

The Effects of Imports of Crude Oil and Petroleum Products on the National Security

An Investigation under Section 232 of the Trade Expansion Act of 1962, as Amended

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- OIL-001 January 1989 - Previous Investigation Final Report: *Effects of Crude Oil and Refined Petroleum Product Imports on the National Security*
- OIL-002 December 1994 (published February 1995) - Previous Investigation Final Report: *The Effect of Imports of Crude Oil and Petroleum Products on the National Security*
- OIL-003 March 11, 1999 - Letter from Representative Ernest J. Istook, Jr., Requesting an Expedited Investigation of the Impact of Low Oil Prices and Increasing Oil Imports on National Security
- OIL-004 March 12, 1999 - Senatorial Letter Requesting an Expedited Investigation of the Impact of Low Oil Prices and Increasing Oil Imports on National Security
- OIL-005 May 4, 1999 - *Federal Register* Notice
- OIL-006 May 11, 1999 – Comments submitted by George Mercier, former member, Mormon Church
- OIL-007 May 18, 1999 – Comments submitted by Dale W. Steffes
- OIL-008 June 3, 1999 – Comments from Petroleum Industry Research Foundation, Inc.
- OIL-009 June 3, 1999 – Testimony submitted by American Petroleum Institute
- OIL-010 June 3, 1999 – Letter from the Government of Mexico
- OIL-011 June 3, 1999 – Comments submitted by the New England Fuel Institute
- OIL-012 June 3, 1999 – Comments submitted by the Irving Oil Corporation and Irving Oil Terminals, Inc.
- OIL-013 June 4, 1999 – Comments submitted by the CITGO Petroleum Corporation
- OIL-014 June 7, 1999 – Comments submitted by the Embassy of Venezuela

- OIL-015** June 8, 1999 – Comments submitted by Independent Fuel Terminal Operators Association
- OIL-016** June 8, 1999 - Comments submitted by Bryan C. M. Chastel De Boinville
- OIL-017** June 8, 1999 – Comments submitted by the Independent Petroleum Association of America (IPAA) and the National Stripper Well Association (NSWA)
- OIL-018** June 8, 1999 – Comments submitted by North Texas Oil & Gas Association
- OIL-019** June 8, 1999 – Comments submitted by Air Transport Association of America, Inc.
- OIL-020** June 8, 1999 – Comments submitted by Collier, Shannon, Rill & Scott, PLLC for the Society of Independent Gasoline Marketers of America (“SIGMA”)
- OIL-021** June 9, 1999 – Comments submitted by the Government of the Province of Alberta, Canada
- OIL-022** Comments submitted by Canadian Embassy



THE EFFECT OF CRUDE OIL AND REFINED PETROLEUM PRODUCT IMPORTS
ON THE NATIONAL SECURITY

An Investigation Conducted Under Section 232
of the Trade Expansion Act of 1962, as amended
(19 U.S.C 1962)

U.S. Department of Commerce
Bureau of Export Administration
Office of Industrial Resource Administration

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The Effect of Crude Oil and Refined Petroleum Product Imports on the National Security - This 1989 report contains the results of an investigation requested under Section 232 of the Trade Expansion Act to study the effect of oil imports on the domestic petroleum industry and on United States energy security. It reviews previous energy security assessments and resulting initiatives, assesses current U.S. energy security, and studies emergency petroleum requirements. The report finds that there have been substantial improvements in U.S. energy security since the last Section 232 Petroleum finding in 1979. However, declining domestic oil production, rising oil imports, and growing dependence on potentially insecure sources of supply raise concerns of vulnerability to a major supply disruption. The report finds that maintenance of U.S. access to sufficient supplies of petroleum is essential to our defense preparedness and concludes that petroleum imports threaten to impair national security. The report recommends a number of cost-effective actions that could reduce our vulnerability, focusing on increased opportunities for domestic energy production and greater insurance that adequate oil supplies are available in the event of a supply disruption.

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EXECUTIVE SUMMARY

Introduction

On December 1, 1987, the National Energy Security Committee, on behalf of a coalition of associations, companies, and individuals, submitted a petition for an investigation under Section 232 of the Trade Expansion Act of 1962, as amended (19 U.S.C. 1862) for an investigation of the impact of crude oil and refined petroleum product imports on the national security.

The petition alleged that imports are weakening the domestic petroleum industry to such an extent that it will not be able to support U.S. security needs in the event of a global conventional war. The petition did not suggest a specific remedy, but requested that the Department of Commerce (DOC) "recommend appropriate remedial action to the President."

On December 23, 1987, the Department of Commerce accepted the petition, initiated an investigation and invited public comment. (Extensive comments reflecting support for and opposition to the allegations made by the petition were received from oil producers, refiners, consumers, public officials, and foreign governments).

Under then-existing law, DOC had one year, until December 1, 1988, in which to complete its investigation and forward its report with recommendations to the President. (Since that time, Congress has amended the statute to require future reports to be completed within 270 days). In conducting the investigation, the Department made use of the extensive data and analysis that were already available regarding the current and prospective status of the domestic petroleum industry and the world oil market as well as the extensive recent national security analyses of oil supply and demand under crisis conditions.

Methodology

The investigation used a three step process to evaluate the effect of petroleum imports on the national security. The methodology for this investigation was to: (1) review previous energy security assessments and resulting initiatives; (2) review current world oil market and status of U.S. petroleum producing and refining industries to develop a current U.S. energy security assessment; and (3) perform a national security review.

Analysis

The investigation commenced with a review of previous analyses of the effect of oil imports on the domestic petroleum industry

and on United States energy security. These included national security investigations conducted in 1975 and in 1979 under Section 232 of the Trade Expansion Act of 1962, as well as the 1959 investigation under Section 8(d) of the Trade Agreements Extension Act of 1958. DOC also reviewed the analyses and findings of two major studies done by the Department of Energy (DOE) -- "Product Imports, Energy Security and the Domestic Refining Industry" (1986) and "Energy Security: A Report To The President of the United States," (1987) and other studies done by the Administration since 1981. This review highlighted the focus of several Administrations regarding this issue.

The investigation presented an analysis of the current and prospective status of U.S. energy security in light of recent developments in the world oil market. This analysis highlighted a number of key trends and factors which will have a significant effect on U.S. energy security in the future.

Since 1979, U.S. energy security has been strengthened and the United States is better prepared than before to deter as well as respond to an energy supply emergency. The following factors have served to enhance U.S. energy security since the late 1970's:

- o U.S. petroleum imports have declined by over 2 million barrels per day (MMB/D) from 1979 to 1987 or 27 percent. The U.S. Strategic Petroleum Reserve (SPR) now contains over 555 million barrels, whereas in 1979 only 91 million barrels were stored. Other OECD countries' government owned emergency oil stocks now amount to 400 million barrels and coordinated energy emergency sharing programs have been developed and tested regularly. In addition, many private companies have stocks in excess of commercial needs. Some of these stocks are potentially available for use in an emergency situation. Non-OPEC oil production now accounts for 60 percent of free world oil production, approximately 9-10 MMB/D of surplus oil production capacity exists in the market. Natural gas supplies use has been expanded in non-OPEC countries. The construction of additional crude oil pipelines has diversified Middle East oil transportation patterns and thus has reduced the share of Persian Gulf production delivered to world markets through the Straits of Hormuz.
- o There have also been important developments in conservation and interfuel substitution that contribute to enhancing U.S. energy security. The United States consumed only as much energy in 1987 as it did in 1973, even though the economy grew 40 percent over that period. At the same time, many large oil users such as industrial firms and utilities have developed the capability to substitute large volumes of natural gas or coal for imported oil when economic conditions or other factors dictate.

- o Since the late 1970's, there has been a shift in the sources and levels of U.S. oil import dependence. Sources outside of the Middle East now account for a larger share of U.S. oil imports. During 1987, Canada, Mexico, and the United Kingdom supplied 31 percent of net petroleum imports as compared to 15 percent in 1979.
- o Although many small U.S. refineries have closed between 1981 and 1986, current U.S. refining capacity (15-16 million B/D) combined with imports from reliable Free World sources is sufficient to meet demand. The principal cause for the closure of 120 U.S. refineries during this time was the elimination of both crude oil price controls and the Small Refiner Bias Provision of the Entitlements Program.

The Department's investigation also identified a number of other factors affecting future U.S. energy security:

- o Various U.S. Government energy reports have concluded that by the mid-1990's and beyond, we may be importing about half or more of our oil consumption. To the extent the United States and other countries import more oil in the future, it is projected they will turn increasingly to OPEC countries - - particularly those located in the Persian Gulf region which have the largest amounts of surplus oil production capacity and reserves. Dependence on a small number of suppliers located largely in a volatile region could make the United States and the OECD countries increasingly vulnerable to oil supply disruptions or cartel manipulation of production and price.
- o U.S. petroleum imports are likely to increase in the years ahead because domestic reserves of economically recoverable oil are declining. Further, as world crude oil prices have declined since 1986, the relatively smaller U.S. oil fields with higher cost U.S. production became uneconomic and some wells were shut-in or abandoned.
- o The level of domestic drilling activity remains low, and the low prices have had an adverse effect on the U.S. petroleum services industries.
- o The most promising currently known prospects for major new oil fields in the United States are in the Outer Continental Shelf (OCS) and in the Arctic National Wildlife Refuge (ANWR). Exploration and eventual production from these areas could help offset anticipated production declines in other parts of the United States, thereby helping to limit the growth in U.S. dependence on foreign oil supplies. However, the long lead times needed from exploration to production mean that it could still be a decade before oil is extracted, even if access were granted within the next year or so.

- o Though not currently a problem, in the event of a large price or volume increases, rising outlays for imported oil would increase the need for expansion of exports or decreases in other imports. However, if priced below the cost of domestic supplies, expanding oil imports would enhance domestic economic efficiency and continue contributing to the international competitiveness of U.S. firms.
- o On the other hand, lower priced oil has had a beneficial effect on U.S. international competitiveness and economic growth thereby contributing to one of the longest sustained post-war economic recoveries.

In addition, national defense petroleum mobilization requirements were evaluated in light of previous national security studies and a review of the current world oil market. It was determined that the United States would be able to meet defense requirements and essential industrial and civilian needs in a major conventional war from domestic energy production, the Strategic Petroleum Reserve, and reliable petroleum imports. It was also determined that we have sufficient refining capacity to process this oil.

In the event of a three year, large scale conventional conflict coupled with a substantial decrease in oil supplies, defense needs would receive priority. Consequently, domestic dislocations resulting from decreased petroleum availability could be significant and have a significant deleterious effect upon the U.S. economy. Further, growing Free World dependence on potentially insecure sources of oil can constrain foreign policy flexibility and U.S. military power projection capabilities even in peacetime.

Finding

There have been substantial improvements in U.S. energy security since the last Section 232 Petroleum finding in 1979. However, declining domestic oil production, rising oil imports, and growing Free World dependence on potentially insecure sources of supply raise a number of concerns, including vulnerability to a major supply disruption. The investigation found that the maintenance of U.S. access to sufficient supplies of petroleum is essential to our economic security, foreign policy flexibility, and defense preparedness. Given the above factors, it was found that petroleum imports threaten to impair the national security.

U.S. Government Energy Actions Which Enhanced National Security

Since 1981, the Administration has implemented policies that have substantially increased U.S. energy and national security. Major actions include (1) fully decontrolling oil prices in 1981 and eliminating allocation controls; and (2) filling the Strategic Petroleum Reserve to 555 million barrels and committing to a 750 million barrel reserve. Other actions to enhance energy security and maintain a strong domestic oil industry include:

- o Re-establishing the five-year Outer Continental Shelf (OCS) leasing program and reducing the minimum bid for certain offshore leases.
- o Increasing Federal spending for clean coal to \$2.5 billion over the next five years and re-establishing a Federal coal leasing program.
- o Preserving the intangible drilling costs treatment in the Tax Reform Act of 1986 and retaining the full-cost accounting provisions.
- o Encouraging our allies and friends to build up their government-owned strategic stockpiles, which amount to about 400 million barrels (mostly in Germany and Japan), and to coordinate stock drawdowns during an emergency.
- o Developing with our partners in the International Energy Agency policies and programs, including stock drawdown measures, for coordinated international responses to future oil supply disruption.
- o Obtaining Congressional repeal of the the Windfall Profits Tax which removes major disincentives for producers to develop further existing oil reserves, explore for new reserves, and reduce the paperwork burden on the industry, and
- o The implementation of the U.S.-Canada Free Trade Agreement which will promote increased bilateral energy trade and provide reliable supplies at competitive prices.

Recommendations

While U.S. energy security has improved since the 1970's, a threat to U.S. national security cannot be ignored and future projected trends require vigilance. Although no single program or specific action could eliminate U.S. dependence on some insecure petroleum imports, there are a number of cost-effective actions that could reduce our vulnerability and increase our flexibility.

The best means to enhance U.S. energy security is to increase opportunities for economic domestic energy production and to ensure that adequate oil supplies are available in the event of a supply disruption. The Congress and the States should continue to be urged to take immediate steps to implement the President's program. Specifically:

- o Enacting Comprehensive Natural Gas Reform - this action would help gas to reach its full potential in substituting for imported oil;
- o Permitting Environmentally Sound Oil Exploration and Development of the Arctic National Wildlife Refuge Coastal Plain in Alaska and of the Outer Continental Shelf - these are the most promising prospects for discovering major new oil reserves in the United States. Exploration and production from these areas would serve to limit our growing dependence on foreign oil;
- o Ensuring the Viability of Nuclear Power Through Licensing Reform - This would involve the issuance of a combined license for both construction and operation of a nuclear power plant. This action would provide a vehicle so that utility, public, State, and Federal concerns could be resolved before plant construction, thereby reducing project costs;
- o Removing Tax Disincentives To Domestic Oil Exploration and Development and Reducing Early Well Abandonment - These consist of: (1) increasing the net income limitation on the percentage depletion allowance from 50 to 100 percent per property; and (2) repealing the transfer rule to permit use of percentage depletion for proven properties that have changed hands;
- o Filling the SPR to 750 Million Barrels - The Naval Petroleum Reserves at Elk Hills, California, and Teapot Dome, Wyoming, should be sold in order to finance an increased fill rate for the SPR, which is a more effective emergency reserve, and to pay for a new 10 million barrel Defense Petroleum Inventory;

An action to adjust imports by way of quotas, fees or tariffs, under the authority of Section 232, is not recommended because such actions are not cost beneficial and, in the long run, impair rather than enhance national security. Section 232 states that "In the administration of this section, the Secretary and President shall further recognize the close relation of the economic welfare of the Nation to our national security..." An oil import fee and/or quantitative import restrictions would raise the price of oil resulting in only a small temporary increase in U.S. production, while causing substantial increased economic costs and adverse competitive impacts throughout the

U.S. economy. In addition, the beneficial effect that the President's initiatives should have on U.S. energy security argues against taking formal action to adjust imports under Section 232.

The DOE Energy Security report of 1987 examined oil import fees in detail. The report found that oil import fees have overall economic costs far in excess of their benefits. Specifically, the study concluded that a \$10 per barrel fixed import fee could increase domestic production (about 400 thousand B/D) and discourage consumption, leading to a reduction of imports of about 1.5 million B/D.

