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Statement before the
Subcommittee on Energy and Mineral Resources
of the
United States Senate
Committee on Energy and Natural Resources
at the
Oversight Hearing on the
Strategic Petroleum Reserve

by

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President

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I wish to thank you for inviting me to testify at this Oversight Hearing on the U.S. Strategic Petroleum Reserve (SPR).

As you may know, I testified on the subject of the SPR very recently before the House Committee on Energy and Commerce. Since neither my views nor the underlying facts have changed since then, I would like to begin my testimony with a brief summary of my remarks at the House hearing.

I expressed the view that the filling of the SPR should be treated as a high priority national security measure. In fact, I said, it was much more likely that international events affecting our security might require utilization of the SPR than use of the highly sophisticated, high cost military equipment we are currently constructing.

I believe therefore that the SPR should be filled at a rate as close as possible to the 300,000 B/D target indicated by Congress. Neither physical limitations in the government's underground storage facilities nor budget considerations should cause the fill rate to drop significantly below this 300,000 B/D target. Yet, under present Administration plans, the planned fill rate for the period from January 1, 1982 to the end of the next fiscal year (September 30, 1983) will drop to only 172,000 B/D, compared to nearly 300,000 in fiscal year 1981.

I suggested that to the extent that available SPR underground storage capacity was causing a temporary bottleneck in attaining the target fill rate, the DOE should make use of leased tankers, steel tanks and privately owned underground storage facilities. All of these have currently substantial excess capacity and are therefore available at relatively depressed prices. I estimated that over a period of time on the order of 100 million barrels of oil could be temporarily stored in this manner. This would mean that the attainment of a 500 million barrels storage level (about twice the current level) could be advanced from late 1986 to mid-1984. From the point of view of national security this would be a significant contribution. I pointed out in this connection that in view of our declining oil import requirements, we may find by 1984 that an SPR level of 500-550 million barrels, rather than our present ultimate target of 750 million barrels, is sufficient to cope with most realistic oil interruption scenarios.

This ends the summary of my House testimony. With your permission, Mr. Chairman, I would like to submit the entire testimony into the record of this Hearing.

I would now like to make some additional points. The need to fill the SPR as rapidly as possible has taken on new urgency since the President's veto of S. 1503, the "Standby Petroleum Allocation Act." The veto has effectively elevated the SPR from one important element in our overall energy emergency response

plan to our sole crisis response mechanism. I would have preferred to have both the rapid fill of the SPR and the standby control authority, and I am not alone in my view, as this Committee is acutely aware.

In its report, "Emergency Preparedness for Interruption of Petroleum Imports into the United States," the National Petroleum Council stated,

"that the government's overall strategy for emergency management of oil import disruptions should be to rely to the maximum extent on market mechanisms, but to have available a variety of emergency standby options of increasing severity to deal with shortages of increasing magnitude."

Among the possible consequences of not having standby authority in place are:

(1) The irresistible pressure to pass legislation, at the height of a crisis, mandating controls. Such legislation, hastily drawn, is likely to be more rigid than the vetoed standby authority. The resulting controls, rashly implemented, are likely to use a "firefighting" technique rather than the cohesive, carefully considered system necessary to minimize adverse impacts.

(2) The passage of individual state laws designed to deal with energy emergencies. These laws, by definition, will be serving the interests of the states which pass them and are likely to conflict with the interests or laws of other states. This crazy quilt of regulations will lead to inefficiency and inequity, the opposite of the Administration's goals. Under S. 1503 such state laws would have been preempted by federal

legislation. Thus, the absence of one flexible, federal stand-by law on this matter could well lead to the enactment of dozens of rigid state laws.

(3) The President's insistence that market forces could cope with most likely oil supply interruptions by adjusting demand to available supply could cause major economic distortions and dislocations. If the adjustment required a significant reduction in demand, oil prices would have to rise quite steeply, given oil's known very low short-term price elasticity of demand. Since in the absence of any legislation the oil companies would have to become the enforcement and, hence, collection agencies for this adjustment, their earnings could soar dramatically during such periods. This accumulation of funds in the hands of a single industry under these circumstances is likely to be politically unacceptable and economically untenable.

My next point is a brief elaboration of the comments I made in my earlier testimony on the cost of storing oil in tankers. We had estimated the total annual cost for tanker at \$3.00/Bbl. These estimates were made last year and tanker chartering rates have come down since then. More important, our figure did not reflect market quotations but full cost, including interest and capital repayment. Actually, in the present tanker market one can readily charter large ships (VLCC's and ULCC's) from a \$1.80 to \$1.20/Bbl annually, with the rate varying inversely with the tonnage size. These ships would probably operate at a minimal positive cash flow at such rates. The alternative, laying the

ships up while keeping them in operating condition results in a cash loss. It is estimated that some 50 such ships are currently idle, and available, including, I understand, the world's largest tanker, "Seawise Giant," which has a carrying capacity of 4 million barrels. Given the current worldwide reduction in floating storage, this number can be expected to increase. Thus, if staggered over a period of time, say, one year, it may be possible under current and near term tanker market conditions to obtain enough annual charters to store some 30-35 million barrels of SPR oil in this manner without any significant impact on charter rates.

The tankers which would probably be anchored mostly in the Caribbean or Gulf Coast would also add considerable flexibility to the SPR delivery system because they would permit immediate crude oil deliveries to coastal refineries not connected to the SPR underground storage system. For this reason it might even be worth considering the possibility of keeping some SPR oil permanently stored in tankers.

Another point on which I would like to elaborate briefly is the storage of refined products. The U.S. East Coast currently depends on imports for about half of its residual fuel oil supply. Last year these imports amounted to 565,000 B/D. If a large part of these imports became unavailable it would be very difficult for U.S. Gulf Coast refiners to make up the difference considering that their total current output of this

product is only about 500,000 B/D. The DOE should therefore give serious consideration to the possibility of storing some volume of this particular product at East Coast market locations as part of the SPR program. Current prices of this product are probably at a historic low relative to the cost of the crude oil from which it is made.

In conclusion, I would like to point out that the lower fill rate now at issue is less a result of DOE's budget constraints than of the salt cavern capacity constraints and DOE's reluctance to contract for interim storage. According to our estimates, DOE's purchases of oil from funds already appropriated or requested for the SPR could support a fill rate of some 260 M B/D in FY '82 and '83, instead of the average rate of slightly under 200 M B/D now projected. Therefore, with a relatively small increment to the funding level, just to cover the cost of interim storage facilities, we could have nearly 50 million barrels more oil in storage by the end of Fiscal 1983. With a larger funding increment, to cover the cost of purchasing more oil as well as storing it in interim facilities, we could be even further along in reaching our often-delayed goal of filling the SPR.