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HEARING

BEFORE THE

SUBCOMMITTEE ON

ANALYSIS OF MONOPOLY AND BUSINESS RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

NINETY-SIXTH CONGRESS

SECOND SESSION

ON

GASOLINE PRICES

JUNE 18, 1980

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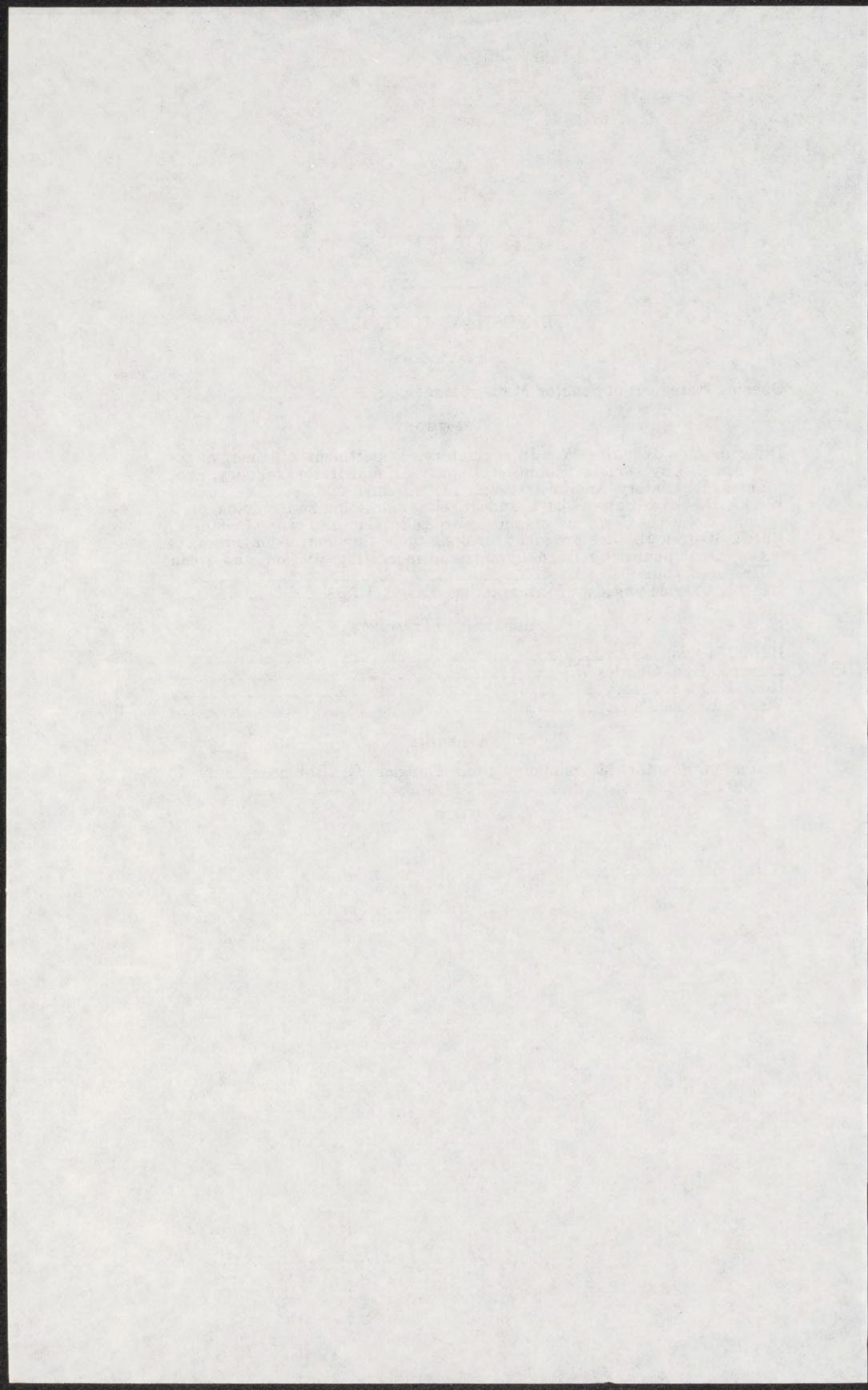
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(III)



WHY GASOLINE PRICES REMAIN HIGH DESPITE EXCESS SUPPLY

WEDNESDAY, JUNE 18, 1980

U.S. SENATE,
SUBCOMMITTEE ON ANTITRUST, MONOPOLY
AND BUSINESS RIGHTS,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 5110, Dirksen Senate Office Building, Senator Howard M. Metzenbaum (chairman of the subcommittee), presiding.

Present: Senators Metzenbaum and Thurmond.

Also present: Herman Schwartz, chief counsel; Margery Baker, counsel; Peter Chumbris, minority chief counsel; Joseph Lanham, minority chief economist; and Marilyn Falksen, chief clerk.

Senator METZENBAUM. The subcommittee will come to order.

OPENING STATEMENT OF SENATOR METZENBAUM

Elementary economics says that when supply exceeds demand, prices will fall. So why do prices of gasoline and heating oil keep going up?

Supplies of crude oil, gasoline and heating oil are way above normal, and the U.S. gasoline and heating oil consumption have dropped for 2 years in a row. But in defiance of the principle of supply and demand, prices are not falling—and most experts say prices will even rise further.

Those are my views. Those are the questions I want answered. But I am not alone in raising this issue. For the words and questions I have just recited are a direct quote from an article in last Friday's Wall Street Journal.

The people of this country have heard a lot of inspiring rhetoric over the last several years on the need to conserve energy.

The administration has used conservation to justify its policy of promoting higher and higher energy prices. The oil industry has filled the airwaves with advertisements calling upon the country to "go on an energy diet."

We have heard time and again from the industry and the administration about letting "the market" set the prices. In fact, on Monday of this week, Mobil published an ad with this conclusion:

We think that most Americans, given the choice, would prefer the scramble of free markets—and the cost efficiencies that only competition can produce.

I agree with Mobil 100 percent. The American people believe in competition. They believe in the free market. They are entitled to the benefits that competition brings.

But what we are asking today on behalf of the American people is a very simple question—and that is, why is the oil market in this country so totally exempt from the economic laws that prevail in a truly free market?

Consider for a moment the perverse behavior of gasoline prices since January. We see gasoline supplies way up—in fact, stocks of gasoline over this period were far above the normal range, according to the Energy Information Administration of the Department of Energy.

We see that gasoline consumption came down. But prices—prices rose, then leveled off somewhat. But in spite of excess supply, prices did not drop and are not dropping today. In fact, the experts are predicting sharply higher prices in the months to come—with gasoline reaching \$2 a gallon in 1981.

Now I am familiar with the argument that OPEC is to blame for the fact that oil prices rise, even in times of glut. That is how the oil companies explained what happened last winter, when oil and diesel fuel prices went up by nearly 90 percent over the level of a year before.

But what really caused those whopping increases?

According to a thorough investigation conducted at the time by Congressman Benjamin Rosenthal, last year's increases in diesel fuel and heating oil prices were far in excess of the levels that could be justified by higher crude oil prices and the general effects of inflation.

Between September 1978 and September 1979, refiners' margins for these fuels increased by an incredible 200 percent—from 7 cents a gallon in 1978 to 21 cents a year later.

Oil company profits from heating oil rose in the same period by 800 percent and diesel fuel profits went up by 700 percent.

Where, I wonder, was that "cost efficiency" and "scramble of free markets" which Mobil so lavishly praises in this week's canned economic wisdom?

Why was it that one of those fierce competitors in the oil industry could not have settled for—say—a mere 100-percent increase in heating oil profits, as against the actual 800 percent.

Wouldn't that have been more in the competitive manner?

In the immortal words of Yogi Berra, "You can observe a lot just by watching."

Congressman Rosenthal was not the only one who was watching.

The prestigious National Bureau of Economic Research, for example, has published a study which concludes that soaring OPEC prices go hand in hand with soaring oil industry profits.

In September 1979, the Wall Street Journal ran an article entitled "Refiners Are Suspected of Using Heating Oil To Warm Their Profits."

Now all of these analyses make it clear that the oil companies of this country cynically used 1979's OPEC price increases to camouflage their own gouging of the American consumer.

Let those with short memories remember what that unconscionable price runup meant for millions of people in this country.

Let us not forget the emergency legislation that the Congress had to pass to get the poor through the winter without freezing.

Let us not forget the millions of Americans—particularly the elderly—who had to choose between heating and eating.

Let us not forget either that the extraordinary oil company profits derived from diesel fuel showed up in higher transportation costs and, therefore, in higher prices for everything that every one of us must buy.

Above all, we cannot afford to forget how the oil companies, with the active assistance of the Treasury and Energy Departments, used the phony "Iranian shortfall" of 1979 to create gaslines and to double gasoline prices.

Remember when we were told last year that the loss of Iranian imports meant gaslines and higher prices? But now we know that imports from other countries more than offset the loss of imports from Iran.

As a matter of fact, world production of crude oil in the first half of 1979 was almost 6 percent higher than it was for the comparable period in 1978, and U.S. imports were up almost 8 percent in 1979.

No, there was plenty of crude around—it was just not being brought on line by an industry whose refineries were operating at the extraordinarily low rate of 83 percent. What gasoline there was went into stockpiles—and off the market.

Now Treasury knew there was no shortage. The DOE knew it too. But revealing the true acts would have been inconsistent with the administration's high-price policy. So Americans waited in line, and paid the extortionist prices, while their own Government sat by with arms folded and did nothing.

The inaction was profitable—immensely so—for the oil companies of this country.

In the first quarter of this year, while profits in the non-oil-manufacturing sector of our economy dropped by 6 percent as compared with the same period last year—and in this chart over here you can see where other manufacturers have had difficulty—oil company profits were up an average of 80 percent.

[Senator Metzenbaum pointing to charts.]

Senator METZENBAUM. That is, 80 percent above the record pace that oil profits set in 1979. And as extraordinary as these profits figures are, they may, in fact be understated.

Charles Breecher, a member of the Republican National Committee's Council of Economic Advisers, has pointed out that the industry's use of sophisticated accounting techniques has "successfully camouflaged" true earnings that are even higher than the outrageous levels to which the industry will admit.

Today, we are going to hear from several major oil companies and the Secretary of Energy. I hope that they will be able to shed some light on issues that are profoundly disturbing to me and to the people of this country. We need answers—and we need them now.

The Chair wishes to acknowledge the presence of the Secretary of the Department of Energy. I am aware of the fact that his presence here this morning was at some inconvenience to himself. He was out of the city. He came back. He has two hearings this morning, one with Senator Bayh on another subject. I want to say to him that I am very

grateful to him for finding the time to be with us this morning. I know that the Secretary has a statement and will take a few questions and then has to leave, but Mr. Doug Robinson will remain, in his stead. But I do want to express my appreciation to you for finding the time to be with us this morning. Your testimony is very important to us.

We will be very happy to hear from you now, sir.

STATEMENT OF HON. CHARLES W. DUNCAN, JR., SECRETARY, DEPARTMENT OF ENERGY, ACCOMPANIED BY DOUGLAS ROBINSON, DEPUTY ADMINISTRATOR, OF POLICY, ECONOMIC REGULATORY ADMINISTRATION

Mr. DUNCAN. Thank you very much, Mr. Chairman.

I appreciate the opportunity to discuss with you recent trends in gasoline supplies and prices.

We believe that the apparent anomaly of increasing gasoline prices coupled with high gasoline supplies has one main explanation; that is, higher costs for gasoline producers, particularly the skyrocketing price of the crude oil they refine.

We estimate that from June 1979 to June 1980, the average cost of crude oil to domestic refiners increased by 70 percent, from about \$17 per barrel to about \$29 per barrel.

The price of gasoline at the pump increased a little over one-half, from about 80 cents per gallon to about \$1.23 to \$1.25 per gallon.

In the testimony this morning, I am going to briefly outline the conclusions that we have reached on this issue. I have a prepared statement that I will submit for the record, Mr. Chairman, which has some exhibits.

Senator METZENBAUM. Your prepared statement will be included in the record at the conclusion of your oral testimony.

Mr. DUNCAN. It will go into the question in more detail than I will in my brief statement. As you indicated, Mr. Douglas Robinson, who is the Deputy Administrator for Policy of the Economic Regulatory Administration, is here with me and will stay after I leave to help respond to your questions.

During the past several months, the supply situation in the United States for crude oil, gasoline, and other products has improved significantly over the corresponding period in 1979.

The stocks of crude oil are about 18 percent higher than at the same time 1 year ago. Gasoline stocks at the primary level are at near record highs, about 18 percent above the level of 1979.

Similar supply conditions have been reported in other parts of the world. Much of the credit for this improvement in the United States must go to the people and the businesses of this country. They have increased dramatically their efforts to conserve fuel. Let me add a word of caution. The fact that supplies are relatively sufficient today in no way guarantees that they will be adequate tomorrow. World supply and demand are in a very tenuous balance. It is a balance that could be upset very easily and suddenly. We must continue to make every effort we possibly can to reduce our dependence on imported oil.

In spite of the relatively adequate supply of crude oil average crude oil prices, both foreign and domestic, have continued to rise at a substantial pace.

We have seen OPEC price increases in December, in January, in April, and now in June.

Last June, 1 year ago, the average cost of oil—foreign and domestic—to U.S. refiners was about \$17 a barrel. The average cost of the imported barrel was around \$21. Based on the recently announced price increases by many producing countries, we now estimate that average refiner acquisition cost during this month will be over \$29 per barrel for all crude oil, and about \$35 a barrel for imported crude oil.

Even in a market that is characterized by relatively ample supplies, most of these cost increases would be reflected in the prices of products such as gasoline.

In the long run, suppliers must price their products in such a way as to recover their costs. This is recognized in the Department's gasoline price regulations which provide that increased crude oil costs may be passed through to the price of gasoline.

Therefore, even the presence of abundant supplies is not likely to reverse the trend of increasing prices if crude oil prices and other costs are also increasing significantly.

But, in a competitive market one can expect adequate supplies to have a moderating effect on the upward price trend, as refiners and marketers keep their profit margins lower than they otherwise would be in order to sell gasoline.

In fact, precisely that appears to have happened over the past few months.

Recently, the price of gasoline at the pump has risen at a very modest rate. Since March, it has increased only about a penny or two a gallon. That statement is based on independent surveys that were published by Platt's Oilgram.

We are generally finding that fewer and fewer dealers are actually pricing at or above their maximum margins, a result that we think is caused by the relatively ample supplies and, therefore, increased competition.

The refiners' "banks" or "banked costs," the unrecovered costs from previous months, have risen very dramatically in the past year.

All of this evidence leads to the conclusion that both increased gasoline supplies and increased competition have kept the price of gasoline lower than the increased costs alone would have made those prices.

In short, product prices will continue to rise even in a market of ample supplies if refiners continue to experience substantial increases in cost, particularly in crude oil cost. But the existence of relatively ample supplies is moderating these price increases by reducing refiner and marketer profit margins from the levels they would otherwise have reached.

Gasoline prices are higher, but they are not as high as they would be if we did not have our current high inventory levels.

We have had some success in our program. The percentage of imported oil in the total mix of oil we use was approaching 50 percent. It is now down to approximately 40 percent.

We are using so far this year about 1.1 million barrels per day less of imported oil than we were in the same period last year.

We are using about 600,000 barrels of gasoline per day less than we were at the same time last year. The policies are beginning to work.

I thank you very much, Mr. Chairman. That concludes the brief summary of my statement.

Senator METZENBAUM. I thank you very much, Mr. Secretary. I do have some questions. I will try to be direct and succinct.

I don't think anybody challenges the fact that there is not an unlimited supply of oil and that although there is a surplusage at the moment, that it is not permanent. The purpose of this inquiry is not to challenge that assertion.

The purpose of this inquiry is to ask: Why is it, when there is a surplus of supply, that prices have not come down and that the oil companies, as a general rule, have substantially increased their profits. First-quarter profits of the three companies that will appear today are up an average better than 100 percent. One is 101.6 percent. One is 105.3 percent. One is 96.1 percent.

Now, normally, if you had too many potatoes, if you had too many tomatoes, if you had too much wheat, the price would come down. You have indicated that prices have moderated, that the increases have moderated.

We accept the fact that the OPEC price increases have to be worked in, but why have the oil companies been in the position to double their profits at the expense of the American consumer, and at the expense of the inflationary spiral which is probably one of the Nation's greatest challenges.

That is the thing that I do not think the American people can understand.