However, a \$10 per barrel import fee would have greater negative effects on the overall economy (e.g., stimulating inflation, decreasing the competitiveness of oil consuming industries, reducing the GNP). Consumers would pay higher prices for oil and this would inflate costs throughout the economy. Thus, the economy would incur substantial adjustment costs. The Department of Energy has estimated that the economy would suffer a loss in output of \$150 - 200 billion over the 1988 - 1995 period as a result of a \$10 per barrel fee. This output loss would exceed the estimated benefits accruing from the fee.

The DOE Energy Security report also analyzed the impact of a \$5 per barrel fee on the economy. DOE estimates that the \$5 fee would result in an additional 200,000 b/d of domestic oil production by 1995. However, the \$5 fee would also have the same negative effects on the economy as the \$10 fee, albeit on a smaller scale. On balance, the costs of \$5 fee outweigh the benefits to the petroleum sector. Additionally, other methods for affecting imports, such as volumetric quotas, would have similar economic and competitiveness impacts.

Section I. INTRODUCTION AND METHODOLOGY

Introduction

On December 1, 1987, the Department of Commerce received a petition under Section 232 of the Trade Expansion Act of 1962, as amended, to initiate an investigation concerning the impact of crude oil and refined petroleum product imports on the national security. The petition was filed by the National Energy Security Committee (NESC), which represents a broad coalition of independent producers, royalty owners, drilling equipment manufacturers, geologists and others involved in the U.S. petroleum industry. The Department published a notice in the Federal Register on December 29, 1987 announcing the initiation of the investigation and soliciting public comment within 30 days. A copy of the Federal Register notice is attached at Tab A.

The articles investigated for this study include crude oil and refined petroleum products. Crude oil is currently classifiable in the Tariff Schedules of the United States (TSUSA) Annotated (1987) as items 475.05 (crude oil testing under 25 degrees A.P.I.) and 475.10 (crude oil testing 25 degrees A.P.I. or more).

The following refined petroleum products are classified under these specific TSUSA categories: 475.25 (motor fuel, including gasoline, leaded and unleaded; naphtha-type jet fuel and kerosene-type jet fuel); 475.30 (kerosene derived from petroleum, shale oil or both - except motor fuel); 475.35 (naphthas derived from petroleum, shale oil, natural gas or combination thereof - except motor fuel); 475.40 (mineral oil or medicinal grade derived from petroleum, shale oil or both); 475.45, 475.55 and 475.60 (lubricating oils and greases, derived from petroleum shale oil, or both, with or without additives); 475.65 and 475.70 (mixtures of hydrocarbons not specifically provided for, derived wholly from petroleum shale oil, natural gas, or combinations thereof, which contain by weight not over 50% of any single hydrocarbon compound); 494.22 (paraffin and other petroleum waxes); 517.5120 (petroleum coke); and 521.11 (asphaltum, bitumen and limestone-rock asphalt).

Under then-existing law, the Department of Commerce had one year to submit a report with findings and recommendations to the President. Since that time, Congress has amended Section 232 to require that future reports be completed in 270 days.

Summary of Petition

The NESC petition raised the following major concerns and allegations:

- o Rising imports of inexpensive crude oil and petroleum products are having a negative impact on the domestic petroleum industry.

- o With declining world crude and product prices, higher-cost U.S. producers are not able to compete with lower-priced imports and have often been required to shut-in production.
- o The petitioners state that this has resulted in a decline in domestic crude oil production, which in turn has diminished the availability of capital necessary to fund exploration and development of new oil sources. As a consequence, the nation is not replacing crude oil reserves currently being produced. In 1982, capital expenditures for drilling, exploration and production were on the order of \$53 billion. In 1986, capital expenditures fell to about \$16 billion.
- o In terms of domestic exploration and development activities, (comparing the years 1982 and 1986), the number of active seismic crews fell 66 percent; exploratory wells completed dropped 57 percent; drilling permits issued annually fell 60 percent; total footage drilled declined 55 percent; and the number of active rotary drilling rigs fell 68 percent.
- o Proven crude oil reserves dropped 1.5 billion barrels in 1986, to 26.9 billion barrels, a 5.4 percent drop from 1985. New oil field discoveries were the lowest in the last 10 years and were less than one-third of the 1977-84 average.
- o From a peak of 9.2 million b/d in February 1986, domestic crude oil production declined steadily to 8.2 million b/d in August 1987. Conversely, since 1985, imports of crude oil and petroleum product have increased from 32 percent to 39 percent of U.S. oil consumption.
- o The decline in overall industry activity has resulted in the loss of a substantial number of jobs. In January 1982, there were approximately 754,000 workers engaged in oil and gas extraction activities. By 1987, employment had declined to 425,000 workers.

Based on all these factors, the NESC argues that U.S. national security is impaired and is threatened with continual impairment, as a result of a growing reliance on imported oil. The petitioner calls for immediate, remedial action by the Administration if the United States is to continue to enjoy the freedom of foreign policy options and an unchallenged military readiness posture. If such action is not forthcoming, then the United States' ability to defend itself in a conventional world war is placed in jeopardy. While the petition did not request a specific remedy, the NESC did urge the selection of an approach which will adjust the import of crude oil and petroleum products so that such imports will not threaten to impair the national security of the United States.

A total of sixty separate commenters submitted their views during the comment period. A listing and a summary of the comments filed are attached at Tab B.

Methodology

The Department of Commerce used a three step process to evaluate the effect of crude oil and refined petroleum product imports on the national security.

Step 1: Review of Previous Energy Security Assessments and Resulting Initiatives: The issue of U.S. dependence on foreign oil has been a subject of several national security studies conducted by the Federal Government since the 1950's. The Department reviewed the analyses, findings and recommendations of previous oil security studies to determine whether there were any common concerns raised and to use these analyses as benchmarks to assess the current U.S. security position.

(The most 1979 Section 232 Petroleum investigation concluded that imports threaten to impair the national security. This finding is still effective today and serves as the legal basis for the embargo of crude oil from Libya that was imposed in 1982.)

Step 2: Review of Current World Oil Market and Status of U.S. Petroleum Producing and Refining Industries to Develop a Current U.S. Energy Security Assessment:

The next step involved an evaluation of any factors which have served to enhance U.S. energy security as well as any factors which have served to erode U.S. energy security since these studies were completed. It was intended that such an assessment would 1) set forth a current overview of the general U.S. energy security position and 2) provide the basis for the development of appropriate remedies, should the investigation conclude that imports threaten to impair the national security.

In conducting this assessment, the Department relied upon the extensive body of data already available on the world oil market and U.S. petroleum industry. In view of the availability of this data, it was determined that an industry survey was not necessary.

Step 3: Review of National Security Issues:

The next step involved a petroleum supply/demand analysis based on a three year global conventional war scenario preceded by a one year mobilization. This analysis was based on approved national security planning guidelines with updated Defense Department petroleum requirement estimates. This assessment also accounted for the recent trends in U.S. consumption, production and imports.

* * * * *

Based on the above analysis, the Department determined that there have been substantial improvements in U.S. energy security since the last Section 232 Petroleum finding in 1979. However, declining domestic oil production, rising oil imports, and growing Free World dependence on potentially insecure sources of supply raise a number of concerns, including vulnerability to a major supply disruption. The investigation found that the maintenance of U.S. access to sufficient supplies of petroleum is essential to our economic security, foreign policy flexibility, and defense preparedness. Given the above factors, it was found that petroleum imports threaten to impair the national security.

Section II. REVIEW OF PREVIOUS ENERGY SECURITY ASSESSMENTS AND RESULTING INITIATIVES

National Security Investigations

Energy security problems and concerns similar to those raised by the current petition have been brought to the attention of the U.S. Government on several occasions since the late 1950's. These policy concerns have prompted major studies focusing on one or another aspect of the relationship between U.S. national security and our growing dependence on foreign oil. These studies range from the 1959 national security investigation of oil imports to the 1987 Department of Energy's "Energy Security: A Report To The President of the United States" (hereafter Energy Security). Moreover, these studies have in turn generated a large energy database which constitutes an important resource for this study.

This review of previous national security investigations includes the 1959 investigation on petroleum imports under Section 8(d) of the Trade Agreements Extension Act of 1958, and the studies completed in 1975 and 1979 investigating oil imports under Section 232 of the Trade Expansion Act of 1962. The three prior investigations provide a broad overview of the issues concerning petroleum and national security which the U.S. government has addressed over the past three decades.

The 1959 Study

On March 10, 1959, President Eisenhower issued Proclamation 3279, which announced that crude oil and the principal crude oil derivatives and products were being imported in such quantities and under such circumstances as to threaten to impair the national security. The Proclamation established a Mandatory Oil Import Program (MOIP) for the purpose of stimulating U.S. oil exploration, development and refining capacity. The Secretary of the Interior administered the MOIP, which consisted of a system of percentage quotas, import licenses to implement the quotas, and allocation guidelines to distribute the licenses among the five U.S. geographic districts.

The crude oil import ceiling volumes were first pegged to a percentage of demand (based on historical 1957 shares under the Voluntary Oil Import Program) and later limited to 12% of domestic production. Refined petroleum product imports were also tied to historical (1957) volume levels. As a consequence, established importers had their import purchase volumes scaled back, and new traders and importers were granted access to the program on a limited basis. The MOIP lasted until 1973 as a volume control program in various forms, and then until 1983 as a fee program.

The Presidential Proclamation was prompted by the investigation conducted by the Director of the Office of Civil and Defense Mobilization (OCDM) under Section 8(d) of the Trade Agreements Extension Act of 1958, to determine the effects of imports of crude oil and its derivatives and products on the national security. The OCDM Director advised the President on February 27, 1959 that crude

oil and the principal crude oil derivatives and products were being imported in such quantities and under such circumstances as to threaten to impair the national security.

The investigation was undertaken as a result of continuing concern about the effect of increased oil imports into the U.S. during the 1956-1959 period. In April 1957 the OCDM Director reported to the President that he had "reason to believe that crude oil was being imported in such quantities and under such circumstances as to threaten to impair the national security". This determination was issued under Section 7 of the Trade Agreements Extension Act of 1955, pursuant to a petition filed by the Independent Petroleum Association of America (IPAA) on August 7, 1956. President Eisenhower responded to the 1957 report by agreeing with the determination. However, he urged the OCDM Director to further investigate the possibility of effectively limiting imports on a voluntary basis. This eventually led to the 1959 Presidential Proclamation establishing the MOIP.

The 1959 determination that oil imports were threatening to impair the national security was based on several factors, including the following:

- o The level of oil imports and their ratio to domestic oil consumption rose steadily from 1954-1959 (with the exception of a brief period during the Suez Crisis in 1956), to a high of 19% of consumption.
- o Notwithstanding the effectiveness of the Voluntary Oil Import Program, which began in 1955, the quantities and circumstances of oil imports had not yet been stabilized.
- o In particular, the quantities of imports of the principal crude oil derivatives and products had actually increased during the voluntary program, and the circumstances suggested deliberate circumvention of the intent of the program.
- o From 1954-1958, the domestic demand for petroleum products increased 16.8%, while domestic crude oil production increased only 5.8%. This deterioration threatened the ability of the domestic petroleum suppliers to meet the requirements of an expanding industrial economy.
- o There appeared to be a relationship between the decline in reserves relative to demand and the decline in exploratory drilling. The decline in drilling was itself related to imports of crude oil and products from areas of much greater proven reserves with lower production costs than the United States.
- o Finally, it appeared that excessive quantities of low-priced oil were seeking a U.S. market in a situation of world over-supply. Without any production restraints in producing countries there would be substantial incentives to increase imports into the United States.

- o This would continue to upset a "reasonable balance between imports and domestic production", with deleterious effects upon adequate exploration and the development of additional domestic reserves which could only be generated by a healthy domestic production industry.

Transition Period 1959-1975

Notwithstanding the creation of the MOIP in 1959, the rate of increase in domestic oil consumption outpaced U.S. oil production. Consequently, net oil imports continued to grow. They rose from 1.61 MMB/D during 1960 -- the first full year of the MOIP -- to 6.03 MMB/D during 1973. Presidents Kennedy, Johnson, and Nixon responded to this problem by using Section 232 authority to increase the import quota levels.

A Cabinet task force on oil imports found in 1970 that the U.S. energy situation had changed since 1959 and that the MOIP had not fulfilled all of its original objectives. (See The Oil Import Question: A Report on the Relationship of Oil Imports to the National Security, the Cabinet Task Force on Oil Import Control, February 1970). The report cited as a major problem the various exceptions to the MOIP that had been granted to various regional U.S. energy markets. Further, the report concluded that in the future the U.S. would depend on additional oil imports. As a result, President Nixon used Section 232 authority to enact significant changes in the MOIP. First, the President modified the existing oil import quota system. He also suspended the existing tariffs on petroleum product imports. In its place, he created a graduated schedule of import licensing fees.

Concurrently with the changes in the U.S. oil import situation, the world oil market was also changing rapidly. Venezuela, Saudi Arabia, Kuwait, Iraq, and Iran founded the Organization of Petroleum Exporting Countries (OPEC) in September of 1960. OPEC was created to establish a joint consultative mechanism for the members to maximize the exploitation of their oil resources. What began as an organization to prevent the continued decline of oil prices to below \$1 per barrel grew over the next decade into an entity that took control over oil pricing decisions away from the international oil companies. By 1973, OPEC countries were: (1) assuming majority ownership and operational control over their oil production at the expense of the international oil companies; (2) adjusting the financial terms of their relationships with these companies; and (3) raising oil prices. These actions meant higher prices for Western oil consumers who by now were heavily dependent on OPEC oil.

The 1973 Arab/Israel War and the ensuing Arab Oil Embargo and associated oil production cutbacks resulted in a quadrupling of world oil prices. OPEC was firmly entrenched as the determiner of world oil prices which rose rapidly in response to the production cutbacks by its Arab oil exporting members as a consequence of the 1973 Arab/Israel War. Moreover, the Western consuming nations,

particularly the United States were also subject to oil embargoes that could harm their economies. These developments led the U.S. Government to begin a comprehensive review in 1974 of the prospects of becoming totally self-sufficient in energy by the early 1980's. The resulting Project Independence Study concluded that total energy self-sufficiency: (1) could not be accomplished before the mid-1980's; (2) that the cost would be very expensive; and (3) that the U.S. Government should stockpile crude oil as protection against another supply interruption.

The 1975 Study

On January 23, 1975, President Ford issued Proclamation No. 4341 establishing a system of license fees to replace the old quota system under the MOIP. License fees of up to \$3.00 per barrel were imposed beginning immediately. They were gradually phased-out during the next 7 years.

The proclamation was issued pursuant to the January 14, 1975 Section 232 investigation report by the Treasury Secretary determining that crude oil, crude oil derivatives and products, and related products derived from natural gas and coal tar were being imported into the U.S. in such quantities and under such circumstances as to threaten to impair the national security. The investigation was self-initiated by the Secretary of the Treasury.

