Federal Energy News

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REMARKS OF THE HONORABLE FRANK G. ZARB
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BEFORE THE

INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA
MADISON HOTEL
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FOR IMMEDIATE RELEASE

Thank you for inviting me to speak to your meeting. I know there has been some criticism by members of your association for the President's energy tax proposals -- expecially the windfall profits tax.

Keep in mind that we aren't locked into a final program. We do know the approach we want to take and the goals we want to achieve. But we are still running numbers and evaluating specific options. We know the health of your industry is vital to our energy goals. And we know you need reasonable profits to maintain that health.

We at FEA are working closely with the Treasury Department to see that the final program that goes to the Hill keeps you in business and keeps our 1985 energy independence goals on line.

That's one of the main reasons I am here today. To give you our thoughts on how things are shaping up and to get your thinking on how they can be improved.

Let me say at the outset that I don't expect us to reach 100 percent agreement on these issues today. But I hope our dialogue will provide a good give and take of opinion: that I can provide some insight into the rationale of the program and that you can share with me whatever doubts you may have about it. I'm sure that, when we get to our question-and-answer session, you will fulfill your side of this exchange, and I'll start trying to fulfill mine right now.

The problems we face as a Nation are interrelated and inseparable. So are the actions necessary to solve them.

The President's program for energy and the economy is a comprehensive package designed to do just that. It is interrelated and, largely, inseparable. Some critics have said that it is complicated; of course it's complicated because our energy and economic problems are as challenging as any we have faced in a generation. There may be people who would take aspirin when the doctor calls for brain surgery, but they won't be around for long. Right now, in the fields of energy and economy, major surgery is required. And that is what the President has prescribed -- not some so-called "simple" remedy that would just prolong and compound our difficulties.

In broad outline, our energy program has two elements: first, short-term conservation -- conservation that requires both American consumers and American industry to make sacrifices so that we can curb our 40 percent dependence on foreign energy. And second, a long-term program that entails continuing conservation and measures to provide incentives for, and promote production of, domestic energy from both conventional and unconventional sources.

The President had to make some critical choices in coming up with an effective plan. After all, the quest for all of our national goals -- for energy independence, protection of the environment, economic recovery and growth -- involve conflicts. And while we can't afford to lose sight of any one goal, we have to adjust our priorities to the situation we face at any given time. I think that the President weighed the tradeoffs carefully and offered the Nation the balanced program that it needs for 1975, the remainder of the '70's, and the decade ahead.

Because price is the best regulator of commodity demand and consumption, the President has proposed a market solution to accomplish our conservation goals. The increase in license fees on oil imports is the first step.

An equivalent excise tax will also be levied on domestic oil and gas to further dampen demand and head off any shift from oil to natural gas, which, of course, is already in extremely short supply. These steps should reduce our dependence on imports and excessive energy consumption in general.

The Treasury Department is still working our details on these proposals -- how the taxes will be collected, when, and from whom -- purchasers or producers. A final legislative draft will be completed and sumitted to Congress within the month.

Before I get into the specifics, I'd like to touch briefly on the basic facts and assumptions about energy and the oil industry that were used in developing these proposals.

Natural gas and oil account for three-quarters of the country's energy consumption and they aren't going out of style. We all know that, for the next decade or longer, they will continue to supply the bulk of our energy. We started with those facts.

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Then, we considered the make-up of the oil industry. The breakdowns between majors and independents in expenditures, production and exploratory drilling, as well as capital needs, were all factored into our analysis.

We were convinced that price uncertainties and differentials had to be eliminated and a stable market condition established for the domestic oil and gas industry if we were to meet our long-term energy production goals. With sixty percent of domestic production coming from "old" oil at a price-controlled $5.25 a barrel, the decline in production over the part year from 9.2 to 8.8 million barrels of crude a day signaled clearly that price controls are counterproductive to increased supplies.

No discussion of change in oil industry taxes would be complete without considering the percentage depletion allowance. The depletion allowance, as you know, is the most popular target around whenever the oil industry comes under attack. Eliminating the depletion allowance would cause some pain to the major oil companies, but it would really hurt you independents. We have reached the conclusion that the cost of this damage is too high both for your industry and for the nation in terms of curtailed exploration and production.

Unless some other method can be found to help inedpendent producers attract outside capital and maintain an adequate cash flow, we feel the depletion allowance should be retained.

Two other basic proposals being assessed will combine price decontrols with some type of windfall profits tax.