Mr. DUNCAN. The prices that the oil companies charge for gasoline have to be within the guidelines of the Department of Energy because gasoline prices are controlled, and also, within the COWPS guidelines. What has happened in the marketing of gasoline, and Doug Robinson can check me on my numbers, is that refiners' banked costs, costs that they could not pass through on gasoline, have approximately doubled in the past year having gone from something like \$2.5 billion, up to something in the neighborhood of \$5 billion.

Are those numbers correct, Doug?

Mr. ROBINSON. Yes.

Mr. DUNCAN. That's one thing. Now, as to what extent those profits are attributable to their production, and to what extent they are attributable to refining or to marketing, you better ask them. They will be testifying later.

But, in the case of the prices of gasoline, they do have to live within guidelines because those prices are controlled, and their banked costs have risen dramatically in the last year.

Senator METZENBAUM. You say that their prices are controlled, but the fact is that decontrol is now working in this country, and is working at a rate where gasoline prices or oil prices have gone up at about an 80-percent rate in the last 6 or 7 months.

Now, isn't part of the problem the fact that the administration has seen fit to decontrol the price of oil, and, were it not for that fact,

wouldn't the profits of the oil companies and the price of gasoline be a substantially lower figure?

Mr. DUNCAN. The decontrol of oil was done by the administration because it does exactly the right things to diminish our dependence on foreign oil. It does exactly the right things to encourage conservation.

It means that you can amortize conservation investments and conservation capital expenditures at a more realistic rate. It encourages the development of alternatives. It helps us move more quickly toward a set of energy conditions which will mean that we have more control over inflation, more control over the value of the dollar, and more control over the balance of payments deficit.

The fact that gasoline has gone up is attributable, of course, to the increased cost of crude oil, more than any other single factor. That is what I said in my testimony.

Senator METZENBAUM. Well, you say it increases production. Our figures don't support that. For example, one company's profits between 1978 and 1979 went up 55 percent, but they only increased their energy capital expenditures 31 percent. They spent well over \$1 billion to buy up companies totally out of the energy field.

Another company's profits were up almost 80 percent—78 percent. Their capital expenditures were up only 45 percent.

For another company, the percentage increase in profits was 92 percent. Their increase in energy capital expenditures was only 9 percent—about 10 percent of their total increase in net profits.

Now, really, to say that decontrol helps them produce more, helps conservation, I think is stating it too simply. It just isn't working that way.

Mr. DUNCAN. Mr. Chairman, I would say that the process of decontrol is fundamental to the implementation of a successful energy policy.

Let's look at what happened. I can't comment on oil company capital expenditures. I don't know whether you mean by that exploration or the development of additional wells. I don't know what constitutes your definition, so I can't comment on it. Again, it is more appropriate that you talk to them about that.

Let us look at what's happened in the exploration for oil and gas in this country. Last Monday, there were 2,806 drilling rigs active in America. That is more drilling rigs than have been active since December 1956. That is more than there have been active in the last 24 years. That is about 800 more than there were as recently as 1 year ago.

There has been a dramatic increase in the exploration for oil and gas in this country.

There has been a dramatic momentum that is still developing behind the development of alternative fuels. There has been a dramatic emphasis behind conservation. These initiatives are absolutely essential if we are going to relieve our dependence on foreign oil and regain control of our economy.

Senator METZENBAUM. We aren't regaining control of our economy when energy prices are adding about 50 percent to the total impact on inflation in this country.

Mr. DUNCAN. But the issue, Mr. Chairman, is: What are you going to do about it?

Senator METZENBAUM. Well, what I am saying is——

Mr. DUNCAN. The issue is: Are we going to adopt policies that show political courage and have the political will to regain control of the situation? That is what I suggest these policies are doing.

Senator METZENBAUM. Do you think that it takes political courage to decontrol the price of oil?

Mr. DUNCAN. I think that was a courageous act.

Senator METZENBAUM. Well, I am not going to challenge the statement. But I think it was an ill-advised act.

Mr. DUNCAN. We disagree, with all due respect, Mr. Chairman.

Senator METZENBAUM. Because what we have done is, and the issue before us is, whether this Government is permitting the oil companies to literally gouge the public. Certainly their profits are up between 80 and 100 percent, some over 100 percent. That isn't helping the economy. It isn't producing more. They are using their funds to buy up all sorts of companies in this country.

The real question is: Why does this administration continue to push for greater oil company profits?

Mr. DUNCAN. What this administration pushes for is our regaining energy security, adopting those policies which will over the long term see that we gain control of our destiny from the standpoint of energy.

When you say "energy," that means your economic destiny. We have to do those things which encourage the development of alternatives. That is exactly what we are doing. We have to adopt those policies that encourage conservation. That is what we are doing.

We are very mindful of the social and economic impacts of decontrol. That is the purpose of the windfall profits tax.

Senator METZENBAUM. Well, Mr. Duncan——

Mr. DUNCAN. We have to consider lower-income people and those who are socially disadvantaged and the impact on them of higher energy costs. We believe that very keenly.

We are promulgating programs to do just that.

Senator METZENBAUM. Well, Mr. Secretary, you suggest that the higher prices will achieve conservation. Yet, I am sure you are familiar with the lead story in the Wall Street Journal, a few weeks ago, indicating how much prices had gone up in France, and that they are up over \$3 a gallon. The analysts there are saying that it would have to go up to over \$8 a gallon for there to be conservation. The fact is that they are consuming more in France.

Now, I——

Mr. DUNCAN. I would like to make a comment on that, Mr. Chairman. The level of discretionary driving in the United States is far higher than it is in Western Europe.

The President's conservation fee was intended to address that area of petroleum consumption which was most discretionary, which is discretionary driving in automobiles.

The reason that the level of discretionary driving is lower in France of the other countries that were commented on in the Wall Street Journal article is because their prices have been more nearly at world levels for a longer period of time than has been the case in the United States, where they are not even today at world levels.

The price of gasoline in almost any country in the industrialized world is several times the price of gasoline in the United States.

Because of that, there is less discretionary driving. Now I don't advocate a dramatic increase in gasoline prices to achieve that level. We are making good progress in conservation. The fact is that you are comparing apples and oranges when you talk about what happened in France and what is happening in the United States.

Senator METZENBAUM. Well, Mr. Secretary, I know that the oil companies are going to discuss the questions of certification and allocation, and I know your time is running short. I will ask you just one more question or so in this area.

If a gasoline station goes out of business, the jobber serving that station is still entitled under the regulations to that defunct station's allocation.

Now, according to all the information we have, when the gasoline station closes up, the jobber gets that particular allocation and is then able to use that amount of gasoline and market it in any way he or she desires.

As a consequence, the Department's regulations are making it possible for jobbers to broker that gasoline at any price, and that is adding to the upward push for prices in this country.

I am told by the ERA that the price of gasoline increases each time the gasoline changes hands. Now, my real question is: Why is the Department not doing something about this problem of jobbers brokering gasoline and increasing the price? They know about the problem. They have apparently known about it for several years. Yet, nothing is being done. It just adds to the increased prices all along the line.

Mr. DUNCAN. We are considering a rule on that, Mr. Chairman. I think it would be more appropriate for Doug Robinson, who is intimately involved in it, to comment on that.

Senator METZENBAUM. Very well.

In accordance with my understanding with you, it is 10 o'clock. I appreciate your being here with us. I will be very happy to have Mr. Robinson elaborate further on that. I will ask him a few more questions.

Thank you very much for being with us.

Mr. DUNCAN. Thank you, Senator Metzenbaum.

Senator THURMOND. Mr. Chairman?

Senator METZENBAUM. Excuse me. Mr. Duncan, I apologize. The ranking minority member is sitting right next to me.

Senator THURMOND. Would you have somebody come here and testify and not give us the chance to pose questions?

Senator METZENBAUM. I apologize to my friend, on my left, sometimes on my right.

[Laughter.]

Senator THURMOND. Generally on the right.

[Laughter.]

Senator METZENBAUM. I did not mean to do that at all. Please, Senator Thurmond, it was purely an oversight and totally unintentional.

Senator THURMOND. Mr. Secretary, we are glad to have you with us. I notice in your statement you say:

The existence of relatively ample supplies clearly is having a moderating impact on these price increases in the form of reduced refiner and marketer profit margins. Prices are not as high as they would be if we did not have our current high stock levels.

Now my question is, What effect, if any, do the current inventories of United States oil have on oil prices domestically and internationally?

Mr. DUNCAN. I think they have a moderating impact. I think you can look at just a couple of things, a couple of facts which will substantiate that statement.

First, as I indicated to the chairman a moment ago, the refiners' banked costs, meaning the costs that they have not been able to pass through on gasoline, have grown very substantially in the last year by several billions of dollars.

Now that is attributable at least in part to the degree of competition in the market, which is a function of supply in the market.

Second, a year ago, when we had the period of gasoline lines, the figures will indicate that there was not nearly the price differential between full service and self-service in the gasoline station. I should say that that gap narrowed.

Now there is a very substantial discount for self-service, which I think is a function of competition. You will see that people are shopping around more and more for the lowest price on gasoline.

I think the Lundberg newsletter, dated May 23, if I recall the date correctly, commented about that.

I think it is a fact that competition in the marketplace is having a moderating influence. That is very desirable.

Senator THURMOND. What would be the likely impact, price or otherwise, of implementing the proposed 750-million-barrel reserve?

Mr. DUNCAN. You mean the strategic petroleum reserve?

Senator THURMOND. Yes.

Mr. DUNCAN. That depends on the market situation that exists, the rapidity with which you make the fill, and whether you make the fill from domestic resources or from foreign resources. Those are the kinds of considerations that will be involved.

In S. 932, the Congress made some judgments as to what that fill level ought to be and made some statements affecting timing and administration discretion in the area.

I haven't studied what they did in S. 932 in complete detail, but I have seen nothing yet that causes me significant trouble.

Senator THURMOND. Now a little history on the oil imports might be enlightening here. In this subcommittee's 1969 oil import quota hearings Dr. M. A. Edelman, of MIT, testified. He made this statement:

Perhaps more close to the point, the early 1966 residual oil imports into the United States were freed from controls. Since then, they have increased by about 40 percent. Despite the high taxes levied in Venezuela, the principal producing nation, and despite the efforts of the Government and the oil companies to roll back the price from a previous \$1.50 to \$1.60, the price today is well below \$1.40, and still is going down.

If the United States imported much more than it does now the result would be lower, not higher prices. Every producer would be under the greatest inducement and pressure, and host governments would lower taxes to let companies cut prices.

The effect would be particularly strong in the United States, because we have a number of large domestic refiners who are net crude buyers and would bargain independently on a scale rarely seen in Europe or Japan.

Do you have any comment on Dr. Edelman's statement?

Mr. DUNCAN. Not really. The point in time was in the 1960's?

Senator THURMOND. In 1969.

Mr. DUNCAN. That was 11 years ago. OPEC was not as significant a factor then.

Senator THURMOND. Now in November–December of 1973, OPEC raised prices to \$15 a barrel and increased from time to time to its present \$29 to \$35 a barrel, as you have testified.

Mr. DUNCAN. I don't think the price was \$15 a barrel in 1973.

Do you have anything, Mr. Robinson?

Mr. ROBINSON. I would only say that historically, up until the Arab embargo of 1973, imported oil prices were significantly lower than domestic oil prices, because there did exist a competitive situation in a worldwide market.

But that competitive situation, as we all know, no longer exists in the world oil markets because the world prices for crude oil are established by collusion and conspiracy among the producing countries of the world.

Mr. DUNCAN. Let me say this, and this also addresses, Mr. Chairman, some of the comments that you have made. You are talking about the price of gasoline respecting traditional economic criteria.

It is a simple fact that people who produce gasoline have to pass through increased costs.

Now, when the main cost element—the price of crude oil—is not functioning within traditional economic criteria, it imposes great stress on the system.

As I have indicated publicly many times since the most recent round of price increases, the fact is that those increases were without economic justification. They were not taken within any traditional economic criteria.

The unfortunate fact of life is that when the cost of crude oil goes up, the cost of gasoline inevitably goes up.

Senator METZENBAUM. I have told Senator Thurmond you have made a commitment—

Mr. DUNCAN. My problem, Senator Thurmond, is that I had a 10 o'clock hearing with Senator Birch Bayh, for which I am now 10 minutes late.

Senator THURMOND. I will advance some more questions to you through Mr. Robinson.

Mr. DUNCAN. I am very sorry that I must leave, Senator.

Senator METZENBAUM. We understand, Mr. Secretary. Thank you for being with us.

Mr. Robinson, would you be kind enough to respond further to Senator Thurmond?

Mr. ROBINSON. Yes, sir.

[The prepared statement of Mr. Duncan follows:]

PREPARED STATEMENT OF CHARLES W. DUNCAN

Thank you for the opportunity to present to you the Department of Energy's comments on recent trends in petroleum supplies and prices.

In the past several months the supply situation in the United States for crude oil, gasoline and several other products has improved significantly over what it was during the corresponding period of 1979. Crude oil stocks as of the end of the first week of June stood at 376 million barrels, and 18 percent increase over last year's level. Gasoline stocks at the primary level were about 268 million barrels, near record high levels and up 40 million barrels, or also about 18 percent, over May 1979 levels. (Attached as Appendices I, II and III are charts showing that stock levels are well above the normal range.) These stock levels are not only high in absolute terms but are particularly high considering the fact that total petroleum consumption has declined about 9 percent between the first five months of 1979 and the corresponding period of a year ago.

Similar supply conditions have also developed in other parts of the world, as reflected in a significant reduction in the premiums paid for spot purchases of

crude oil in the world market. The spot purchase premium was as high as \$12 to \$15 per barrel over official prices late last year. Today it is typically \$2 to \$5 per barrel, and in the case of some high-priced crude oils, there have been isolated spot sales at or below official prices.

Nevertheless, average crude oil prices, both foreign and domestic, have continued to rise at substantial rates since the beginning of the year. Department of Energy data for March 1980, the most recent month available, shows the average refiner acquisition cost of all crude oil at \$26.88 per barrel, up from \$23.63 in December 1979. The weighted average acquisition cost of imported crude oil went from \$28.91 to \$33.42 a barrel over this same period. Attached at Appendix IV is a chart showing that estimated average world oil official prices are continuing to climb, up from \$29.72 (FOB) in March to \$31.56 per barrel on June 1. The average cost of all domestically-produced crude rose from \$18.84 to \$22.03 per barrel between December 1979 and March 1980, largely due to higher world oil prices and the phased decontrol program, which took effect in earnest in January 1980 with the release of 4.6 percent of all upper tier production per month. Based on recently announced price increases by many producing countries, we estimate the average refiner acquisition cost in June to be over \$29 per barrel for all crude oil and about \$35 per barrel for imports.

Even in a market characterized by ample supplies, one would expect most of these cost increases to be reflected in product prices, since suppliers must price over time in such a way as to recover their costs. (Even in the case of gasoline, the price of which is controlled, DOE regulations provide for the passthrough of increased costs.) Therefore, the existence of relatively abundant supplies is not likely to reverse the trend of increasing prices if crude prices and other costs are also increasing significantly. But in a competitive market one can expect supply adequacy to have a *moderating* effect on the upward price trend, as refiners and marketers reduce their profit margins in order to sell.

That in fact appears to have happened over the past few months, although the results are not dramatic. The price of gasoline at the pump has risen at a very modest rate since March—only about a penny per gallon, based on Lundberg Survey data published by Platt's Oilgram. For example, full-serve leaded regular increased from 122.6 to 123.4 cents per gallon between March and May, while self-serve regular actually declined from 119.6 to 119.5 cents per gallon. The effect that adequacy of supply is having on price may be reflected in the growth in refiners' "banks," or unrecovered costs from earlier months. Banked costs for gasoline for the 29 largest refiners rose from about \$2.5 billion in June 1979 to almost \$5.4 billion in February 1980 (the most recent month for which data are available). We are also generally finding that fewer and fewer dealers are pricing at or above their maximum margins, a result which we think has been caused by relatively ample supplies and, therefore, increased competition. The reduction of dealer margins in order to become more competitive in the marketplace has been reflected in a reduction in the number of complaints received on DOE's hotline.

Not only have retail dealer apparent margins declined generally since March, in the face of increasing costs, but the decline has been most significant for self-service sales, which are a more sensitive indicator of competition. During the period of tight gasoline supplies last year, the difference between full-service and self-service prices for a given grade of gasoline declined to less than 2 cents per gallon on a nationwide average, according to the Lundberg data, and volumes sold at self-service pumps decreased. As supplies have improved, motorists have become more sensitive to potential price savings associated with self-service and dealers with adequate supplies have begun to discount prices again at self-service pumps in order to attract more customers. Recent surveys show that the differential has again climbed to about 3 and a half cents per gallon, which is approximately the historical average.