The determination was based on several factors, including the following:

- o From the late 1940's (when the U.S. became a net importer of petroleum) until 1973, the shortfall in domestic petroleum production (compared with domestic demand) had grown into a potential problem to our economic welfare in the event that supplies from foreign sources were interrupted. (Note: Domestic demand in 1973 was 17.3 million barrels per day, of which 6.0 million barrels per day were supplied by imports.)
- o Our balance of payments position had also deteriorated by 1973 as a result of petroleum imports, with an outflow of \$8.3 billion for oil imports, only partially offset by exports of petroleum products.
- o In September 1973, the worsening petroleum import situation was further aggravated by an embargo on crude oil imposed by some members of OPEC. The embargo prevented 2.4 million barrels per day of petroleum from reaching the world market for a brief period, and the price of imported oil quadrupled (from \$2.50 per barrel to \$10.00 per barrel) immediately.
- o These price increases placed further pressure on the U.S. balance of payments position, so that by the end of 1974 the outflow of payments for imported petroleum was running at a rate of \$25 billion annually.

- o The investigation report concluded that the United States could reduce consumption of petroleum imports by one million barrels per day through conservation without adversely affecting the level of economic activity. However, the United States could not absorb another 2.4 million barrels per day disruption without a prompt and substantial impact upon its economic well-being.
- o Considering the "close" relationship between the nation's economic welfare and security, a large and sudden oil supply disruption would clearly threaten to impair the national security.
- o Further, in the event of a "worldwide political or military crisis", there would be a risk of a more complete interruption of the flow of imported oil, and the total U.S. production of 11 million barrels per day in 1973 "might well have been insufficient to supply adequately a war-time economy, even after mandatory conservation measures were imposed."
- o In addition, the massive payments outflow to other countries for oil imports inevitably would reduce the flexibility and viability of our foreign policy objectives. For this reason, a payments outflow posed a more intangible, but just as real, threat to the security of the U.S. as the threat of petroleum supply interruption. On both grounds, decisive action was considered essential.

The 1979 Study

On March 29, 1979 the Treasury Secretary issued a report under authority of Section 232 of Trade Expansion Act of 1962, stating that oil was being imported in such quantities and under such circumstances as to threaten to impair the national security. The investigation was initiated by the Treasury Secretary on March 15, 1978, and the determination was based on the nation's increasing dependence on oil imports from one area of the world, the increased U.S. vulnerability to supply disruptions from unstable areas of the world, and the adverse effects on the U.S. balance of payments arising from increased oil prices and oil imports.

The investigation report considered the following key factors in arriving at a determination that oil imports were threatening the national security:

- o The U.S. had increased its dependency on a small number of existent foreign oil suppliers, located mostly in the Eastern Hemisphere, and particularly in the Middle East. (The proportion of oil imports from the Middle East had risen from 21% of all imports in 1959 to 34% by 1978.)

- o The value of oil imports had jumped sharply from \$1.5 billion in 1959 to \$42.3 billion in 1978, putting pressure on the U.S. balance of payments position. This could increase the danger of reduced international confidence in the dollar, which could result in downward pressures in the foreign exchange market. Such a loss of confidence would impair the national security.
- o The risk of disruption of oil imports as a result of political disagreements was highlighted by the events in Iran which led to an abrupt decrease in oil imports available to the U.S. in late 1978/early 1979.
- o Furthermore, other types of supply disruptions were considered possible at the time. Six of the Middle Eastern nations which were major suppliers of oil to the U.S. shipped their oil through the narrow Strait of Hormuz, a supply route considered vulnerable to disruption. Moreover, the producing nations themselves faced a risk of terrorist action with attendant harm to oil production and shipment facilities.
- o In addition, the impression of vulnerability created by the nation's seeming inability to control its increasing dependence on oil imports directly affects the nation's defense and foreign policy.
- o In short, the overall potential for an embargo or other interruption had not decreased since the 1973 embargo, nor since the 1975 finding by the Treasury Secretary that such a risk threatened to impair the national security.

Five Presidential Proclamations resulted from the 1979 Section 232 investigation. On April 6, 1979, in the midst of a mounting energy crisis triggered by the Iranian revolution, President Carter signed Proclamation No. 4655, which reduced all fees and tariffs on crude oil and petroleum products to \$0.00 per barrel for a three-month period, from April 1-June 30, 1979. President Carter took action in light of the market shortages and adverse price conditions, and the proclamation specifically provided for automatic reimposition of fees (ranging from \$0.21 to \$0.63 per barrel) unless the Secretary of Energy found that such reimposition was not in accordance with the MOIP. The Secretary of Energy subsequently deferred reimposition for two consecutive six-month periods beginning in June 1979.

The second proclamation occurred on November 2, 1979, when President Carter issued Proclamation No. 4702, banning all imports of crude oil from Iran. This action was taken, under the authority of the 1979 determination made under Section 232 of the Trade Expansion Act of 1962, in the wake of the taking of American hostages.

On April 2, 1980, President Carter issued the third proclamation (No. 4744), which imposed import fees on crude oil and petroleum

products under a new program entitled the Petroleum Import Adjustment Program (PIAP - it was also known as the Gasoline Conservation Fee Program). The PIAP was structured to ensure that importers recovered the fees, and that the added cost of importation ultimately would be borne by the consumer in the form of a \$0.10 per gallon tax on gasoline. This aspect of the PIAP led to litigation in which a federal district court held that the PIAP was not authorized under Section 232 of the Trade Expansion Act of 1962 (Independent Gasoline Marketers Council v. Duncan).

The fourth proclamation (No. 4766) was issued on June 19, 1980, rescinding the PIAP and declaring that the MOIP would once again govern the importation of oil into the U.S. President Carter further provided that the \$0.00 fee would remain in place through December 31, 1980, and he did not include any provision for import fees to be reimposed after December 31. Accordingly, on December 22, 1980, the Department of Energy issued a notice stating that a fee of \$0.00 would remain in effect "as long as the President does not take further action"

Finally, the fifth proclamation (No. 4907) was issued on March 10, 1982, declaring that the 1979 finding of the Treasury Department's Section 232 study on oil was still valid and that imports threatened to impair the national security. The President used this authority to embargo imports of crude oil from Libya. (In November 1985, The President extended the embargo to include refined oil products from Libya under Section 504 of the International Security and Developmental Cooperation Act of 1985.)

On December 22, 1983, President Reagan used his authority under Section 232 to dismantle the Mandatory Oil Import Licensing System originally created in 1959. While the import licensing system was eliminated, the Reagan Proclamation (No. 5141) maintained in effect the existing tariff rates as normal customs duties reflected in the Tariff Schedules of the United States, on imports of crude oil and refined petroleum products.

The previous discussion of studies completed under Section 232 of the Trade Expansion Act of 1962 is helpful to illustrate the concerns the U.S. government has faced in examining the impact of petroleum imports on the national security. These studies primarily dealt with the increasing vulnerability of U.S. supplies of imported oil to supply disruptions caused by political or military upheavals in the Middle East, and to a lesser extent, with the dangers of increasing balance of payments problems arising from high oil prices and increasing dependency on imports to fuel U.S. consumption. Finally, the 1959 study examined the dilemma of domestic consumption rising faster than the increase in oil reserves or in oil production, threatening to impair the ability of the U.S. to supply its economy with the necessary fuel for industrial expansion.

Recent Department of Energy Studies on Energy Security

More recently, the Department of Energy (DOE) has undertaken a number of energy studies which review the changes in the world oil market and the U.S. oil industry between 1979 and 1986. The following DOE studies examine the issues of the U.S. refining industry and our overall energy security in the current situation of lower-priced oil, increasing U.S. oil imports since 1986, and a declining U.S. oil and natural gas resource base.

The 1986 Department of Energy (DOE) Refinery Study

The DOE refinery study, entitled "Product Imports, Energy Security and the Domestic Refining Industry" (published in June, 1986), was undertaken to examine the implications for energy security of both reductions in domestic refining capacity since 1981 and increasing product imports.

The conclusion of the analysis indicated that total domestic refining capacity in 1986 and the expected level of product imports would not pose an energy security threat to the United States. Further, the study predicted that there would be no further net closures of refining capacity through 1988, and that there was sufficient excess refining capacity in the U.S. and in other major petroleum refining centers to refine the available crude oil in the event of a product supply disruption in the Middle East and North Africa.

Between 1981 and 1986, about 120 U.S. refineries closed down. Of these closures, 98 had capacities of less than 30,000 barrels per day (MBD). The major cause of refinery closures was the elimination of crude oil price controls and the Small Refiner Bias of the Crude Oil Entitlements Program. This resulted in a shock to the U.S. refinery industry, which had been accustomed to an artificial cost advantage over foreign refiners from the oil price subsidy created by crude oil price controls. In addition to price controls, the small refiners were used to an additional subsidy from the Small Refiner Bias, which provided them a cost advantage compared with large, integrated refiners.

Furthermore, between 1981 and 1986, the United States experienced a surge in product imports, partly due to the lack of competitiveness of many small U.S. refiners who no longer had access to lower crude oil costs than their competitors. Another cause for the increase in imports was that foreign refiners had continued to upgrade their facilities and could yield an increasing proportion of light products, at a time when U.S. demand for lighter petroleum products had begun to increase. Many of the domestic refiners were unable to compete with these imports after the elimination of Federal price and allocation controls. It should be noted, however, that although light product imports increased, the total volume of light products (i.e. gasoline) consumed in the U.S. also increased during the same period.

By the end of 1985, those U.S. refiners who remained in business had added sophisticated capacity to upgrade the cheaper heavy oils into lighter products which are in greater demand in the U.S. market. Although capacity closures were still occurring in 1986, the restructuring of capacity through new purchases and reactivations resulted in a higher capacity utilization in early 1986 (about 83%) than at any time since the elimination of price controls in 1981. Lower oil prices have also contributed to higher profit margins for refiners.

The refinery study also examined the potential benefits to energy security and likely economic effects of imposing a protective tariff on imports of refined petroleum products. The report concluded that a tariff would produce no energy security benefits. There would be ample excess capacity available in the United States and in other secure countries to refine available crude oil supplies into the products needed to replace those lost during disruptions of refineries located in the Middle East and North Africa. A product tariff would, however, reduce imports of refined products, increasing domestic refinery output and profits at the cost of raising product prices to U.S. consumers. A tariff is unlikely to increase domestic refining capacity but would cause existing refineries to operate at higher utilization rates.

The DOE Energy Security Study

The DOE study entitled "Energy Security: A Report To The President of the United States" (published in March 1987), was undertaken to consider the national security implications of declining domestic oil production and growing reliance on imports from a small group of supplier countries.

The study notes that oil prices had fallen since 1981, and that they have dropped precipitously since 1986. Lower oil prices have brought benefits to the economy: inflation and interest rates are down, while employment, consumers' purchasing power and total economic output are up.

While lower oil prices provide many benefits to the economy, they also have had an adverse impact on the U.S. oil industry. For instance, lower oil prices accelerated the decline in oil production from high-cost sources (finding and producing oil is more expensive in the United States than in most other countries). Further, U.S. drilling is off sharply. For example, capital expenditures for oil exploration declined by 50% or more in 1986, and oil drillers' revenues fell by 49% between the third quarter of 1985 and the third quarter of 1986. Moreover, stripper-well production (oil wells on properties with an average production of 10 barrels per well per day) and the oil service industry were especially hard-hit, with many wells temporarily shut-in, or plugged and abandoned. In the summer of 1986, drilling activity reached a 46-year low rig count of

less than 700, compared with 3970 rigs in use in 1981. Further, the number of seismic crews engaged in exploration in 1986 was 47% below the 1985 level.

In addition to these direct impacts, the study notes that financing for oil exploration is more difficult than ever. As a result of many bank failures over the past few years and lower oil prices since 1986, many financial institutions will only consider lower-priced oil scenarios to evaluate future earnings on loans for oil exploration and development. The study also notes that oil-producing states' revenues have also been affected by lower oil prices. It is estimated that for every dollar decline in oil prices, Alaska loses about \$150 million and Texas loses about \$100 million in combined revenue from production taxes and royalty payments.

In order to project future developments in the U.S. oil industry, the study utilized two main price scenarios, ranging from a "low price case" scenario in which prices rise to \$15 per barrel by 1990 and about \$22 per barrel by 1995); and a "high oil price case", where oil prices rise to \$23 per barrel by 1990 (\$28 per barrel in 1995).

Generally, the study notes that lower oil prices stimulate consumption while discouraging production and encouraging more oil imports. U.S. oil imports will probably increase substantially by 1995 (in fact, we may be importing over 50% of our oil consumption by that time). Higher oil imports translates into a growing worldwide reliance on OPEC oil, especially from the Persian Gulf. This anticipated dependence on Persian Gulf oil would pose a problem for energy security because it would make the United States more vulnerable to oil supply disruptions from an unstable area of the world. (As noted earlier in this historical overview, the United States suffered from Middle East supply disruptions in 1973 and in 1978/79, which resulted in soaring oil prices and severe economic impacts.)

The DOE study warns that revolutions, regional wars, or conflicts instigated by outside powers in the Middle East could disrupt oil supplies again and cause economic hardship for the United States and other countries. In the event of a military emergency, an oil disruption could further complicate an already difficult situation.

Furthermore, politically inspired production cutbacks by major oil producers also could hurt the U.S. economy and/or limit its geopolitical options. According to the study, if dependence on certain oil producers carries with it these dangers, the government has a responsibility to take some type of defensive action.

DOE describes the challenge for policy makers as the ability to find the proper balance between relying on free and competitive markets, where they can exist, and taking appropriate, cost-effective action to ensure the Nation's economic health and national security.

According to the study, the Free World has improved its ability to leverage supply disruptions in light of the experiences of the 1970's. Stock levels for OECD as a group are substantial and improving (this includes the U.S. Strategic Petroleum Reserve - SPR). OECD countries can respond to disruptions better than in the past through coordinated drawdowns of stocks, alternative delivery routes, and fuel-switching capabilities in consuming sectors. In addition, the United States has dismantled its programs for price control and allocation of oil so that the market can respond more effectively to future supply disruptions.

Nevertheless, DOE maintains that we need to continue the policy of encouraging more domestic energy production, increased energy efficiency, and greater fuel substitution to limit excess dependence on oil imports and the vulnerability which is inherent in that dependence.

A variety of options available for government action are described in the study, including (1) direct incentives to boost U.S. oil activity (such as oil import fees, tax and financial options, and lease terms and royalty fees modifications), and (2) more indirect methods of removing impediments and targeting research and development R&D to make U.S. oil more competitive (such as modifying tax and regulatory disincentives, increasing access to Federal lands, ending barriers to exports of U.S. crude oil from California and the North Slope of Alaska, and targeting R&D through Government and private sector cooperation).

There are no recommendations made in the study about a proposed action plan, however each option is evaluated and some options clearly are presented with many more costs than benefits. For example, the costs of an oil import fee involve rising energy prices (for oil and its substitutes), reduced economic growth, increased inflation, and decreased competitiveness in both foreign and domestic markets. According to DOE, these costs outweigh the value of increased Federal revenues (which would be largely offset by reduced income tax collections and increased government expenditures) and the benefits to the U.S. oil industry and to overall U.S. oil production. Another option examined was a gasoline tax, which would, according to the DOE report, reduce GNP, increase the general price level during the year of enactment, and have a negative impact on many gasoline-dependent industries.