As you know, price controls were originally imposed to prevent industry profiteering at consumer expense. But their effect has been to hold down production more than excessive industry revenues. It's clear that the high cost of production from stripper wells and those that need secondary and tertiary recovery methods aren't economic at controlled prices.

To provide the production price incentives necessary to get us to independence by 1985, the President proposed decontrol of all domestic oil prices.

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This will eliminate the inefficiencies and inequities of the two-tier price system and effectively remove government from the pricing end of the oil marketplace for a substantial period of time.

Now, let's look at the other side of this same equation. The world market price of $11 oil is just as artificial and as arbitrarily set as the present controlled price of $5.25 for "old" domestic crude.

Allowing domestic crude to rise to the same level as the cartel-dictated price for international oil, when general exploration and operating costs cannot justify such an increase, will result in an economic distortion. Namely, some sectors of the economy could benefit unfairly at the expense of the rest of the economy. The windfall profits tax is designed to see that this does not happen.

At the same time, the tax is being structured to recapture only that part of industry profits that are over and above costs, including an inflation factor, and a reasonable rate of return. In no event may the windfall subject to tax exceed 75 percent of NET income from a barrel of oil.

I realize that those of you with small drilling and production operations fear that the short-term profit sacrifices may outweigh the long-term benefits and limit new exploration and production.

I understand both your concern and your point of view. But I cannot agree with your conclusions. Most of you were probably in this business two years ago when oil prices ranged between $3 and $4 a barrel. The President's proposed base price effectively doubles your returns over 1973 levels. Studies on operating and production costs, including this Association's last report, indicate that your costs for this same period rose about 30 percent -- on less than one-third of projected profit increases, even with the windfall tax.

We feel this substantial increase in profits over historic levels, coupled with the elimination of government interference in oil pricing, will provide adequate incentives for increased exploration and production.

By way of conclusion, let me say that I wouldn't be here today if I didn't believe that the President's overall program -- even with the required sacrifices -- is the best way to get this country back on the road to energy self-sufficiency -- to provide energy at the lowest cost of all Americans, while maintaining a profitable rate of return for your industry.

I would urge you to consider our program as a whole. There may well be some features of it that disturb you. But I am convinced that you cannot only live with most of it, but live with it comfortably and profitably.

In other words, I'm asking you to look at the big picture. That is what George Mitchell of TIPRO (Texas Independent Producers Organization), for example, did when he testified for the Energy Resources Council last December. He devoted much of his statement to the need to increase natural gas production. That's part of the Administration's price deregulation strategy, and an extremely important part. We are convinced that the deregulation of new natural gas field prices is essential if we are ever to have any hope of bringing natural gas demand and supply back into balance. Here, too, is another area where bandaids won't do the job. Surgery is needed, and our new natural gas bill reflects our convictions.

The Administration's program makes demands and requires sacrifices; but it does so with an even hand -- with minimal overburdening of any single segment of society. Furthermore, its thrust is in the mainstream of America's economic traditions. Seldom, if ever before, has a government sought to grapple with problems so vast with such a minimum of "social engineering." To the maximum degree, the President has avoided the "Big Brother" approach, which some of his critics are all too eager to embrace; instead, he has tried to harness the positive forces of the marketplace -- of the free economy -- to solve our energy problems.

That is an approach which was strongly endorsed by George Mitchell in his testimony and an approach which I'm sure most of you favor.

There may well be elements of the Administration's program with which you disagree. And, no doubt, our ultimate national energy policy -- as it evolves from the give-and-take among Congress, the Administration, interested organizations like the I.P.A.A. and others -- will not be an exact duplicate down to the last decimal point of what we have proposed. But in your consideration of it -- and in your efforts to influence the outcome of the present debate here in Washington -- I would ask you to bear in mind just one or two things. It is not the President who has proposed an unworkable, ineffective and counter-productive rationing scheme; it is not the President who has proposed a new, federally-sponsored corporate oil giant; it is not the President who has proposed elimination of the depletion allowance.

What he has proposed is a balanced, and sound -- if somewhat painful -- remedy to our energy ills. We may not all like the taste of the prescription, but -- as you well know -- there are plenty of people standing by with far larger doses of far more disagreeable medicines -- medicine which, furthermore, wouldn't solve the problem. The President's program will, and I hope you will give it -- and the likely alternatives -- most careful consideration in determining which you wish to support.

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