JOINT ECONOMIC COMMITTEE
SENATE REPUBLICANS

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**OPENING STATEMENT OF**
**SENATOR SAM BROWNBACK**

**JOINT ECONOMIC COMMITTEE HEARING**

# IS MARKET CONCENTRATION IN THE U.S. PETROLEUM INDUSTRY HARMING CONSUMERS?

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Today's hearing focuses on whether merger activity in the energy sector has increased market concentration, possibly leading to higher gasoline prices. We are all well aware of recent re-acceleration of gasoline prices, as we prepare to enter the summer driving season. It seems that each spring, just before the summer driving season, gasoline prices rise, and we repeatedly hear that one significant factor is "lack of refining capacity." We also hear every year that conspiracy and collusion among oil companies contributes to higher prices, as various political entities accuse "big oil" of purportedly withholding inventories in order to take advantage of our nation's current high demand for gasoline.

When I think about the evaluations an energy company must make when deciding whether to construct a new refinery, I think about a complicated set of considerations. These decisions involve the long-term investment of billions of dollars. If I were deciding on such a project, I would have to think about what the energy market will look like next year, in five years, in ten years, and beyond. While gasoline and oil prices are currently near record highs, where they might be five or ten years from now is difficult to forecast accurately. It is also not easy to forecast to what extent our nation will rely on ethanol or other gasoline substitutes in the future. If I were deciding on a refinery project, I would also have to consider existing and potential future environmental laws. I would have to think about potential lawsuits, and I would have to think about where to locate a new facility, given vigorous community organization around the "NIMBY – not in my backyard" concept. Given all of these factors, it is not entirely surprising that we have not seen a new refinery built in this country since the mid-1970s. We have, of course, seen large increases in the capacity and efficiency of our existing refineries.

We must also address the notion that energy companies engage in conspiracy-oriented activities to withhold gasoline supply in order to drive up prices. First, given that over half the cost of every gallon of gasoline is attributed to the cost of crude oil, which is set on the world market, and also given that gasoline prices have closely mirrored crude oil prices for many years, it would seem clear that world crude prices have much to do with gasoline prices. Further, it should be mentioned that U.S. gasoline prices are set based upon trading activity primarily on the New York Mercantile Exchange (NYMEX). Given that North America – predominately the U.S. – contains about 25% of the world's crude oil refining capacity, almost all of which is currently being utilized, it would be hard to make a legitimate case stating that the large oil companies are constraining supply to raise fuel prices. Finally, given all of this evidence – in addition to the fact that over 95% of our nation's fueling stations are independently owned, as opposed to ownership by the large oil companies – it is impossible to see direct price setting schemes undertaken by "big oil".

One of the questions before the Committee today seems to be whether recent high gasoline prices somehow reflect increasing market concentration, as a result of merger activity, allowing energy companies to, quoting from the majority's Joint Economic Committee website, "…raise their prices above competitive levels and strategically withhold capacity to keep prices high…"

It is useful that we have a representative of the Federal Trade Commission here today. The FTC is, of course, charged with the authority to police anticompetitive practices in our nation's markets. The FTC has a very capable staff of professionals who, from what I can tell, monitor the energy sector, including short-term and long-term fluctuations in gasoline prices, very carefully. The FTC has taken numerous steps over time, including actions in the midst of a wave of merger activity in the energy industry in the 1990s, aimed at ensuring that competitive forces remain at work in our nation's energy sector.

The FTC has published three studies since 1982 (the latest in 2004) analyzing mergers and structural changes in the petroleum industry and antitrust enforcement actions undertaken in the industry in the past 20 years. According to these studies, over the past two decades (paraphrasing today's testimony from the FTC):

- Mergers of private oil companies have not significantly affected worldwide concentration in crude oil (important given that crude oil prices are the chief determinant of gasoline prices).
- Concentration for most levels of the U.S. petroleum industry has remained low to moderate.
- Economies of scale have become increasingly important in shaping the petroleum industry. The U.S. has fewer refineries than it did 20 years ago, but the average size, efficiency, and total output of refineries have increased.

So, my reading of the evidence compiled by the professional staff at the FTC is that there has not been a significant increase in concentration or anticompetitive practices in the energy sector.

It is also useful that we have a representative of the U.S. Government Accountability Office here today. The GAO has performed analyses showing that merger activity has led to small increases in gasoline prices. While the GAO study investigated price effects after mergers have taken place, the FTC typically analyzes the potential for anticompetitive effects of proposed mergers, before they occur. The FTC, however, has argued that past GAO studies of effects on gasoline prices of merger activity in the energy sector has been, to quote FTC congressional testimony given in 2004, so "fundamentally flawed" that its quantitative analyses are "wholly unreliable."

As I mentioned earlier, the evidence on effects of industry concentration on gasoline prices does not appear to show that energy companies "strategically withhold capacity to keep prices high.” Rather, it seems that we are facing what Al Gore might label an inconvenient truth: Gasoline price spikes are not the result of monopolistic, evil-intentioned energy companies. Rather, the price spikes might just be representative of a well-functioning price system that efficiently allocates a scarce resource and encourages conservation in times of tight supply.

Fundamentally, recent increases in gasoline prices reflect the operation of the laws of supply and demand – laws which no amount of legislation or regulation will appeal. Given the high-capacity utilization of existing refineries and refinery potential near to levels of demand, even small shocks to the refinery sector, such as a spike in crude oil prices or unplanned refinery shutdowns, can cause temporary spikes in gasoline prices. Those increases in gasoline prices are precisely what are needed to ration the existing supplies. The U.S. has a history of attempts to interfere with that price system, through the use of price controls. The result was rationing by lines, rather than dollar prices, infuriating many consumers. The price mechanism is a much more efficient allocation system and is the centerpiece of the U.S. economic system.

Temporary spikes up in gasoline prices may cause drivers to cut back on discretionary driving, although continued growth in gasoline demand despite high prices suggests that consumers are braving the higher prices and continuing to drive. More persistently high gasoline prices do exactly what the price system should do – they provide an incentive for demanders to alter their investment patterns. If consumers and businesses expect high gasoline prices to remain, they will change their investments toward more fuel efficient forms of transportation.

Nobody likes high prices. Another inconvenient truth, however, is that there are tradeoffs in economics, as in life. High energy prices mean that consumers are left with less discretionary income after purchasing energy products. No consumer likes that. High energy prices also mean, however, that a scarce resource is being allocated toward the highest valued uses. Everyone who participates in the U.S. market-based economy can appreciate that, even though it hurts at the pump. The evidence I have sited during my remarks, as well as evidence presented by the FTC in today’s testimony, indicates that high gasoline prices are primarily a result of high world crude oil prices and high demand, both in the U.S. and around the word – not industry concentration within the energy sector or the withholding of supply.