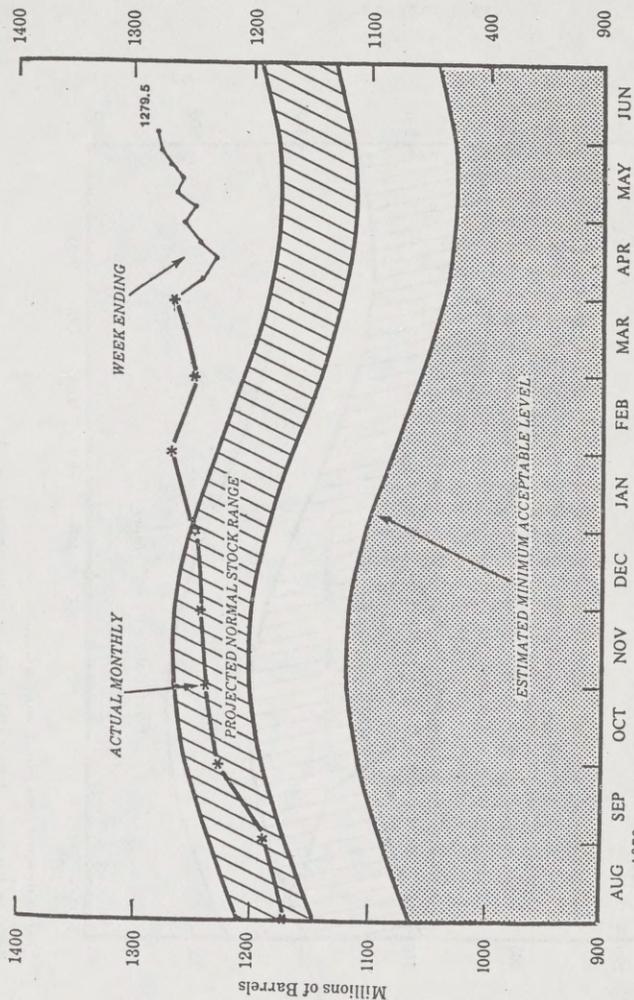
We have attached at Appendix V a chart which shows the relationship between gasoline pump prices and their cost components since December 1978. The last three months' figures have necessarily been derived or estimated from non-DOE data. The flattening of gasoline prices recently in the face of rising crude costs should be noted.

In short, product prices are continuing to rise even in a market of relatively ample supplies because of continued substantial increases in costs, particularly crude oil costs. But the existence of relatively ample supplies clearly is having a moderating impact on these price increases in the form of reduced refiner and marketer profit margins. Prices are not as high as they would be if we did not have our current high stock levels.

Mr. Chairman, that completes my prepared testimony. I would be happy to answer your questions.

APPENDIX I

U.S. Petroleum Stocks at Primary Level (Crude and Products)

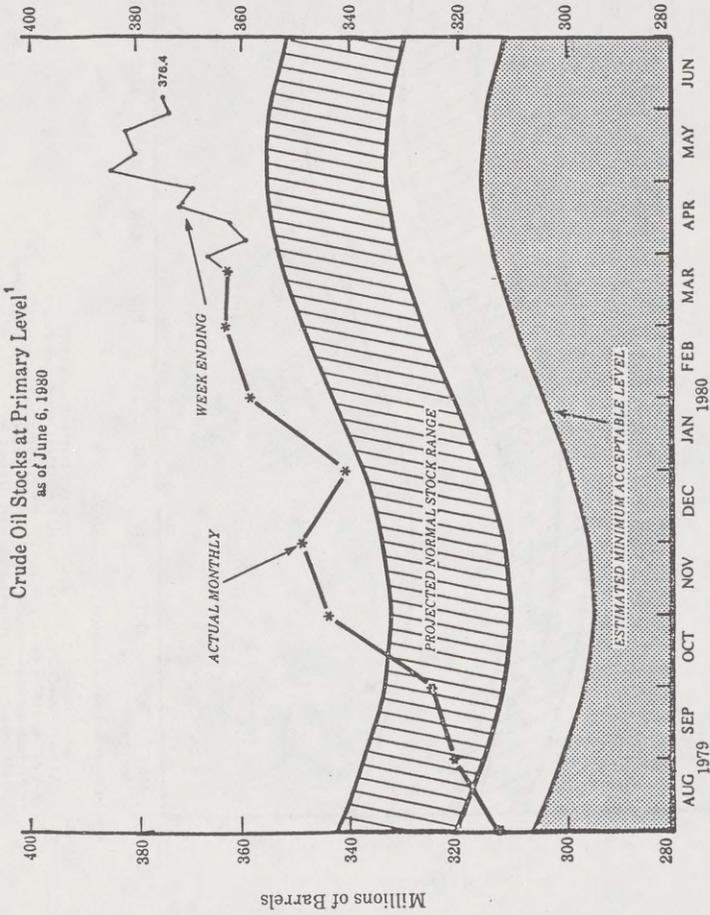


1 Excludes stocks held in the Strategic Petroleum Reserve.

- SOURCE:
- August - January 1980: EIA, "Petroleum Statement, Monthly"
 - February - March 1980: EIA, "Monthly Petroleum Statistics Report"
 - April 4, 1980 - Current week: EIA weekly data
 - Projections and estimates through second quarter 1980: EIA estimates (see appendix for derivation and explanation)

Stocks

APPENDIX II



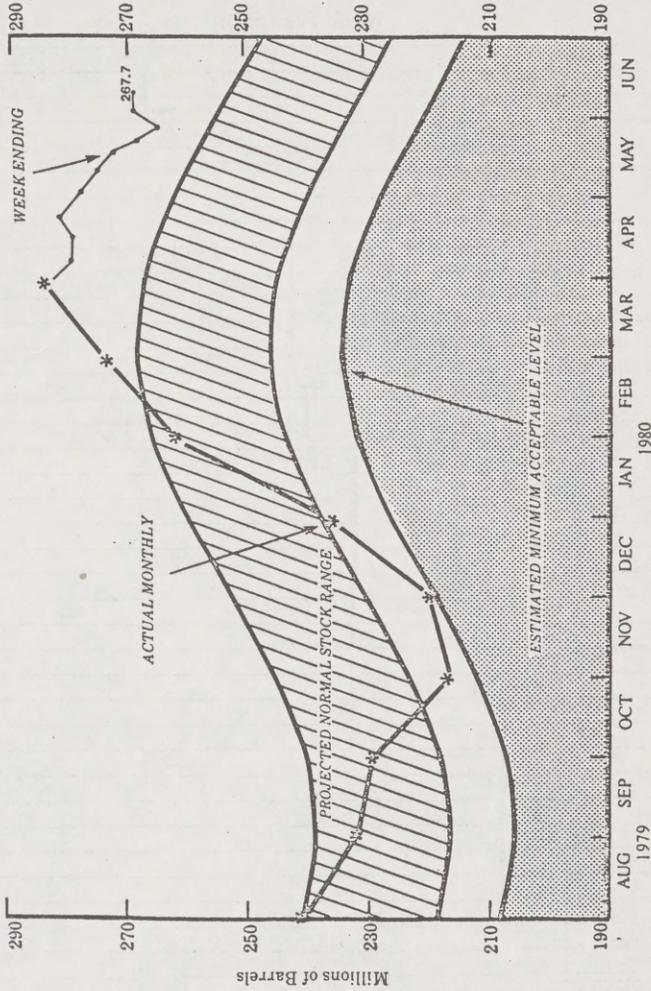
¹ Excludes stocks held in the Strategic Petroleum Reserve.

SOURCE:

- August 1979 - January 1980: EIA, "Petroleum Statement, Monthly"
- February - March 1980: EIA, "Monthly Petroleum Statistics Report"
- April 4, 1980 - Current week: EIA weekly data
- Projections and estimates through second quarter 1980: EIA estimates (see appendix for derivation and explanation)

APPENDIX III

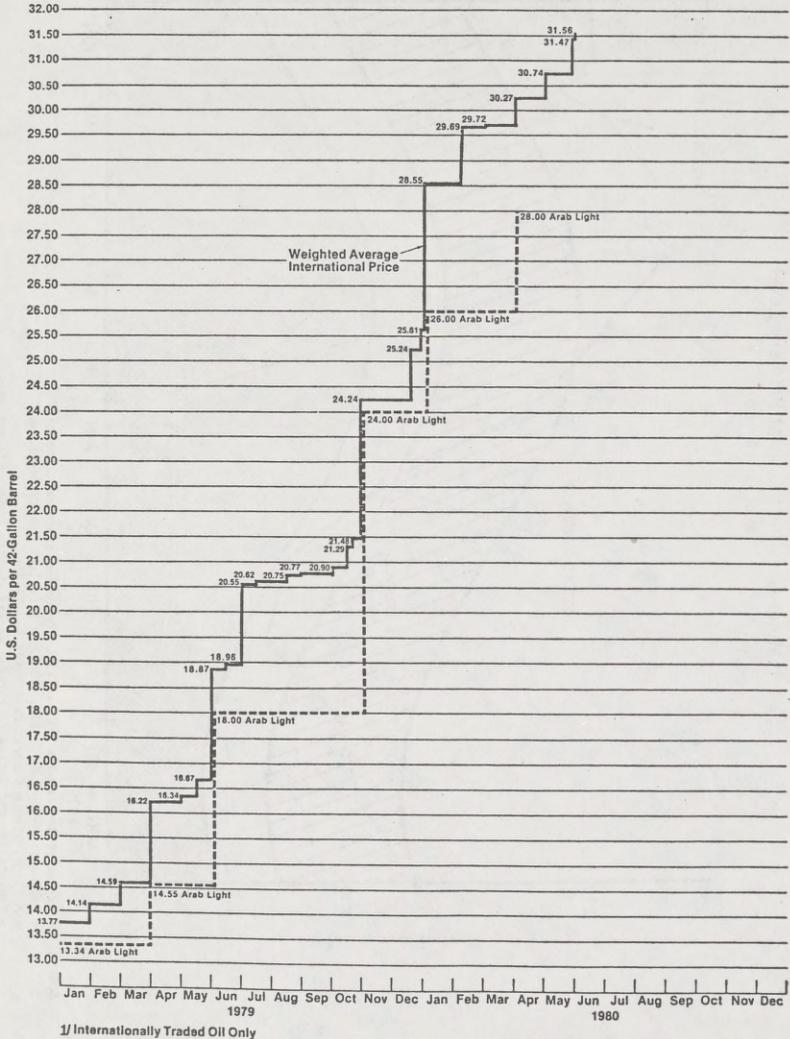
Motor Gasoline Stocks at Primary Level
as of June 6, 1980



SOURCE: ● August 1979 - January 1980: EIA, "Petroleum Statement, Monthly"
 ● February - March 1980: EIA, "Monthly Petroleum Statistics Report"
 ● April 4, 1980 - Current week: EIA weekly data
 ● Projections and estimates through second quarter 1980: EIA estimates
 (see appendix for derivation and explanation)

APPENDIX IV

World Price of Oil^{1/}



APPENDIX V

.....
 *
 COMPONENTS OF REGULAR GASOLINE PRICES
 *

| MONTH | CRUDE COST | REFINER & JOBBER MARGIN | DEALER MARGIN | MOTOR FUEL TAXES | PUMP PRICE |
|-------|------------|-------------------------|---------------|------------------|------------|
| DEC78 | 30.8 | 16.6 | 8.5 | 13.1 | 69.0 |
| JAN79 | 31.2 | 15.9 | 8.2 | 13.1 | 68.4 |
| FEB79 | 32.0 | 16.6 | 8.4 | 13.1 | 70.1 |
| MAR79 | 32.6 | 18.0 | 9.5 | 13.1 | 73.3 |
| APR79 | 34.6 | 18.9 | 10.7 | 13.1 | 77.3 |
| MAY79 | 36.7 | 19.8 | 11.9 | 13.1 | 81.4 |
| JUN79 | 40.5 | 20.1 | 14.1 | 13.1 | 87.8 |
| JUL79 | 44.2 | 19.9 | 15.2 | 13.7 | 93.1 |
| AUG79 | 47.0 | 21.5 | 14.5 | 13.8 | 96.8 |
| SEP79 | 48.0 | 23.1 | 14.1 | 13.8 | 99.0 |
| OCT79 | 49.2 | 23.2 | 13.5 | 13.8 | 99.8 |
| NOV79 | 52.5 | 21.4 | 13.4 | 13.8 | 105.1 |
| DEC79 | 56.3 | 21.4 | 13.6 | 13.8 | 112.7 |
| JAN80 | 59.1 | 25.7 | 14.0 | 13.8 | 112.7 |
| FEB80 | 62.2 | 28.6 | 14.2 | 14.2 | 119.1 |
| MAR80 | 64.0 | 30.6 | 13.8 | 14.2 | 122.6 |
| APR80 | 64.4 | 30.9 | 13.5 | 14.2 | 122.9 |
| MAY80 | 67.9 | 27.7 | 13.5 | 14.3 | 123.4 |

UNITS: CENTS/GAL

SOURCE: ERA ESTIMATES BASED ON DOE AND INDUSTRY DATA

Senator THURMOND. What the American people want to know today is what they can do to keep the price of gasoline down? What can be done? Can anything be done? That is what the people want to know.

In other words, who is responsible for the prices? What can be done to bring them down?

Mr. ROBINSON. As the Secretary just indicated, the one factor, or the most significant factor that is keeping prices up is the cost of the raw material that goes into the manufacture of gasoline, and that price, as we all know, is not within our control.

The best way to look into the future, to keep gasoline prices low or relatively low, to keep them competitive and to maintain a competitive market, is to loosen the grip that the foreign oil producers have on our energy supplies. In the short run, that may mean some economic and energy policies which may result in higher prices for products than people are used to paying.

But the ultimate goal is to break that grip so that we do have within the power and the authority of the U.S. Government the ability to control the prices from the point of production to the point of distribution and sale.

Senator METZENBAUM. How much will decontrol cost the American people this year?

Mr. ROBINSON. To answer you in two steps, we estimate that decontrol so far, and by decontrol, I am talking about various steps that were taken last year such as the decontrol of heavy oil and other measures of that sort which have resulted in—

Senator METZENBAUM. And the tilt rule.

Mr. ROBINSON. Well, I am not including the tilt rule, which we do not consider a decontrol action. The decontrol of crude oil is what I am talking about, and so far it has resulted in probably about 6 cents of the current price of gasoline.

As you know, decontrol is being phased in and each month an additional amount of oil is released from controls. We estimate that the effect of that, month-by-month, is about 0.8 of a cent per gallon.

Senator METZENBAUM. So that you are saying that your projected amount for the entire year is what? Six cents?

Mr. ROBINSON. No, 6 cents is the impact from June 1979 when decontrol began, to May or June of this year.

Senator METZENBAUM. So, that is \$6 billion, using the usual rule of thumb that the American people have had to pay by reason of decontrol?

The rule of thumb is that 1 cent a gallon means a billion dollars.

Mr. ROBINSON. That is roughly \$6 billion on gasoline, but gasoline is only half of the product mix. So in fact the number is twice that amount.

Senator METZENBAUM. So that the American economy has been impacted by a \$12 billion increase in cost by reason of decontrol; is that what you are saying?

Mr. ROBINSON. That's correct. That is roughly correct.

Senator THURMOND. I would like to continue now, if you don't mind, Mr. Chairman.

Senator METZENBAUM. Please do.

Senator THURMOND. You can take it over in just a minute. Now I want to ask you this question. Is decontrol in the end going to provide incentive to produce more and therefore should bring the price down?

Mr. ROBINSON. It will provide an incentive to produce more oil. Probably more significant than that is that it will provide a very substantial incentive for alternate fuels.

Senator THURMOND. For what?

Mr. ROBINSON. For alternate fuels, which in the past have not been able to compete with petroleum because they are more expensive to produce. But they are becoming increasingly more competitive now as the price of petroleum rises to match the cost of producing alternate fuels.

For example, alcohol production is substantially more competitive now with traditional gasoline production than it was a year ago.

Senator THURMOND. That is used in what they call gasohol.

Mr. ROBINSON. Yes.

Senator THURMOND. Ten percent alcohol and ninety percent gasoline; is that right?

Mr. ROBINSON. Correct.

Senator THURMOND. And decontrol, in your opinion, has had that effect?

