks of active independent explorers and producers were thinned by about half, dropping from approximately 20,000 in the mid-1950's to about 10,000 who remain in the industry today. The result has been an unnecessary shrinking of our producible petroleum reserves.

Just as the declining activity by independents, who traditionally have performed the lion's share of domestic exploration, has been a major factor contributing to our worsening energy supply position, we believe efforts to revitalize and encourage the domestic producing industry, particularly the independent sector, offer the most effective and least costly means of alleviating the oil crisis and assuring reasonable prices. The only other choices for the short-term are (1) restricted consumer use with the attendant dangers of economic depression and unemployment, or (2) further dependence on imported oil now priced at from $10.00 to $20.00 per barrel.

The bill recognizes that oil price controls should not impede "the long-run function of prices and profits in eliciting new production..." To that end, the bill provides that the President my increase price ceilings "for the sole purpose of providing increases in the price of new supply to encourage increased domestic exploration and production of crude oil..."

This recognition and provision have useful and helpful purposes. I submit, however, that these purposes cannot be accomplished because the bill limits domestic crude oil prices to no more than a pass through of production cost increases actually incurred. The concept of price controls based on costs has been proven to be not only impractical but harmful in the case of petroleum. Costs have been the basis for price controls on natural gas producers by the Federal Power Commission for the past 20 years. The difficulties of determining costs have resulted in interminable delays, prolonged hearings and inaction. The results have been a critical shortage of natural gas -- a primary contributing factor in the overall shortage of U. S. energy.

There is a basic economic relationship between crude oil prices and supply over the long term. The "passthrough" of costs actually incurred at any given time is only one of many factors involved in the responsiveness of supply to changes in price. Other crucial factors include the need to generate huge amounts of capital for exploration and development, the need to encourage the expenditure of these funds, and the <u>prospective</u> profitability which takes into account future costs as well as costs actually incurred.

Today's average price for domestic crude oil is not excessive in terms of generating the funds and incentives needed to expand U. S. petroleum exploration, development and production. These activities should be doubled, or perhaps tripled, if we are to restore our energy independence. It is likely that higher prices will prove to be required.

In this connection, there has been understandable concern as to increases in prices of oil products to the consumer and speculation that we may be facing gasoline prices of 75 cents or $1.00. In this regard, it is pertinent to keep in mind that the current average price of domestic crude oil is only some 6 cents a gallon over the 1972 price. Obviously, since the average price of gasoline in 1972 was 36 cents, domestic crude oil prices have not been, and will not be, the cause for 50 cent, 75 cent, or $1.00 prices for gasoline. The increase in domestic crude oil prices, however, have increased U. S. exploration and development and we are convinced will result in increased supplies for consumers.

Fundamentally, I believe that crude oil and natural gas price controls by the federal government have been the most disastrous aspect of past energy policy. I further believe that restoration of a free market would go far toward bringing forth the tremendous capital investments required to close our total energy supply gap. And I believe the market would function effectively to determine competitive and proper prices and to allocate different fuels to their most productive uses.

I believe, in short, that crude oil and natural gas price decontrol would be the most important single contribution that Congress could make toward regaining energy independence for the United States.

It is pertinent to recall that in the mid-1950's, government began to substitute its judgment for competitive market disciplines in determining the well-head prices for oil and gas. Under a Supreme Court mandate in 1954, natural gas prices have been rigidly regulated by the Federal Power Commission since 1954. A condition of the oil import quota program initiated in 1959 required "surveillance" of domestic crude oil prices which resulted in effective price restraints by persuasion and coercion under successive administrations, both Democratic and Republican.

As a result of these government-administered prices, the real price of domestic crude oil in constant 1973 dollars declined by $1.31 a barrel or 27 percent from 1957 to 1972, and the combined price of both oil and natural gas at the wellhead, with gas expressed in crude oil equivalent, declined $1.00 a barrel or 31 percent. Confronted with these persistently eroding real prices during a period of rapidly accelerating costs, independent oil and gas producers progressively curtailed their activities and thousands simply chose to sell out or quit.

Onshore exploration and development expenditures by independent producers dropped almost 50 percent since 1956, and the number of exploratory wells drilled reflected this decline, also decreasing about 50 percent. As a result, the nation has a growing gap between its demands for oil and natural gas and its capacity to produce these essential fuels.

