Jerry Jordan's Testimony to the House Judiciary Committee

Testimony Of Jerry Jordan On Behalf Of The Independent Petroleum Association of America And The National Stripper Well Association Before The Judiciary Committee U.S. House of Representatives

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Mr. Chairman, members of the committee, I am Jerry Jordan, President of Jordan Energy, Inc. of Columbus, Ohio. Today, I am testifying on behalf of the Independent Petroleum Association of America and the National Stripper Well Association. IPAA represents independent oil and gas producers, the segment of the industry that is damaged the most by the lack of a domestic energy policy that recognizes the importance of our own national resources. NSWA represents the small business operators in the oil and natural gas industry, producers with stripper or marginal wells.

This hearing is addressing a key question – solutions to the competitive problems in the oil industry. To best address this threat it is essential to understand the current state of domestic energy and its production. We have an economy that is based on energy – from transportation to manufacturing to the Internet. More specifically, it is based on petroleum – crude oil and natural gas. And, like it or not, despite all the efforts to change the mix of energy sources, petroleum remains the predominant source and will continue to do so for the foreseeable future.

Domestically, we import about 56 percent of our crude oil demand. In all likelihood, we will not become self-sufficient in crude oil. So, the issue is how to try to limit our foreign dependency and to emphasize the most reliable of our foreign suppliers. Natural gas – on the other hand – is largely a domestic resource, and imports are mainly from other North American sources. In the future domestic oil and natural gas production will be more and more dependent on a healthy <u>independent</u> exploration and production industry – major oil companies began shifting their new production from the United States after the oil price crisis in 1986, and this pattern will continue.

Oil prices are set on a world market. The U.S. is a price taker. Independent producers are the most susceptible to shifts in prices. We were damaged the most severely during the low oil price crisis of 1998-99. We are recovering slowly, but we need stability and we need policies designed to reflect the nature of our industry

The current situation is not stable and we need to understand how vulnerable the US economy is to decisions by foreign governments. As a result of the extended low oil prices in 1998-99, capital investment in oil production throughout the world declined. Existing production was lost. In the U.S., production dropped from 6.5 million B/D to 6.0 million B/D. Worldwide, new projects were delayed which limited increases in production capacity. Meanwhile, demand continued to increase.

Excess short-term capacity worldwide is limited. Experts placed it between 3 and 4 million barrels per day before the recent OPEC action – probably closer to the lower figure. Everyone is still trying to assess exactly what production increases will result from OPEC's decisions. But, the key point is that – in the short term – the world is not awash in oil that can be supplied by opening the spigots.

Moreover, the wild card becomes Iraq. In late May or early June, the UN sanctions review is scheduled. If Iraq pulls its exports off the market – as it has before – prices can skyrocket well above current levels. Depending on the severity of the situation, the United States' only recourse could be use of the Strategic Petroleum Reserve – and that is not a long term solution.

Clearly, Saddam will use his country's oil resources to try to extracate Iraq from the straight jacket of UN sanctions. Many knowledgeable experts already want to end the sanctions. If Iraq withdraws its oil from the market, it could erode what little resolve exists in the world constrain his actions. Then, Iraq will be in a position to sell as much oil as needed to rebuild its oil industry, its armaments, and worst of all, to terrorize the world with its weapons of mass destruction.

Taken together, this shows that this important factor of our economy is in the hands of foreign rulers. We end up relying on a kingdom in Saudi Arabia to work with a radical Iranian government to stabilize oil prices. We have effectively handed Saddam Hussein the control of world oil prices that he sought when he invaded Kuwait.

These policies make no sense. But, if not these policies, what should we do? There is no single answer.

First, we must continue to work with foreign producer nations to move toward oil policies that produce the stability needed to maintain and enhance our domestic production. And, as we do, we cannot assume that other countries are willing to sacrifice their national incomes to meet our expectations that product prices should be low in the U.S.

Second, we must develop better policies to enhance and maintain domestic oil and natural gas production – we need both. Frequently, they are discovered and produced together. We must begin treating domestic oil and natural gas production as a critical element of national economic security. To do this at the federal level we must direct our efforts at the two areas where they can have the greatest effect – access to capital and access to domestic natural resources from government controlled lands and waters.

Access to Capital

Let me first address access to capital. Since domestic producers must take the world oil price, the federal government needs to look at actions it can take to improve capital flow into this critical industry. Generally, there are two areas for possible action – tax reforms and federally backed financial instruments. I want to focus on tax reforms.

Following his recent radio address, President Clinton released documents indicating that he intended to propose legislation to allow expensing of geological and geophysical costs and of delay rental payments. These are sound first steps, but more must be done.

He also indicated that he was evaluating proposals dealing with marginal wells. Action regarding these wells is essential to preserve existing production and we believe there are four key elements that should be enacted immediately:

- A 5-year net operating loss carryback;
- Eliminating the net income limitation on percentage depletion for marginal wells;
- Eliminating the 65 percent net taxable income limit on percentage depletion; and,
- Creating a countercyclical marginal wells tax credit.

Will these steps guarantee that domestic production will rebound? Nothing is certain but it will guarantee that more capital will get into this industry when it is needed. And it will avoid the mistakes of 1986 when Congress enacted Alternative Minimum Tax provisions, just as the industry needed capital to rebound from low oil prices. This was one of many factors that have resulted in the loss of about 2 million barrels per day of domestic production from 1986 to 1997.

Subsequently, we may need to look at other tax reforms that can help bring capital to this industry.

Land Access

Regarding access to natural resources, the Administration avoids dealing with the clear need to open federal lands to exploration and production. It hides behind an environmental sensitivity argument that is proven wrong by its own DOE report. It focuses on arguments against opening ANWR and avoids dealing with access issues offshore and in the Rockies where its own National Petroleum Council *Natural Gas* study concludes that some 213 trillion cubic feet of natural gas is either off limits or difficult to permit.

Access issues differ between these areas. ANWR has been closed by executive action and can be opened with the stroke of a pen. Constraints on offshore activity are both executive and legislative, through moratoriums. These are based on outdated reactions to spills occurring in the past. The Administration's own study, *Our Ocean Future*, concluded unequivocally that offshore oil and natural gas production is a success story. We need to move into the 21st century in making enlightened decisions to use these critical national resources.

Access in the Rockies won't be resolved by a single act. Here, we are dealing with a mosaic of limitations. In some areas, land has been placed completely off limits. The Antiquities Act of 1906 has been used to declare some areas as national monuments. In other areas, the Department of Agriculture is proposing to expand roadless areas in national forests that will preclude oil and natural gas development. We must also deal with permitting limitations. For example, many areas in the Rockies are limited during certain times of the year because of management plans designed to protect various species. While each plan individually provides opportunities for resource development, collectively, they interact to effectively prohibit oil and natural gas extraction. Similarly, because these are federal lands, federal agencies must permit the actions. These agencies are charged with task of developing environmental management plans for areas under NEPA. NEPA can be used to create effective, environmentally sound management plans or it can be used to delay and deny access. Frequently, the results reflect the attitude of the agency and its leaders.

If we are to provide the country with the domestic energy it deserves, we need to create national policies that allow environmentally sound development of these resources. It can be done but it will take courage to counteract environmental extremists.