

A National Policy
FOR THE
Oil Industry

BY
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For E. G. R.

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Note to Third Printing

This printing corrects the text in a few details, but does not undertake to bring the material thoroughly up to date.

E. V. R.

*New Haven, Connecticut
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SHORT FORM REFERENCES

The following short form citations will be used in the notes:

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TNEC HEARINGS AND MONOGRAPHS: United States Congress, Temporary National Economic Committee, Pursuant to Pub. Res. No. 113 (75th Cong.), 76th Cong., 2d and 3d Sess., Investigation of Concentration of Economic Power (1939-41);

COOK: COOK, CONTROL OF THE PETROLEUM INDUSTRY BY THE MAJOR OIL COMPANIES, TNEC MONOGRAPH NO. 39 (1941);

COLE COMMITTEE HEARINGS: United States House of Representatives, Sub-committee of the Committee on Interstate and Foreign Commerce, on H. Res. 290 and H. R. 7372, 76th Cong., 2d Sess., *Petroleum Investigation* (1939);

BAIN: J. S. BAIN, THE ECONOMICS OF THE PACIFIC COAST PETROLEUM INDUSTRY; PART I, MARKET STRUCTURE, (1944);

BAIN: *id.*, PART II, PRICE BEHAVIOR AND COMPETITION (1945); Part III of Professor Bain's study, PUBLIC POLICY TOWARD COMPETITION AND PRICING (1947) became available after this paper went to press.

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PREFACE

THE purpose of this study is to investigate the forces which determine the level of prices and output in the petroleum industry; to examine the functioning of the system of law which defines public policy towards that industry; and to consider alternative courses of action for the industry which might be pursued in the national interest. Oil is more than one of the largest of American industries, in terms of the money, steel and men engaged in producing and selling it. Oil is an essential weapon of modern war, and oil policy must be judged ultimately from the point of view of national security.

The concern of the inquiry, moreover, is not only to analyze the petroleum industry for its own sake, but to weigh in this important instance the practical applicability of more general hypotheses about desirable national policy for the organization of industry.

The basic hypothesis of the investigation is that the organization of industry is a matter of central consequence to national policy in at least three particulars.¹ First, industrial structure is important in relation to the simple issues of economic welfare. Do petroleum products cost more than they might? Is an appropriate share of the national resources being devoted to the production of petroleum products? Is an appropriate share of the national income going to the sellers of such products? Would we get more for our money by importing more petroleum products, or exporting less?² Secondly, industrial organization is to be appraised in connec-

1. This paper is part of a larger inquiry into the functioning of our system of public law for the control and direction of the national economy. In the course of that study it is hoped that the hypotheses of these paragraphs will be appraised systematically and in detail.

2. The general literature about the price and output problems of large-scale industry has become formidable. It is marshalled in:

CHAMBERLIN, *THEORY OF MONOPOLISTIC COMPETITION* (5th ed. 1946), with supplemental bibliography (1941) 56 Q. J. ECON. 160; A. R. BURNS, *THE DECLINE OF COMPETITION* (1936).

tion with the trade cycle. The effect of competitive and monopolistic factors on industrial fluctuations is a matter of some controversy among economists.³ But all parties to the debate agree that the organization of industry is one of the central problems of trade cycle theory and policy. Consideration must therefore be given to the question whether changes in the business structure could make it easier to control the trade cycle, and to maintain the economy at a high and stable level of useful employment. In the third place, and perhaps most important of all, industrial organization has sociological and political results.⁴ One of the major problems requiring a social decision in our time is whether we could achieve a wider dispersal of power and opportunity, and a broader base for the class structure of our society, by a more competitive organization of this and other industries, in smaller and more independent units.