Mr. ROBINSON. Absolutely. It has had that effect.

Senator THURMOND. The other alternate fuels that have been encouraged by decontrol—

Mr. ROBINSON. Are there other alternate fuels?

Senator THURMOND. Yes.

Mr. ROBINSON. Certainly every other alternate fuel has been encouraged by the rising petroleum prices. For example, there is a greater incentive for oil shale production and there is more activity in that area than there had been in the past.

I also don't want to deemphasize the efforts and attempts that are being made to increase domestic crude oil production. While the crude oil may be of the same quality we produced in the past, it is becoming increasingly more difficult to find, produce, and so on. I believe we have provided substantial incentives for producing that type of crude oil which previously was not competitive or marketable.

For example, the substantial reserve of crude oil we have in California is very heavy, tar like crude oil which is difficult to refine and so on. Because of general increased prices, California crude oil production has also increased and is obviously adding to our domestic supply.

The Secretary mentioned that drilling rig activity is at a very high level, undoubtedly given some incentive by higher crude oil prices.

Senator THURMOND. Has decontrol encouraged the oil producers to go out and look for more oil onshore and offshore?

Mr. ROBINSON. Yes, sir, we believe that is true, as indicated, among other things, by increased drilling activity.

Senator THURMOND. It is your opinion that any decontrol would enable us to bring in more oil than it would have without decontrol?

Mr. ROBINSON. Absolutely.

Senator THURMOND. And if we have more oil, then should that help to keep the price down rather than for it to go up?

Mr. ROBINSON. It is our view that by realistically pricing energy so that it reflects its true replacement cost we will in fact lessen our dependence on imported supplies of oil and create more of a competitive market place for energy supplies in this country as we turn to domestic sources, whether they happen to be petroleum or some alternate form of energy.

Senator THURMOND. And you could have a more competitive market than in the end, should not that be to the advantage of the consumer?

Mr. ROBINSON. We believe that it will be; yes sir.

Senator THURMOND. Thank you.

Thank you, Mr. Chairman.

Senator METZENBAUM. But the fact is, Mr. Robinson, the very point that the Senator from South Carolina is just making—that is, that increased supply should normally bring the price down is not working in this economic situation at the moment; is it? Prices are not coming down.

Mr. ROBINSON. There are many factors to consider. It is true that prices are not going down. I would say that the traditional economic theory is, all other things being equal, when you have more supply, you should have a reduction or at least the same level of demand. In fact, what we have here is a reduced level of demand, so you would expect prices to go down.

But all other things are not equal, particularly the price or cost of producing the products. Those prices, as we have repeatedly emphasized this morning, are going up.

We are not here to defend the high profits of the oil companies. They are high. They are probably excessive, which is one of the reasons the President proposed and the Congress enacted a windfall profits tax to eliminate some of those high-profit levels we have seen in the past.

But to say that economic principles are not working in today's marketplace is not quite correct, because we clearly have had, even in the face of very rapidly rising raw material costs, some moderation of prices. There is evidence all around us that there is increasing competition in the marketplace for gasoline and other products.

Senator METZENBAUM. I have to say to you that I don't see that. I had some pictures taken of what prices are presently costing. [Indicating.]

Senator METZENBAUM. There is \$1.33.4 and \$1.28.4, \$1.31, \$1.27, \$1.41.8, \$1.37.4 and \$1.30. That doesn't look to me—and these are very recent pictures—that doesn't look to me as if there is much moderation in the price in spite of what oil companies might say or the Department of Energy might say.

So, I don't see that, but I suppose that is a matter of each of us determining whether we think it is costing more or less each time we buy gasoline.

Let me ask you just one more question. I am told by people at the EIA and the ERA that information on refiner margins does not exist within DOE, and that the information on refiner margins is not requested from the companies, despite the fact that you have the authority to obtain it.

But I also know that the Secretary indicated, and I think you confirmed, that dealer margins are down. Now that means that dealers are taking a cut in their profits, but not the refiners; in other words, not big oil. Profits for them, we know from that chart over there are way up. [Indicating.]

In this chart over here, they are way up, 80 percent up in the first quarter of 1980.

Does this indicate to you that there may be some effort on the part of the big oil companies to drive out the small independent dealers?

Mr. ROBINSON. As a point of information, in the prepared testimony that we asked be submitted for the record, there is an appendix, appendix 5, in which we have done our best to describe the components of gasoline prices, starting at the pump price and then working back to include motor fuel taxes, dealer margins, refiner and jobber margins, and crude oil costs.

I think generally those numbers indicate that dealer margins have at least flattened out in recent months. They also indicate that refiner and jobber margins, the two combined, we do not have them separately, have steadily increased over the course of the last year, although they would appear to be flattening out a little bit in the last couple of months as well.

On the question of whether the majors are driving out the independent competitors, it is clearly the case that we have a reduction in the total number of units selling gasoline in this country. We had a reduction of some 15,000 to 20,000 gasoline stations in the course of the last year.

It is also undoubtedly true that most of that reduction has been in the independent sector.

The information and statistics we have shown that the 15 largest oil companies have not substantially increased their market share at the retail level, but that the smaller refiners have increased their market share at the retail level. That is, there appears to be more vertical integration going on among the smaller refiners than there is among the larger refiners, at least from the refiner to the retail level.

There also does appear to be substantial concentration of retail outlet ownership in the hands of jobbers; that is, those people who are not in the refining business at all, but who wholesale large volumes of gasoline, have integrated themselves from the wholesale level down to the retail level and substantially increased their market shares at that level.

Senator METZENBAUM. Now, Mr. Robinson, there may be some other questions that I have as well as other members of the committee. But we appreciate your being with us this morning. Thank you for your help.

Mr. CHUMBRIS. Mr. Chairman, may I finish one point that Senator Thurmond had. He had to take a telephone call and leave the hearing room.

Senator METZENBAUM. Yes.

Mr. CHUMBRIS. Thank you, Mr. Chairman.

Senator Thurmond was going to point out further that what he was bringing out in 1974 was that the old oil of domestic producers was increased somewhere around \$5 a barrel, but the OPEC nations were charging somewhere around \$14 a barrel. That was the point that he was making.

Whereas, prior, in 1969, the American producers were getting \$3.50 to \$3.75 per barrel to the east coast, whereas the imported oil was only \$2 a barrel.

So, you have almost a 2-to-1 ratio, U.S. domestic oil higher than imported oil. Now you have maybe twice as much and sometimes three times as much higher price of imported oil as against the domestic oil. We know the domestic oil is harder to get out of the ground. As Senator Hart said, in 1969, "It only costs 12 cents to get a barrel

of oil out of Saudi Arabia," while costs of drilling 35,000 feet in western Oklahoma was very costly. That was the point he was making.

You may want to respond to that.

Mr. ROBINSON. Yes. I think those numbers and relationships are roughly correct; that is true.

Senator METZENBAUM. Thank you very much, Mr. Robinson.

Mr. ROBINSON. Thank you.

[Additional submission of Mr. Robinson follows:]

DEPARTMENT OF ENERGY,
Washington, D.C., July 7, 1980.

Hon. HOWARD M. METZENBAUM,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: At the June 18, 1980 hearing of your subcommittee on competitiveness in the pricing of gasoline (at which I appeared with Secretary Duncan), you asked me how much crude oil decontrol would affect product prices over the course of this year. I answered that about 6 cents of the current gasoline price is due to crude oil decontrol that has already occurred and that this amount is increasing by about 0.8 cent per gallon per month. With your permission, I would like to supplement the record of the hearing on this point in order to provide clarification of my oral comments.

The estimate I gave you was the impact of crude oil decontrol on the average acquisition cost of all crude oil purchased by U.S. refiners. However, since an increase in average crude costs also tends to raise the cost of refinery fuel, which is the largest single component of a refiner's operational costs, further adjustments must be made to determine the full impact of crude oil decontrol on product prices. Depending on market conditions, the total portion of gasoline prices attributable to crude oil decontrol may be 0.3 to 0.5 cent per gallon per month higher than a straight passthrough of higher crude oil prices. Roughly speaking, then, the impact of crude oil decontrol may range from a little less than a penny a gallon per month to a little less than a penny and a half per month.

These estimates assume that world oil prices rise between 10 and 15 percent per year. If world oil prices rise at a faster rate, the impact of decontrol will of course be greater, since the price of domestic oil released from controls will reflect world price levels and the effect on product prices will increase as the volume of domestic uncontrolled oil increases. This can be illustrated by the following: Prior to June 1979, when phased decontrol began, about 60 percent of all crude run in U.S. refineries, including foreign oil, was uncontrolled. Therefore, an increase of \$1 per barrel in world prices meant an increase of 60 cents per barrel in U.S. crude oil prices, or about 1.5 cents per gallon. By early next year, about 85 percent of all crude will be uncontrolled. (Most of this percentage increase will be due to phased decontrol, although some will also be due to the natural decline in controlled oil production.) The result of a \$1 per barrel world price increase at that time would be 85 cents per barrel for U.S. refiners, or about 2 cents per gallon. With total decontrol the impact of the same increase will be the full \$1 per barrel, or a little less than 2.5 cents per gallon.

I hope this clarifies the estimates given in the hearing. If I can be of further assistance, please let me know.

Sincerely,

DOUGLAS G. ROBINSON,
Deputy Administrator for Policy,
Economic Regulatory Administration.

Senator METZENBAUM. Our next witness will be Mr. R. G. Weeks, executive vice-president, U.S. Marketing and Refining Division, Mobil Oil Corp.

The Chair will hear each oil company separately as has been requested by the oil companies. The Chair has no objection to that procedure.

STATEMENT OF R. G. WEEKS, EXECUTIVE VICE PRESIDENT, U.S. MARKETING AND REFINING DIVISION, MOBIL OIL CORP., ACCOMPANIED BY ANDY GABORIO, GENERAL COUNSEL

Senator METZENBAUM. Mr. Weeks, we are happy to have you with us this morning. Please be good enough to identify the gentleman accompanying you.

Mr. WEEKS. Thank you, Mr. Chairman.

This is Andy Gaborio. He is the general counsel for the Marketing and Refining Division for Mobil.

Senator METZENBAUM. Happy to have you with us, sir.

Mr. GABORIO. Thank you.

Mr. WEEKS. We welcome this opportunity to present our views on the current high gasoline prices in the Nation.

Gasoline prices are high primarily because of the rapid escalations that have occurred in crude oil costs, both for U.S. oil and imported oil.

Last week OPEC announced a mechanism for yet another world crude price increase. In addition, inflation, of course, has hit all parts of the energy business. Another component of gasoline price that is at an all time high is State and local taxes.

You are examining why the current gasoline price, which is about \$1.25 per gallon can't be lower. Especially, why can't it be lower in the face of an apparent abundance of oil and oil products? There are two principal answers to these questions.

First, supply is not abundant and second, forces which are far stronger than textbook economics continue to dominate gasoline prices; namely, OPEC actions, and the obsession of many State governments to increase the tax burden on U.S. oil businesses.

There is not a whole lot Mobil or any other oil company can do to ease the motorists' burden of \$1.25 a gallon. In Mobil's case, total U.S. energy earnings last year amounted to about 3.5 cents per gallon. The burden of the motorist is not Mobil's 3.5 cents; and the potential for any noticeable lowering of price can't be found in the 3.5 cents.

Some combination of three factors could cause gasoline prices to drop—falling worldwide crude oil prices, a reversal of inflationary pressures and lower direct and indirect taxes on gasoline. Each of these happenings appear to be wishful thinking at least for some time to come.

On the question of supply, it is true that inventories are high and above historical levels. It is not true that supply is abundant.

It is not true that consumers, and companies such as Mobil, have access to ample supplies.

Speaking for Mobil, while our U.S. inventories of all oil are also at high levels, they represent about 120 days of sales. But then what?

Obviously the secret of the oil business is not necessarily to have 100 or 120 days of oil in inventory. It is to have ongoing, continued access to oil.

Currently Mobil is less sure of its access to oil than we have been in any recent period. U.S. domestic production continues about flat and worldwide production cutbacks such as in Kuwait leave little chance for supply flexibility.

If production in Saudi Arabia would drop below the recent level of 9.5 million barrels per day, for reasons of politics, economics, or whatever, the U.S. and world crude availability would tighten very quickly.

Most companies and most countries suffer these uncertainties and in fact the entire world continues to exist on the knife edge of a crude shortage. During these times, consumers are well served by high inventories.

Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you, Mr. Weeks.

Mr. Weeks, Mobil's profits in the first quarter went up from \$473 million to \$922 million or an increase of 105.3 percent.

Now, you talk about gasoline prices being high because of crude oil costs. You talk about inflation. You talk about State and local taxes. But isn't it a fact that that additional \$450 million in the first quarter—which is probably something higher because it is after tax dollars—contributed to the higher prices? If you hadn't had that much of an increase, wouldn't the price of gasoline have been down?

Mr. WEEKS. If we had been forced to make no more earnings in the first quarter of this year than in the first quarter of last year, some of the earnings in the U.S. marketing and refining part of our business, that would have been slightly lower.

Senator METZENBAUM. How many gallons do you sell in a quarter?

Mr. WEEKS. We sell about 7 billion gallons a year, so we sell just under 2 billion in a quarter.

Now, not much of this \$400 million increase that Mobil reported in the first quarter of this year was in my business.

Senator METZENBAUM. It was not in gasoline sales?

Mr. WEEKS. Not in the refining and marketing, that is right.

Senator METZENBAUM. Where was it?

It wasn't in Montgomery Ward. You lost \$44 million in Montgomery Ward.

Mr. WEEKS. That's right, it was not in Montgomery Ward.

Senator METZENBAUM. So you have an extra \$44 million that you made in the oil industry.

Mr. WEEKS. Much of it was in what is inventory profits in foreign countries. In most foreign countries that we do refining and marketing business in, an income item is the extent to which inventories are valued higher at the end of the period than they were at the beginning of the period.

Senator METZENBAUM. Don't you use LIFO accounting?

Mr. WEEKS. Not in many foreign countries—we do not.

Senator METZENBAUM. You have different accounting procedures in one country as against another?

Mr. WEEKS. Yes, sir.

Senator METZENBAUM. Mr. Weeks, how do you manage? How do you manage? You run a big oil company, one of the biggest. You get too much supply, demand is down—I have been in the business world. When supply was too great and demand was down, prices came down.

Now, how does the oil industry work this out? I know you don't call up your friend over at the other oil company and say, "Let's

keep prices up," but how do you do that? How come competition doesn't work in the oil industry?

Mr. WEEKS. The problem is we don't have access to supply. As I mentioned—

Senator METZENBAUM. Mr. Weeks, look, the U.S. petroleum stocks are way up. They are higher than they have ever been. The projected normal stock range is way down there, around the 200 level. You are up to 1.2 or 1.3 million barrels. The estimated minimum acceptable level is considerably below that.

So, you are not different from the rest of the industry. Your supply is up. Your inventory is higher.

Mr. WEEKS. That's true.

Senator METZENBAUM. How do you do it? How do you do it? I am interested as a businessman. How can you possibly keep prices up? And isn't this the reason that the American people think that the oil industry is a monopoly that really works against the people's interests?

Mr. WEEKS. It isn't. The problem that we have now is access to oil. One of the reasons why we have, and our numbers, of course, are in there, one of the reasons that we have high levels of inventories are because of that fact. We cannot at all be certain that we will have continued access to oil, enough to satisfy our customers, enough to play the same role in the business as we have been playing.

Senator METZENBAUM. Well, every time the oil companies want to raise prices or keep prices up, they raise this bugaboo: "There is a shortage."

Schlesinger and the oil companies did that the day there was an Iranian oil problem. The ships were still coming across the sea, but he sent up the signal and the oil companies cut back their refinery operations.

As a matter of fact, in that very moment, there was more oil coming into this country than there had been. Now how do you do it?

Don't the American people have some right to know why the law of supply and demand doesn't work in the oil industry?

Mr. WEEKS. It does work in the oil industry. Let's go back to your Iran example. What happened when Iran cut off? In our case—Mobil Oil's case—we lost about 8 percent of our supply.

When we lose 8 percent of our supply, and we are in a world where we cannot make up and recover that, we are in trouble and our customers are in trouble. High inventories come in very handy during those times.

Senator METZENBAUM. You will agree that the whole industry didn't have any shortage. That the imports of world oil production at that time were up about 6 percent and imports in this country were up about 7.7 percent.

Maybe Mobil did have some 8 percent falloff. But the fact is, it has been confirmed that there was an adequate supply, that there was more coming in. The Treasury Department, you will recollect, held back a report from the American people which indicated that very fact. They wouldn't share that information with the American people.

