



Comments on the U.S. Department of Energy Draft "Comprehensive National Energy Strategy"

**A Presentation by
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My comments will focus on two particular basic goals of the CNES: insuring against energy disruptions, and international cooperation on global issues, although no single goal can really be considered in isolation.

Assessing Oil Imports

Discussions about risks of energy disruption are often associated with high levels of oil imports, so I wish to make some brief comments on what I consider an incorrect linkage. High, indeed rising, levels of oil imports are inevitable. Right now, the U. S. imports nearly half of its total oil supplies, or just over 9 MBD. According to the Department of Energy's own Reference Case Forecast, net imports will rise to about 10 MBD in 2000---52% of total supplies---and nearly 14 MBD in 2010---about 60% of supply. But high levels of imports should not be viewed as against the national interest. Access to low-cost energy supplies from abroad benefits American consumers and commercial users of energy. Many oil exporting countries are among the best US markets for exports thus helping sustain high employment. The costs of efforts to curb the growth in imports could be very high, requiring a combination of curtailments in demand and investments in very high-cost energy. The former would reduce living standards while the latter would be wasteful and potentially much more damaging to our own and the global environment than low-cost oil imports. Of course other major countries manage with much higher import shares. Germany imports about 96% of its oil supplies, Japan 99%.

It should be kept in mind that US exposure to oil market disruptions is not tied simply to import levels. In a global market, the US would share any international price shocks even with much lower levels of imports. (In 1973-4, the share of imports in the US oil supply was much lower than today, about 35%, but the US suffered from the first global oil price shock about as much as countries with much higher import shares.)

Insuring Against Energy Disruption - The SPR

Insurance against outright disruption comes from readily available spare supply. In principle, there are two sources: spare, shut-in production capacity and non-commercial, strategic inventories. The first, however, is very limited and highly concentrated in a particular location abroad. There is about 3 to 4 MBD of readily available spare production capacity in the world, equivalent to about 5% of global demand. Nearly all of it is in one limited geographic area, the Persian Gulf, with over half in one country, Saudi Arabia. This is of course the region where the world's major supply curtailments have taken place.

The U.S.'s most secure, immediate, source of replacement supplies in case of disruption is the *Strategic Petroleum Reserve* (SPR). While there are also commercial inventories, they are used for normal business operations and can play only a very limited role in emergencies. In time of disruption, with prices rising, market incentives favor building or holding inventories, exacerbating supply problems. The SPR has a critical role at such times in calming markets---as was demonstrated during the Gulf War. The security benefits then came primarily from its existence and supply potential as opposed to the small level of sales that actually took place.

Currently, the maximum drawdown rate for the SPR is equivalent to about 40% of US imports, more than enough for any conceivable international supply disruption, provided the disruption is short-term. This maximum drawdown rate could only be maintained for 90 days before falling off, slowly at first but after 150 days very rapidly. Recent major supply disruptions have not been short-term. It took nearly two years for Kuwaiti oil to return to market after Iraq's invasion in August, 1990 and of course Iraqi oil supplies still remain limited by UN mandate. Fortunately several OPEC countries, most importantly, Saudi Arabia, had enough spare capacity to offset the loss of Iraq and Kuwait exports within a few months in 1990. Right now, the U.S. and Iraq may be headed for a new military confrontation. So far, there has been very little oil market reaction. But the duration and outcome of any new crisis with Iraq is highly uncertain, as is the ultimate impact on oil supplies. A drawdown in the SPR for narrow budgetary reasons seems particularly unwise at such a time. At a minimum, Congress should delay the current requirement that \$207 million worth of oil be sold from the SPR during this fiscal year.

Maintaining the SPR benefits other oil-consuming countries as well as ourselves. Of course we benefit from stocks held by other countries. At present, the SPR accounts for just under half of the total OECD country stocks held for emergency purposes. We believe coordinated policies regarding size and use of emergency stocks is clearly in the US interest, as well as the interest of other oil consuming countries.

Assuring Diversity of Supply and Imposing Sanctions: A Policy Conflict

As the world's largest consumer of oil, the US has an overriding interest in promoting competitive stable oil markets. A broad competitive, international market not only has lower risks of disruption, but offers the best prospects for long-term supplies at reasonable cost. Diversity of supply is key to sustaining such a market and in this regard, certain US policies are having a negative impact.