The degree of competition in the organization of industry will have a good deal to do with determining whether we

3. O. LANGE, *PRICE FLEXIBILITY AND EMPLOYMENT* (1944); A. P. LERNER, *THE ECONOMICS OF CONTROL* (1944); A. NEAL, *INDUSTRIAL CONCENTRATION AND PRICE INFLEXIBILITY* (1942); Bissell, *Prices, Costs and Investment* (1941) 31 *AM. EC. REV. SUPP.* 200; Boulding, *In Defense of Monopoly* (1945) 59 *Q. J. ECON.* 524, and *Comments* (1946) 60 *Q. J. ECON.* 612, 615, 619; Edwards, *The Relation of Price Policy to Fluctuations of Investment* (1938) 28 *AM. EC. REV. SUPP.* 56; Hansen, *Price Flexibility and Full Employment of Resources*, in *National Resources Committee, The Structure of the American Economy, Part II* (1940) 27; Lavington, *Monopoly and Business Stability* (1926) 6 *ECONOMICA* 135; Mason, *Price Policies and Full Employment*, in 1 *PUBLIC POLICY* (1940), ed. by C. J. FRIEDRICH and E. S. MASON, at 25; *id.*, *Price Inflexibility* (1938) 20 *REV. ECON. STAT.* 53; Simons, *Economic Stability and Antitrust Policy* (1944) 11 *U. OF CHI. L. REV.* 338; Wallace, *Monopoly Prices and Depression*, in *EXPLORATIONS IN ECONOMICS, NOTES AND ESSAYS IN HONOR OF F. W. TAUSSIG* (1936), at 346. For another view, see De Haas, *Economic Peace Through Private Agreements* (1943) 22 *HARV. BUS. REV.* 139; J. SCHUMPETER, *CAPITALISM, SOCIALISM AND DEMOCRACY* (1942) ch. 8.

4. A fourth important aspect of the problem is the connection between the organization of business and the rewards of labor: the extent, that is, to which monopolistic factors in the structure of industry lead to labor "exploitation" in the economic sense. J. ROBINSON, *THE ECONOMICS OF IMPERFECT COMPETITION* (1933) Book 8. While it is undoubtedly true as a general proposition that elements of monopoly in the structure of the market for a commodity tend to permit the sellers of the commodity a favorable division of total income, as compared with labor less monopolistically organized, problems of wage policy have not been of special or peculiar importance in the petroleum industry, and will not be considered at length here.

remain a community long capable of social and political democracy. It should be easier to achieve the values of democracy in a society where economic power and social prestige are more widely distributed, and less concentrated, than in the United States today. Moreover, monopolistic concentration would make direct state controls, and the ultimate socialization of industry, far more likely than a regime of competitive smaller business. Concentration works towards enlarging the necessary direct economic control functions of government, and narrowing the permissible scope of private enterprise. In our society monopoly is bound in the end to be regulated or reorganized; government can safely allow it far less freedom than competitive business. Men like Mises and Hayek, and their followers, who fear and distrust the modern growth of the state and its powers, should especially favor measures to increase the importance of competitive influences in the organization of industry.⁵

One of the principal topics to be investigated, therefore, is whether in the petroleum industry, as a case in point, there are significant monopoly factors affecting market structure, and whether it would be legally and technically feasible to seek a more competitive pattern of organization for the industry.

The conclusion of this study is that the oil industry is monopolistic in its organization to an important extent; that a more competitive form of organization would be economically and socially desirable, and should be available as a practical matter under the construction of the Sherman Act which has recently been developed by the courts; and that a reorganization of the industry in the interest of competition would not involve giving up the economies of the large scale of production, or other technological advantages, but should on the contrary result in the elimination of important wastes associated with excessive size and monopoly.

In the oil industry, as in many others, the large size of the corporate units of ownership and management is not a necessity, based on technological imperatives; nor on balance does

5. See F. HAYEK, *THE ROAD TO SERFDOM* (1944) 35-38.

the large size of the business unit result in important technological advantages.⁶ The unit of optimum efficiency in all phases of the oil industry is far smaller than the principal units of corporate organization. The bigness of the big integrated oil companies is a device to permit them to obtain the profits and security of monopoly; it has substantially nothing to do with their efficiency or their costs. A program designed to increase the competitive character of the industry would not in any sense be a turning back to an earlier era of "horse-and-buggy" technology or business. On the contrary, it would be an indispensable part of the economic policy which in our

6. The history of many corporations is the best possible evidence of the motivation for their growth. In instance after instance the motive for growth appears to have been the quest for monopoly power, not the technological advantages of scale. The formation of the Sugar Trust in the eighties, for example, involved the amalgamation of 17 refining companies, owning 20 out of 26 American refineries, representing 78 per cent of refining capacity. The companies subject to the amalgamation were capitalized at \$6 million at the time of their union; the combination was capitalized at \$50 million. One result of the combination was the destruction of refineries, as well as price increases. PEARCE and others, TRADE ASSOCIATION SURVEY, TNEC MONOGRAPH No. 18 (1941) 106 ff.; *People v. North River Sugar Co.*, 121 N. Y. 582, 24 N. E. 834 (1890); *United States v. E. C. Knight Co.*, 156 U. S. 1 (1895).

