



**Review of *Marine Resources of Oil and Gas: A Review of Economic Issues* by
Arlon Tussing**
By Dr. Mason Gaffney

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MARINE RESOURCES OF OIL AND GAS: A REVIEW OF ECONOMIC ISSUES

Comment by Mason Gaffney on a paper by Arlon Tussing

Dr. Tussing's paper impresses one at first as too casual. No sources are cited for sweeping, controversial allegations; subjective preferences are commingled with objective reasoning; the exposition is often foggy, terms loosely defined and variously used; tendentious codewords and catchwords creep in to shift from analysis to exhortation; and so on. One needs a very good opinion of Dr. Tussing to accept on his authority various judgments and evaluations advanced to be facts. But I do hold such an opinion, even though the present work is not the basis for it. His attitudes and judgments, formed from experience during a distinguished career in this field, carry weight and deserve serious review.

Further, the casual style is itself an artful form of persuasion. He wins our confidence by reciting standard economic premises, and by appealing to our group loyalty against ill-advised natural scientists, before leaping over to controversial doctrinal views and derivative policy ideas. The offhand style lets him marshal arguments on one side of an issue without our, and perhaps his noticing that he is screening out the other side. The result can be disarmingly persuasive, the moreso when new topics and subtopics fly by with bewildering acceleration.

To bring some order, I list below ten doctrinal positions and seven policy positions which form the core of the paper. I comment on most of them as they go by.

A. Tussing's doctrinal positions

(Tussing's position in caps; Gaffney's comment in lower case.)

1. THE DISTRIBUTION OF WEALTH AND INCOME IS UNIMPORTANT, SO LONG AS GOVERNMENT DOES NOT GET TOO MUCH OF IT. OPTIMAL ALLOCATION IS ALL THAT SHOULD

CONCERN ECONOMISTS. The damage done to good men by an education at Chicago and its colonies (in this case, both) can last a lifetime; post-hypnotic suggestions keep popping up. But we need not press this point, for Tussing moves to a worse position: on page 6 he laments that "The public debate ... focuses on ... the means by which the federal government can maximize the rent it extracts ... and hardly at all on ... maximizing ... benefits to society ..." Thus he presumes a conflict between a landlord collecting the market rent, and efficient allocation of land. On page 10, again, "...the size of the welfare benefit (is) ... a higher concern than the ability of the federal treasury to capture the whole of that benefit." To most economists these objectives are at least compatible; to some of us they are inseparable.

Put underlined words in caps.)

On page 21, he tells us that we (I obstinately refer to the U.S. Government as "we" in this context) should not have a leasing schedule, but transfer all the OCS to private hands right away, unless we believe society has a lower discount rate than private "individuals" (corporations in this case). May we not also dislike the distributive results of mass transfer of undrilled structures?

a) The financial strength to gamble on possible cash flows several decades after bidding is limited to a few giants of the Exxon class. The effect would be further to concentrate key resource control, ⁱⁿ an industry whose competitive structure is parlous at best. That aside, advance sales effectively screen out most potential bidders because few investors today can tolerate payback times as long as 10 years, let alone 30 and more as mass sales would require. Massive advance sales would quickly exhaust most buyers, and turn into a giveaway to a very few of the super-rich. b) Among speculators, the gains to wealth would be distributed more by chance than by functional contributions to the commonwealth. The results of gambling are inherently regressive. c) We will sell or lease

more advantageously if we, rather than the buyers, choose the time and place of sale or lease - a privilege accorded almost all other owners of real estate, so why not us, too? d) The industry already carries hundreds of millions (sic) of acres of undeveloped leases, well beyond its capacity to use for years, held for speculation, for sequestering private information, for preemption, and for tax shelter games. e) With every passing year that we hold back disposal, we and they all know more on which to base reasoned bids and hold-back prices, and to optimize the time of exploitation and severance. We gain the spillover benefit of information from tracts that are drilled, and cash in on drainage sales. f) The long term evolution of land disposal policies in most countries is progressive, offering real hope for better future ones, if not posthaste at least post-Watt. g) If our government be viewed as alien -- as "them," not "us" -- it is less so than the multi-national oil corporations whose influence in Washington is the cause of our alienation. We can't even learn who own their shares, but we do know many large owners are foreign, and that whoever own and control them care not for us, but use us for naval protection, a national base, and subsidies.

