

**The "Switch and Drill" Plan  
to Reduce the Price of Oil**

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## The "Switch and Drill" Plan to Reduce the Price of Oil

### Introduction

The price of oil has increased from an average of about \$23 per barrel in 2002 to a high of about \$140 now. This is an annual growth rate of about 35%, much more than inflation in the United States or in other developed countries. Clearly, the members of the Organization of the Petroleum Exporting Countries (OPEC) have changed their pricing strategy, no longer wanting to maintain stable prices as

*"Never again will we be held hostage to the manipulation of oil prices. The United States must become a net exporter of oil within 5-10 years." – Sonny Landham*

in the past. This has put tremendous financial pressure on low-income individuals and families and small businesses, causing not only gasoline to increase in price but also food and most other goods and services. This has led to many consumers defaulting on loans, creating the sub-prime mortgage

crisis and precipitating a sharp decline in real estate values. In addition, many small businesses have failed. Both of these underlie the current banking crisis.

Since OPEC is the source of the current high oil prices, this "**Switch and Drill**" plan to reduce oil prices focuses on reducing the demand for OPEC-supplied oil by making the United States a net exporter of oil. The U.S. can become a net exporter of oil by switching consumption to non-oil alternatives to reduce the demand for oil overall and increasing production.

The members of OPEC have put their futures at great risk with their current pricing strategy. The high prices have accelerated efforts to develop and produce vehicles that run on non-oil substitutes and have made consumers very angry, putting them in a mood to switch. The sleeping giant has been awakened once again. OPEC's only rational response to this plan will be to reduce price immediately and hope that they have done it in time to slow, or stall, the worldwide switch to non-oil alternative sources of fuel. Further price increases simply will accelerate their decline. They have gone too far, killing the goose that was laying the golden eggs for them.

### "There's Something Out There, and It Ain't A Free Market"

*Why are oil prices so high?* The market for oil is not a free market. It is dominated by an economic cartel, OPEC. The very purpose of an economic cartel is to control prices. In the past, OPEC's strategy was to maintain price stability; however, now they are implementing a strategy to increase revenue by increasing price, taking advantage of the inelastic demand for oil. They can continue to increase revenue by increasing price until they reach the point at which the percent decrease in demand is greater than the percent increase in price. They have been "testing the market" by steadily raising the price, looking for that price at which their demand for oil will decline.

*Why is OPEC manipulating the price of oil?* The obvious answer is to make more money, but it is a strange coincidence that the current upward trend in oil prices began in 2003 after we invaded Iraq. The fact that they risk causing the future demand for oil to collapse with this strategy makes this more than just a strange coincidence.

*How are oil prices being manipulated?* Members of OPEC agree to individual production quotas for each member country except for the swing producer, Saudi Arabia. The swing producer manipulates the price through its production decisions. If they want the price to go down, then the swing producer will increase production or pull oil out of inventory and offer it for sale on the spot market at a lower price. It will be purchased readily because of the lower price. If they want to increase the price, then the swing producer will produce less oil or put more oil into inventory to create a temporary supply shortage in the marketplace. This artificial shortage results in greater demand in the spot market which is met by oil offered at the desired higher price. Since the economies of the world are so heavily dependent on oil, buyers will pay just about any price that is asked – the demand for oil is highly inelastic.

## **Misconceptions**

Several misconceptions about the cause of the high oil prices have been tossed into the public discourse. These misconceptions take us down blind paths, diverting our attention from the real cause and keeping our response unorganized and weak. They must be corrected.

The market price of oil is determined in the spot market. The price of oil has been, and is being, manipulated by activity in that market. Some claim that speculation in the oil futures market is the cause of the high prices, but speculators in oil futures speculate on the future price of oil in the spot market. Their decisions are based upon their expectations of future spot market prices.

Some analysts and pundits believe that speculation in the oil futures market may add up to \$2 a barrel to the price of oil. This is only 1/70<sup>th</sup> (about 1.4%) of the overall price at \$140 a barrel – in the range of normal daily price fluctuations. Even this is questionable, though. The demand for oil is derived from the activities of consumers who base their decisions on the price of gasoline, diesel fuel, etc., not on the price of oil in the futures market. Those who buy oil, the refiners, decide how much to buy based upon their expectations of consumer demand for refined oil products, not on the price of oil in the futures market.

Also, speculators trade money, not oil, so they do not affect the demand for oil. The vast majority of oil futures, perhaps 97-99%, are offset before they expire with settlement in cash. Speculation and hedging in the oil futures market are mostly financial transactions. Speculators try to make money on movements in the spot price, and hedgers try to reduce the risk of price variability in the spot market. The spot market drives the futures market, not the other way around. Blaming speculators in the oil futures market for high oil prices is simply a straw man that diverts attention from the real culprit – OPEC.

Others try to explain the high prices as some vague interaction between "supply and demand." This is like saying that the sky is blue; and focusing on it conceals the reality in the oil market. The oil market is not a competitive market, but one dominated by an economic cartel that controls prices. There is no short-term shortage in the supply of oil. The worldwide inventory of oil totals more than 4 billion barrels, enough to increase supply by 5 million barrels a day for more than 2 years. This "supply and demand" explanation, too, is simply a straw man that diverts our attention from the real culprit – OPEC.

