

OIL MARKETS AND ENERGY PROBLEMS ON THE U. S. EAST COAST

A joint statement by the Petroleum Industry Research Foundation, Inc. of New York, N.Y. and the Independent Fuel Oil Marketers of America of Washington, D. C. prepared for The National Fuels and Energy Study of the U. S. Senate Committee on Interior and Insular Affairs

NOTE: Except where noted, the views and comments herein are subscribed to by both Petroleum Industry Research Foundation, Inc. and Independent Fuel Oil Marketers of America.

August 17, 1962

INTRODUCTION

Since both Petroleum Industry Research Foundation, Inc. and Independent Fuel Oil Marketers of America, by virtue of location, membership and function, are concerned primarily with the energy problems affecting the East Coast region of the United States, we would like to address ourselves principally to those aspects of the U. S. Energy Sector which are of primary significance to the East Coast region (the U. S. Bureau of Mines' PAD District I). These problems are: a) oil imports, since 72 % of all crude oil and nearly 100% of all residual fuel oil imports are delivered and consumed at the East Coast; and b) interfuels competition, since direct market competition between all three major mineral fuels is more pronounced in the region comprising the East Coast states than in any other part of the United States. The table below is an indication of this competition in PAD District I.

East Coast Interfuels Consumption* - 1959

	<u>Physical Units</u>	<u>Million BTU's*</u>	<u>Share Of Each Fuel</u>
Natural Gas (millions cft.)	1,781,239	1,870,050	19.7%
Anthracite (millions tons)	16,235	412,369	4.3
Bituminous Coal (millions tons)	112,614	2,950,487	31.1
Distillate Oils (thousands bbls.)	313,918	1,829,050	19.3
Range Oil (thousands bbls.)	61,391	347,151	3.6
Residual Oil (thousands bbls.)	329,619	<u>2,083,851</u>	<u>22.0</u>
TOTAL		9,492,958	100.0%

* Excludes distillate and residual oil used for road and miscellaneous purposes, tractor fuel, natural gas field use and coal used for coking. The region consists of P.A.D. District I.

Source: Bureau of Mines - Mineral Market Reports MMS 3035, MMS 3109 and MMS 3132; Minerals Yearbook 1959, Vol. II.

CRUDE OIL IMPORTS

Crude oil imports have been a significant feature of the U. S. energy market for about 45 years. During this period such imports were at times encouraged and at other times discouraged by Government policy, depending on whether this country was faced with, or was lead to expect, a shortage or surplus of domestic crude oil supply, relative to demand. The current policy of imports restriction is a reflection of the shut-in capacity of a significant proportion of U. S. crude oil production. Conversely, the policy of official import encouragment practised during the 1920's reflected the then prevalent belief that U. S. oil reserves were not sufficient to sustain our growing oil demand much longer, while a similar policy in existence from 1945 to 1955 stemmed from the inability of the domestic oil industry to expand its production rapidly enough in the early postwar years. It is entirely possible that at some future time the Government would once again find it necessary to encourage the importation of crude oil.

Between 1916 and 1961 5.3 billion barrels of foreign crude oil were imported into the U. S. east of the Rocky Mountains*, the bulk of this crude oil has competed directly with domestic oil. Consequently domestic oil production and exploration have grown at a somewhat slower pace than they would have in the absence of imports (but it should be emphasized that U. S. crude oil production did experience a growth rate throughout this entire period.)

Against this adverse economic impact of crude oil imports on domestic oil production must be held the following beneficial aspects of these imports on the energy sector of the U. S. economy.

1. As is true of all imports, the lower price of the foreign commodity has created a competitive incentive of unknown proportions for domestic crude oil producers. Furthermore, since oil production - like that of all minerals - is subject to the economic principle of diminishing returns, the supplementation of domestic oil supplies by foreign supplies has acted to retard the impact of this principle on domestic oil prices by delaying the need to develop our less favorably located oil deposits.

2. The price mix resulting from the intermingling of lower-cost foreign crude and higher-cost domestic crude has tended to reduce the overall price level of crude oil to U. S. refiners from what it would have been in the absence of imports.

3. Crude oil imports have enabled the U. S. oil industry to maintain consistently smaller and, hence, less costly inventories of proved underground reserves than would otherwise be possible. The foreign countries to which the burden of proving and carrying some of the reserves necessary to sustain U. S. oil demand has been shifted have usually a much higher ratio of such reserves to production than the U. S. industry.

- - - - -

* Crude oil imports into the West Coast began only a few years ago and - unlike imports east of the Rocky Mountains - are designed primarily to supplement the steadily declining local crude oil production of this formerly self-sufficient region.

4. Inasmuch as our ultimate domestic oil resources, like all non-renewable natural resources, are physically finite and therefore continually shrinking, imports have contributed to stretch these resources over a longer period of time than would otherwise be the case. This form of domestic natural resource conservation may not appear significant during periods of domestic oversupply but its long run effect is obvious.

These diverse impacts of crude oil imports on the U. S. energy economy, as well as the frequent historic fluctuations between public encouragement and discouragement of such imports, make it imperative that any oil imports policy adopted by the government be as flexible as is consistent with sound administrative practices, so as to reflect at all time the actual requirements of current conditions rather than those of a previous period which may no longer be applicable. It is our belief that a federal crude oil imports policy, whatever its intended purpose, in order to be effective must be free of specific restrictions and criteria which can only be altered by Congressional action or by pre-defined time-consuming bureaucratic procedures. Furthermore, we believe that such a policy should give as much weight to the above mentioned beneficial effects of oil imports on the U. S. energy economy as to their competitive impact on domestic crude oil production.