Mr. WEEKS. But, Mr. Chairman, that must have been just a few days following the Iranian emergency. Certainly, 1 month, 2 months, after the oil that is on the water gets to the United States, certainly after that time, there was less oil.

Iran was producing about 5 million barrels a day, before the emergency.

Senator METZENBAUM. But Saudi Arabia was producing more. The figures are confirmable. There is no argument that the world oil supply was up. That has been confirmed time and time again.

What has happened is—look, look what you did over here [indicating]. This was 1979.

[Senator Metzenbaum indicating to charts on display.]

You cut back your production in the early part of the year. It went down below the previous low. Now this is 1980, and you are way down, across the board, as far as production is concerned.

Why are the refineries operating at less? You have plenty of stocks on hand. What are you doing with it?

Mr. WEEKS. The demand is lower.

Senator METZENBAUM. Very well.

Why doesn't the price come down?

Mr. WEEKS. How much can price come down? Where does it come from?

Senator METZENBAUM. It comes from your profits. Normally, if you do less business, most business people make less. Look what is happening to the rest of the manufacturing in this country. Look. Here is the rest of the manufacturing in this country. It is down [indicating].

That is what has happened to their net income.

But the oil companies, boy, they have had a heyday. My question is, when their demand goes down, their profits go down. When your demand goes down, your profits go up. Why?

Mr. WEEKS. If you take the 3.5 cents—

Senator METZENBAUM. Mr. Weeks, I have heard all of the stories about the 3½ cents and how little you make. 'But I know that you have the best accounting procedure, you have LIFO, you have accelerated depreciation, you have successful efforts, you have deferred taxes, and you can play games with the increase in the value of the energy resources held as to whether you show them high or you show them low.

So, when you tell me it is 3½ cents, I don't get very persuaded by that, because that is the way you computed it.

But the fact is, if you take a look, you just told me, we just agreed that your profits were up \$473 million in the first quarter.

Now, if you take that \$473 million, and you sold about 2 billion gallons of gasoline—

Mr. WEEKS. But the 2 billion gallons of gasoline—

Senator METZENBAUM. I am not going to say it all came from there.

Mr. WEEKS. Very few of the \$400 millions had anything to do with the 2 billions of gallons we sell in the United States of gasoline.

Senator METZENBAUM. Well, let me ask you this question. All the oil companies' oil profits are way up, 80 percent, 100 percent; now you say it had nothing to do with it. Are you saying that none of the reason for higher profits for oil companies results from the fact that gasoline prices are hitting the highest figures in our Nation's history? Are you saying that?

Mr. WEEKS. That's right—very, very little. In our annual report, last year, in 1979, the reported earnings for that part of the business

that I manage, which is all U.S. refining and marketing, was about \$180 million, after tax.

Senator METZENBAUM. How much was it before tax?

Mr. WEEKS. Probably—I don't know exactly. I would guess in the neighborhood of \$300 million, \$250 million.

Senator METZENBAUM. How much tax does Mobil actually pay?

Mr. WEEKS. I don't—I don't have that with me.

Senator METZENBAUM. What you actually paid, not deferred taxes.

Mr. WEEKS. On page 35, of our annual report, consolidated statement of income, there is an entry: income taxes. This is for the entire corporation, all governments' income taxes, \$4.8 billion.

Senator METZENBAUM. Then there is another item probably on that page, isn't there, showing how much is deferred?

Mr. WEEKS. I don't see that.

Senator METZENBAUM. Well, are you saying that you paid \$4.8 billion in taxes last year?

Mr. WEEKS. In income taxes. There is another line that talks about taxes other than income taxes and that line is \$7.1 billion.

Senator METZENBAUM. Well, you are aware of the Vanik committee studies indicating oil companies are paying something between 1 and 4 percent of their profits as taxes.

I have to say to you, I don't have your balance sheet in front of me, and I don't want to get into a discussion with you about that, but my opinion is, you didn't actually pay \$4.8 billion in actual checks written.

I will ask your lawyer. Do you know the answer to that, sir?

Mr. GABORIO. The answer as to whether we paid the \$4.8 billion? I certainly believe we paid it. I didn't see the check.

Senator METZENBAUM. No; I understand you did not see the check.

Mr. GABORIO. But the figure of 1 percent I think is way out of line.

Senator METZENBAUM. We won't stay on that.

Mr. Weeks, I have one more question for you. You said that prices have increased because State and local gasoline taxes have increased.

I have before me the chart that was just submitted to us by Mr. Duncan, which indicates that over a period from December 1978 to May 1980 motor fuel taxes only went up a little bit over a penny. So that really isn't a very major factor, is it?

Mr. WEEKS. Yes; it is. It hasn't been, except for the penny, but what is happening today, especially when you are attacking the question why can't subsequently the gasoline prices come down. What is happening today is a very determined effort on the part of a number of States and municipalities to tax gasoline.

The taxi driver that brought me over here told me that this morning gasoline in the District had gone up 8 cents—8 cents is a number that makes our 3½ cents look rather small.

Senator METZENBAUM. But it hasn't gone up yet 8 cents. He is talking about what might happen. We are talking about what has happened so far, Mr. Weeks, not what is going to happen. The reason taxes are going up, let's not kid ourselves, is that every local official, State, county, city, even some Federal think, "Well, if the oil companies can do it this easily, then why shouldn't we get our share of it, the people won't care about another 2 cents or a nickel or a dime."

Really, your increasing profit is one of the major reasons why so many local communities have said, "Well, if they can charge that much, then why don't we get our share of the pie." I think the blame falls directly at your door step. Because obviously, in the past, taxes have gone up very, very little, about a penny. That is nothing compared to prices of \$1.30 and \$1.40 a gallon.

Mr. WEEKS. But, Mr. Chairman, what's happening now is that States like Connecticut and New York State are passing gross receipts tax which are in the neighborhood of 2 cents a gallon.

Senator METZENBAUM. I am sorry, I didn't hear you. Excuse me. I apologize.

Mr. WEEKS. What is happening currently is that States like Connecticut and New York State have enacted gross receipts tax on oil companies, oil products, and these are brand new taxes where there never existed a tax and they are in the neighborhood of 2 cents.

This is just witness of one of the struggles that we all have in trying to keep gasoline prices from going up, at least going up any more than they have to.

Senator METZENBAUM. That also is prospective and can't account for the present high prices. But let me just check with you on something, because you said you paid \$4.8 billion in taxes?

Mr. WEEKS. This is worldwide. The number that I read to you is worldwide.

Senator METZENBAUM. Well, as a matter of fact, I have before me your annual report. On page 43, it says that you paid \$458 million to the United States.

Now, I don't know what you pay overseas. Of course, if you are including in that the fact that you buy oil with "taxes" in Saudi Arabia which is sort of that gimmick procedure that is used so that you can get a tax credit, that is something else. But as far as your income taxes in this country are concerned, you only paid \$458 million.

Mr. WEEKS. That is right, \$458 million.

Senator METZENBAUM. Not \$4.5 billion.

Mr. WEEKS. Well, as it shows on that page 43, Mr. Chairman, in the foreign countries we paid \$3.8 billion.

Senator METZENBAUM. Yes, but that includes what you paid to Saudi Arabia as "taxes," which are really the cost of the product itself.

Mr. WEEKS. Saudi Arabia calls it a tax. They require us to pay it and we pay it. We don't have any choice.

Senator METZENBAUM. Mr. Weeks, thanks very much.

Mr. WEEKS. Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Weeks follows:]

PREPARED STATEMENT OF R. G. WEEKS

We welcome this opportunity to present our views on the current high gasoline prices in the United States.

Gasoline prices are high primarily because of the rapid escalations that have occurred in crude oil costs, both for U.S. oil and imported oil. Last week OPEC announced a mechanism for yet another crude price increase. In addition, inflation has hit all parts of the energy business. Another component of gasoline price that is at an all time high is state and local taxes.

You are examining why the current gasoline price, which is about \$1.25 per gallon, can't be lower. Especially, why can't it be lower in the face of an apparent abundance of oil and oil products? There are two principal answers to these ques-

tions. First, supply is not abundant and second, forces which are far stronger than textbook economics continue to dominate gasoline prices, namely OPEC actions, and the obsession of many state governments to increase the tax burden on U.S. oil businesses.

There is not a whole lot Mobil or any other oil company can do to ease the motorists burden of \$1.25 a gallon. In Mobil's case, total U.S. energy earnings last year amounted to about $3\frac{1}{2}\%$ per gallon. The burden of the motorist is not Mobil's $3\frac{1}{2}\%$; and the potential for any noticeable lowering of price can't be found in the $3\frac{1}{2}\%$. Some combination of three factors could cause gasoline prices to drop—falling worldwide crude oil prices, a reversal of inflationary pressures, and lower direct and indirect taxes on gasoline. Each of these happenings appears to be wishful thinking at least for some time to come.

On the question of supply, it is true that inventories are high and above historical levels. It is not true that supply is abundant. It is not true that consumers and companies such as Mobil have access to ample supplies. Speaking for Mobil, while our U.S. inventories of all oil are also at high levels, they represent about 120 days of sales. Then what? Obviously the secret of the oil business is not necessarily to have 100 or 120 days of oil in inventory. It is to have ongoing, continued access to oil. Currently Mobil is less sure of access to oil than we have been in any recent period. U.S. domestic production continues about flat and worldwide production cut backs such as in Kuwait leave little chance for supply flexibility. If production in Saudi Arabia would drop below the recent level of 9.5 million barrels per day, for reasons of politics, economics or whatever, the U.S. and the world's crude availability would tighten very quickly.

Most companies and most countries suffer these uncertainties and in fact the entire world continues to exist on the knife edge of a crude shortage. During these times, consumers are well served by high inventories.

Senator METZENBAUM. Our next witness is Warren E. Burch, from Sun Oil Co.

STATEMENT OF WARREN E. BURCH, VICE PRESIDENT FOR OPERATIONS, SUN PETROLEUM PRODUCTS CO., ACCOMPANIED BY DEAN LYNN, RETAIL MARKETING DIVISION, AND DEAN HESSMAN, COUNSEL

Senator METZENBAUM. Mr. Burch, we are very happy to have you with us this morning. We will be very happy to have you identify yourself, as well as the two people accompanying you.

Mr. BURCH. Thank you, Mr. Chairman.

I am vice president of operations for Sun Petroleum Products Co., Industrial and Wholesale Marketing and Manufacturing Division, of Sun Co., Inc.

I have with me Mr. Dean Lynn, to my left. Dean has considerable knowledge in the retail marketing end of the business. I hope that together we can be responsible to your inquiries.

In addition, Mr. Dean Hessman, to my right, is an attorney with our company. I have asked him to be along.

Senator METZENBAUM. I am happy to have all of you with us this morning.

Mr. BURCH. Thank you.

Our divisions are responsible for Sun's domestic fuel, fuels, petrochemical and lubricants businesses. Your invitation to testify stated in part that "over the past 5 months, gasoline prices have continued at a high level despite a large surplus of oil domestically and internationally."

Senator METZENBAUM. Mr. Burch, just let me interrupt you for one second.

Mr. BURCH. Yes, sir.

Senator METZENBAUM. I just want to say publicly that I appreciate your being here on short notice, as well as Mr. Weeks, as well as our third witness from the oil companies. It was very gracious of you, because in all fairness, we did not give you a lot of notice. I just wanted to interrupt for the mere purpose of thanking you. I do not mean to interrupt your testimony in any way.

Mr. BURCH. Thank you very much. We have done our best to be ready.

Senator METZENBAUM. Well, we are very grateful to you, sir.

Mr. BURCH. The question at today's hearing is what is "high" relative to both prices and inventory. Under the circumstances we face today neither is too high in our opinion.

I would like first to speak to the industry inventory levels.

For security reasons the 20 participating member nations of the International Energy Agency, IEA, as it is known, of which the United States is one, have agreed to maintain a 90-day supply of oil in inventory.

Even with the current inventories, the United States has about 60 days supply if one considers the total inventory of crude, refined products, and the approximately 90 million barrels in the strategic petroleum reserve.

A less comforting fact is that the U.S. distribution system requires large volumes just to maintain operations and those stocks are unavailable for use.

According to a recent study of minimum operating inventory levels by the National Petroleum Council, the United States has approximately 88 million barrels of crude oil above that minimum operating level. That represents about a 6½ day supply of crude oil, excluding the strategic petroleum reserves.

The gasoline volume available over the minimum operating requirement is 56 million barrels or equivalent to about 8 days of demand.

Senator METZENBAUM. The Chair wishes to point out that both you and Mr. Weeks have addressed yourself to the question of the high inventory levels.

The Chair is not challenging the high inventory levels nor the desirability of maintaining those high inventory levels. That is not the thrust and concern of this committee. We do think it does serve the national interest for you to have high inventory levels. What bothers us is why the prices don't come down in spite of that fact. I won't interrupt you further.

Mr. BURCH. The point I am trying to make here, Mr. Chairman, is that our inventories really aren't high. If you consider the fact that we have something like 8 days of equivalent demand in gasoline stocks, that in my view, is not a high inventory.

Senator METZENBAUM. Well, they are certainly higher than they have ever been in the past.

Mr. BURCH. Yes, sir.

Senator METZENBAUM. I think once before in history they might have reached a higher level, but generally speaking, as the chart's

projected minimum adequate level and projected actual normal stock range indicate, the levels are higher at the present time.

Again, I want to repeat, I find no fault with that. I just would like to have some natural consequences of that flow to the American people, and to bring down the inflation rate.

Mr. BURCH. The higher than normal stocks are due to concerns about security of supply, the rising price of crude oil, and the lower demand due to conservation efforts.

In other words, what I am trying to say here, we are going through sort of an adjustment period.

The foregoing is to assist you in understanding the issue of inventory levels. Specifically—how high is high.

Incidentally, I would like to remind you that about a year past, the industry was accused of deliberately lowering inventories in 1978 prior to the Iranian crisis, thus creating shortages after the crisis. The implication was that we should have planned for the unforeseen event.

Business decisions by some companies may call for reductions in gasoline inventories. However, presently Sun's gasoline inventories are lower than normal due to plant shutdown for maintenance on some of our major gasoline producing units.

Sun does not have a surplus of gasoline; in fact, we have been purchasing gasoline, at high prices, during 1980 to supply our customers.

Your letter inviting Sun to appear at this hearing indicates that you may be more concerned about price than inventory level.

Turning to prices, we believe that gasoline market prices are cost-driven in a market controlled by competitive forces. This market reacts and adjusts to many complex factors such as: raw material costs, manufacturing and distribution costs, profit margins, uncertainty of supply and governmental actions.

Our raw material costs, principally crude oil, have risen 17.2 cents per gallon in the 6 months from November 1979 through April 1980.

Incidentally, there has already been mentioned that there is another price increase coming in from the OPEC nations, not included in these numbers.

Operating costs for this same period have increased by 2½ cents per gallon.

In response to these cost increases the gasoline prices for December through May have increased by about 19 cents per gallon for a margin decrease of about 0.7 cent per gallon over the past 6 months.

I believe it would be useful at this point to briefly discuss profit margins to put cost and price changes in perspective.

Although we are unable to precisely determine the cost of manufacturing individual products, we can average costs over all products to approximate profitability.

In 1979, the U.S. manufacturing and marketing divisions of Sun earned just under 1¼ cents per gallon on all products, which includes fuels, petrochemicals, and lubricants. This margin resulted in a return on capital employed of 13.4 percent.

We firmly believe that each segment of our business must be self-sufficient and generate sufficient profits to justify the very sizable capital investment.

Senator METZENBAUM. You said 13.4.

Mr. BURCH. Yes, sir.

Senator METZENBAUM. Didn't you have a 19.6 return on equity?

Mr. BURCH. That is the entire company, Sun Company. I am addressing here the refining and marketing segment of the business, which I believe your hearing was directed toward.

Senator METZENBAUM. Are you saying that your profits on the oil part of your business were less than the profits from the rest of your business?

Mr. BURCH. I am saying that our refining, marketing of gasoline and all the other fuels, petrochemicals and lubricants' business, our earnings were 1¼ cents per gallon or 13.4 percent return on capital employed.

I am not addressing the profits on the crude oil and natural gas production.

Senator METZENBAUM. Oh. Now you are separating your oil business—

Mr. BURCH. Yes, sir.

Senator METZENBAUM. [continuing]. In different categories.

Mr. BURCH. Yes, sir.

