INTERIM REPORT OF THE NATIONAL PETROLEUM COUNCIL'S COMMITTEE ON CAPITAL AND MATERIALS REQUIREMENTS FOR INCREASING AVAILABILITY OF PETROLEUM PRODUCTS

(Million Barrel Committee)

FEBRUARY 26, 1951

Headquarters

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NATIONAL PETROLEUM COUNCIL
Suite 601, 1625 K Street, N. W.
Washington 6, D. C.

February 26, 1951

C O P Y

Hon. Oscar L. Chapman
Secretary of the Interior
Washington, D. C.

Dear Mr. Secretary:

On January 29, 1951, Mr. Hugh A. Stewart, Director of the Oil and Gas Division of the Department of the Interior, addressed a letter to me as Chairman of the National Petroleum Council, in which he requested the appointment of a committee to consider the problem of capital and materials requirements to maintain indefinitely a million barrels of extra products productive capacity. This request was referred to the Agenda Committee, where it was approved and later submitted to the Council, where it was likewise approved as a matter for the Council's consideration.

In the light of this request, which I considered as of an emergency character in relation to our national security, I promptly appointed a committee to go into this subject, and Dr. Robert E. Wilson, Chairman of the Board of the Standard Oil Company of Indiana, is Chairman of this Committee. The Committee is composed of a good cross-section of all segments of the petroleum industry. For your information, I enclose a copy of the membership.

In pursuance of this request, the Committee organized promptly and has prepared an "interim" report, which Chairman Wilson has submitted to me. I feel that this interim report is of such urgent importance that I should pass it along to you and the members of your staff. You will understand that it has not been approved by the Council, but will be submitted for Council consideration at the next meeting. In the meantime, I desired that you have the benefit of the information herein contained, which bears upon this important subject relating to our national defense program.

Sincerely yours,

/s/ Walter S. Hallanan

C H A I R M A N

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enclosures

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Chicago 80, Illinois
February 26, 1951

Mr. Walter S. Hallanan, Chairman
National Petroleum Council
1625 K Street, N. W.
Washington 6, D. C.

Dear Mr. Hallanan:

I transmit to you officially the final draft of the Interim Report of our Million Barrel Capacity Committee with the suggestion that in view of the urgency of the depletion matter, you consider forwarding same promptly to Honorable Oscar L. Chapman, Secretary of the Interior.

Sincerely yours,

/s/ Robert E. Wilson
c
Robert E. Wilson, Chairman
Committee on Capital and Materials
Requirements for Increasing Availability
of Petroleum Products
(Million Barrel Committee)

Enclosure

INTERIM REPORT OF THE

NATIONAL PETROLEUM COUNCIL'S

COMMITTEE ON CAPITAL AND MATERIALS REQUIREMENTS

FOR INCREASING AVAILABILITY OF PETROLEUM PRODUCTS

(Million Barrel Committee)

FEBRUARY 26, 1951

At the meeting of the National Petroleum Council in Washington, D. C., on January 30, 1951, Mr. H. A. Stewart, Director of the Oil and Gas Division of the Department of the Interior, advised the Council that "Preliminary studies of the Petroleum Administration for Defense indicate that in the event of war there will be need for a significant increase in the availability of petroleum products to meet military and civilian requirements", and requested the Council to make a study of the quantities of capital and material needed to provide a million barrels daily of petroleum products over the average of those produced between November 1, 1950 and January 1, 1951, all of this increase to come from the Western Hemisphere. The National Petroleum Council appointed a Committee under the Chairmanship of Dr. Robert E. Wilson, and at a meeting in New York on February 12th this Committee adopted the present memorandum as an interim report. Further reports dealing with the various phases of the subject are in the hands of Subcommittees appointed for the purpose.

Solely to maintain the production in the United States of approximately 6,000,000 barrels of crude oil daily will require not only a continuation of the present vigorous campaign of exploration and development but, - due to the increasing cost and difficulty of finding substantial new oil deposits -, a steady increase in such activities. To provide a material portion of the proposed additional million barrels daily will require the finding of new oil deposits with an ultimate yield of several billion barrels and will demand a still further large expansion of all phases of production activities; geological and geophysical exploration, drilling of wildcat wells, and rapid development of new fields when discovered. Most of the capital required for this purpose must be provided by the operations of the producing branch of the oil industry itself. This, of course, applies specifically to the independent operators who do the larger part of the country's wildcat drilling and whose activities are limited to the producing branch of the industry.

A sound and far-sighted tax policy providing for percentage depletion has for many years been of the greatest importance in providing the Nation with a plentiful supply of low cost petroleum products, by attracting capital and by enabling oil operators, large and small, to plow back income in order to continue and expand the hazardous and increasingly costly search for new oil resources. A reduction in percentage depletion as now proposed by the Secretary of the Treasury would automatically result in a serious curtailment of exploratory activities. This would be directly contrary to the objectives of the Government as expressed at every recent meeting of the National Petroleum Council by Secretary of the Interior Chapman, speaking as Petroleum Administrator for Defense, who has consistently urged upon the industry a maximum exploratory effort.

A depletion deduction for the oil industry similar to that now in effect was established by the Congress at the end of the First World War. Solely for the purpose of simplifying administration it was changed in form, but not in substance, in 1926, and has remained in force without change since then. For the same period intangible drilling costs (labor, transportation, etc.,) have been deductible as operating costs in determining taxable income of the oil producing industry.