2. To Tussing, "FINDING AND PRODUCING OFFSHORE OIL . . . IS IDENTICAL TO . . . PRODUCING SOMETHING . . ." CONSISTENTLY, HE TREATS DEPLETION AS EITHER INCONSEQUENTIAL OR UNKNOWABLE AND HENCE TO BE OVERLOOKED. But, to many of us, finding something that already exists, and in limited quantities on a small and shrinking planet, is significantly distinguishable from producing things by labor using renewable resources. For one thing it often entails territorial expansion, with military costs and risks, and displacing other claimants. Few of us today (I hope) would follow the ultimate Chicago guru, Frank Knight, who

wrote that the cost of "killing or driving off previous occupants" of land is just another investment. For another thing, each discovery depletes the world stock of undiscovered resources to be found by later seekers. For yet another, the business of severing natural goods from the ground involves an element of stripping, so some people justly object to the word "producing." "Exploiting" may be loaded, the other way, as Jerry Milliman has complained, and "severing" may be a properly neutral term. Whatever the word, a charge for depletion is in order, and Tussing treats this with extraordinary insouciance.

As to macro-economics, payments for bonuses and royalties to landowners, private or public, are not payroll payments that make jobs in the same sense as payments to ordinary producers. Rent aside, the business is highly capital-intensive because of the uncommonly long lag between investment and recovery of capital. In a capital-short era, this trait warrants unfavorable notice. In a time of high unemployment, the passive investment in accruing values in situ is clearly inferior to the active investment that creates payrolls.

3. If "PRODUCTION GENERATES SUBSTANTIAL ECONOMIC RENTS . . . PRODUCTION IS A GOOD THING." True enough with renewable resources, but it makes sense to hold back exhaustible oil and gas while their value in situ is rising faster than money in the bank. Rent is good, but more is better. And if someone is to hold for the rise, why should we turn this over to others on the rapid part of the growth curve? One could make the case by demonstrating that government is bad at calculating optimal sales schedules, but very good at auctioning, and this is the case the industry pushes and Tussing is endorsing. But is it not suspiciously selective to argue government is inept at doing what you want, and efficient at doing what I want?

4. PRICE SIGNALS TELL US WHAT CONSUMERS REALLY WANT. This sounds like a theory of first best, with no recognition that demand for energy is heavily encouraged by various consumption subsidies. Subsidies to urban sprawl are a case in point: they may more than double the demand for gasoline in the U.S., which has created in our times the most energy-using settlement pattern ever known to man. Roll-in pricing by power utilities is another subsidy to consumption, and one could go on, and on. On the cost side, the partial repeal of the old depletion allowance has barely scratched the surface of tax preferences to oil and gas, a subject so vast that I modestly refer you to my forthcoming article in the summer 1982 NATURAL RESOURCES JOURNAL. One theme there is that the tax treatment of leasehold abandonments (an ordinary loss deduction) is outlandishly preferential, and creates a powerful tax-induced motive to play the game of leasehold acquisition. Whether I be right or wrong, the question of tax subsidies and other subsidies surely wants a look before anyone interprets industry bids for OCS leases as reflecting consumer sovereignty. Tussing seems to be following along in the pattern set by Potter/Christy, and then Barnett/Morse, of taking market prices at face value as indicators of resource values, ignoring subsidies. Not surprisingly, it leads him toward the same anti-Malthusian resource optimism that led us into the OPEC trap ten years ago.

5. THE WEIGHT OF INSTITUTIONAL BIAS IS AGAINST USING THE EXTENSIVE GEOGRAPHIC MARGIN, SPECIFICALLY OCS OIL AND GAS. While he advances a good case, I believe the weight of bias goes the other way. Space prevents expanding. See my chapter in M. Crommelin and A. Thompson (eds.), Mineral Leasing as an instrument of public policy (UBC Press, 1977).

6. CONSERVATION IS NONSENSE. SYNFUELS AND NUKES ARE ALREADY CHEAPER THAN NEW DOMESTIC OIL AND GAS, HE ALLEGES ON PAGE 1 (on what basis I cannot imagine, as these two industries emit death rattles; on page 4 HE RENEGES ON SYNFUELS.) THE FUTURE WILL BE RICHER THAN WE ARE, HE STILL BELIEVES, AND SMARTER, TOO, ^Ainspite of plummeting student performance. Here is a strong heart indeed, uninfected by the gloom of our times, still singing songs of the soaring sixties. Singing thus, he overlooks what is perhaps the best argument against conservation, that there may be no market for oil and gas during the coming depression. But this, if a good forecast, would not lead us to sink more national capital into OCS development at this time.

Depression or not, as I read America in Ruins I am persuaded that our future capital needs will far exceed the supply. Tussing's resource optimism is silently premised on there being plenty of cheap capital to develop all the new resources he lists. That premise is dangerously, demonstrably, unequivocally wrong.