Senator METZENBAUM. But the fact is that your company had a return on equity of 19.6 percent, which is higher than industry generally and is about the level of the rest of the oil industry which runs in the area of 20 percent. That is a very substantial return on equity, for a business, is it not?

Mr. BURCH. It was an excellent year for Sun in 1979. It was record earnings for us and substantially above anything we had ever enjoyed before.

Senator METZENBAUM. Your profits were actually up almost 100 percent, 96.1 percent over the first quarter of the previous year; is that correct?

Mr. BURCH. Yes, 96.

Senator METZENBAUM. It is 96?

Mr. BURCH. Yes.

Senator METZENBAUM. And the American people have been told and Mr. Duncan has told us, and the President has told us that all of you need more profits in order to produce more. But isn't it the fact that although your profits in 1979 were up—up 92 percent for the whole year 1979 over 1978—you only put about 9 percent into energy capital expenditures?

Mr. BURCH. I don't think that is right, sir. I have the annual report with me. I don't know that I have—let me read from our quarterly report, if I can.

Senator METZENBAUM. Yes.

Mr. BURCH. This is a statement by our chairman, Mr. Ted Burtis:

These higher profits are for the most part the result of Government policies which call for higher oil and gas prices to spur increased investment, investment in developing new sources of energy, and at the same time, to end wasteful consumption of scarce energy supplies.

We see this as national policy.

At Sun, the high earnings translate into increased investments and effort to develop energy on the North American Continent.

We have greatly increased our capital spending program over recent years to about \$1.2 billion per year.

We expanded our programs to find and develop conventional oil and gas supplies. We are increasing our activities in developing coal, geothermal, uranium properties and expanding our oil sands plant in Canada.

In addition, our recent \$2.3 billion offer for the U.S. oil and gas properties of Texas Pacific Oil Company, including three million acres of promising and unexplored land offer another tangible expression of our commitment to help solve our energy problems.

Senator METZENBAUM. Mr. Burch, that is a fine statement that your chairman made, but let me tell you what your senior vice president, Mr. Kephart said, on November 14, 1978, before the SEC.

Answer. We had in our view, approximately \$1 billion in excess cash flows out of the normal operations of the company. We talked about the concept of what we soon called the beachhead strategy which was to follow the concept of going after major additions to the corporation, but not trying to do it all at once, because we didn't feel we knew enough about any particular industry or company.

And, as a matter of fact, instead of putting your money into energy production, isn't it the fact that you put your money into buying about 34 percent of Becton-Dickinson, which is a company that is I think in health products or something of the kind.

You bought Carboline, a manufacturer of specialty protective coating.

You bought Elk River Resources Company.

You bought Chromaloy Company.

You bought a Seagram subsidiary, Texas Pacific.

Now the argument may be made, well, we bought Texas Pacific because we wanted more opportunity to explore. But the fact is that the company you bought, Texas Pacific, was already exploring. They were already in the energy business.

The whole concept of decontrol was: give you more money, so that you would go out and put some more pipes in the ground. Becton-Dickinson didn't do that. Carboline didn't do that.

Mr. BURCH. Sir, if I may interrupt, we did not acquire Becton-Dickinson.

Senator METZENBAUM. You acquired 34 percent of it.

Mr. BURCH. No, sir. We ran into problems with the Government. That has been a bad experience.

Senator METZENBAUM. So you didn't get it because you couldn't get it; is that what you are saying?

Mr. BURCH. Yes, sir, that is about right.

Senator METZENBAUM. All right. [Laughter.]

I am not going to quarrel with you. It so happens, you did the wooing, but you didn't consummate the relationship. [Laughter.]

Mr. BURCH. I must—that is perhaps right, but I must tell you that we have had a change in our company policy. At that time, when we were looking at Becton-Dickinson, the company had a policy, attempting to acquire other businesses to diversify. This was prior to deregulation.

Since then, we have concentrated on energy and we have a stated policy of energy being our primary business. This is what we plan to be, an energy company.

Now when you refer to the acquisition of Carboline, Carboline was a relatively small acquisition, in the order of \$50 million. It is in line with some of the products we currently produce. We see this as not being so far away from our basic business.

Senator METZENBAUM. Mr. Burch, my figure of your putting 9.4 percent into increased energy capital expenditures while you had a 92 percent increase in profits, comes from your annual report.

Mr. BURCH. Did you say 9.4 increase?

Senator METZENBAUM. Yes.

Let's see, you went from \$615.9 million to \$674.1 million. That was for energy, conventional petroleum. Where else can I go except to your annual report?

Mr. BURCH. I must tell you that following our annual report, we did acquire Texas Pacific, that was \$2.3 billion.

Senator METZENBAUM. But that was only buying the company. That didn't produce any more oil.

Mr. BURCH. Along with that we made a commitment to invest as a condition of the sale, \$400 million for the exploration and the development of the three million acres that we also gained rights to.

Our intent is to move more aggressively into oil and gas production, wherever we may have the acreage.

We are also investing money in our refineries wherever we are in the energy business.

Senator METZENBAUM. Mr. Burch, I have one last question.

Mr. BURCH. Yes, sir.

Senator METZENBAUM. You say that prices of gasoline have not fallen because crude costs have increased. But between January 1979, and March 1980, according to the Energy Regulatory Administration, gasoline increased by 54 cents per gallon, while crude costs increased only 33 cents per gallon.

Now my statistics are coming from Platt's/Lundberg. If you add 5 cents per gallon increase in retailer margins, plus 2 cents per gallon for the gas tilt rule, plus another 5 to 6 cents per gallon to account for a 20-percent inflation rate—and it really wasn't quite that high—that still leaves another 8 cents per gallon increase in prices that is unexplained.

Isn't it that additional 8 cents or whatever the number may be, that made it possible for you to increase your profits from \$128 million to \$251 million in the first quarter of 1980?

Mr. BURCH. Whether that has been responsible for it?

Senator METZENBAUM. Yes.

Mr. BURCH. Let me—I didn't finish my statement.

Senator METZENBAUM. I am sorry.

Mr. BURCH. Let me get back to my statement if I could.

Senator METZENBAUM. Fine.

Mr. BURCH. I will come back to that.

Senator METZENBAUM. I don't mean to keep you from doing that, sir. I had no intention of doing that.

Mr. BURCH. OK. Well, I mentioned the 13.4 percent return on capital employed. I would like to restate, we firmly believe that each segment of our business must be self-sufficient and generate sufficient profits to justify the very sizable capital investment.

I might digress here and tell you that in the refining and marketing end of the business, our assets, from our annual report, are \$1.861 billion. That is a very substantial investment. We expect it to produce profits.

Senator METZENBAUM. And we want you to produce a profit. All we don't want you to do is to produce an excessive profit.

Mr. BURCH. Yes, sir.

We believe that this profit margin we have in a modest one and leaves no room to make product price reductions, particularly with rapidly rising crude oil costs.

Now crude oil supply from OPEC nations is uncertain at best. Quantities of foreign contract crude have been curtailed forcing Sun and others into a more expensive spot market for a greater portion of its crude requirements.

The result is a disincentive to purchase additional crude oil or in any way promote additional demand. Since our national goal is to reduce crude oil imports, the result is consistent with that goal.

Government actions have also added to the cost of gasoline. The granting of a fraction of an entitlement to residual fuel importers to protect Northeast consumers directly adds to prices of products. The Government's desire to keep heating oil prices down results in costs being shifted to other products for attempted recovery.

Similarly, the "gas-first" policy for powerplants and some industry has created a depressed residual fuel market in certain regions of the country. These actions force oil companies to attempt to recover costs and make profits by increasing gasoline prices.

Not that I said "attempted recovery of cost" because full recovery is not always possible. Gasoline has been under price controls since August 1971.

In November 1973, the EPAA was enacted, followed by the EPCA in December 1975. Both limited price increases to specific cost increases which are not being fully recovered by the industry.

According to the Lundberg letter, in 1979, the unrecovered allowable cost increases for the 20 largest refiners increased from \$523 million to \$3.7 billion and is continuing to climb in 1980.

This is a clear indication that the market is controlling prices. Most refiners are not raising prices as much as would be permitted by price controls.

Despite the rising raw material costs and increased manufacturing costs, gasoline prices have been relatively stable over the past 2 months. Spot gasoline prices have declined reflecting the higher than average inventories.

Indications from press reports are prices do not appear to be increasing as rapidly as in the past.

I hope I have been responsive to your inquiry. I will be happy to answer any more questions, Mr. Chairman.

Senator METZENBAUM. Very well.

Now will you tell me whether that missing 8 cents helped to create the additional \$123 million? Are you going to tell me the same as Mr. Weeks that increased gasoline prices haven't had anything to do with the fact that your profits are up almost 100 percent?

Mr. BURCH. Yes. Dean has pointed out to me that you did not include the increased manufacturing costs that go along.

Senator METZENBAUM. That is inflation. I allowed 20 percent on that. That was pretty generous.

Mr. BURCH. I am not so sure that that is generous. You must remember that we burn a lot of fuel in a refinery and as gasoline prices and other fuel costs go up, our cost of operations go up.

We consume quite a bit of this high priced crude oil and equivalent products to operate our refineries.

But, I must have to tell you, we do not have a missing 8 cents. If we got an additional 8 cents a gallon profit, our profits would be very substantially higher than they are.

Senator METZENBAUM. How many gallons do you sell in a quarter?

Mr. BURCH. About a billion. A little over a billion gallons.

Senator METZENBAUM. A billion.

Mr. BURCH. Of gasoline.

Senator METZENBAUM. It is interesting. Mobil sells about 2 billion, and they made about 25 percent of that—about \$456 million, \$473 million.

In a quarter, you sell a quarter of a billion? Is that what you said?

Mr. BURCH. About a billion.

Senator METZENBAUM. About a billion. You made an additional \$123 million.

You sell 4 billion a year, do you?

Mr. BURCH. About 4 billion a year.

Senator METZENBAUM. Four billion. So, that actually, would come out to about 12 cents a gallon. I am not suggesting that is a direct relationship.

I am saying, it is interesting that as you sell more gasoline, you also make that much more profit. Yet, now I have had two witnesses, both of whom have said that really has nothing to do with our increased profits.

I say to you that that is difficult for the American people to believe.

Mr. BURCH. Your numbers might be interesting, but I don't think they are relevant to our business.

Senator METZENBAUM. Tell me what is relevant.

Mr. BURCH. Well, I would have to say—

Senator METZENBAUM. Tell me where the money came from. Where did you make that extra—

Mr. BURCH. I thought I read it from the statement by our chairman. It came largely from the production end of the business, production being gas and crude oil production due to Federal Government policy which decontrol crude oil.

Senator METZENBAUM. So it is directly by reason of decontrol that you made \$123 million extra?

Mr. BURCH. I am saying this was a major contributor.

Senator METZENBAUM. That is what I have been saying to the President, but he hasn't heard me. [Laughter.]

Mr. BURCH. In our manufacturing and marketing end of the business, we did have some improved earnings in our petrochemical end of the business for the first quarter. That I might say has since turned about downwardly rather dramatically, because of supply and demand.

The other facet of our business that did better than the comparable quarter in the prior year was our lubricants business. This business had been in a loss position in the first quarter of 1979. We turned it around until we made some profit in the first quarter of 1980.

Senator METZENBAUM. But when all is said and done it all comes down to a three-letter word called "oil." And by reason of higher prices for lubricants, higher prices for gasoline, higher prices for petrochemicals—that relates also to the oil industry—when all is said and done, you have been able to exploit the market. I am not saying that you are doing anything illegal, but I am saying that it

has hurt the economy, that oil companies have increased prices when normal competitive factors should have caused prices to come down.

Mr. BURCH. Well, I get a little confused. We have a national policy to decontrol crude oil prices. We increased the price of natural gas to encourage production. We are pouring this money back, that doesn't fall into the U.S. Treasury through the so-called windfall profits tax which really is an excise profits tax, an excise tax, I should say.

We are pouring these moneys back into the energy business. This is precisely what the national policy is.

Senator METZENBAUM. But you only put 9 percent back in 1979. And the fact that you didn't buy Becton-Dickinson isn't because you had not made a very substantial commitment to buying it. You were paying 43 percent over book. You had really moved in to take over that company. It had nothing at all to do with energy. It was a very major number of dollars. I forget how many hundred million, but it was well up into the hundreds of millions, as I recall it.

Mr. BURCH. The increase in investments in the oil industry that you are quoting, you quote from the annual report. I am sure they are right.

However, we have had a very major change in policy. I tried to indicate that to you. Part of that change in policy came about as a result of the change in the Federal policy. Everything was under control. Profits were being held down in the oil business. We are in business to see our business survive. Survival didn't seem to be the way that we would end up if we pursued the energy business in total prior to the time when we began to see some change here down in Washington.

Senator METZENBAUM. Mr. Burch, the American people can hardly cry for your company when your senior vice president back in 1978 talked about what you were going to do with the extra \$1 billion you had. Since then your profits were up, 1979 over 1978, by 91.8 percent, and your profits were up the first quarter of 1979, over the first quarter of 1978, by 96.1 percent.

Do you think that the American people are really cheerful about the condition of the American oil industry?

Mr. BURCH. Well—

Senator METZENBAUM. When they are paying these kinds of prices. Let's see, there is your's over here, \$1.33.4, and \$1.28.4. That is pretty good. [Laughter.]

Mr. BURCH. Mr. Chairman, let me mention one little fact about Sun's business. We are short. We are not self-sufficient in crude oil.

Currently our acquisition costs of crude, our average cost of crude, based on our numbers compared to published numbers by the Department of Energy, our cost of crude is running somewhere between \$2 to \$3 a barrel above the national average. And that is quite a bit of money.

If you see our pump prices a little bit higher than others, that to a very large extent accounts for it.

Senator METZENBAUM. Well, as a matter of fact, SoCal which has a good crude supply, better than yours, had profit increases that weren't even as high as yours. So, even though you are a procurer rather than a supplier of all of your own product, the fact is, your profits increased

by reason, at least in part, of higher prices, even with respect to the lubricants. You had more ability than in the past to raise prices there.

As a consequence, you are now making money in that end of the business where you weren't making it before.

Mr. BURCH. Yes, sir.

Senator METZENBAUM. Mr. Burch, I don't know if you have anything further, but I am trying to keep things rolling.

Mr. BURCH. All right.

Senator METZENBAUM. If you do, I will be very happy to have any further statement. I don't mean to cut you off in any way, sir.

Mr. BURCH. Fine.

Senator METZENBAUM. Thank you very much.

Mr. BURCH. Thank you very much.

Senator METZENBAUM. I appreciate your being with us, as well as the other two gentlemen.

[The prepared statement of Mr. Burch follows:]

PREPARED STATEMENT OF WARREN E. BURCH

I am Warren Burch, vice president of operations for Sun Petroleum Products Company, the industrial and wholesale marketing and manufacturing division of Sun Company, Inc. We are responsible for fuels, petrochemical and lubricants businesses. Your invitation to testify stated in part that "over the past five months, gasoline prices have continued at a high level despite a large surplus of oil domestically and internationally." The question at today's hearing is what is "high" relative to both prices and inventory. Under the circumstances we face today neither is too high in our opinion.

I will speak first to the industry inventory levels.

For security reasons the twenty participating member nations of the International Energy Agency (IEA), of which the United States is one, have agreed to maintain a ninety day supply of oil in inventory. Even with the current inventories, the United States has about a 60 day supply if one considers the total inventory of crude, refined products, and the approximately 90 million barrels in the strategic petroleum reserve. A less comforting fact is that the United States distribution system requires large volumes just to maintain operations and those stocks are unavailable for use.

According to a recent study of minimum operating inventory levels by the National Petroleum Council, the United States has approximately 88 million barrels of crude oil above that minimum. That represents about a 6½ day supply of crude oil excluding the SPR. The gasoline volume available over the minimum operating requirement is 56 million barrels or equivalent to about eight days of demand.

These inventories are higher than those normally carried by the United States petroleum industry. The higher than normal stocks are due to concerns about security of supply, the rising price of crude oil, and the lower demand due to conservation efforts.

The foregoing is to assist you in understanding the issue of inventory levels. Specifically—how high is high. Incidentally, I would like to remind you that about a year past, the industry was accused of deliberately lowering inventories in 1978 prior to the Iranian crisis thus creating shortages after the crisis. The implication was that we should have planned for that unforeseen event.

Business decisions by some companies may call for reductions in gasoline inventories. However, presently Sun's gasoline inventories are lower than normal due to plant shutdown for maintenance on some of our major gasoline producing units. Sun does not have a surplus of gasoline; in fact we have been purchasing gasoline, at high prices, during 1980 to supply our customers.