RESIDUAL FUEL OIL IMPORTS

Residual fuel oil imports are basically different from crude oil imports in that they do not displace a domestic commodity but replace it. For domestic residual fuel oil production is an incidental by-product of domestic refinery operations whose steady decline is directly related to the growing efficiency of domestic refinery operations.

The technical reason for the decline in the volume of domestic residual fuel oil output is the steady drop in the yield of this product per barrel of refined crude oil. It should be emphasized that this decline in yield did not occur as a consequence of imports but, on the contrary, was the principal cause for the steadily rising level of residual fuel oil imports. Proof that the decline in the yield and production of domestic residual fuel oil is not attributable to imports lies in the fact that this decline has occurred as much in those U. S. areas not penetrated by imports as on the East and Gulf Coasts.

The decline in the yield of domestic residual fuel oil has continued unabated in the face of imports restrictions (both the present ones and the still more severe ones in existence between 1933 and 1939), temporary domestic shortages and occasional substantial price increases. It is therefore reasonable to assume that this trend is irreversible and that the availability of an adequate supply of this product will depend increasingly on the level of imports. If that level falls short of requirements the ensuing hardship would fall principally on the U. S. East Coast which consumes the bulk of all residual fuel oil available east of California.

INTERFUELS COMPETITION

It is a matter of general agreement among businessmen and economists in this country that market competition is the most desirable regulator of supply and demand. The importance of interfuels competition lies in its contribution towards the determination of supply and demand among the various energy suppliers. However modern economic theory has also recognized that competition is generally imperfect and limited because no two products, nor two producers or buyers are fully interchangeable. Since this principle is thought to limit even competition among seemingly homogenous commodities, it applies all the more to interfuels competition which takes place among commodities with clearly noticeable differences in physical aggregates and use characteristics.

This fact has obvious implications on Government fuels policy. For whenever a consumer is forced by Government policy to change from his preferred fuel to another less desirable, he is generally not just alternating between fully interchangeable commodities but is made to substitute the fuel which he considers best for his purpose by one less well suited. Because of this limitation in the interchangeability of fuels - even when used for the same purpose - a restriction in consumers' fuels choice is likely to cause a reduction in the overall efficiency of fuels utilization. Hence, the aim of any Government fuels policy under our economic system should be to keep intervention with consumer fuel preferences to a minimum, commensurate with the Government's general responsibilities towards the national welfare and security.

UNEQUAL COMPETITION

Effective interfuels competition is also limited by the fact that while some energy suppliers must rely on the mechanism of market competition for the determination of prices and profits, in the case of others both prices and profits are largely determined by Government regulation.

(*) The most obvious example of the latter are, of course, the producers, transporters and distributors of gas and electric power whose activities are generally subject to federal, state, and local Government regulation. To the extent to which these businesses are bona fide utilities such regulation is necessary and desirable. Historically, its impact on non-regulated fuels suppliers has been limited, since utility gas and electricity was used principally for purposes other than space heating and thus did not compete widely with oil and coal. In the last decade, however, gas has emerged as a major space heating fuel and electricity is now making rapid inroads into the same field. Fuel oil marketers are therefore faced by monopolistic competitors whose rates of return and economic continuity are assured by Government decree.

- - - - -

(*) This paragraph expresses only the views of the Petroleum Industry Research Foundation, Inc. and not necessarily those of the Independent Fuel Oil Marketers of America.

(*) No solution to this problem of unequal competition has yet been suggested. But it has already had a serious impact on fuel oil marketers throughout the United States and we believe more attention should be given to the problem than has been done up to now. One possible avenue of partially redressing the unequal competitive balance might be to require the exclusion from the utility rate structure of all expenditures incurred specifically to combat competition from other fuels.

Another aspect of unequal competition arises from the allocation of individual residual fuel oil import quotas. Many residual fuel oil marketers must compete - directly or indirectly - with other fuels. However, while their supply is limited by means of the government imposed quotas, the marketers of competing fuels have no such restrictions. All residual fuel oil marketers whose own supplies are inadequate to meet their customers' requirements are likely to suffer from the effect of this unequal competition, regardless of the overall level of permissible residual fuel oil imports. The only real solution to this problem would be the abolition of these imports restrictions.

SUMMARY

In conclusion we would like to reiterate that the self-adjusting process of consumer choice and market competition -- despite its inherent limitations -- has generally succeeded in channelling the various fuels into their most efficient uses. We believe this process can be relied on to continue to serve this purpose. As a matter of policy, therefore, we must resist any tendency toward end-use controls. They would distort the economic allocation of our energy resources, do harm to the energy industries themselves and counter the best interests of the consumer. If for no other reason, U. S. policy should avoid end-use controls simply because they are unnecessary. The outlook for each of the major sources of energy is one of expansion, not contraction; of prosperity not poverty. But this outlook can only be realized in an environment of competition. Only in this way can our country reap the benefits of a strong and healthy energy economy.

(*) This paragraph expresses only the views of the Petroleum Industry Research Foundation, Inc. and not necessarily those of the Independent Fuel Oil Marketers of America.