7. POTENTIAL BENEFITS FROM OIL AND GAS PRODUCTION SWAMP OUT ALL ENVIRONMENTAL DAMAGES THAT MIGHT RESULT. "All"? Surely that is overreacting to Jane Fonda. Many, perhaps most, but an economist recognizes margins where small net benefits from oil and gas must yield to large environmental values.

But, he continues (pulling a Kissinger,) if you suppress OCS oil you will get worse, e.g. tanker imports, which is the alternative. But this industry refrain overlooks the alternative of using less oil and gas, one that reduces damages in production, transportation, refining and consumption. In the hot summer of 1967 Mayor Maier of Milwaukee shut down all the gas stations and sealed the city from cars, to forestall arson (remember those days?). As an interesting by-product, the muggy summer air became sparkling crystal clear, such as never seen after.

I would welcome more holidays for cars, and from cars.

But note how damages must be "quantifiable." Given the industry mindset betrayed throughout this paper, that sly word implies that the burden of proof of environmental damage is with the damaged (assuming they get standing in court), and limited to provable quantities. Environmentalists can be annoying, I know, but without their continual fussing what kind of a hell would this world be when greed and irresponsibility, vanity, stupidity and immaturity command modern technology? May the protestors not be squelched under impossible measurement burdens. They fight our battles, and not for profit.

8. NUKES ARE OUR CLEANEST SOURCE OF ENERGY. If you overlook contingent hazards, rapid decay, decommissioning, and ultimate waste disposal, I suppose you could believe that.

9. GEOLOGICAL INFORMATION SHOULD HAVE MORE ECONOMIC CONTENT. D'accord, and bless the memory of Orris Herfindahl. But geologists know on which side bread is buttered, and there is no danger that fundamental research will crowd out "economic" content from our industry-oriented schools of mines. The wonder is that fundamental research survives, and it seems that the single-minded profit approach, common to everyone in business, might benefit by the stimulus and challenge of research done to a different drummer.

The true shortage is of economists who look into geology from a public viewpoint, to work out tax and leasing plans to protect the public. Recent research on this topic, which Tussing finds so "massive," "radical," not "responsible," full of "mischief." and "not clear," would not consume the profit of a good oil well. It is worth remembering that energy industry sales in 1981 were some \$600 Billions, which really IS massive: it is 12 times the sales of steel, for instance,

6 times sales in non-food retailing, 7 times food retailing, and so on. Yet, for every economist writing on oil leasing and taxation, there are a dozen Doctorates in the Philosophy of mixing hog feed in Iowa. Profit will be served, never doubt it; but who will guard the common weal?

10. SELECTIVE NIHILISM. THE ECONOMISTS' ANALYTICAL APPARATUS IS "USELESS" WHEN USED BY GOVERNMENT, BUT THE CORRECT BASIS FOR PRIVATE DECISIONS. THE SOCIAL DISCOUNT RATE IS NOT "OPERATIONAL," BUT PRIVATE DISCOUNTING IS. I once voted Libertarian myself, but this is ridiculous. If we are to have government at all, let us order it to act rationally. If we are not to have a government, forget about those leases, for some other government will discover a claim to our OCS and act "appropriately."

Early Libertarians like Albert J. Nock and Frank Chodorov, let us remember, were Henry Georgists. Let government collect and distribute land rents equally, and then proclaim liberty throughout the land. Latter-day Libs promote the conclusion but forget the premise, without which it will never fly. And you cannot collect rent without applying the economists' analytical apparatus.

B. Tussing's Policy Positions

1. BONUS BIDDING IS BEST. THIS FOLLOWS FROM DOCTRINES 1 & 9, AND DEFERENCE TO "RESPONSIBLE PERSONNEL IN BOTH . . . GOVERNMENT . . . AND IN THE INDUSTRY . . ." Foot-dragging bureaucrats become "responsible personnel" where we like the status quo, but I am not persuaded. No one ever reformed an agency without kicking butts and raising squawks.

We do indeed need more study of the optimal size and number of tracts in a lease sale, but I wonder why Tussing should care since he wants it all leased "now". Lease terms before drilling also need review, but Tussing clearly would have us lengthen them towards infinity, for how else could we sell all the OCS now before the industry could develop it.