According to the study, some of the more desirable direct tax incentives include the following: (1) repeal of the Windfall Profit Tax (Note: This was accomplished in the Omnibus Trade and Competitiveness Act of 1988), (2) repeal of the "transfer rule" for the percentage depletion deduction, (3) increase in net-income limitations for the percentage depletion deduction, (4) raise the depletion allowances for independents, (5) increase the depletion allowances on new production, (6) allow for a faster recovery of geological and geophysical (G&G) costs, (7) provide tax credits for

exploration and development, and (8) provide financial loan-price guarantees.

Some of the more desirable indirect incentives according to DOE would include: (1) developing and implementing a new leasing program for the Outer Continental Shelf (OCS), (2) allowing exploration and development to occur in the Coastal Plain of the Arctic National Wildlife Refuge (ANWR), (3) improving environmental regulations to reduce uncertainty, delays and compliance costs in a way that maintains environmental protection, and (4) targeting long-term R&D through government and private sector cooperation.

Finally, the study notes that removal of oil export control restrictions on exports of crude oil from North Alaska and California could remove economic inefficiencies in the transport and use of that crude oil. This would raise oil prices at the wellhead and stimulate additional production. Increased production would reduce net U.S. oil imports and contribute to energy security.

Removal of the crude oil restrictions, however, would adversely reduce the availability of militarily useful tankers. It could also increase the price of petroleum products in California as the excess crude in that region was shipped elsewhere, and large investments in pipelines to move excess California crude to other U.S. markets would be jeopardized if the export restrictions vanished.

The DOE report recognized the problems associated with continued and growing dependence on potentially insecure foreign oil and recognized the need to stimulate more economic domestic energy production by removing disincentives. Accordingly, it outlined the various options for government action mentioned above.

Summary of Previous Energy Security Issues

Since the 1950's, the U.S. Government has conducted several formal studies on energy security. Our concerns have centered on: (1) the increased need for the United States to import oil to meet its consumption requirements, (2) the increasing vulnerability of U.S. supplies of imported oil to supply disruptions caused by political or military upheavals in the Middle East, (3) the dangers of increasing balance of payments problems or the potential for such problems, arising from high volume oil imports (whether at the high oil prices experienced in the 1970's or at low oil prices experienced in the 1950's and today, which could presumably drive up prices in the long-run), (4) the implications of a declining domestic oil resource base, which is projected to decline throughout the rest of the century, and (5) the need to stimulate additional domestic oil exploration and development and the enhanced recovery of the oil-in-place to mitigate somewhat the impacts of the concerns mentioned above.

Given the historical record of energy security concerns noted above, it is important to examine the current state of the oil market (both international and domestic) and any current national security concerns arising from oil imports. The historical precedents should serve as benchmarks against which to evaluate the current situation, in order to confirm a continuing threat to national security or to report that the threat has been finally eliminated.

Section III. CURRENT U.S ENERGY SECURITY ASSESSMENT

Both the energy security position of the United States and the economic status of the domestic oil industry differ today from what they were in the 1970's, when several of the studies described in the previous chapter were conducted.

Factors Enhancing Energy Security

There are a number of factors which have served to enhance U.S. energy security as well as several factors that are now contributing to its erosion. This section will describe both sets of forces as they affect energy security. In many respects, the overall energy security position of the United States has improved from the 1970's, when net oil imports at one point exceeded 43 percent of consumption and OPEC imports were 30.5 percent of consumption (See Table III - 1). This improved energy security position is also evidenced by the current disarray within OPEC and low world oil prices. The factors which have improved U.S. energy security are described below:

- o Strategic Petroleum Reserve (SPR) - The United States now has a strategic reserve of 555 million barrels which provides 96 days of protection based upon 1987 net imports of 5.8 million barrels per day (MMB/D).¹ Other OECD nations have also created government-owned stockpiles amounting to 400 million barrels. In addition, many private companies in OECD countries have stocks in excess of commercial needs. Some of these stocks are potentially available for use in an emergency situation.
- o Emergency Sharing Programs - The United States works closely with its partners in the International Energy Agency (IEA) to develop policies and programs for a coordinated international response to future oil supply disruptions. As oil markets change and governments' response capabilities improve, the IEA works to enhance existing emergency response programs, develop entirely new programs more suited to today's circumstances, and test national and international emergency response procedures.
- o Decontrol of Domestic Oil Market - The elimination of oil price and allocation controls has enhanced energy security by ensuring that the market will adjust more efficiently to any future oil supply interruptions.
- o Non-OPEC Oil Supplies - The growth of non-OPEC production primarily from Mexico and the North Sea contributed to an overall increase in non-OPEC supplies from 21.7 MMB/D in 1980 to 26.8 MMB/D in 1987.² At the same time, OPEC production has declined from almost 32 MMB/D during 1977 to 19 MMB/D in 1987. As a result, today there exists approximately 9-10 MMB/D of surplus oil production capacity in the Free World (See Table III - 2).
- o Natural Gas Development - The development of large North Sea and Canadian pipeline gas, as well as liquefied natural gas (LNG) has

TABLE III - 1
U.S. Crude Oil and Refined
Product Imports, 1973 to Present
(Thousand Barrels Per Day)

| <u>Year</u> | <u>Total OPEC</u> | <u>Total Arab OPEC</u> | <u>Non-OPEC Sources</u> | <u>Gross Imports</u> | <u>U.S. Exports of Crude & Products</u> | <u>Apparent Net Imports</u> | <u>Petroleum Consumption* (MMB/D)</u> | <u>Net Imports as a Percentage of Apparent Consumption</u> | |
|-------------|-------------------|------------------------|-------------------------|----------------------|---|-----------------------------|---------------------------------------|--|---------------------|
| | | | | | | | | <u>Total Imports</u> | <u>OPEC Imports</u> |
| 1973 | 2,993 | 915 | 3,263 | 6,256 | 231 | 6,025 | 17.3 | 34.8 | 17.3 |
| 1978 | 5,751 | 2,963 | 2,613 | 8,363 | 362 | 8,002 | 18.8 | 42.6 | 30.6 |
| 1979 | 5,637 | 3,056 | 2,819 | 8,456 | 472 | 7,984 | 18.5 | 43.2 | 30.5 |
| 1980 | 4,300 | 2,551 | 2,609 | 6,909 | 544 | 6,365 | 17.1 | 37.2 | 25.1 |
| 1985 | 1,830 | 472 | 3,237 | 5,067 | 781 | 4,286 | 15.7 | 27.3 | 11.7 |
| 1986 | 2,837 | 1,162 | 3,387 | 6,224 | 785 | 5,439 | 16.3 | 33.4 | 17.4 |
| 1987 | 2,994 | 1,255 | 3,547 | 6,541 | 773 | 5,767 | 16.6 | 35.7 | 18.0 |

* Apparent Consumption consists of total petroleum products supplied from refiners and storage. Exports of petroleum products and crude oil have already been netted out.

Total Petroleum Products Supplied

| <u>Year</u> | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1985</u> | <u>1986</u> | <u>1987</u> |
|----------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Motor Gasoline | 7.4 | 7.0 | 6.6 | 6.8 | 7.0 | 7.2 |
| Home Heating Oil and Diesel Fuel | 3.4 | 3.3 | 2.9 | 2.9 | 2.9 | 3.0 |
| Residual Fuel Oil | 3.0 | 2.8 | 2.5 | 1.2 | 1.4 | 1.3 |
| Jet Fuels | 1.1 | 1.1 | 1.1 | 1.2 | 1.3 | |
| Liquid Petroleum Gases | 1.4 | 1.6 | 1.5 | 1.6 | 1.5 | 5.1 |
| Other | 2.5 | 2.7 | 2.6 | 2.0 | 2.0 | |
| Total | 18.8 | 18.5 | 17.1 | 15.7 | 16.3 | 16.6 |

Note: Totals may not equal sum of components due to independent rounding.

Sources: 1973-86, EIA Annual Energy Review - 1986, page 121; 1987, DOE Petroleum Supply Monthly, January 1988, pages 2-3 and 8-9.

TABLE III - 2

Free World Crude Oil
Production Capacity - 1988*
(Million Barrels Per Day)

| <u>Region</u> | <u>Capacity**</u> | <u>Projected Production</u> |
|---------------|-------------------|-----------------------------|
| Persian Gulf | 19.8 | 12.3-13.0 |
| Other OPEC | <u>8.9</u> | <u>6.9-7.0</u> |
| Subtotal OPEC | 28.7 | 19.3-20.0 |
| Non-OPEC | <u>27.4</u> | <u>27.0-27.2</u> |
| Total | 56.1 | 46.4-47.1 |

Total Surplus Capacity 9.0-10.0

*Includes crude oil, natural gas liquids, and refinery processing gains.

**Consists of maximum sustainable rates that can be attained within 90-100 days and sustained for at least 90 days.

SOURCE: Energy Information Administration, U.S. Department of Energy.

limited the growth in demand for oil.³ The availability of excess gas production/deliverability capacity in Free World markets facilitates interfuel substitution during a supply emergency.

- o Reduced Oil "Intensity" of the U.S. Economy - Oil plays a smaller role in the economy today than it did in the 1970's. The United States consumed only as much energy in 1987 as it did in 1973 even though the economy grew 40 percent over that period. At the same time, many large oil users have developed the capability to substitute large volumes of natural gas and coal for imported oil when economic conditions or other factors dictate.
- o Petroleum Transportation Flexibility - The construction of additional crude oil pipelines has diversified Middle Eastern oil transportation patterns and thus reduced the delivery of oil through the Straits of Hormuz. Since the late 1970's, approximately 4.5 MMB/D of crude oil pipeline capacity has been built and another 1.6 MMB/D is under construction. These pipelines include: (1) the Petroline from Saudi Arabia's eastern oil fields to the Red Sea; (2) the Iraq-Saudi pipelines which transship Iraqi oil through Saudi Arabia to the Red Sea; and (3) the Iraq-Turkey pipelines.⁴ The capability by 1990 to export 6 MMB/D of crude by pipeline represents a major improvement since late 1980 when pipeline export capacity amounted to only 1 MMB/D. The construction of these pipelines results in a diversification of transportation routes, and thereby reduces the share of Persian Gulf production delivered to world markets through the Straits of Hormuz.

The U.S. Refining Industry

As noted in Chapter II, DOE's 1986 study of domestic refineries has documented several changes in that industry in recent years. For example, following the removal of crude oil price and allocation controls in 1981, small U.S. refiners lost their access to price-subsidized crude oil. Largely as a result of this action, 120 refineries closed down, 98 of which had processing capacity under 30,000 B/D.⁵ Refiners have recently begun to operate at higher utilization levels, and sales of refined products have increased. Increased demand for refined products translates into improved financial success for U.S. refiners. As the data in Table III - 3 point out, the utilization rate of U.S. refineries increased from 69 percent during 1981 to 82 percent in 1987.

The data in Table III - 3 shows total domestic refining capacity of 15.7 MMB/D. At an 82 percent utilization factor, the United States processed approximately 13 MMB/D or nearly 80 percent of the 16.6 MMB/D domestic consumption. The remainder of U.S. consumption was accounted for through natural gas liquids, refinery processing gains, product stocks changes, and 1.9 MMB/D of product imports.

TABLE III - 3

DOMESTIC REFINERY CAPACITY AND
UTILIZATION RATES, 1950-1987
(As of January 1)

| <u>Year</u> | <u>Number of Refineries</u> | <u>Average Capacity (Million B/D)</u> | <u>Gross Input</u> | <u>Utilization Rate (%)</u> |
|-------------|-----------------------------|---------------------------------------|--------------------|-----------------------------|
| 1950 | 320 | 6.22 | 5.98 | 93 |
| 1960 | 309 | 9.84 | 8.44 | 85 |
| 1970 | 276 | 12.02 | 11.52 | 93 |
| 1973 | 268 | 13.64 | 13.15 | 94 |
| 1974 | 273 | 14.36 | 12.69 | 87 |
| 1975 | 279 | 14.96 | 12.90 | 86 |
| 1979 | 308 | 17.44 | 14.96 | 84 |
| 1980 | 319 | 17.99 | 13.80 | 75 |
| 1981 | 324 | 18.62 | 12.75 | 69 |
| 1985 | 223 | 15.66 | 12.17 | 78 |
| 1986 | 216 | 15.46 | 12.83 | 83 |
| 1987 | N/A | 15.70 | 12.91 | 82 |

SOURCE: 1950-1979, Product Imports, Energy Security and the Domestic Refining Industry, Department of Energy, June 1986, p. 8-9; 1980-86, DOE, Energy Information Administration, Petroleum Supply Annual, 1986, May 1987, p.66; 1987 data from Weekly Petroleum Status Report, DOE, January 15, 1988, p.4.

Capacity and gross input numbers are estimated for 1987.

Total U.S. refining capacity is not expected to change much in the near term. However, U.S. refiners have added substantial upgrading and desulfurization capabilities. These plant upgradings provide U.S. refiners with the flexibility to process various crude oil feedstocks to meet the slate of products demanded. The DOE Refinery Study found that U.S. downstream refinery capacity amounts to approximately 82 percent of total distillation, compared to other regions of the world where this capacity ranges from 15 to 40 percent of distillation capacity.

The amount of U.S. refining and conversion capacity relative to product consumption addresses only one of the issues concerning energy security and the U.S. refining industry. It is also necessary to examine the levels of U.S. refined product imports, the availability of non-OPEC Free World refining capacity, and the status of OPEC refineries. Table III - 4 indicates that since 1980, U.S. imports have increased only slightly, ranging from 1.6-2.0 MMB/D. This amounts to 10-12 percent of U.S. oil consumption. Within that aggregate number, imports of gasoline grew between 1980 and 1985 and have then leveled off. Imports of middle distillates, including jet and diesel fuels, have increased by 39 percent since 1981, but imports of residual oil have declined sharply. On balance, there is unlikely to be a major surge in product imports.

Another major index of the capability to provide U.S. product requirements during an emergency is the availability of Free World refining capacity. Table III - 5 shows that during 1987, surplus Free World refining capacity exceeded 8 MMB/D.

The amount of U.S. refining capacity combined with the non-OPEC surplus refining capacity suggests strongly that capacity is available to carry out refining operations in the event of a disruption of product imports from Middle Eastern OPEC sources.

The OPEC nations appear unlikely to send massive product exports to the United States for a number of reasons.⁶ First, these countries will need to meet rising internal requirements. Second, petroleum products are more expensive to transport than crude oil, and the Middle Eastern nations have more proximate product markets in Western Europe and Japan. The exporters will probably seek to diversify product exports between the United States, West European, and Japanese markets.

Third, some OPEC countries are purchasing refineries and marketing operations in consuming countries. This trend is likely to continue as producing countries seek long-term access to major oil consuming markets. To the extent that OPEC producers, such as Kuwait and Saudi Arabia, increase downstream investments in OECD energy markets, there will be an incentive not to take actions which will disrupt oil markets.