Before concluding, I would like to clarify one matter. In introducing this bill on January 24, the Chairman referred to testimony by the IPAA in August 1972 before your Committee, stating that this testimony showed "that a domestic price of $4.10 per barrel would be adequate to assure the United States 100 percent self-sufficiency by 1980." The Chairman recognized that this projection was in constant dollars, stating that the IPAA figure of $4.10 per barrel would have to be increased to $4.55 today to take account of inflation.

A number of additional points should be recognized in connection with the 1972 IPAA projection:

(1) The price of $4.10 (or $4.55 today) was not based on assuring 100 percent self-sufficiency in 1980. It was based on 85 percent self-sufficiency for oil and natural gas combined -- the 1970 ratio between domestic production and domestic consumption.

(2) More important, the price of $4.10 (or $4.55 today) was derived from the combined price of crude oil and natural gas, and assumed that the average price of natural gas would increase to 50 cents per MCF.

In contrast, the average price of natural gas in 1973 was 21.3 cents.

(3) Using the 1973 price of natural gas the IPAA analysis, in terms of constant 1973 dollars, shows that an average price of about $6.65 per barrel for crude oil for <u>all</u> domestic crude oil would be required over the long run to achieve 85 percent self-sufficiency in oil and gas by 1980 and $8.40 for 100 percent self-sufficiency, recognizing that today's critical shortages of domestic oil and the need for tremendous expansion of exploration and development may well require higher prices in the short run. It should also be recognized that the many variables and assumptions involved in supply/price relationships make it impossible to predict precisely what price will be required to bring forth any particular level of supply. The IPAA analysis, and the resulting price figures, are useful in shedding light on approximate required price levels, if historical relationships continue into the future. However, there is no "magic number" for a necessary or proper price.

(4) The IPAA analysis was based on a long-term historical relationship of price and supply over the 20 year period 1952-1971. Unusual conditions at any given time can and have resulted in deviations from this long-term relationship. For example, the country was confronted with an oil shortage following World War II as a result of wartime price controls and shortages of materials. As shown on the chart, "U. S. Petroleum Exploration & Development Expenditures vs. Combined Price of Oil & Gas," substantial price increases, over and above the long-term relationship between prices and expenditures, occurred in 1947 and 1948. As a result, expenditures for exploration and development were encouraged greatly and domestic supply was increased so that shortages were overcome. Prices decreased and the long-term price/supply

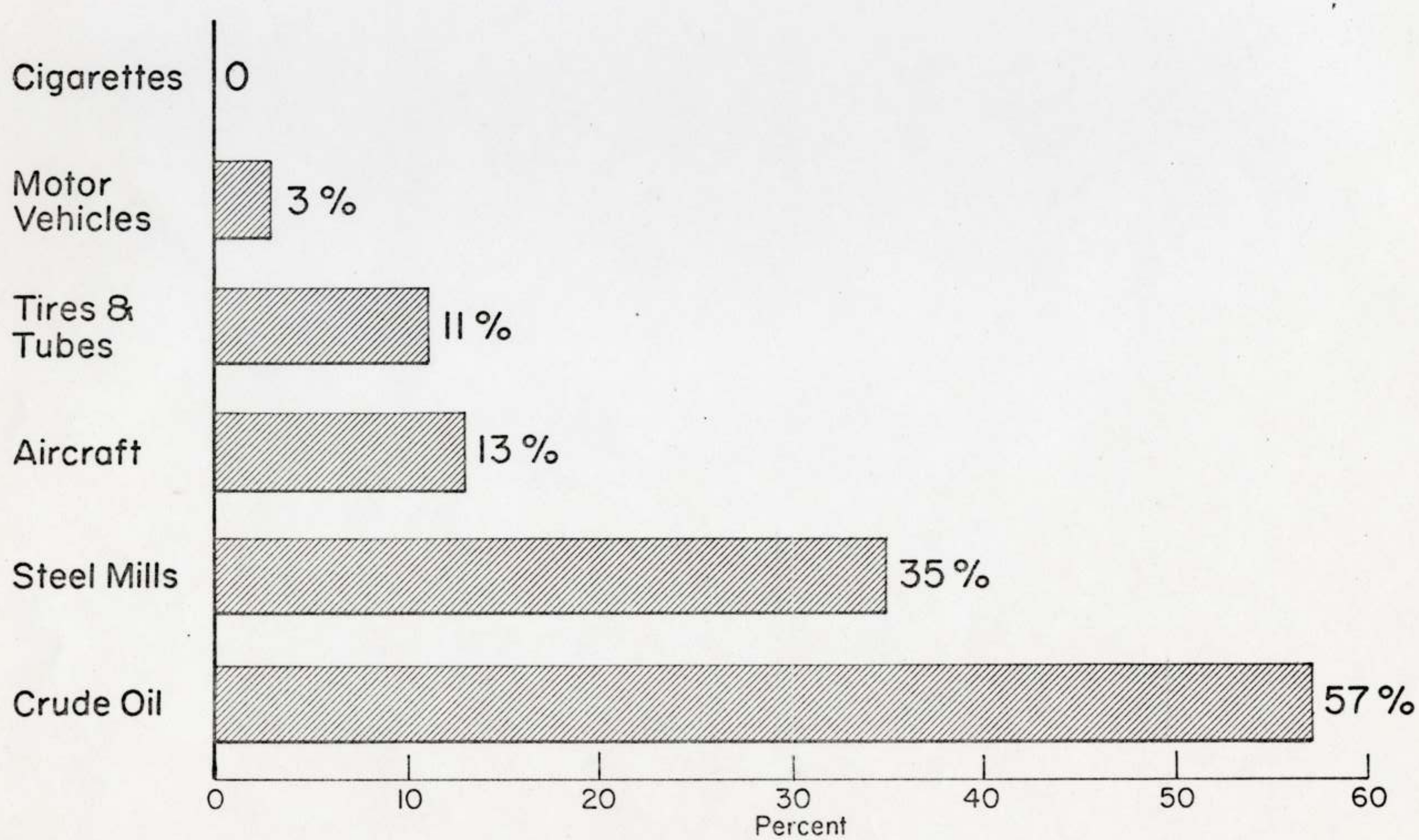
relationship was restored. This is comparable to the situation that exists today. Shortages are here and there is a need for extraordinary incentives to increase domestic supplies. For the short term, prices may have to exceed levels based on long-term relationships. Otherwise, shortages could become more acute. The longer range best interests of the country would be served by higher prices to bring about increasing supply which would bring prices in line with past relationships.