That Congress acted wisely in establishing these measures is evidenced by the fact that the Nation's estimated proved oil reserves are almost five times as large as at the end of 1918, notwithstanding an increase in consumption of nearly 400% during the period. At the same time, the retail price of gasoline (excluding taxes) is approximately 20% less than the 1918 price, and for a far superior product.

The industry was able to supply the enormous quantities of oil required by the United States and its allies during the Second World War, only because of the large reserves and great producing capacity built up, due to the action of Congress mentioned above. With smaller reserves and fewer wells it would not have been possible to meet the requirements of the last war. The Treasury's proposal would inevitably cause a drastic curtailment of the search for, and development of, new oil resources in this country.

If the present percentage depletion had never been established, the oil industry could, and would, of course, have adjusted itself to the condition that would then have prevailed. It would, however, have meant a greatly reduced volume of exploratory work, with consequent much lower national reserves and producing capacity, plus very much higher prices for gasoline and all other petroleum products, and with steadily increasing dependence on foreign production. The present industrial and agricultural productive capacity in the United States has been built upon a plentiful supply of low cost petroleum products.

The tax proposals of the Treasury Department would seriously and adversely affect the exploratory and development activities of all elements within the industry, but would naturally fall most heavily on the smaller companies and independent operators who as wildcatters have discovered a large percentage of the Nation's oil resources. It is common practice among independent operators to have recourse to bank loans for the development of their producing properties. The adoption of the Treasury's proposals would seriously impair their ability to obtain such loans and to repay those now outstanding. Many operators would be thrown into bankruptcy or forced to sell their holdings at sacrifice prices.

In respect of the vast majority of independent operators and smaller companies it can be stated that any reduction in income, whether through higher taxes or for other reasons, means less money available for exploration. The absolutely necessary expenses of the operators will have to be met; exploratory activities constitute the expense item most easily susceptible of reduction or elimination and, therefore, will be immediately curtailed. In the interest of national security, however, these are the very activities which should be stimulated and increased to a maximum extent.

The acceptance of the Treasury's proposal would deal a death blow to a vast number of secondary recovery operations with the permanent loss to the Nation of an estimated several billion barrels of oil which cannot be recovered by ordinary methods of production.

A serious reduction in new oil discoveries such as would result from adoption of the Treasury Department's proposals would lead to inability to meet current demands and would be bound ultimately to cause higher prices for petroleum products. Therefore, the Treasury Department is in effect proposing a step that would be distinctly inflationary in nature.

It should be pointed out that if the Treasury Department's recommendations are followed and the inevitable result of this action shows itself in the dwindling of new discoveries and development work, the downward trend cannot then be reversed on short notice by a reinstatement of present tax measures. The search for oil is a continuing and long-term operation, involving geological and geophysical exploration, acquisition of long-term leaseholds, curing of titles, drilling of wildcat wells, etc. New oil fields cannot be found and delivered on short notice, no matter how great the urgency.

The Treasury Department has repeatedly stressed the supposedly large additional revenue that would result from the enactment of its proposals. However, any estimate of additional revenue based on the increase in taxes which the oil industry would pay if the Treasury

Department's suggestions were followed is largely illusory for the reason that losses of revenue in other directions would be directly caused thereby. Reduced operations of hundreds of drilling and hauling contractors, geophysical survey companies, etc., losses of income by thousands of lease brokers and by tens of thousands of farmers in the form of reduced income from lease bonuses and rentals, would result in reduced tax collections from these sources which should be offset against any added revenue estimated to be collected from the oil industry. Furthermore, many other industries and activities which have been built up on the basis of cheap and abundant oil products would be adversely affected with resultant loss of revenue to the Treasury. Therefore, the Treasury's proposal would be largely self-defeating.

Whatever the net amount of added revenue may be -- if any -- it will in any case amount to only a very minute fraction of the Budget, and the price paid for an insignificant amount of additional tax collections would be a drastic curtailment of the exploratory effort of the industry and especially of the independent operator who in the past has been responsible for the finding of a very large percentage of the country's oil reserves. This would occur at the very time when the oil industry is being urged by the Government to carry out a maximum amount of exploration as an important part of the country's defense program.

From the point of view of national revenue, it should be emphasized that the production of vast volumes of oil products - especially gasoline - at cheap prices has provided the Federal and State Governments with a highly productive source of revenue, yielding each year a return many times greater than the relatively small amount which the Treasury Department claims it could have collected from the oil industry in additional taxes by the proposed changes in percentage depletion. A materially higher cost of gasoline, which would have obtained if the Congress had not had the wisdom and foresight to enact the present percentage depletion, would not have left room for the high gasoline taxes now prevailing.

Quite apart from the paramount question of national security through adequate oil supplies, and considered solely from the viewpoint of production of revenue, the depletion provision which has been in effect for nearly a third of a century, far from entailing a loss of tax revenue, has in effect been a most profitable policy for the Government.

Respectfully submitted,

Robert E. Wilson, Chairman

Committee on Capital and Materials Requirements
For Increasing Availability of Petroleum Products
(Million Barrel Committee)

COMMITTEE ON CAPITAL AND MATERIALS REQUIREMENTS
FOR INCREASING AVAILABILITY OF PETROLEUM PRODUCTS

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