TABLE III - 4

U.S. IMPORTS OF PETROLEUM PRODUCTS
BY TYPE OF PRODUCT, 1973-1987
 (thousand barrels per day)

| <u>Year</u> | | | | | | | Products Imports as a Percent of: | |
|-------------|-----------------------|-------------------|--------------------------|--------------------------------|--------------|------------------------|-----------------------------------|------------------------------|
| | <u>Motor Gasoline</u> | <u>Distillate</u> | <u>Residual Fuel Oil</u> | <u>Liquified Petroleum Gas</u> | <u>Other</u> | <u>Product Imports</u> | <u>Gross Oil Imports</u> | <u>Total Oil Consumption</u> |
| 1973 | 134 | 392 | 1,853 | 132 | 502 | 3,012 | 48.1 | 17.4 |
| 1974 | 204 | 289 | 1,587 | 123 | 432 | 2,635 | 43.1 | 15.8 |
| 1975 | 184 | 155 | 1,223 | 112 | 277 | 1,951 | 32.2 | 11.9 |
| 1979 | 181 | 193 | 1,151 | 217 | 195 | 1,937 | 22.9 | 10.5 |
| 1980 | 140 | 142 | 939 | 216 | 210 | 1,646 | 23.8 | 9.7 |
| 1981 | 157 | 173 | 800 | 244 | 226 | 1,599 | 26.7 | 10.0 |
| 1985 | 381 | 200 | 510 | 187 | 588 | 1,866 | 36.8 | 11.9 |
| 1986 | 326 | 247 | 669 | 242 | 561 | 2,045 | 32.9 | 12.6 |
| 1987 | 366 | 240 | 553 | 190 | 551 | 1,901 | 29.1 | 11.5 |

Source: DOE Petroleum Supply Monthly, January 1988,
 Department of Energy, p. 2-3, 11-18.

Table III - 5 - Market Economies Refinery
Capacity and Utilization - 1987
(Million Barrels Per Day)

| <u>Countries</u> | <u>Crude Oil Distribution Capacity</u> | <u>Refinery Output</u> | <u>Spare Capacity</u> |
|-------------------------------|--|----------------------------|---------------------------|
| OECD North America | 17.9 | 16.7 | 1.1 |
| OECD Pacific | 5.3 | 4.0 | 1.3 |
| OECD Western Europe | 14.1 | 11.5 | 2.6 |
| OPEC | 6.2 | 5.0* | 1.2* |
| Other Developing Countries | 11.9 | 9.5* | 2.4* |
| Total for Market Economies | 55.4 | 46.7 | 8.6 |

*Estimated. These figures assume that non-OECD countries used 80 percent of refining capacity.

Note: Individual numbers may not add correctly because of rounding.

Sources:

U.S. Refinery Capacity - DOE Petroleum Supply Annual, 1986, Energy Information Administration

Non-U.S. Refinery Capacity - Oil and Gas Journal, December 28, 1987, Pennwell Publishing Company.

U.S. Refinery Output - Petroleum Supply Monthly, February 1986, Energy Information Administration.

Other-OECD Refinery Output - OECD Oil and Gas Statistics.

In summary, the Department of Commerce concurs with the analysis in a recent DOE study, Product Imports, Energy Security, and the Domestic Refining Industry (June 1986), which concluded that total U.S. refining capacity and the expected level of product imports pose no energy security threat to the United States. Moreover, the establishment of the SPR, the decontrol of U.S. crude oil prices, the growth in non-OPEC crude oil supplies, the expanded role for natural gas, the reduced oil intensity of the U.S. economy, improvements in interfuel substitution, and increased petroleum transportation flexibility have all served to reduce the energy security threat to the United States from OPEC oil imports and, to a degree, imports in general. These developments have at the present time effectively curtailed the power of OPEC to fix the world price of oil at a predetermined level.

Factors Impairing Energy Security

Despite the operation of forces limiting energy security threats, there are also causes for continuing concern. Net oil imports have risen again to 35 percent of domestic consumption in 1987 from a recent low of 27 percent in 1985 (See Table III - 1). Moreover, the percentage of domestic consumption accounted for by imports is expected to continue increasing over the next decade. In addition, U.S. dependence on OPEC as a source of imports is also increasing - from a low of 11.7 percent of domestic consumption in 1985 to 18.0 percent in 1987.

Imports into other consuming countries also are projected to increase in the 1990's. The world's growing demand for oil imports will be met increasingly by supplies from countries with the largest excess production capacity and the largest low-cost reserves - - namely the OPEC countries located in the Persian Gulf region. The OPEC share of Free World oil supplies is projected to rise from 42 percent in 1987 to between 45 and 60 percent by 1995, while the Persian Gulf market share is projected to rise from its current 27 percent to between 30 and 45 percent.

The remainder of this chapter contains a discussion of the major factors which explain this increasing reliance on imports including: the status of domestic exploration and production activities, the declining U.S. oil resource base, the economics of production in U.S. oil fields, and the Free World oil market outlook.

Current Status of Domestic Oil Industry

The major decline in oil prices during 1986 has had a significant impact on the U.S. oil industry, reducing both production and exploration. A few details on recent oil price history are useful in explaining the current situation: the price of oil dropped between 1981 and 1985 as oil consumption in the industrialized countries declined. For example, the OPEC official price for its

"marker" crude oil declined from \$34 per barrel in 1981 to \$26 in 1985.⁷ Between August 1985 and August 1986, Saudi Arabia increased oil output from approximately 2.3 to 6.4 MMB/D in an effort to recapture its market share of the market which had eroded substantially since 1981. As a result, oil prices fell from about \$26 per barrel in January 1986 to \$9-11 per barrel by mid-1986. Oil prices had only partially recovered by the end of 1986 and remained very volatile in the \$14 to \$18 range during 1987.

In the last decade, the total U.S. oil supply has varied from 10.3 to 10.6 MMB/D (See Table III - 6). However, since oil prices plummeted, the annual crude oil production component of supply has declined by approximately 700,000 B/D to 8.3 MMB/D in 1987. At the same time, imports of inexpensive OPEC oil increased by over 1 million barrels per day.

As a result, domestic oil companies either shut-in or, in some instances, abandoned sources of output with high production costs. The impact of low oil prices has been especially hard on a particular type of well with relatively high production costs - known as a stripper well. Oil wells on properties with an average production of 10 barrels per well per day or less are called stripper wells. The Department of Energy estimates that in 1987 there were 450,000 stripper wells (74 percent of all U.S. wells) accounting for 1.3 MMB/D of domestic production.⁸

In public comments on the Section 232 petition initiating this investigation, the Texas Independent Producers and Royalty Owners Association stated:

According to the National Stripper Well Association, 19,233 stripper wells were abandoned in 1986 - or virtually three times the number abandoned annually at the beginning of the decade. It is estimated that at current prices, as many as 70,000 additional wells are on production hold, waiting for improvement in production economics.

Furthermore, the Interstate Oil Compact Commission and Ram Group Ltd. in a 1986 study estimated that sustained oil prices of \$15 per barrel would result in the loss of approximately 277,000 barrels per day of stripper production. Moreover, they estimated that if oil prices fell to \$10 per barrel and remained there for an extended period, about 638,000 barrels per day of stripper production in the United States would be lost.⁹

In addition, as noted in the previous chapter, capital expenditures for oil exploration have declined by 50 percent or more in 1986, and oil drillers' revenues fell by 49 percent between the third quarters of 1985 and 1986. Lower cash flow and reduced profitability have resulted in many companies postponing plans for secondary and tertiary recovery operations that would partially offset production declines from older fields. In addition, the companies with less capital funds are drilling fewer development wells that would replace declining production.

U.S. Petroleum Supply - Salient Statistics
1978-1987
(Million Barrels Per Day)

| <u>Year</u> | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1985</u> | <u>1986</u> | <u>1987</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|
| <u>Total Petroleum Supply*</u> (including crude oil, natural gas liquids) | 10.3 | 10.2 | 10.2 | 10.6 | 10.3 | 10.0 |
| of which crude oil | 8.7 | 8.6 | 8.6 | 9.0 | 8.7 | 8.3 |
| <u>Imports</u> | | | | | | |
| <u>Crude Oil**</u> | 6.4 | 6.6 | 5.3 | 3.2 | 4.2 | 4.7 |
| <u>Products</u> | 2.0 | 1.9 | 1.6 | 1.9 | 2.0 | 2.1 |
| | <u>8.4</u> | <u>8.5</u> | <u>6.9</u> | <u>5.1</u> | <u>6.2</u> | <u>6.8</u> |

*Does not include refinery processing gains which amounted to 630,000 B/D during 1987.

** Includes up to 100,000 B/D of annual acquisitions for the Strategic Petroleum Reserve.

Note: Gross U.S. oil imports during 1987 totaled 6.5 MMB/D while exports reached 0.8 MMB/D, resulting in net imports of 5.8 MMB/D.

Sources: For 1978-86, DOE Petroleum Supply Annual 1986, p xii;
For 1987, DOE Petroleum Supply Monthly, June 1988, p 2.

The numbers in Table III - 7 shows the fall off in activity between 1985 and 1987. The average number of active rotary rigs in use for exploration declined from 1,980 to 936. The number of seismic crews at work fell from 378 to 176. Total footage drilled dropped from 307 to 148 million feet. Equally important, the number of exploratory and developmental wells completed plummeted from 69,170 to 33,320. If these levels are compared to 1981, the peak year of the U.S. drilling boom, the decline is even greater. Finally, employment in the oil and natural gas extraction industries dropped from 692,000 in 1981 to 425,000 in 1987.

The drop in oil industry activity has also affected the industry's infrastructure. The petitioner, in additional materials submitted during the public comment period, cited Bureau of Labor Statistics figures indicating that between 1981 and 1985, employment in the oil and gas field services sector of the industry alone had declined from 430,000 to 221,000.

In other public comments on the petition, the International Association of Drilling Contractors described the impact of low oil prices on employment and firms this way:

A substantial portion of the workforce consists of highly trained professionals. The professionals who have been laid off, have in many cases, left the industry. Experience has shown that they are unlikely to come back even if the market were to eventually turn around.

The contract drilling business is being devastated. More than 40 percent of the firms engaged in oil and gas drilling just a few years ago are out of business. Many of these that remain are on the brink of bankruptcy.

Not all the economic consequences of the 50 percent drop in oil prices between 1981 and 1986 have been negative. For example, industries in the United States which utilize petroleum-based inputs to manufacture goods such as plastics or use oil for energy to produce and transport goods have benefited from reduced costs for these supplies. In this regard the Petrochemical Energy Group stated in its public comments on the petition:

The petrochemical industry is one of the industries that is vulnerable to increases in oil prices. When the price of oil goes up, so does the price of the basic raw materials that are derived from oil and natural gas, and are used in the production of all petrochemicals.

In addition, the general public has benefited from lower costs for automotive gasoline and for home heating oil. In terms of the economy as a whole, these changes have contributed to a reduction in inflation, a rise in real disposable income, and an increase in real GNP.¹⁰

TABLE III - 7

U.S. Oil Industry Indicators, 1973-87

| <u>Year</u> | <u>Rotary Rigs In Use For Oil and Gas Exploration</u> | <u>Average Number Of Seismic Crews Onshore and Offshore</u> | <u>Footage Drilled In Million Feet</u> | <u>Employment</u> | <u>Total Wells Complet (Oil, Natural Gas, Dry Hole Explorator & Development Wells</u> |
|-------------|---|---|--|-------------------|---|
| 1960 | 1,748 | 385 | 192.2 | 309.2 | 45,620 |
| 1970 | 1,028 | 195 | 138.6 | 270.1 | 28,170 |
| 1973 | 1,194 | 250 | 139.4 | 273.9 | 27,690 |
| 1974 | 1,472 | 305 | 153.8 | 300.2 | 33,040 |
| 1980 | 2,909 | 530 | 312.3 | 559.7 | 69,840 |
| 1981 | 3,970 | 681 | 408.8 | 692.1 | 90,030 |
| 1985 | 1,980 | 378 | 307.0 | 582.9 | 69,170 |
| 1986 | 964 | 201 | 170.1 | 457.4 | 37,890 |
| 1987 | 936 | 176 | 147.5 | 425.2 | 33,320 |

SOURCE: Energy Information Administration. Annual Energy Review 1986, May 1987, p. 79-83, DOE Monthly Energy Review, December 1987, pp. 72-73. Employment figure for SIC-13, Total Oil and Gas Extraction Employees is from the Bureau of Labor Statistics Database.

U.S. Oil Resource Base

One of the chief factors affecting the outlook of the domestic oil industry is the oil resource base. The United States has only modest reserves relative to current and projected future production because we have depleted much of our petroleum reserves that are currently known and are economic given current oil prices and development costs.

The data in Table III - 8 point out the relatively small size of the current U.S. oil resource base in relation to domestic production and world reserves. Since 1978, proven reserves of crude oil declined from over 31 billion barrels to about 27 billion barrels. This resulted in a drop in the index of reserves to domestic production from 9.86 to 8.94 years of remaining proven reserves in relation to current production. Most of this drop in proven reserves occurred when prices were still high, prior to the price collapse at the end of 1986.

The Department of Energy recently estimated that the U.S. finding rate for oil per foot drilled declined from 17 barrels during the 1970's to about 8 barrels in 1986.¹¹ At a finding rate of 8 barrels per foot drilled, the United States would have to drill almost 379 million feet during 1988 to replace 3.03 billion barrels produced during 1987. The major implication of this data is that the United States does not appear to have an ample supply of low-cost oil remaining to be discovered.

Exploration for new oil fields in the United States has not been very successful in recent years. In fact, over 80 percent of additions to reserves over the past 10 years have come from revisions and extensions of existing oil fields rather than from development of new fields.¹² There remain some important prospects in North Alaska and in the Outer Continental Shelf which may help to stem the decline in U.S. reserves and production, but they are unlikely to reverse the trend. Additionally, improved understanding of geology and better drilling and recovery technology may also help in the future, but application of new technologies will tend to be expensive compared with the large, low-cost reserves available in other countries.

Table III - 9 shows the relatively small size of U.S. oil reserves compared to Free World reserves. While U.S. proven reserves declined by 4 billion barrels since 1976, OPEC and Arab OPEC reserves increased by 271 and 207 billion barrels respectively. These groups also account for 75 and 56 percent respectively of total world reserves of 889 billion barrels.

The reserves situation in the United States is not surprising when one considers that the United States was one of the first countries to produce oil and for many years was the world's largest producer (and is currently the second largest producer). As a result, the

TABLE III - 8

U.S. Crude Oil: Reserves-To-
Production Index, 1978-85
(Billion Barrels)

| <u>Year</u> | <u>Crude Oil Reserves</u> (Billion Barrels) | <u>U.S. Crude Oil Production</u> (Million Barrels Per Day) | <u>Reserves-to-Producti Index</u> (Years) |
|-------------|--|---|--|
| 1978 | 31.36 | 8.71 | 9.86 |
| 1979 | 29.81 | 8.55 | 9.55 |
| 1980 | 29.81 | 8.60 | 9.47 |
| 1981 | 29.43 | 8.57 | 9.41 |
| 1982 | 27.86 | 8.65 | 8.82 |
| 1983 | 27.74 | 8.69 | 8.75 |
| 1984 | 28.45 | 8.88 | 8.75 |
| 1985 | 28.42 | 8.97 | 8.68 |
| 1986 | 26.89 | 8.68 | 8.49 |
| 1987 | 27.26 | 8.35 | 8.94 |

Note: Estimates of reserves are as of the end of each calendar year. The reserves to production index measures the number of years remaining of proven crude oil reserves. The index divides annual crude oil production into remaining crude oil reserves to obtain the number of years of proven crude oil reserves remaining at current oil production rates.