Your letter inviting Sun to appear at this hearing indicates that you may be more concerned about price than inventory level.

Turning to pricing, we believe that gasoline market prices are cost-driven in a market controlled by competitive forces. This market reacts and adjusts to many complex factors such as:

Raw material costs, manufacturing and distribution costs, profit margins, uncertainty of supply, and governmental actions.

Our raw material costs, principally crude oil, have risen 17.2 cents per gallon in the six months from November, 1979, through April, 1980.

Operating costs for this same period have increased by 2.5 cents per gallon.

In response to these cost increases the gasoline prices for December through May have increased by about 19 cents per gallon for a margin decrease of about .7 cents per gallon over the past six months.

I believe it would be useful at this point to briefly discuss profit margins to put cost and price changes in perspective. Although we are unable to precisely determine the cost of manufacturing individual products, we can average costs over all products to approximate profitability. In 1979, the U.S. manufacturing and marketing divisions of Sun earned just under 1 $\frac{3}{4}$ cents per gallon on all products, which includes fuels, petrochemicals and lubricants. This margin resulted in a return on capital employed of 13.4 percent. We firmly believe that each segment of our business must be self-sufficient and generate sufficient profits to justify the very sizable capital investment. This modest profit margin leaves no room to make product price reductions particularly with rapidly rising crude oil costs.

Crude oil supply from OPEC nations is uncertain at best. Quantities of foreign contract crude have been curtailed forcing Sun and others into a more expensive spot market for a greater portion of the crude requirements. The result is a disincentive to purchase additional crude oil or in any way promote additional demand. Since our national goal is to reduce crude oil imports, the result is consistent with that goal.

Government actions have also added to the cost of gasoline. The granting of one half of an entitlement to residual fuel importers to protect Northeast consumers directly adds to prices of products. The Government's desire to keep heating oil prices down results in costs being shifted to other products for attempted recovery.

Similarly, the "gas-first" policy for powerplants and some industry has created a depressed residual fuel market in certain regions of the country. These actions force oil companies to attempt to recover costs and make profits by increasing gasoline prices.

Note that I said "attempted recovery of cost" because full recovery is not always possible. Gasoline has been under price controls since August, 1971. In November, 1973 the EPAA was enacted and followed by the EPCA in December, 1975. Both limited gasoline price increases to specific cost increases which are not being fully recovered by the industry. According to the Lundberg letter, in 1979 the unrecovered allowable cost increases for the 20 largest refiners increased from \$523 million to \$3.7 billion and is continuing to climb in 1980. This is a clear indication that the market is controlling prices. Most refiners are not raising prices as much as would be permitted by price controls.

Despite the rising raw material costs and increased manufacturing costs, gasoline prices have been relatively stable over the past two months. Spot gasoline prices have declined reflecting the higher than average inventories.

Indications from press reports are prices do not appear to be increasing as rapidly as in the past.

Senator METZENBAUM. Our next and last witness is Mr. E. J. Hess, vice president of the marketing department of Exxon Co.

**STATEMENT OF E. J. HESS, VICE PRESIDENT FOR MARKETING,
EXXON, U.S.A.**

Senator METZENBAUM. Mr. Hess, I would guess you were in the room when I indicated my appreciation to the oil companies for coming on short notice. That certainly applies to your company as well. I do appreciate that kind of cooperation.

I am happy to have you with us this morning, sir.

Mr. HESS. Mr. Chairman, I am E. J. Hess. I am vice president of marketing for Exxon Co., U.S.A. I am here, of course, at your request

to present my company's views on gasoline and other petroleum product prices and on crude and petroleum product inventory levels.

My comments will focus on three areas. These are first, industry supply conditions; secondly, current Exxon supply of gasoline; and third, cost and other factors affecting product prices.

My statement is brief, Mr. Chairman, and then, when I am finished, of course, I will be happy to answer any questions that you may have.

First, combined industry inventories of crude, motor gasoline, and distillates as of June 6, 1980, were 110 million barrels higher than the average of 1974-78 based on data published by API.

While this appears to be a large volume of oil, it is relatively small in terms of days supply.

For example, the variation from historic levels represents only 3 days' crude supply and 5 days of motor gasoline supply, respectively.

Two factors contribute significantly to this situation. The first is reduced demand. During the first 5 months of 1980, consumption of motor gasoline in the United States is down more than 8 percent, and consumption of all petroleum products is down more than 9 percent compared to the comparable period of 1979.

Continued availability of supply from domestic and foreign sources has also allowed recovery of inventories to these current more adequate levels.

Second, the United States is still dependent on foreign sources for over 40 percent of its petroleum supply. Given present uncertainties regarding the future availability of this supply, to the extent possible, it is prudent that suppliers maintain higher inventory levels than in the past as a reserve against unforeseen disruptions.

With regard to gasoline supply, Exxon is currently making an ample supply of gasoline available to the market.

In total, Exxon is making more gasoline available than its customers are purchasing.

Exxon's allocation fraction for June is 86 percent.

However, a fraction below 100 percent does not necessarily indicate reduced motor gasoline availability.

Customers' entitlements with Exxon's current allocation fraction of 86 percent are actually greater than last year's sales. This is because regulatory adjustments and assignments have increased the basis for allocation above actual sales in the historical base period.

Although in total Exxon's customers are not taking all the gasoline to which they are entitled, and here, by customers, I mean dealers and distributors, some customers do continue to be limited by controls. Only with decontrol can all customers expect to receive all the product they would like to have.

Market conditions, we believe, illustrate the adequacy of gasoline supply. There are no lines, and service stations have resumed more normal operating hours in recent months.

Finally, with regard to costs, looking first at wholesale gasoline prices, and, of course, you realize Exxon is primarily involved in the wholesale part of the gasoline business, escalating raw material and other costs continue to put upward pressure on prices, despite the apparent adequate supply.

Crude costs have increased for both foreign and domestic crude, and, in some cases, retroactively.

Imported crude oil increased sharply when some OPEC members raised prices late in 1979, effective November 1.

Other foreign producers have raised prices several times since then.

The most recent increases were imposed despite what appears to be ample supplies in the free world.

Based on data published by the DOE, imported crude prices paid by domestic refiners increased from \$25 per barrel in October 1979 to over \$32 per barrel by March 1980.

Although price trends could be misleading when perceived over a short period of time, this illustrates recent cost pressures on product prices.

Domestic crude prices, which were restrained for years by Federal price controls, also are now increasing under the administration's phased decontrol program.

Each month, average domestic crude prices rise, and should continue to do so until October 1981, when complete decontrol is achieved.

Based on DOE data, the average price paid by refiners for domestic crude increased from \$17 per barrel in October 1979, to over \$21 per barrel by March 1980.

Regarding pricing at the retail level, continued allocation and price controls dampen competition.

Currently, there is some indication of more competitive pricing at the retail level. Based on observations we have recently made, it appears that dealer margins may be 2 to 3 cents per gallon on average below ceilings established by the DOE.

Nevertheless, a dealer that is limited by his allocation from his supplier has little incentive to reduce prices, since he cannot enjoy the normal volume improvement that he would experience in a free market.

The influence of traditional market competition cannot be expected until the market is allowed to be free of regulation.

In summary, higher than historic inventories are not excessive in terms of days supply, particularly when considering the continued uncertainty regarding availability of imports.

Crude and other cost increases continue to exert upward pressure on prices for petroleum products.

Finally, it is unrealistic to expect prices to reflect a higher degree of competition as long as Federal price and allocation controls continue.

Thank you Mr. Chairman.

Senator METZENBAUM. Thank you very much. I do have some questions, Mr. Hess.

Your profits in the first quarter, 1980, were up 105.3 percent, or \$473 million, for a total of \$922 million.

What portion of that would you say resulted from your ability to increase gasoline prices at the pump?

Mr. HESS. Senator, when you talk about gasoline prices and their adequacy and other petroleum product prices, you are dealing, as your question earlier to another oil company representative indicated, with the difference between crude costs and then the prices that are incurred for petroleum product sales, and all the costs that are incurred against that margin.

In effect, you are dealing with refining and marketing profits and margins.

In the first quarter of 1980, our total before tax refining and marketing profits in Exxon Co., U.S.A., were only in the range of 3 cents a gallon. Now, that was up from a loss in the fourth quarter of 1979 when crude costs and other costs had incurred much more rapid escalation than our product prices did, of close to a penny a gallon.

Senator METZENBAUM. You all like to talk about your profits from refining and marketing not being very great, but you don't like to talk about your total oil profits.

Now, you know, what difference does it make if refining and marketing doesn't make as much, but the other end of the business makes a lot more? The American people don't know the difference. You may run your company and you may be in charge of the marketing and refining end of the business, somebody else may be in charge of production and somebody else may be in charge of other divisions.

But the fact is, that it is all one. It is all part of the same operation. You are paying from the left-hand pocket to the right-hand pocket.

So, you all have been talking about your refining and marketing profits not being much. I might say to you that when this committee has indicated an interest in divesting you of your refining and your marketing operations and to have it not be an integrated oil company, the oil companies have descended upon the Congress as if we had just suggested heresy.

So that although you claim you don't make much there, and you say you are losing money there, when we were making those proposals, you certainly fought any efforts on the part of the Congress to cause divestiture.

Now my question is, not what the refining and marketing end made and these figures you give about 3½ cents a gallon. My question is, how much were your oil profits up as distinguished from the computer businesses and the typewriter businesses or the other businesses that you are in?

How much are your oil company profits up and how much of that resulted from being able to charge more, largely by reason of decontrol?

Mr. HESS. Senator, that was a rather lengthy commentary.

You finally got the question, but—

Senator METZENBAUM. I specialize in filibusters. [Laughter.]

Mr. HESS. But it is my understanding that you called this hearing to talk about gasoline and petroleum product prices in the face of ample inventories. When you call the hearing to talk about gasoline prices, you need to talk about refining and marketing prices.

Now you say I and the other inventory witnesses like to talk about the refining-marketing segment of our business and forget the rest, but your very own question a few moments ago started with crude oil prices.

You are looking for some mysterious 8 cents a gallon that had disappeared. You were talking about refining and marketing profits, and justifiably so. You were talking about refining and marketing profits because that is the issue at hand when you talk about gasoline prices.

That is why I like to come back and talk about what they are. Now we do make profits on production. You know, Exxon is essentially an oil and gas company. We talk about \$4.3 billion of profits world-

wide in 1979, essentially all of that comes from oil and gas operations, the petroleum business.

But most of it comes from overseas. I guess we are talking about \$1.5 billion from our petroleum products operations in the United States.

Our capital expenditures in the Nation exceed that. Capital and exploration expenditures exceeded it in 1979.

Senator METZENBAUM. Your capital and exploration expenditures, you use that in your ads. But the fact is, in 1979, your profits over 1978 were up 78.2 percent.

In all fairness, you did expend a fair proportion on increased energy capital expenditures. But that was only 45 or 46 percent as compared to 1978. So that not all of that was in that area.

Mr. HESS. No, but that is a numbers game, Senator. I mean, you talk about percent increase from one year to the other. The problem was that in 1978, the year before, our capital and exploration expenditures were considerably in excess of our profits, even more so than in 1979.

In 1979, our net income was \$4.3 billion, worldwide.

Our capital and exploration expenditures were \$6.9 billion.

Senator METZENBAUM. What is your cash flow?

Mr. HESS. Excuse me.

Senator METZENBAUM. What is your cash flow? Was it about \$8 or \$9 billion?

Mr. HESS. Well, OK, if you want to add depreciation in there, there was additional cash flow.

Senator METZENBAUM. How much was the cash flow?

Mr. HESS. At the same time, we had to pay dividends to shareholders.

Senator METZENBAUM. How much was the cash flow?

You know, the oil companies are always very proud to talk about how much more they spend than their profits. But they forget to say that they don't pay all those taxes they are supposed to, and much of it has to do with the accounting procedures that the oil companies can use and the rest of American industry cannot use.

You have special arrangements for taxes that no other industry in this country has.

Mr. HESS. Well, do you want to talk about—what was it, cash flow? Funds available—funds provided from operations were \$7.7 billion. And then, of course, we had dividends and we had capital exploration expenditures and all these things balanced up to that same number. I think you have our report, Senator, on the subject.

Senator METZENBAUM. But the fact is that the cash flow is always substantially higher than the profits; is that right?

Mr. HESS. Yes, but the facts are also that all of the profits are not available for that cash flow either because we have to pay dividends to shareholders. They could just as easily put their money into savings accounts, and at the kind of interest rates they are paying today, they might prefer to do it than pick up some of the returns they can in industry.

So, Senator, I am sure you realize, you have to offer an investor an incentive to be involved in the business.

Senator METZENBAUM. Mr. Hess, isn't the real question one that I have asked before and I will ask again. Supply is up, demand is down,

consumption is down, dealer margins are down. The only thing that stays up are prices and your profits.

In fact, despite the rise in supply and fall in demand, your profits are higher than ever before conceived by any company in this country, much higher than many nations in this world.

How do you do this? How do you keep the prices up when there is an excess of supply?

Mr. HESS. Well, when you talk about these high profits and all this money, and truly, when you talk about \$2 billion for earnings for the first quarter of 1980, which is what Exxon Corp., worldwide, reported, that is a big number, but of course, we are in a big industry and in a big country.

I might remind you that the Federal budget that you are dealing with is probably going to spend that much of the public's money in 1 to 2 days, this coming year.

So, when you have big jobs to do, it takes big money to do those jobs.

In the case of our gasoline situation and ample inventories, I think I tried to show in my statement that even though inventories are higher than last year—than the normal—last year, you remember, was quite low because of the impact of the Iranian crisis. They are still not overly abundant.

I am sure you are no more comfortable than I am with 40 percent of our petroleum supply coming from overseas, when you see the political uncertainties and the other uncertainties to the continuation of that supply.

So, a few days extra inventory seems to me would be a desirable thing and not one that somebody would be quarreling with.

Senator METZENBAUM. I don't have any quarrel about your having additional inventory. But what I do have concerns about is why you keep exploiting the market conditions even with an excess of supply.

Mr. HESS. Senator, you say "exploit." I can't accept that. We don't exploit market conditions. Our prices on gasoline have generally been below the market during the last 12 months of 1979 and the first 4 months of this year.

Senator METZENBAUM. Well, I don't seem to see that on the signs that are here [indicating].

Mr. HESS. You are looking at dealer retail prices. I am talking about Exxon's prices.

Senator METZENBAUM. Well, I don't think that the American people think that Exxon is below market, at least I have not heard that.

I want to talk to you about this question of needing additional money.

Mr. HESS. Excuse me. We have been below the market during most of this period. Right today, even right today, we are below the average of our major competition.

Senator METZENBAUM. Now Mr. Hess, some of the most conservative economists around, and I mean conservative politically, don't think that you need those increased profits for exploration.

Charles Brecher, who describes himself as a Reagan Republican, a member of the Republican Platform Committee's Council of Economic Advisers, wrote the following:

To sum up, the international oil business of oil giants is far more profitable than American manufacturing business, but that is obscured by oil company accounting and financial reporting.

For the business as a whole, the profits may still not be obscene. But it is flatly untrue that the large oil companies need higher prices and higher profits before they can produce more oil and gas at today's prices.

Big oil is swimming in cash. It may well be that a primary motive, say for Exxon to pay over \$1 billion for Reliance Electric, an absolutely ridiculous price of 18 times earnings, three times book value, may be the desire of Exxon's management to get rid of some rather embarrassing cash right now.

Now that wasn't Howard Metzenbaum speaking. That was Mr. Charles Breecher, conservative economist and a member of the Republican Party's Council of Economic Advisers.

Now do you think that the whole world is out of step, the whole army is out of step?

Mr. HESS. Senator, I went to grammar school in New Jersey. That is a rather lengthy and very sophisticated speech about what is necessary and what isn't. I am afraid I don't know who this individual is that you are quoting in the statement.

But let me show you some numbers on whether we are swimming in money or not swimming in money.

We published a document just this last year which looked at our percent return on shareholders' equity. You may have noticed that last year our return on shareholders' equity did climb very dramatically to 20 percent, 20.1 percent, which is quite a desirable one.

But for many years, it had been floating in the 14, 15 percent range. In 1973, which was also a pretty good year, it was 18.8 percent.