In conclusion, actions by the government to roll-back crude oil prices, reduce the profitability of producers, or increase the tax burden on domestic production would be counter-productive to the basic and pressing need to increase U. S. supplies of oil and natural gas.

This leads to the central question at issue: With many in government calling for reversing our declining energy supply position, which need has the greater priority, price reductions or more energy? If the answer is more energy, then I believe Congress ought to give present market forces some time to prove themselves before moving precipitously to impose more stringent crude oil price controls.

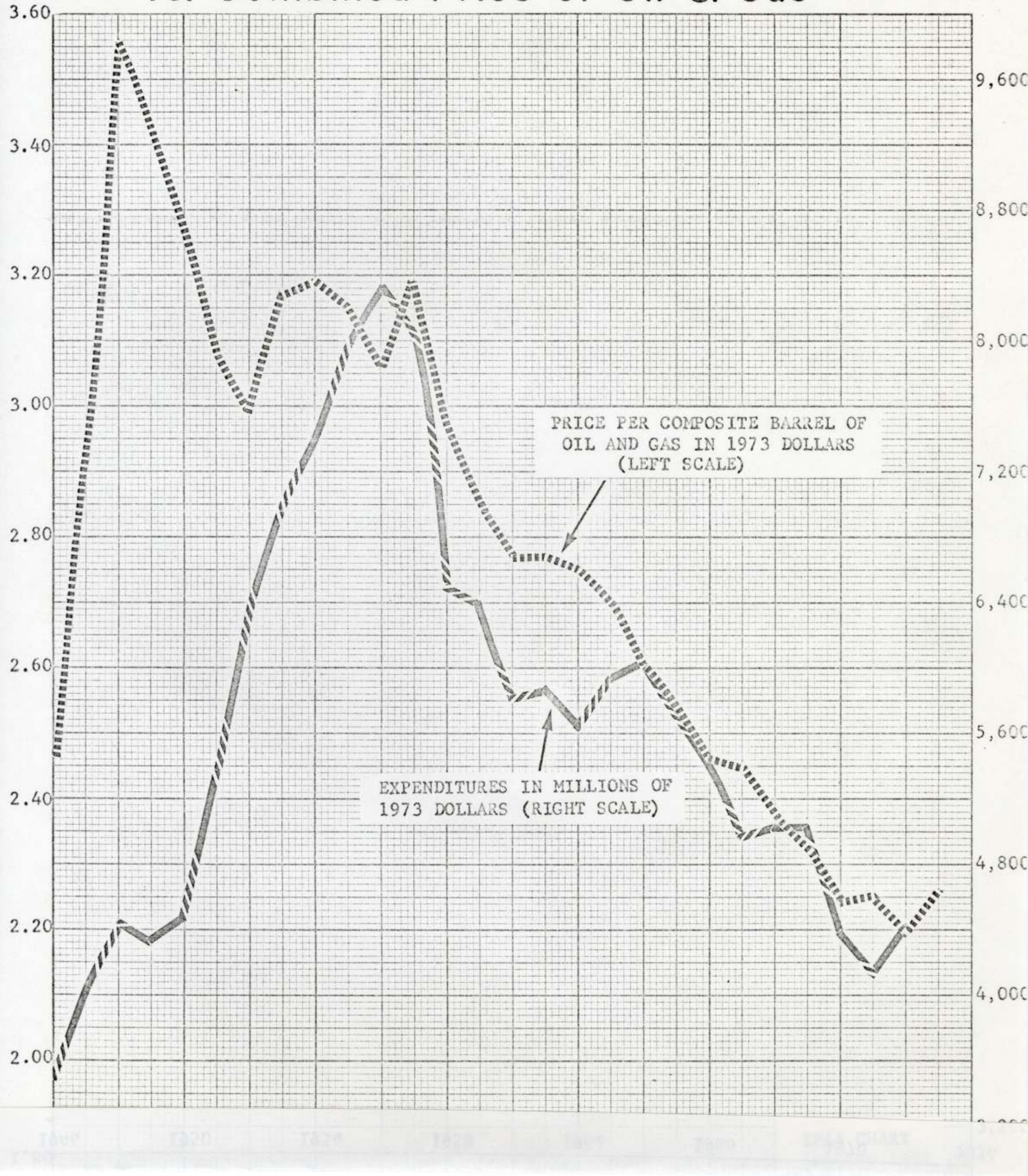
We respectfully request that your Committee give most careful consideration to the possible damaging effects of S. 2885 on domestic supplies of crude oil and natural gas.