Another misconception is that greedy American oil companies are the cause of the high oil prices. U.S. oil companies are beneficiaries of the price manipulation, but are not the cause. They control only about 10% of the world's supply of oil, which is dwarfed by OPEC's nearly 40%. To the contrary, U.S. oil companies are key elements in our response to the price manipulation by OPEC. Their oil profits are a source of the investment capital needed to expand the production of oil and to construct hydrogen production and distribution facilities. Blaming "greedy oil companies" for high oil prices is another straw man that diverts our attention from the real culprit – OPEC.

### What Can We Do About It? – "Switch and Drill"

As long as OPEC follows its current pricing strategy, oil prices will not begin to decline until the demand for OPEC-supplied oil declines by a greater percentage than the price increases. Our response, then, is to try to make this happen by switching to non-oil alternative fuels and by non-OPEC producers increasing their production. For example, if the worldwide demand for oil were to decline by 10% (about 8.5 million barrels/day) because of a switch to alternative fuels and the non-OPEC producers were to increase their production by 5% (about 2.6 million barrels/day), then demand for OPEC's oil will decline by about 35%. Prices would plummet.

*"OPEC is playing economic hard ball, and we must respond in a like manner. The United States must become a net exporter of oil to take market share from OPEC." – Sonny Landham.*

The United States could accomplish this alone if we were to become a net exporter of oil. To become a net exporter of oil, we most likely

would have to reduce our demand for oil by at least 50% (about 10 million barrels/day) and increase production by at least 33% (about 2.6 million barrels/day). We can reduce our demand for oil by 50% by reducing our demand for gasoline and distillate fuel oil by 75%, running our cars and trucks on non-oil alternative fuels. We also can increase the production of oil by pumping more oil out of Iraq as compensation to U.S. taxpayers for the cost of the Iraq War.

### The "Switch and Drill" Plan to Reduce the Price of Oil

*Objective.* Make the United States a net exporter of oil within 5-10 years.

*Goal.* Reduce demand for oil by at least 50% (about 10 million barrels per day) and increase production by at least 33% (about 2.6 million barrels per day) within 5-10 years.

*Implementation Plan.*

1. Mandate that all gasoline and diesel fuel retail outlets be capable of providing hydrogen for hydrogen-fueled vehicles within 2 years, providing low-cost loans through the Small Business Administration for small retailers so that they are not put out of business and allowing all costs to be expensed in the year incurred.
2. Mandate that all gasoline- and diesel-powered vehicles sold in the United States be flex-fuel, capable of operating on a 100% alcohol fuel (non-corn-based), beginning with the 2010 model year.
3. Allow all research, development, and retooling costs for alternative-fueled vehicles to be expensed in the year they are incurred.
4. Allow all research, development, plant modification, and plant construction costs to produce alternative fuels to be expensed in the year they are incurred.
5. Allow the cost of retro-fitting vehicles to run on alcohol, or modifying them to run on hydrogen, to be deducted as a non-itemized expense on individual tax returns and fully deducted by businesses in the year incurred.
6. Allow businesses that convert from fuel oil to another non-oil-based source of energy to expense the conversion costs in the year incurred. Allow individuals to deduct such conversion costs as a non-itemized deduction on individual tax returns.
7. Remove all excise taxes and subsidies from energy-related activities to level the playing field among alternative sources of energy.
8. Remove impediments to exploring and drilling for oil within the United States and offshore. *The key to low-priced oil in the future is low investment cost today!*
9. We are borrowing money to pay for the war in Iraq. Iraq should pay us with oil, valued at \$40 a barrel or market price if lower, to help U.S. taxpayers with this burden. It is time for Iraq to step up to the plate and help the rest of the world by exporting more oil.
10. We have an abundant supply of coal in the United States. We must use coal as much as possible in efficient and clean-burning applications, particularly in our power plants.

High oil prices themselves provide the primary incentive to switch to alternative fuels. This plan works to accelerate efforts that already are underway within the private sector of the U.S. economy. The mandates reduce physical barriers-to-entry for alternative fuels; the accelerated expensing provides a

tax incentive; and repealing excise taxes and subsidies levels the playing field among competing alternatives. Government assistance through low-interest loans is provided to prevent small retailers from going out of business because of the hydrogen mandate.

The private sector has plenty of money to finance this plan as long as the government does not tax it away. Oil companies have plenty of money to invest in hydrogen production and distribution facilities as do venture capitalists, other energy companies, and companies who may want to enter the energy industry. A windfall profits tax would slow our switch to hydrogen-fueled vehicles by taking investment capital out of the economy. Promoting such a tax shows a lack of foresight and a lack of understanding of the problem we face. Any other assistance from government, such as sharing in research and development expenses, is unnecessary overkill and would be a waste of taxpayer dollars. The government simply needs to get out of the way of the private sector and let them work.

### **Hydrogen – The Great Weapon Against Price Gouging in Oil**

*"Hydrogen is the fuel of the future, and it is time to make it a reality now. I am proud to stand with my far-sighted friend and fellow politician, Governor Arnold Schwarzenegger, in promoting the rapid development and introduction of vehicles fueled by hydrogen." – Sonny Landham*

Hydrogen, in its application, will totally replace oil, unlike hybrids and alcohol blends, making it the most effective weapon to use to stop price gouging in the oil market. In addition, hydrogen dominates oil in several other

aspects. Hydrogen is nonpolluting; and it can be derived from water, which is the most plentiful substance on earth, is readily available, is renewable, and does not lend itself to the formation of economic cartels. Hydrogen is the fuel of the future, and it is time to make it a reality now.