Source: 1978-85, DOE Petroleum Supply Annual, 1986, page XIV. 1986 and 1987 production, DOE Petroleum Supply Monthly, June 1988, page 2. 1986 and 1987 Reserves, U.S. Crude Oil, Natural Gas, Natural Gas Liquids Reserves; Advance Summary for 1987, Annual Report page 3.

TABLE III - 9

Estimated International
Crude Oil Reserves, End of Year
1976 and 1987
(Billion Barrels)

| | <u>1976</u> | <u>1987</u> | Billions Barrels Gain/Decline | |
|--------------------------|-------------|-------------|----------------------------------|----------|
| | | | <u>+</u> | <u>-</u> |
| North America | 44.1 | 82.7 | +38.6 | |
| of which U.S. | 30.9 | 27.3 | | -3.6 |
| Central/South America | 22.6 | 65.7 | +43.1 | |
| Western Europe | 24.6 | 22.4 | | -2.2 |
| USSR & Eastern Europe | 81.5 | 60.8 | | -20.7 |
| Middle East | 325.9 | 564.7 | +238.8 | |
| Africa | 60.6 | 55.2 | | -5.4 |
| Far East & Oceania | <u>39.4</u> | <u>37.8</u> | | -1.6 |
| TOTAL | 598.7 | 888.9 | +290.2 | |
| Of which OPEC | 399.1 | 670.7 | +271.6 | |
| Of which Arab OPEC | 287.0 | 494.9 | +207.9 | |

Sources:

1976

United States - - American Petroleum Institute

Other Countries -- Oil and Gas Journal, December 1976,
Pennwell Publishing Company.

1987

United States - - U.S. Crude Oil, Natural Gas, and Natural
Gas Liquids Reserves, Advance Summary for 1987, Annual
Report, Energy Information Administration.

Other Countries - - Oil and Gas Journal, December 28, 1987,
Pennwell Publishing Company.

United States is the most heavily explored petroleum bearing region in the world. Approximately 80 percent of all wells drilled world-wide (2.9 million) prior to 1986 have been in the United States.¹³ Total cumulative oil and gas production exceeded 144.7 billion barrels of crude oil and 715 trillion cubic feet of natural gas by the end of 1987.¹⁴

Economics of Production

Another critical factor having an effect on the domestic oil outlook is the economics of production. The United States is a high-cost petroleum producer compared to other producing areas in large part because much of its readily accessible oil resources have already been extracted. The Department of Energy estimates that the cost of finding and producing a barrel of new petroleum in the United States runs about \$13, not including taxes and royalties.¹⁵ In contrast, additional oil production can be achieved in Middle East oil fields for \$2.50 per barrel or less.¹⁶ Given high exploration and production costs and low world petroleum prices, rates of return on investment in domestic oil exploration and production are low compared with rates of return on alternative investments both in the United States and abroad.

Thus, the scarcity of capital for exploration and development cited by petitioners is not simply or even primarily a product of short-term capital shortages for individual firms. For large integrated firms, which generally have substantial capital resources, the problem is the high opportunity cost of investing in activities with low expected rates of return. For smaller, less integrated firms, the problem is that outside lenders and investors perceive domestic oil exploration and development as unattractive compared with less risky and potentially more profitable investments.

One exception to the economic constraints described above are new supplies of oil which have high yields per well and, therefore, relatively low variable costs of production. Two potential sources of such oil still exist in the United States: on the Coastal Plain of the Arctic National Wildlife Range (ANWR), and on the Outer Continental Shelf (OCS), particularly the offshore California area.

The Department of the Interior estimated that the Coastal Plain of ANWR has potential of up to 9 billion barrels of economically recoverable oil.¹⁷ If the entire 9 billion barrels were found, production after the year 2000 could reach 1.5 MMB/D.¹⁸ Similarly, the Department of the Interior estimates the OCS resources ("mean undiscovered recoverable resources") at 12 billion barrels of oil and more than 90 trillion cubic feet of natural gas.¹⁹ Included within the OCS estimate is some 2 to 5 billion barrels of oil equivalent in potential offshore California reserves across some 37 million acres. Were petroleum exploration/development to be permitted in these areas, successful exploration and development would reduce, but not eliminate the problem of a diminishing oil resource base and dependence on imported oil.

A final factor significantly affecting the economics of oil exploration is the domestic natural gas market. Petroleum producers engaging in exploration frequently cannot predict whether they will find oil, natural gas, or both because exploration is not oil specific. Higher natural gas prices would provide incentives for drilling and development projects of all kinds whether the project is oil or natural gas. Moreover, the presence of natural gas and gas liquids in association with crude oil enhances the profitability of a project.

At the present time, the price of some "old gas" (i.e. low cost gas) is still regulated and held below market price levels. This has resulted in disincentives for full production of old gas and helped to artificially maintain the higher price of new or unregulated natural gas.²⁰ Further, the lack of open access to pipeline transportation has a depressing effect on market transactions. As the DOE Energy Security Study states:

Willing buyers and sellers cannot always deal directly with each other, since pipelines generally control access to the transportation system. Pipelines can shut in low-cost gas to alleviate take-or-pay [i.e., minimum purchase requirement] liabilities. Lack of open access to transportation prevents producers from selling these supplies to consumers.²¹

Combined with wellhead price controls, the lack of open access to transportation results in the underutilization of natural gas supplies. A major consequence of the underutilization of natural gas is less exploratory drilling for hydrocarbon energy sources. This in turn means less new oil reserves are likely to be found.

Dependence on Imported Oil

Based on assumptions contained in the Department of Energy's Energy Security report (see Appendix to Section III for details), U.S. oil imports can be expected to increase gradually over the next few years. Other OECD countries also are projected to increase their oil imports over the near term. Since OPEC members have significant excess capacity totaling approximately 9 MMB/D, it is likely that OPEC nations will provide a large share of the Free World's increasing demand for oil.

During 1988, U.S. consumption of oil is expected to grow at the modest rate of 1 to 2 percent from 16.56 MMB/D, and reach 16.7 to 16.9 MMB/D by the end of the year.²² Domestic supplies of crude oil are expected to decline by about 100,000 B/D in 1988 with total domestic oil supply estimated at 10.5 MMB/D for the year (See Table III - 10). Therefore, net imports by the end of 1988 are expected to rise from 5.8 to 6.0-6.3 MMB/D. Increased demand in the rest of the Free World in 1988 is estimated at between 0.4-0.7 MMB/D.²³

TABLE III - 10

WORLD OIL BALANCE
(Million Barrels Per Day)

| | <u>1986</u> | <u>1987</u> | <u>1988</u> |
|---|-------------|-------------|-------------|
| 1. <u>Supply*</u> | | | |
| U.S. | 10.9 | 10.6 | 10.5 |
| OPEC | 19.7 | 19.3 | 19.6 |
| Non-Opec Free World | 15.8 | 16.2 | 16.6 |
| Net Communist Exports | <u>2.1</u> | <u>2.2</u> | <u>2.1</u> |
| Total Supply | 48.5 | 48.2 | 48.8 |
| 2. <u>Net Petroleum Stock Additions</u> | 0.9 | 0.2 | 0.1 |
| 3. <u>Petroleum Products Supplied</u> | 48.0 | 48.5 | 49.1 |
| Statistical Discrepancy (2+3 minus 1) | 0.4 | 0.5 | 0.4 |
| 4. <u>Closing Petroleum Stocks</u> (billion barrels) | 5.11 | 5.18 | 5.23 |

* Includes production of crude oil, natural gas liquids, other hydrogen and hydrocarbons for refinery feedstock, refinery grains, alcohol, and liquids produced from coal and other sources.

Source: DOE Energy Information Administration, Short-Term Energy Outlook, January 1988, p. 39

111 10

The total Free World demand for oil is expected to grow from 48 to 49 MMB/D in 1988.²⁴ The increase will not tax OPEC resources and is unlikely to lead to higher prices. This soft oil market outlook should continue for the next several years. The outlook reflects: (1) the availability of excess crude oil supplies; (2) limited growth in Free World oil demand (See Table III - 11); (3) fairly high Free World oil stocks of 5 billion barrels (See Table 10); and (4) the inability of OPEC to maintain discipline regarding the production and pricing policies of the members.

The U.S. demand for oil imports will begin to increase at a faster rate by about 1990-1991. Higher demand for imports will stem from declines in production in the United States (See Table III - 12); a peaking of output in other non-OPEC areas such as the North Sea; and a small increase in domestic demand. In addition, total Free World demand is projected to grow slowly, rising from 49 MMB/D in 1988 to 51-53 MMB/D by 1995 (See Table III - 11). The net result is that the Free World demand for OPEC oil by 1995 could range from 22 to 30 MMB/D.

In the case of the United States, net imports are projected to rise from 5.8 to between 7.5 to 10.2 MMB/D by 1995 (See Appendix to this Section). This range of nearly 3 MMB/D is a function of varying assumptions about future oil prices, economic growth, energy efficiency, and the non-OPEC oil resource base and production.

Although U.S. oil imports will increase, U.S.-based oil firms may play a role in meeting this demand. If choice U.S. acreage is not available for leasing and/or drilling results prove disappointing, U.S. firms could shift part of their exploration efforts increasingly away from the United States to other non-OPEC nations. As noted in the 1987 Office of Technology Assessment study, U.S. Oil Production, over the past five years a number of non-OPEC nations have modified their financial/investment terms to attract U.S. private investment in oil exploration and development. For example, Canada has established tax incentives and royalty holidays for companies developing Canadian oil and natural gas resources. Turkey, Canada, and Colombia have removed or raised caps on prices paid to foreign producers. In Argentina and Chile, contractors are now paid in dollars rather than local currency.²⁵ Other changes include cash incentives, lower royalties, and lower tax rates.

Shifting some drilling investment would reduce U.S. exploration and contribute to higher oil imports. However, if investment in non-OPEC nations resulted in increased oil supplies outside of the Middle East, it would also limit growth in worldwide dependence on Persian Gulf and other OPEC supplies.

Even if further diversification occurs, most of the increase in U.S. oil imports in the 1990s would probably come from Middle Eastern sources. Virtually all of the world's excess production capacity is

TABLE III - 11

Projected Free-World Oil Consumption
(Millions of Barrels per Day)

| | 1987 | | 1990 | 1995 |
|------------|-------|-------------------|------|------|
| U.S. | 16.52 | Higher Price Case | 15.7 | 16.4 |
| | | Lower Price Case | 16.7 | 17.7 |
| Other OECD | 18.92 | Higher Price Case | 19.3 | 19.1 |
| | | Lower Price Case | 20.4 | 21.0 |
| OPEC | 3.62 | Higher Price Case | 3.7 | 4.2 |
| | | Lower Price Case | 3.7 | 4.2 |
| LDC's | 9.41 | Higher Price Case | 9.2 | 9.5 |
| | | Lower Price Case | 9.7 | 10.2 |
| TOTALS | 48.47 | Higher Price Case | 47.9 | 49.1 |
| | | Lower Price Case | 50.4 | 53.0 |

SOURCE: Department of Energy, Energy Security: A Report To The President of the United States, March 1987, page 24; 1987 data from Energy Information Administration

TABLE III - 12

WORLD OIL PRODUCTION/
UNDER
ALTERNATE SCENARIOS

Projected Free-World Oil Production*
(Millions of Barrels per Day)

| | <u>1987</u> | | <u>1990</u> | <u>1995</u> |
|--------------|-------------|-------------------------|-------------|-------------|
| U.S. | 10.61 | Higher Oil Price Case** | 10.1 | 8.9 |
| | | Lower Oil Price Case | 9.2 | 7.6 |
| Europe | 4.58 | Higher Oil Price Case | 4.5 | 3.7 |
| | | Lower Oil Price Case | 3.7 | 3.2 |
| Persian Gulf | 12.65 | Higher Oil Price Case | 12.7 | 14.6 |
| | | Lower Oil Price Case | 18.3 | 23.2 |
| Other OPEC | 6.82 | Higher Oil Price Case | 7.3 | 7.4 |
| | | Lower Oil Price Case | 7.0 | 6.8 |
| All Other*** | 13.82 | Higher Oil Price Case | 13.4 | 14.2 |
| | | Lower Oil Price Case | 12.6 | 12.5 |
| TOTALS | 48.48 | Higher Oil Price Case | 48.0 | 48.8 |
| | | Lower Oil Price Case | 50.9 | 53.3 |

* Includes crude oil, natural gas liquids (NGL's), and refinery gains.

** The "Higher Oil Price Case" assumes that the world oil price would rise from \$14 per barrel to about \$23 per barrel in 1990 and to about \$28 per barrel in 1995. It also assumes an average annual gross domestic product (GDP) growth rate of about 2.5 percent and an energy/GDP growth ratio of about 0.5. The "Lower Oil Price Case" assumes that the world oil price would rise from about \$14 per barrel to about \$15 per barrel and would continue until 1990. The price would then gradually increase to about \$20 per barrel in 1995. This case also assumes an annual average GDP growth rate of 2.7 percent and an energy/GDP growth ratio of about 0.6.

*** Includes Australia, Canada, Non-OPEC LDC's, and 2 MMB/D of net exports from centrally planned economies.

Source: DOE Energy Security Study, March 1987, page 22; 1987 data from the Energy Information Administration.

located in OPEC countries; and over two thirds lies in the Persian Gulf states of Saudi Arabia, Iraq, Iran, Kuwait, Qatar, and the United Arab Emirates. Furthermore, about two thirds of the world's oil reserves are located in these Persian Gulf countries.

The United States and other OECD countries are likely to become more dependent on OPEC -- particularly the Persian Gulf countries -- for their oil supplies. The OPEC nations are projected to supply 45-60 percent of Free World oil consumption by 1995; with the Persian Gulf countries supplying 30-45 percent. On balance, oil will remain the primary fuel for Free World energy markets, accounting for approximately 43 percent of Free World energy consumption in 1995.²⁶ Of that amount, the OPEC nations probably will supply 45-60 percent of non-OPEC Free World oil consumption.

Summary

The short term energy security position of the United States has improved. The expansion of SPR stocks, the decontrol of U.S. oil prices, the growth of non-OPEC production, the decline in the oil intensity of the U.S. economy, the substantial excess world oil production capacity, the development of new natural gas supplies, and changes in petroleum transportation flexibility in the Middle East have all reduced the U.S. vulnerability to foreign oil supply disruptions and, to some extent, imports in general.