2. THE ENTIRE OCS SHOULD BE AVAILABLE FOR LEASING "NOW". THIS FOLLOWS FROM DOCTRINES 3 - 7, Q.V.

3. THE TIMING OF LEASE SALES SHOULD BE AT INDUSTRY INITIATIVE, "WHENEVER SERIOUS INTEREST APPEARS". Who will be first to show serious interest? The few with the most patient money. When? When they know something others don't. Where? Wherever is best for them. I cannot imagine a surer formula for rooking the public, coupled as it is with repeated strictures against public collection of useful information. You would never guess from Tussing that Alberta, with its systematic data gathering, is prospering with a bulging treasury; or that Alaska's limited success in tapping lease revenues was won with the leverage of data from well logs required by law.

4. TUSSING GIVES LITTLE WEIGHT TO ENVIRONMENTAL DAMAGE, and would evidently leash David Brower, unleash the roughnecks, and rely heavily on Red Adair. THIS DERIVES FROM DOCTRINE 7, Q.V.

5. GOVERNMENT SHOULD ABANDON ITS FOOLISH QUEST FOR INFORMATION. Look what happened to Eve. THE "INSISTENT CLIENTS" FOR INFORMATION ARE "THOSE WHO WANTED TO CREATE

COMPLICATED SCHEMES . . . TO EXTRACT THE LAST MEASURE . . ." Shylocks, probably.

LET US BE DONE WITH SUCH FOLLY: TRUST THE INDUSTRY. THIS VIEW FOLLOWS FROM DOCTRINES 1,3,9 & 10, Q.V., AND IS AT THE HEART OF THE PAPER.

6. IN MATTERS OF LEASING, SIMPLE IS BEAUTIFUL, SO TAKE A BONUS WHEN IT'S OFFERED AND DON'T PARTICIPATE. Beautiful for them, yes, but not us. If we had a good tax system I would agree: sell the title and walk away. But we don't, so we need a good lease. Leases and other contracts get complex in order to anticipate contingencies, most of which never arrive. I wouldn't go abroad without one. The normal cinema lease, producer-distributor, is more complex than an oil lease, for smaller stakes, and I doubt that the \$600 billion energy industry cannot handle a little boilerplate.

7. "GEOGRAPHIC ADVANCE" INTO THE OCS IS THE CHEAPEST SOURCE OF OIL AND GAS FOR THE NEAR FUTURE. Maybe so, maybe no: we would never know from the fragments of fact and anecdote presented. THE "BEST INDICATOR" IS INDUSTRY BIDS ON TRACTS, but this indicator is not compared to bids in the Overthrust Belt or elsewhere, so we have little to hold fast.

C. In closing, I offer some reasons why the distribution of rents is important.

Rent as public revenue substitutes for taxes, without the disincentive effects of most taxes, and the regressive impact of many. Rents from oil and gas are ones which the public recognizes for what they are and is willing to socialize. 5% of all state revenues now come from severance taxes, and the trend is up. The Federal Windfall Profits Tax (WPT), badly structured though it is, brings in billions. The public correctly perceives that these collections are not mainly shifted forward, but tap fat in the private sector, i.e. rent.

The beneficiaries of rent are highly concentrated. This follows a priori from the nature of most rent-sources: they yield cash flows more deferred than do

most other assets, because they last forever. Oil and gas do not last forever, but leases sold well in advance of use yield cash only after long holding periods, which gives the same effect. Only the well-heeled can afford to apply.

Surpluses like rent (perhaps the only true surplus), privately received, cushion beneficiaries from the full pressure of market forces. They can afford to coast, and often do. If aggressive, they can commit extinction pricing. They can plow back earnings into acquisitions, augmenting market shares at the top. ^{Rents}~~They~~ divide the industry (and the world) into Haves and Have-nots, with profoundly destructive economic, sociological and political effects.

When anyone gets unearned income and wealth it weakens the effect of marginal work incentives. It also hurts social morale, by destroying faith in the market system. It is used to rationalize inefficient devices like price control and roll-in pricing which distribute rent by processes which promote waste. Worst of all rent corrupts, both in the getting and the spending. Let government sell lands to speculators and we get incidents like the recent restitution of the Pauley lease off Sta. Barbara -- an abandoned lease was revested in Pauley after a neighbor found oil. On the spending side, privately-received rent becomes the mothers' milk of politics, and gives recipients a huge edge over ordinary people.

Let us not, therefore, disregard the functional distribution of wealth, as Chicago has long urged. Classical political economy rightly put distribution at the center of our discipline. J.B. Clark and Frank Knight bade us forget all that, but we cannot escape the basic historical fact: "Custer died for our sins." If we forget, the dispossessed do not, and with the rising concentration of economic power on one side, and unemployment on the other, more and more of us fall among those dispossessed.