# PERCENT OF U.S. PRODUCTION BY MEDIUM & SMALL COMPANIES IN 1971 (excludes 8 largest producers)




*Sources: U.S. Dept. of Commerce and IPAA*

# U. S. Petroleum Exploration & Development Expenditures vs. Combined Price of Oil & Gas



# INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

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L. DAN JONES
EXECUTIVE VICE PRESIDENT
AND GENERAL COUNSEL

file

December 13, 1973



The Honorable Harley O. Staggers
U. S. House of Representatives
Washington, D. C. 20515

Dear Harley:

We are very much concerned that the proposed regulations implementing the Emergency Petroleum Allocation Act of 1973, published in the Federal Register of December 13, 1973, will seriously discourage exploration and development of domestic crude oil and natural gas. The regulations would virtually eliminate competition in the crude oil marketplace while permitting refiners to pass through to the consumer unrestricted prices paid for imported oil.

The regulations would guarantee each refiner his supply of crude oil, even if he sits back and does not compete for the producers' crude oil. There is no incentive for the refiner to go out and compete in the domestic crude oil market at the producer level.

During the past few months, there has been active competition for domestic crude oil with the result that exploration and development of domestic oil and natural gas has been stimulated. The 10,000 independent producers in the United States, who drill 80 percent of the exploratory wells, have been substantially reactivated and are preparing for further expansion of their drilling programs in the months ahead. The proposed regulations would disrupt this increased effort because the elimination of competition would reduce economic incentives. For the short term of the next few years, the least costly and most readily available source of supplies of crude oil and natural gas is onshore in the lower 48 states where the thousands of independent producers operate.

If the mandatory allocation program is not to defeat the essential objective of encouraging increased domestic supplies, it is necessary that the proposed program be modified as follows:

1. The Cost of Living Council now exempts from price controls (a) all new crude oil (and released oil) and (b) small or stripper well production. In order to preserve some degree of competition in the crude oil marketplace, new and stripper well production should also be excluded from allocation controls at the refinery level. Such an exclusion would continue to provide some competition as an incentive to producers to explore and develop increased production.

2. That the proposal be clarified to confirm beyond question that producers are exempt from the allocation program. The law does not require that producers be subjected to allocation controls. In fact, it specifically provides that allocation controls need not be established at the producer level. Furthermore, it is not necessary that 10,000 independent producers be frozen in their market pattern as of a given date in order to serve the program's purpose of distributing crude oil proportionally among refiners. This purpose can be accomplished by applying allocations at the refinery level only.

It would very much be appreciated if you would urge the President, Mr. Simon, Administrator of the Federal Energy Office, and other officials with responsibilities in this area to consider our views.

Very truly yours,

Dan

L. Dan Jones