Despite these developments, however, the long term oil security position of the United States is less promising. The reduction in U.S. oil exploration activities and production due to low prices, the declining U.S. oil resource base, the relatively high cost of domestic oil production activities and resulting low rates of return for investments (at current prices), and the expectation of rising U.S. oil imports all point toward increasing threats to the energy security of the United States.

In light of this analysis, we now turn our attention to a review of the national security issues posed by the current and prospective world petroleum market with specific emphasis on defense and essential civilian requirements to prosecute a major conventional war.

FOOTNOTES

1. The Department of Energy, Office of Strategic Petroleum Reserve.
2. For the 1980 number, Energy Security Study, p. 16; the 1987 number is an estimate provided by Department of Energy Staff.
3. The Energy Security Study includes a useful discussion of the potential to develop and substitute non-OPEC natural gas supplies for OPEC oil, see pages 39, 40 and 236.
4. General Accounting Office, Report to the Congress, Energy Security: An Overview of Changes in the World Oil Market, August 1988, pp. 34-36.
5. Department of Energy, Product Imports, Energy Security, and the Domestic Refining Industry (June 1986), p. 7.
6. Ibid, p. 29-37.
7. The OPEC price cited is the "marker price" which is defined as the official sales price for Saudi Arabian Arab light crude oil. The prices referred to in this paragraph, all of which are Saudi marker, were obtained from oil industry price reports and corroborated by U.S. Government data.
8. Estimate provided by Department of Energy staff.
9. Interstate Oil Compact Commission and Ram Group Ltd. in Oil and Gas Journal, March 3, 1986 as cited in Office of Technology Assessment, U.S. Oil Production: The Effect of Low Oil Prices, September, 1987, p. 73. (Hereafter cited as OTA Study.)
10. Energy Security Study, page 4.
11. Ibid., p. 53.
12. Calculations based on data in Energy Information Agency, U.S. Crude Oil, Natural Gas and Natural Gas Liquid Reserves, 1986 Annual Report, October, 1987, p. 6.
13. Energy Security Study, p. 53.
14. EIA Annual Energy Review updated with 1987 data from DOE/EIA.
15. Energy Security Study, pp. 52-53.
16. Ibid., pp. 52-53.
17. Ibid., p. 87.
18. Ibid., p. 87.
19. Ibid., p.87.
20. Ibid., p. 124.
21. Ibid., p. 124.
22. Commerce Department projections based upon Department of Energy data included in the Short-Term Energy Outlook, January 1988.
23. Energy Information Administration, Short-Term Energy Outlook, January 1988, p. 39.
24. Ibid., p. 39.
25. OTA Study, p. 89.
26. Energy Security Study, p. 224.

APPENDIX TO SECTION III

ASSUMPTIONS BEHIND TWO
U.S. ENERGY SCENARIOS:
1985-1995

| <u>Key Assumptions</u> | <u>Case Involving Higher Oil Prices</u> | <u>Case Involving Lower Oil Prices</u> |
|---|---|--|
| World Oil Price (1985 dollars/barrel) | | |
| 1985 | \$27 | \$27 |
| 1986 | \$14 | \$14 |
| 1987* | \$18 | \$18 |
| 1990 | \$23 | \$15 |
| 1995 | \$28 | \$22 |
| Annual U.S. Economic Growth (1985-1995) | 2.5% | 2.7% |
| Degree of Energy Efficiency | Higher | Lower |
| Non-OPEC Oil Resource Base | Higher | Lower |
| U.S. Net Oil Imports** (crude and product) | | |
| 1987* | 5.80 | 5.80 |
| 1990 | 5.66 | 7.54 |
| 1995 | 7.53 | 10.19 |

*1987 Oil Data from the Energy Information Administration

**Consists of Imports into the 50 States

SOURCE: Department of Energy, Energy Security: A Report to the
President of the United States, March 1987, page 21.

SECTION IV. NATIONAL SECURITY ISSUES

The NESC petition alleges that, in the event of a major three year conventional war, the United States would be unable to meet its petroleum requirements from domestic and reliable foreign suppliers. In evaluating these allegations, DOC reviewed a number of studies completed over the past several years.* These analyses dealt with a full range of scenarios from peacetime oil disruptions to full-scale long term conventional war. Particular attention was focussed on the NSC Stockpile Study which provided a comprehensive analysis of oil supply and demand during a three year large scale conventional war. The energy chapter of the NSC Study provided the basis for evaluating emergency petroleum requirements during a three year conventional war preceded by a mobilization year. This is consistent with the scenario contained in the petition.

Overview of the NSC Stockpile Study's Energy Analysis

In June 1983, the NSC established a working group to develop mobilization planning guidelines that would be used as a basis for development of an acquisition and disposal policy for the National Defense Stockpile of Strategic and Critical Materials. As part of this analysis, a major review of overall U.S. national security requirements for a three year major conventional war was conducted. The interagency working group included representatives from the Departments of Defense and Energy as well as CIA, OMB, FEMA, State, Treasury, and Commerce. The analysis was completed using established agency models modified to fit the following war scenario.

This study sought to estimate national demand and supply for a warning year and three years of war and identify any potential constraints that would result. The study estimated national demand by: (1) using macroeconomic models to estimate industry-output levels for a wartime economy and; (2) converting these industry-output levels into demands for critical materials expressed in physical units. The following page describes relevant aspects of this study.

* Over the past several years, a variety of studies have been completed including: the National Security Council (NSC) Energy Security Study (1982); the Department of Defense Sealift Study (1983); a review of U.S. Government energy responses to possible events in the Iran-Iraq War (1985); an NSC review of the national security implications of lower oil prices (1986); an energy analysis as part of the NSC National Defense Stockpile Study (1983); DOE Blue Book Petroleum Supply Interruption Scenarios/Assessments (semiannual); the DOE Energy Security Report to the President (1987) and; periodic assessments within the Defense and Intelligence communities.

Excerpts From War Scenario That Affect Energy Supply Availability

(Deleted to Protect Classified Information)

Source: International Petroleum Supply Analysis, National Defense Stockpile Study.

Summary of Major Assumptions

The energy working group developed the following supply and demand assumptions for petroleum, based on (Deleted to Protect Classified Information)

1) Supply Assumptions:

(Deleted to Protect Classified Information)

The DOE model elasticities highlight the greater responsiveness of world demand (through conservation, fuel switching) to higher crude prices than U.S. and Canadian oil supply increases (through new production). As noted in the previous chapter, the U.S. resource base of easily accessible petroleum is being depleted. Overall U.S. domestic production from existing wells cannot be increased significantly, even in response to substantial price increases and emergency conditions.

Given the limitations and uncertainties inherent in estimating the energy and economic impacts of oil supply disruptions, it is not possible precisely to predict disruption oil prices. Consequently, actual oil prices during a disruption may differ significantly from the point estimates developed by the DOE model. Furthermore, the results simulated by the model should be interpreted carefully since modeling problems are compounded in this type of exercise. The NSC Study acknowledges that the exact combination of events modeled have never occurred in the past and therefore appropriate historical data, used to estimate model parameters, are lacking.

Recognizing these limitations, the table on page IV-8 summarizes the NSC Stockpile Study projections for the base case and disruption scenarios. The demand estimates in the table represent net free world demand before price effects cause demand restraint. However, two adjustments are made:

(Deleted to Protect Classified Information))

Table IV - 1

Summary of Oil Market Simulation
Model - NSC Stockpile Study
(\$1982 and million barrels per day)

| <u>BASE CASE</u> | <u>Base Year</u> <u>(1982)</u> | <u>Warning</u> <u>Year (1983)</u> | <u>War Year 1</u> <u>(1984)</u> | <u>War Year 2</u> <u>(1985)</u> | <u>War Year 3</u> <u>(1986)</u> |
|---|-----------------------------------|--------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| World Oil Price, CIF (1982\$) | | | | | |
| Total Free World Production (MMB/D) | | | | | |
| U.S. Production (MMB/D) | | | | | |
| U.S. Net Imports (MMB/D) | | | | | |
| <u>DISRUPTION SIMULATION</u> | | | | | |
| World Oil Price, CIF (1982\$) | | | | | |
| Total Free World Production (MMB/D) | | | | | |
| U.S. Production (MMB/D) | | | | | |
| U.S. Net Imports (MMB/D) | | | | | |
| (Deleted to Protect Classified Information) | | | | | |
| <u>Consumption (MMB/D)</u> | | | | | |
| United States and Territories | | | | | |
| <u>Production (MMB/D)</u> | | | | | |
| United States | | | | | |
| <u>Net United States Imports (MMB/D)</u> | | | | | |
| 50 State Area U.S. Territories Total United States | | | | | |
| <u>Net Stock Additions (MMB/D)</u> | | | | | |
| U.S. Strategic U.S. Commercial Foreign Total Net Additions | | | | | |
| Source: NSC Stockpile Study | | | | | |

Since the NSC Stockpile Study was completed, DOD has updated its wartime petroleum product requirements. The next sections review the revised requirements and identify U.S. Government actions to supply defense needs during wartime.

Meeting Emergency Defense Requirements

Defense petroleum needs can be broadly categorized into direct military and indirect defense requirements, the latter being petroleum necessary for industrial production and related transportation in support of defense.

Table IV - 2

Increased Direct Military Fuel Demand
Million Barrels Per Day (MMB/D)

| | <u>Warning Year</u> <u>(1983)</u> | <u>War Year 1</u> <u>(1984)</u> | <u>War Year 2</u> <u>(1985)</u> | <u>War Year 3</u> <u>(1986)</u> |
|----------------|---|------------------------------------|------------------------------------|------------------------------------|
| United States | | | | |
| East Asia | | | | |
| Western Europe | (Deleted to Protect Classified Information) | | | |
| Other | | | | |
| Total Increase | | | | |

Source: NSC Stockpile Study

During peacetime, the military consumes about 500,000 MB/D of petroleum products which equates to about three percent of total U.S. petroleum consumption. Seventy percent of this total is purchased within the U.S., the remainder is purchased from foreign sources usually located in or near the region (theater) where it is consumed. Almost three-fourths of military consumption is jet fuels.

The Department of Defense has updated its wartime petroleum product requirements from those provided to the National Security Council in

1983 (see Table IV - 2). The figures in Table IV - 3 show that peacetime consumption has remained at approximately (Deleted to Protect Classified Information), U.S. wartime requirements have increased by (Deleted to Protect Classified Information) from a peak of (Deleted to Protect Classified Information)

Table IV - 3
U.S. Military Petroleum Product Requirements World-Wide
 (Thousand Barrels Per Day)

| | PEACETIME CONSUMPTION | WARTIME |
|-------------|--------------------------|---|
| JET FUEL | | |
| DISTILLATES | | |
| MOGAS | | (Deleted to Protect Classified Information) |
| RESID | | |
| OTHER | | |
| TOTAL | | |

Source: U.S. Department of Defense

Most of the incremental military demand would be overseas close to the areas of conflict. If total oil supplies were constrained by an oil supply disruption coincident with the war and/or major mobilization, total U.S. continental and overseas military demand would represent between ten and fifteen percent of total U.S. oil consumption. As a comparison, during World War II DOD used 23 percent of total U.S. oil, although this was largely because of a less-developed national economy and its associated energy demands.

Indirect defense petroleum requirements during a major war would include those necessary to mobilize the economy in producing and transporting goods and services for the war effort. Of course, the size of additional indirect defense petroleum requirements to support a major mobilization and war effort would depend on the length, scope, and character of the conflict. Although comparable to direct military demand in a large-scale conflict, additional indirect defense demand would emerge at a slower pace as industrial and other commercial consumers convert and increase capacity to support the defense effort.

Actions to Supply Defense Needs During A National Emergency

The U.S. Government can take the following incremental actions to acquire petroleum for national defense purposes. The number of actions implemented would depend on the severity of the disruption and related domestic shortfall:

- o Waive Procurement Statutes - The Secretary of Defense can waive any provision of Federal acquisition statutes to expedite and/or encourage offers of petroleum products to support direct military requirements.
- o Naval Petroleum Reserve Production - The Department of Energy can transfer (with reimbursement) to the Department of Defense any portion of the U.S. Government's share of production from the Naval Petroleum Reserve (NPR). DOD would provide this crude oil to refiners in exchange for petroleum products needed for military requirements. Moreover, the President's FY 1989 budget proposed to sell the Naval Petroleum Reserves with a portion of the revenues to be used to create a more flexible Defense Petroleum Inventory. The latter would be co-located with the Strategic Petroleum Reserve near major refining centers to provide the Department of Defense with direct and early access to petroleum to offset the effects of petroleum disruptions on military readiness and sustainability.
- o Strategic Petroleum Reserves - During a major energy supply disruption, the President would normally authorize the drawdown of the Strategic Petroleum Reserve. If such a drawdown does not result indirectly in adequate supplies of petroleum products for military purposes, the Secretary of Energy could direct that up to ten percent of the total monthly volume sold out of the SPR be distributed to DOD. As in the case of the NPR, DOD would exchange this crude oil directly with refiners for military petroleum products. Or, DOE could arrange for exchanges with refiners to supply indirect defense requirements. If dictated by the severity of the situation, the Administration also could request emergency legislative authority or use the Defense Production Act to direct a greater proportion of the SPR drawdown to defense purposes.
- o Defense Production Act - The Secretary of Energy could invoke the Defense Production Act to direct refiners to supply direct or indirect defense needs on a priority basis. These refiners would also be provided with priority orders by DOE allowing them to purchase crude oil on a priority basis to meet this requirement. If this resulted in severe energy supply dislocations in the private sector, the President could allocate energy resources to mitigate the impact.
- o NATO Wartime Activities - The USG participates in the NATO Wartime Oil Organization as part of NATO's civil emergency preparedness activities and structure. This organization provides a

mechanism to coordinate emergency programs of member governments to ensure adequate supplies of petroleum during NATO emergencies.

Wartime/Mobilization Situations

In wartime and associated military/industrial mobilization, defense demands would receive priority. Analyses have been conducted assuming a three year, large scale conventional war. Under such a scenario, domestic civilian austerity would be necessary. Although increased efficiencies, conservation, and interfuel substitution would reduce the level of civilian austerity required, it can be anticipated that hardships resulting from petroleum shortages could be significant.

In this regard, the petitioner underestimated the amount of civilian austerity and industrial/commercial fuel switching and conservation that would occur during a three year large scale war. The petitioner assumed civilian oil consumption of over 15 million B/D throughout each of the war years, or more than 90 percent of 1987 peacetime consumption of 16.5 million B/D. On the other hand, more inclusive analyses undertaken by the NSC and the Department of Defense indicate significantly lower civilian sector oil consumption than those submitted by the petitioner.

Our analysis concludes that the United States will be able to meet direct and indirect military petroleum requirements during a major conventional war. In the event of major conventional conflict coupled with a substantial decrease in oil supplies, defense needs would receive priority. DOD direct and indirect supply requirements can be satisfied from domestic oil production (Note: this assumes current levels of domestic oil production during the war), reliable petroleum imports, and the Strategic Petroleum Reserve. Further, Free World refining capacity will be available to supplement domestic capacity and help meet offshore U.S. military requirements during a conflict. This is based upon analysis contained in the NSC Stockpile Study, the U.S. Government actions discussed earlier, and the review of the current world oil market in Section III.