The US use of economic sanctions limits supply diversity---to the extent they are effective. Sanctions can be effective only when they are widely supported by the international community, as is the case regarding Iraq. But this is not the case with US sanctions on Libya and Iran, which do not have international support. While US policies have had some impact on investment and credits flowing to those countries, they are still selling their oil and investments are still taking place. Indeed, world oil markets would

look very different if in fact their supplies---equal to about 7% of world production and flowing at a daily rate about one-third higher than the maximum SPR drawdown rate---were not available.

Unilateral sanctions policies have their clearest, negative, effects on US companies. US companies, including oil service companies, lose their chance to compete for markets and production opportunities in the sanctioned countries. Perhaps more important, other countries may assign a risk premium to doing business with US companies as they allow for the possibility of becoming future targets of unilateral US sanctions.

Access to acreage is critical for long term development of new diverse supplies. The opening of new areas abroad and reopening of old areas to international companies are spurring development of substantial new sources of supply from the Caspian Sea, Venezuela, and other areas. With sanctions policy a prominent exception, US policies have encouraged this process.

Domestic Frontier Areas

But access to acreage at home is also important. The most promising new domestic supply prospects in the deep waters of Gulf of Mexico could not have come to fruition without the initial lease sales to start the exploration and development process. Some of the most prospective domestic acreage, the ANWR, remains off-limits. This decision should be reassessed. Production declines from the original North Slope fields and reduced pipeline throughput mean increasing spare capacity to move future production from ANWR, and therefore less new infrastructure required with its accompanying environmental concerns. It should also be pointed out that most Alaskans strongly support the opening up of ANWR.

Development of frontier areas at home has a further benefit, promotion of new exploration and production technologies that are applicable world-wide. The new technologies employed in the deep-water Gulf are also being used abroad to develop oil resources in similar geologic prospects such as deep-water offshore West Africa.

Comments on Global Warming

Before concluding, I want to comment on what may be the most challenging, complex, set of international energy issues we face, those involving Global Warming. With the signing of the Kyoto protocol, the US and other industrial countries are committing themselves to significant reductions in Greenhouse Gas emissions.

If the concerns about Global Warming are scientifically validated, the world collectively will have to make substantial reductions in Greenhouse Gas emissions that go far beyond the initial targets agreed to in Kyoto. But while a great deal can be achieved, especially through technological advance if lead times are long enough, we question the realism of the Kyoto targets within the 2008-12 time frame. The absence so far of any commitments

by non-Annex I countries is a serious omission from the Protocol as it currently stands. The Protocol is not set in stone and these concerns should be addressed in future negotiations, including at the next Conference of Parties. We agree with the Administration broad emphasis on market-oriented policies and policies to promote long-term technological advance.

While the emphasis is correct some specific Administration proposals would actually create disincentives for technological advances, specifically for those producing incremental gains. The Administration's current proposal for a \$3,000 tax credit for cars getting twice the base fuel economy of their class, and \$4,000 for cars getting three times the base fuel economy of their class is just such an example. It is all or nothing---leaving no incentives for manufacturers to improve current technologies, even if they could get a 99.9% efficiency gain from doing so.

The proposed credits are also temporary, with the full \$3,000 tax credit available only from January 1, 2000 through the end of 2003, before being phased out by 2006. a similar pattern applies to the proposed \$4,000 credit, which would come into effect at the beginning of 2003. These proposals in their present form risk forcing a premature marketing what are still very tentative technologies. The example of the rushed introduction of diesel cars in the early 80s and the very limited performance of the current electric car are reminders that rushing to market prematurely can mean expensive disappointment. The Global Warming problem is very long-term in nature and solutions will not come quickly, especially in the transport sector. There is more room for early improvement in emissions from stationary sources where near and medium term possibilities for fuel switching are far greater and can be more readily implemented than in transport. In many stationary energy facilities fuel switching and/or improved fuel utilization can be accomplished within the existing facilities and does affect end users. In the transportation sector this is not the case.

We support the concept of emissions trading as an appropriate, market-oriented approach to curbing Greenhouse Gas emissions. Any trading system is going to be very complex and substantial preparation is required to make sure that whatever is put in place will be workable. The draft plan correctly calls for detailed study over the next five years before implementation. As part of this study process, there should be broad consultations with affected industries. Preliminary proposals should be exposed to the assessments of those who will actually operate under whatever system is put in place.