Similarly, in the steel industry, the component parts of the United States Steel Corporation were purchased at inflated prices, in anticipation of the profits of combination, "upon a scale that was huge and in a manner that was wild." *United States v. United States Steel Corp.*, 223 Fed. 55, 167 (D. N. J., 1915), *aff'd.* 251 U. S. 417 (1920). Judge Woolley's conclusions—and his analysis was specifically approved by the Supreme Court, 251 U. S. at 442—was that "combinations were created by acquiring competing producing concerns at figures not based upon their physical or their business values, as independent and separate producers, but upon their values in combination; that is, upon their values as manufacturing plants and business concerns with competition eliminated. In many instances, capital stock was issued for amounts vastly in excess of the values of the properties purchased, thereby capitalizing the anticipated fruits of combination. The control acquired over the branches of the industry to which the combinations particularly related measured by the amount of production, extended in some instances from 80 per cent to 95 per cent of the entire output of the country, resulting in the immediate increase of prices, in some cases double and in others treble what they were before, yielding large dividends upon greatly inflated capital." 223 Fed. at 167.

Comparable experience can be advanced in many other industries. See, e.g., *The New England Investigation*, 27 I.C.C. 560 (1913), 578 ff., for account of the building up of the New Haven Railroad system, involving an increase of its capitalization from \$93 million to \$417 million during 9 years, by financial methods which the I.C.C. characterized as "wasteful in the extreme" (p. 592); *United States Bureau of Corporations, The International Harvester Co.* (1913) 1-18, chs. 2-4.

present state of knowledge offers society its best chance of meeting the universal demand for full employment and economic security, without ceasing to be free.⁷ For it is my own view, though the issue will not be fully canvassed here, that a more competitive organization of business should help to make the swings of the trade cycle less severe, to enlarge the number of private investment opportunities and greatly to facilitate the task of trade cycle control. A competitive economy should be more responsive than a monopolistic one to government programs designed to maintain and expand the level of national income. A greater degree of competition in industrial organization should reduce the burden of economic enterprise falling on a modern government.

Our laws controlling the petroleum industry are a fantastic and inordinately complicated patchwork of State and federal regulation, and of industrial self-regulation.⁸ They rest on a premise of constitutional law which is no longer tenable: namely, the proposition that mining is not "commerce among the several States," and therefore that the production of oil is outside the power of the federal government. Our system of oil law is wasteful and expensive; its consequences have no connection with its avowed purposes. It permits and strengthens monopolistic patterns of policy for an industry which, in an appropriate legal environment, might serve the community as a model of the social and economic benefits of competition.

In view of the richness and quality of the literature about oil, this book has a restricted purpose. Except as made desirable by the accumulation of recent data, it attempts to

7. For aspects of the conception of policy out of which an economic program for American democracy can be built see M. POLANYI, *FULL EMPLOYMENT AND FREE TRADE* (1945); W. H. BEVERIDGE, *FULL EMPLOYMENT IN A FREE SOCIETY* (1944), [and review by SIMONS (1945) 53 J. POL. ECON. 212]; G. CROWTHER, *ECONOMICS FOR DEMOCRATS* (1939); S. FINE, *PUBLIC SPENDING AND POST WAR ECONOMIC POLICY* (1944); B. WOOLTON, *FREEDOM UNDER PLANNING* (1945).

8. A useful bibliography of materials on the oil industry appears in COOK, 53-55.

avoid going over ground well described in earlier work by Ise, Stocking and Watkins. It is planned rather as an essay, to evaluate the possibilities of a positive oil policy in the public interest, giving to the criteria of public interest a specific definition, and specific content, in the light of the law, economics, technology and politics of the problem.