But then, if you adjust that for inflation—we don't think you want to get into a talk about what is causing all the inflation in this country, maybe your economist would have some comments on that—but if you adjust all this for inflation, and go back to the value and the purchasing power of these dollars, our return on equity from the 1973 to 1979 period has fluctuated between 12.8 and 11.3 percent, because we had to put investments in and money in that had much higher purchasing power than the income it was finally generating did, 5, 6, 7, 8, 10 years later.

I think that this is a problem that all American business has. With the rampant inflation what used to be considered a reasonable return on investment is no longer a reasonable return on investment.

Senator METZENBAUM. Mr. Hess, you address yourself to the problem. But much of the American people think that you are the problem and you are the reason that inflation is going up as much as it is. When I say, "you," I use it generically, to mean the industry.

The oil industry has pushed up prices so much that the net result to the American people has been that inflation is up at an 18-percent, 20-percent, figure.

If you took out the energy factor, it would be down about half of that. Now in all fairness, you have no control over the OPEC price increases. You do have control over the profits, these \$2 billion in profits. I am not saying that you should not be making a profit, but the thrust of my concern as chairman of this committee is whether or not the oil companies operate as a monopoly, in such a way as to keep prices up artificially when they should be coming down based upon normal economic conditions.

Mr. HESS. Senator, that was another lengthy speech.

Senator METZENBAUM. Well I don't intend to apologize to you, sir, for wishing to address myself to the issues. I will make as many lengthy speeches as I want to.

Now you go ahead and answer the question.

Mr. HESS. The thrust of my incentive is to convince the American public that we are not operating as a monopoly. I categorically deny that we are the source of this so-called problem.

The American energy industry has done everything that it can to provide energy to this country and plans to continue to do so. You talk about the need and swimming in dollars and the need for capital expenditures.

I am sure you are familiar with some of the data, but if we are going to look at synthetics and other sources of petroleum supply, which we are obviously going to have to if this country is ever going to make a dent in this 40 percent of the petroleum that comes from overseas, you are going to look at a 50,000-barrel-a-day plant for shale or for liquids from coal that is going to run in the range of \$3 to \$4 billion.

How much is 50,000 barrels a day? It is less than 1 percent of the total demand in this country. The investments that are going to be involved to do this are astronomical. It is going to boggle the imagination compared to anything that we tried to do in the past.

This money needs to be available and the only way it comes is from profits and from returns on investments.

Senator METZENBAUM. Well, if you need it for that purpose, why did you go out and spend over \$1 billion for Reliance Electric? They don't make any—

Mr. HESS. We bought Reliance Electric because we wanted to conserve energy further, and you had hearings on this, Senator. You know that.

Senator METZENBAUM. You know that the Wall Street Journal said you were just off base on that.

Mr. HESS. We bought Reliance Electric because we had technology that we felt would be useful in the manufacture of electric motors, in saving energy for this country and we needed people who knew how to make those things.

Senator METZENBAUM. I must say that I did have hearings and I was totally convinced that that had nothing at all to do with your reason for the acquisition.

I thought that the testimony was quite clear that they didn't need you in that industry. They didn't ask for you to come in. Reliance actually indicated in unequivocal terms through their president, that they needed no help from Exxon in order to do their job with their motors and the efficiency of their motors.

Let me ask you one last question, if I may. You are familiar with Congressman Rosenthal's study showing that oil company profits on the sale of heating oil went up 800 percent. The oil companies blamed those price increases on higher priced crude too.

In my opening statement, I addressed myself to that subject, as well as to the substantial increase in the profits for diesel fuel.

Do you think that was justified? In answering that, would you be good enough to address yourself to the point that decontrol makes it possible for you to increase the price. Why have the oil companies just

pushed their prices up so dramatically to get an 800-percent increase in profits in one area. I think it was 700 percent in the other one, if I remember correctly, in diesel fuel.

Mr. HESS. I am confused, Senator. You had about three things in there: Rosenthal's study and then what was the last part of that?

Senator METZENBAUM. I will separate that. You are very justified in saying that because that asks about decontrol.

Congressman Rosenthal's study showed that oil company profits from the sale of heating oil went up 800 percent and that profits on diesel fuel, I think, went up 700 percent.

Now, my question is, can the oil industry truly justify those kinds of profit increases?

Mr. HESS. Well, first of all, I disagree with Congressman Rosenthal's study. He picked numbers from different sources. He put them together in ways that indicated a false situation with regard to the facts. Now I can't speak for what other petroleum companies' earnings are because, obviously, I am not privy to those.

But, in looking at our own situation, and at the average of the winter period which is the significant one when you deal with heating oil prices, our average heating oil realizations ran in the range—this is the fourth quarter, of 1979, and first quarter of 1980, which covers pretty much the winter period—our average heating oil realizations ranged about 68 cents a gallon during that entire period.

Our costs of crude were in the range of 54 to 55 cents a gallon, our operating costs in the range of 8 to 9 cents a gallon, and our other costs, supplemental raw materials that we were involved in purchasing so that we would have an adequate supply of products were totally in the range of 3 to 4 cents a gallon.

So our net profit, when you finally worked it all out on total petroleum products during that whole period, over the cost of crude oil, was something in the range of a half cent a gallon or thereabouts.

So, I don't know where Congressman Rosenthal got his 800-percent increase. We sure didn't see it in Exxon.

Senator METZENBAUM. Let me ask you one last question. Oil companies always make more profits, or at least in recent years have, when crude costs increased. Now that is not a normal way for the economy to work.

The question that I have is, how does it happen that every time since about 1973, that oil prices increased, your profits did too? Shortages allegedly developed in some instances, but the bottom line was that after the fact we learned that the oil companies were always able to increase their profits as a result of crude oil price increases.

How do you reconcile increased costs and increased profits?

Mr. HESS. I don't know, Senator. You may be able to do a better job than I can. All I know is every time you run into this shortage situation and the crude prices go up as you described that they do, the Government steps in and applies controls on the industry which didn't exist before that, and the net effect is that the profits do seem to do all right.

But, you know, you speak for the Government; I don't. You probably could answer that question better than I can.

Senator METZENBAUM. Only for a little piece of the Government.

Thank you very much.

Mr. CHUMBRIS. Mr. Chairman, may I just ask one question that Senator Thurmond asked of Secretary Duncan.

Senator METZENBAUM. Mr. Chumbris.

Mr. CHUMBRIS. I believe you were in the audience when Senator Thurmond read from the hearing in 1969, on oil import quotas.

At that time, the price of a barrel of imported oil was \$2, and domestic oil about \$3.50. As Dr. Adelman stated, imported oil dropped down, to \$1.40, because there was plenty of oil.

Then OPEC came in late 1973, and started its increases in the price of oil.

Now prior to that, I think the price of domestic oil was somewhere around \$3.50 a barrel, as far back as in the 1930's or 1940's, I think our record show in the same hearings.

Now had not OPEC taken the position that it has taken and because of its power—a group of nations getting together—and raising these prices considerably, would you believe that the price of a barrel of imported oil would be somewhere nearer the \$2 figure that it had been in the prior 10 or 15 or 20 years, taking into consideration whatever inflation may have developed because of other factors?

Mr. HESS. Well, you are raising an extremely complex question because the world was entirely different in 1969 than it is in 1980.

In 1969, the United States had spare producing capacity. You may remember, we used to talk about 8 days' production in Texas, meaning 8 out of whatever the maximum was. We used to talk about percentages of allowable in Louisiana, all of which were less than 100 percent.

And, at the same time, we had—I think the domestic price was really more like \$3 a barrel for about as long as you can remember.

Mr. CHUMBRIS. Yes, \$3.50 from Texas.

Mr. HESS. Between \$3 and \$3.50. I think the average of all domestic used to run around \$3 to \$3.05 for quite a long period of time.

Foreign oil was in the range of \$1 to \$2 a barrel. Remember, in 1969, while we had spare U.S. capacity, there was an import quota system which tended to limit the imports of this very low cost foreign oil which, at that time, was much below the domestic price. The reason was, of course, we did have a domestic industry.

Mr. CHUMBRIS. At that time, in March 1969, it was about 19 percent imported oil and increasing yearly.

Mr. HESS. Yes; you may remember the famous 22 percent limit that had been put on imports that applied for quite a period of time.

Then, of course, in 1971 or 1972, the United States peaked out on production and capacity and was operating at limits. It was at that time that in effect the OPEC cartel—the successful OPEC cartel—could begin to regulate the price because we didn't have the spare production any more that we would bring to bear on the world market situation and try to keep it down.

From that time on, the role reversed and the foreign price went up well above the domestic price.

Now you say in the bottom line of your question, if these conditions like in 1969, had prevailed, would the price still be in that, way, \$3-a-barrel range domestically. I would have to say that I don't think so. I think it would be much higher than that.

I say that because, again, when you look at the capital expenditures that are involved in exploration and production programs and in the need to look for synthetics and the kinds of capital requirements that they involve, I don't think there is any way the industry could have generated the capital that it would have needed at those kinds of prices. They would have had to come up in any case.

Mr. CHUMBRIS. I am glad you answered that question. There may be some other factors, others may make, such as the oil import quota being completely disbanded in 1972 or 1973.

Mr. HESS. Yes.

Mr. CHUMBRIS. I am glad to have that information for the record. [The prepared statement of Mr. Hess follows:]

PREPARED STATEMENT OF E. J. HESS

INTRODUCTION

Mr. Chairman and members of the Subcommittee, I am E. J. Hess, vice president of marketing for Exxon Company, U.S.A. I am here to present my company's views on gasoline and other product prices, and on crude and petroleum product inventory levels.

My comments will focus on three areas. These are:

Industry supply conditions.

Current Exxon supply of gasoline.

Cost and other factors affecting product prices.

INVENTORIES ARE HIGHER THAN PRIOR YEARS, BUT FUTURE SUPPLIES ARE UNCERTAIN

Combined industry inventories of crude, motor gasoline, and distillates as of June 6, 1980, were 110 million barrels higher than the average of 1974-1978 based on data published by API. While this appears to be a large volume of oil, it is relatively small in terms of days supply. For example, the variation from historic levels represents only three days crude supply and five days motor gasoline supply, respectively.

Two factors contribute significantly to this situation. The first is reduced demand. During the first five months of 1980, consumption of motor gasoline in the United States is down more than 8 percent, and consumption of all petroleum products is down more than 9 percent compared to the comparable period of 1979. Continued availability of supply from domestic and foreign sources has also allowed recovery of inventories to these current more adequate levels. Secondly, the United States is still dependent on foreign sources for over 40 percent of its petroleum supply. Given present uncertainties regarding the future availability of this supply, to the extent possible, it is prudent that suppliers maintain higher inventory levels than in the past as a reserve against unforeseen disruptions.

EXXON IS SUPPLYING MORE GASOLINE THAN CUSTOMERS ARE PURCHASING

Exxon currently is making an ample supply of gasoline available to the market. In total, Exxon is making more gasoline available than its customers are purchasing. Exxon's allocation fraction for June is 86 percent. However, a fraction below 100 percent does not necessarily indicate reduced motor gasoline availability. Customers entitlements with Exxon's current allocation fraction of 86 percent are actually greater than last year's sales. This is because regulatory adjustments have increased the basis for allocation above actual sales in the historical base period. Although in total Exxon's customers are not taking all the gasoline to which they are entitled, some customers do continue to be limited by controls. Only with decontrol can all customers expect to receive all the product they would like to have.

Market conditions illustrate the adequacy of gasoline supply. There are no lines, and service stations have resumed more normal operating hours in recent months.

ESCALATING CRUDE OIL COSTS CONTRIBUTE TO HIGH PRODUCT PRICES

Looking first at wholesale gasoline prices, escalating raw material and other costs continue to put upward pressure on prices, despite the apparent adequate supply. Crude costs have increased for both foreign and domestic crude, and in some cases, retroactively.

Imported crude oil increased sharply when some OPEC members raised prices late in 1979, effective November 1. Other foreign producers have raised prices several times since then. The most recent increases were imposed despite what appears to be ample supplies in the free world. Based on data published by the DOE, imported crude prices paid by domestic refiners increased from \$25 per barrel in October, 1979 to over \$32 per barrel by March 1980. Although price trends can be misleading when perceived over a short period of time, this illustrates recent cost pressures on product prices.

Domestic crude prices, which were restrained for years by federal price controls, also are now increasing under the administration's phased decontrol program. Each month, average domestic crude prices rise, and should continue to do so until October, 1981 when complete decontrol is achieved. Based on DOE data, the average price paid by refiners for domestic crude increased from \$17 per barrel in October, 1979 to over \$21 per barrel by March, 1980.

Regarding pricing at the retail level, continued allocation and price controls dampen competition. Currently, there is some indication of more competitive pricing at the retail level. Based on observations we have recently made, it appears that dealer margins may be two to three cents per gallon on average below ceilings established by the DOE. Nevertheless, a dealer that is limited by his allocation from his supplier has little incentive to reduce prices, since he cannot enjoy the normal volume improvement that he would experience in a free market. The influence of traditional market competition cannot be expected until the market is allowed to act free of regulations.

CONCLUSION

In summary, higher than historic inventories are not excessive in terms of days supply, particularly when considering the continued uncertainty regarding availability of imports. Crude and other cost increases continue to exert upward pressure on prices for petroleum products. Finally, it is unrealistic to expect prices to reflect a higher degree of competition as long as federal price and allocation controls continue.

Senator METZENBAUM. Thank you very much, Mr. Hess. We appreciate your being with us.

The Chair is going to conclude this hearing and say that I am not certain that I am far more enlightened than when I started. I think the oil industry obviously runs counter to normal economic factors in this country, in normal economic ways.

It has been alleged and talked about, and this committee has concerned itself about the fact that the oil industry is in effect a monopoly. Monopolies don't provide for free competitive forces to work.

I think we see that actually having taken place in the oil industry at this present time.

Added to that is the fact of decontrol, which in the Chair's opinion has not helped solve the problem, but has exacerbated the problem and has added to the inflationary spiral which is probably the most challenging problem this Nation faces at the moment.

I thank those who have participated. The hearing stands adjourned. [Whereupon, at 11:48 a.m., the hearing was adjourned, subject to the call of the Chair.]



APPENDIX

Department of Energy
Washington, D.C. 20461

July 7, 1980

Honorable Howard M. Metzenbaum
Chairman, Subcommittee on Antitrust,
Monopoly, and Business Rights
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

At the June 18, 1980 hearing of your subcommittee on competitiveness in the pricing of gasoline (at which I appeared with Secretary Duncan), you asked me how much crude oil decontrol would affect product prices over the course of this year. I answered that about 6 cents of the current gasoline price is due to crude oil decontrol that has already occurred and that this amount is increasing by about 0.8 cent per gallon per month. With your permission, I would like to supplement the record of the hearing on this point in order to provide clarification of my oral comments.

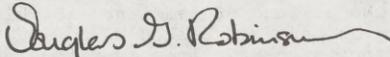
The estimate I gave you was the impact of crude oil decontrol on the average acquisition cost of all crude oil purchased by U.S. refiners. However, since an increase in average crude costs also tends to raise the cost of refinery fuel, which is the largest single component of a refiner's operational costs, further adjustments must be made to determine the full impact of crude oil decontrol on product prices. Depending on market conditions, the total portion of gasoline prices attributable to crude oil decontrol may be 0.3 to 0.5 cent per gallon per month higher than a straight passthrough of higher crude oil prices. Roughly speaking, then, the impact of crude oil decontrol may range from a little less than a penny a gallon per month to a little less than a penny and a half per month.

These estimates assume that world oil prices rise between 10 and 15 percent per year. If world oil prices rise at a faster rate, the impact of decontrol will of course be greater, since the price of domestic oil released from controls will reflect world price levels and the effect on product prices will increase as the volume of domestic uncontrolled oil increases. This can be illustrated by the following: Prior to June 1979, when phased decontrol began, about 60 percent of all crude run in U.S. refineries, including

foreign oil, was uncontrolled. Therefore, an increase of \$1 per barrel in world prices meant an increase of 60 cents per barrel in U.S. crude oil prices, or about 1.5 cents per gallon. By early next year, about 85 percent of all crude will be uncontrolled. (Most of this percentage increase will be due to phased decontrol, although some will also be due to the natural decline in controlled oil production.) The result of a \$1 per barrel world price increase at that time would be 85 cents per barrel for U.S. refiners, or about 2 cents per gallon. With total decontrol the impact of the same increase will be the full \$1 per barrel, or a little less than 2.5 cents per gallon.

I hope this clarifies the estimates given in the hearing. If I can be of further assistance, please let me know.

Sincerely,



Douglas G. Robinson
Deputy Administrator for Policy
Economic Regulatory Administration

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