However, it should also be noted that significant civilian austerity was necessary to deal with decreased petroleum availability, creating some hardships in the U.S. economy, as was the case in World War II. Civilian consumption of oil would be reduced as more of the economy is devoted to supporting the defense effort. As a result of the above noted developments, many sectors of the economy would experience hardship. For example, the transportation sector accounts for approximately 70 percent (10 million B/D) of the 16.5 million B/D of U.S. oil consumption. There are presently no substitutes for gasoline, diesel fuel, and jet fuel. Notwithstanding reduced consumption and conservation resulting from higher prices, less oil would be available during wartime for civilian transportation end-uses.

Foreign Policy and Military Power Projection Concerns

National energy security encompasses not only the capability to meet direct and indirect military needs during a national emergency; it also includes U.S. economic security and foreign policy flexibility. In light of these security concerns, the DOE Energy Security Report noted:

The United States and many of its allies and trading partners are likely to become more dependent on imports, particularly from low-cost suppliers in the Persian Gulf. Higher import dependence would increase the risk of major supply disruptions that are damaging to our economic well-being and energy security. This risk affects national security and the conduct of U.S. foreign policy to the extent that (1) the foreign policy actions of our allies are affected as they respond to perceived vulnerabilities and rivalries for "scarce" supplies undermine allied security' (2) the U.S. loses some flexibility in responding to disruptions, so that it becomes more difficult to reach peaceful resolutions of disputes; and (3) oil supply disruptions coincide with a major defense emergency, complicating an already troublesome situation.

In addition, the dependence on potentially insecure oil supplies by our friends and allies on whom we rely for base access in military emergencies can affect their willingness to provide base access and overflight rights for U.S. military forces in certain situations. This perception about their vulnerability to potential oil supply manipulations, if they were to cooperate with the U.S. military efforts, can constrain U.S. military power projection capabilities and flexibility.

As noted above, dependence upon unreliable sources of petroleum (i.e., subject to interruption) can constrain U.S. foreign policy flexibility as well as U.S. military power projection capabilities. Specifically, the United States and its allies may find themselves constrained from pursuing either unilateral or multilateral foreign policy actions for fear of provoking producer countries into actions that would result in the manipulation of oil supplies and increased prices for consumer countries. Further, the lack of flexibility could also impair allied cooperation to avoid the bidding-up of world oil prices in the aftermath of an interruption of oil supplies (e.g., the Iranian Revolution).

Section V. FINDING, OPTIONS AND RECOMMENDATIONS

FINDING

There have been substantial improvements in U.S. energy security since the last Section 232 Petroleum finding in 1979. However, declining domestic oil production, rising oil imports, and growing Free World dependence on potentially insecure sources of supply raise a number of concerns, including vulnerability to a major supply disruption. The investigation found that the maintenance of U.S. access to sufficient supplies of petroleum is essential to our economic security, foreign policy flexibility, and defense preparedness. Given the above factors, it was found that petroleum imports threaten to impair the national security.

OPTIONS AND RECOMMENDATIONS

In view of the national security concerns raised by this investigation, the Department has evaluated a range of remedial options for Presidential consideration. The following presents an evaluation of the costs and benefits for each option and DOC recommendations. It is important to note that no cost-effective government action could eliminate U.S. dependence on foreign oil entirely, but a number of actions could help limit that dependence.

Trade Actions

The Department has evaluated the proposal to impose a fee on oil imports. The following discussion assesses the benefits and costs of two versions of this concept: a \$10 per barrel fee and a \$5 per barrel fee. An alternative scenario involving a variable fee is also reviewed.

- - \$10 Per Barrel Fee

By raising prices, import fees would stimulate domestic production and depress total demand for oil, thus helping to reduce imports. The DOE Energy Security Study notes that a \$10 per barrel fee (\$10 fee) would have the following specific benefits and costs from now until 1995.

Benefits

- o Domestic production would be 0.4 to 0.8 MMB/D greater than without an import fee.
- o Domestic oil consumption would be 0.7 to 1 MMB/D lower.
- o Net oil imports would be reduced by about 1.5 MMB/D (including increased production) from the projected levels of 8 to 10 million B/D.
- o An additional 120,000 jobs would be created in the oil industry.

- o U.S. payments for oil imports would be reduced by as much as \$10 to 12 billion annually. Moreover, the potential economic losses that would result from a supply disruption would be reduced.

Costs

- o There would be a one-time, inflationary effect of 2 to 3 percent in the Consumer Price Index.
- o Some 320,000 jobs in non-petroleum related sectors of the economy would be lost.
- o Real GNP would be reduced by an average of \$25 to \$35 billion per year.
- o The cumulative costs over the next decade to the United States would reach \$150 to 200 billion (present value in 1985 dollars), compared to benefits of \$25 to 35 billion.
- o The competitiveness of energy-intensive export companies (e.g., petrochemicals) would be diminished.

Other disadvantages of a fee include:

- o Strained relations with close trading partners, such as Canada, Mexico, and the United Kingdom, who may seek exemptions to the fee.
- o Difficulties for certain domestic oil consumers who may seek rebates of the fee.

It is often argued that an oil import fee would generate revenues for the Federal Government. However, the reduced income tax collection caused by the fee could offset or even exceed the revenue collections from the fee.

It is interesting to note that of the 60 commenters on this petition, only seven requested import restrictions on oil. Of these seven, five requested an oil import fee. None of the parties requesting an import fee provided analysis of how a fee would result in increased domestic production or exploration and lower oil imports.

Section 232 of the Trade Expansion Act specifically requires that the Commerce Department recognize the "close relation of the economic welfare of the Nation to our national security", and instructs the Department to take into account "any substantial unemployment, decrease in revenues of government, loss of skills or investment, or other serious effects resulting from the displacement of any domestic products by excessive imports... in determining whether such weakening of our internal economy may impair the national security."

The statute requires that Commerce also examine the impact of any potential remedial actions upon the economy as a whole, taking into account the specific impact on employment, government revenues and investment, and to make a determination about the impact on the overall national welfare.

In this case, the costs of an oil import fee in terms of lost jobs in non-petroleum related sectors, reduced real GNP, and increased inflation outweigh the benefits to the petroleum industry. In fact, the national economy would be weakened by such a measure to such an extent as to threaten to impair the national security, which would clearly negate any benefits to the national security of an oil import fee.

After reviewing all data available to it, the Commerce Department finds on balance that the costs to our national security of the \$10 fee significantly outweigh the potential benefits.

\$5 Per Barrel Fee

The DOE Energy Security Study found that a \$5 per barrel import fee (\$5 fee) would have similar, though smaller, effects compared to the \$10 fee. The specific effects on oil markets and the economy would be as follows:

As a result of high prices, the fee would:

- o Raise domestic oil production in 1995 by 0.2 to 0.4 MMB/D over estimates assuming no import fee.
- o Reduce oil consumption by 0.4 to 0.6 MMB/D.
- o Reduce oil imports by 0.7 to 0.9 MMB/D from the projected level of 8 to 10 MMB/D.

As a consequence of higher prices, the fee would:

- o Eliminate 170,000 jobs in non-petroleum related sectors of the economy. (Note: This loss of jobs would be partially offset by an increase in employment in the petroleum sector.)
- o Hurt energy-intensive export firms although to a lesser extent than a \$10 fee.
- o Increase inflation (Consumer Price Index) by 1.3 percent above what it would be otherwise.
- o Generate a cumulative cost over the next decade of \$75 to 100 billion (present value in 1985 dollars), compared to benefits of \$25 to 30 billion.
- o Have the same negative consequences for trade relations with U.S. trading partners as the \$10 fee.

Other disadvantages of the \$5 fee include:

- o The same strained relations with trading partners who may seek exemptions to the fee.
- o Difficulties for certain domestic consumers who may seek rebates of the fee.

The comments in response to the petition provided no economic data to suggest that the benefits of a \$5 fee were greater than the costs. Further, as mentioned above, the Commerce Department must examine the costs of any proposed remedy in terms of lost employment, government revenues, investment and any other serious effects on the national economy (which is closely tied to the national security). After reviewing all the data available, the Commerce Department on balance finds that the above noted costs to the overall economy, and therefore to the national security of the \$5 fee significantly outweigh the potential benefits.

Floor Price

An oil import fee based on a floor price raises U.S. oil prices only to the extent that world prices fall below a designated floor price (e.g., \$12 per barrel)

Benefits

Advocates of a floor price argue that:

- o The floor price is a more efficient method to assist domestic producers, since it would intervene in the market place to a lesser extent than an oil import fee, while still providing incentives for domestic producers.
- o A floor price would prevent "predatory pricing" designed to drive high-cost producers out of business and later allow low cost producers to raise prices and extract higher economic rents (Note: The latter assumes that low cost producers can act as an effective cartel).
- o If prices never decline to the floor level, the existence of a floor price would provide investors and oil firms with "confidence" that the government opposes oil prices falling to very low levels, thereby encouraging higher levels of investment in the domestic oil industry.

Costs

The disadvantages of an oil price floor, once it is operative, are similar to those associated with an oil import fee:

- o Increased inflation

- o Reduced GNP
- o Reduced employment in non-petroleum sectors of the economy
- o Harm to energy-intensive export firms at a time when the United States faces a large trade deficit
- o Foreign oil producers could peg their oil price to the U.S. floor price. This would eliminate some of the price protection benefits sought by U.S. producers and investors
- o Exemptions would be demanded by nations exporting to the United States.

Only 2 of the 60 commenters on the NESC petition supported a floor price. In both instances, the parties submitted no analysis or data on the costs and benefits of a floor price.

After assessing the advantages and disadvantages of the floor price concept, the Department of Commerce concludes that the overall relationship of economic benefits and costs would be similar to the case of the \$10 and \$5 import fees.

* * * * *

Section 232 specifically states "In the administration of this section, the Secretary and the President shall further recognize the close relation of the economic welfare of the Nation to our national security...." The Department has determined that the costs of import adjustments described above would outweigh the benefits to the petroleum sector. The Department noted with interest comments that further highlight the findings presented above. For example, in their comments on the petition, the Industrial Oil Consumers Group cited the economic consequences of an oil import fee:

actions which result in increased oil prices (via a license fee, import quota or tariff increase) will have an immediate negative impact on the economy generally in the form of inflation, and specifically on the basic, energy-intensive manufacturing sectors whose health is genuinely vital for ultimate national security. To the extent such increased oil prices increase prices of other energy sources, such as natural gas, these effects will be exacerbated.

Further, the U.S. Chamber of Commerce's comments on the petition noted that import adjustments would have deleterious effects on a wide range of U.S. industries. "Industries especially hurt by an oil import tax would be basic metals, metalworking, machinery manufacturing, chemicals, agriculture, and transportation. All are vital to our economy and security."

In light of the above, the Department does not recommend oil import fees as a means to enhance our national security.

Domestic Initiatives

The 5-year Offshore Oil and Gas Leasing Plan

The Outer Continental Shelf (OCS) of the United States contains 1.5 billion acres, of which only 54 million acres have been leased for hydrocarbon exploration. Currently, there are 27.5 million acres of Federal offshore lands under lease. It is estimated that 12 billion barrels of undiscovered, recoverable oil underlie the OCS, in addition to 90 trillion cubic feet of natural gas (which represents an additional 18 billion barrels of oil equivalent). Experts in industry and government estimate that the OCS contains some of the most promising tracts for additional oil and gas exploration in the United States.

The Secretary of Interior approved the current 5-year leasing plan in mid-1987. The plan was transmitted to Congress, which made no changes to the plan during the 60-day period for Congressional review. The Department of the Interior now is proceeding to implement that plan and so far has conducted five of the lease sales set out in the plan.

Since the approval of the leasing plan, the Department of the Interior has delayed action on three planned lease sales (for northern California, the North Atlantic, and the Part II of the eastern Gulf of Mexico) pending further environmental review. In a separate action, Congress has used the Interior Appropriations process as a means for imposing additional moratoria on several lease sales off the costs of California, Massachusetts, and Florida.

Recognizing the importance of domestic oil production to the national security, we recommend that the Administration continue to implement the 5-year leasing plan subject to appropriate environmental safeguards. We further recommend that Congress refrain from introducing new delays into the process.

Exploration of the Arctic National Wildlife Refuge Coastal Plain

The Arctic National Wildlife Refuge (ANWR) contains about 19 million acres, and the 1.5 million acre Coastal Plain of ANWR has the potential of up to 9 billion barrels or more of recoverable oil according to estimates made by the Department of the Interior. Congressional action would be required to provide the authority for exploration and development of the Coastal Plain of ANWR.

There is a long lead time in Alaska between exploration and production. If Congress decided today to allow exploration and development, the anticipated output after the year 2000 could

potentially be as much as 1 to 1.5 million barrels per day. At current oil price levels, that production would reduce the U.S. trade deficit by about \$11 billion per year.

Several bills concerning ANWR leasing have been considered in the Congress. The Administration has on several occasions recommended to Congress that legislation be passed immediately to allow environmentally sound oil and natural gas activity on the ANWR Coastal Plain. We recommend that the Congress pass legislation that would immediately allow for environmentally sound oil and natural gas activity on the ANWR Coastal Plain.

Comprehensive Natural Gas Reform and Nuclear Licensing Reform
In addition to the initiatives to strengthen the domestic oil industry, we recommend action on two programs dealing only with natural gas and nuclear power. For natural gas, we recommend passage of the Administration's legislation promoting a comprehensive approach to natural gas reform, including wellhead price decontrol and open access to pipeline transportation.

The open access initiative would guarantee access to pipeline carriage for natural gas for any type of end user, distributor, marketer, or broker. Before 1985, most natural gas carried through pipelines was also owned by the interstate natural gas pipeline companies. Now, more than two-thirds of gas carried by pipeline is owned by customers. Much of the carriage is done on a voluntary basis by pipelines. In the past, not all gas owners were guaranteed carriage by pipeline. While the Federal Energy Regulatory Commission's current Voluntary Program has resulted in a dramatic increase in the carriage of natural gas not owned by the pipeline companies, we propose that Congress pass the Administration's legislation which could guarantee non-discriminatory open access to pipeline transportation.

Furthermore, the continued wellhead price control of "old gas" (low cost gas) acts as a disincentive to produce this gas. The artificially low prices also serve to subsidize the acquisition of new gas at above market prices. The pipeline companies average the high price of new gas with the low regulated price of old gas for the purpose of reselling the gas to their customers.

Neither the open access provision nor the wellhead price decontrol provision have been passed by Congress. We recommend that Congress take action immediately to pass both initiatives. The elimination of wellhead price controls and constraints on access to open pipeline transportation would lead to increased natural gas use in some applications where oil currently is used, thereby reducing oil consumption. It would also increase drilling for hydrocarbons in general, which would result in higher oil as well as natural gas production. On balance, a comprehensive solution to natural gas pricing and transportation issues would result in the United States requiring about 300,000 to 350,000 barrels per day less foreign oil between 1988 and 1995.

For nuclear licensing reform, we propose that combined licenses be issued for both construction and operation of a facility. This would provide a vehicle so that utility, public, State, and Federal concerns could be resolved before plant construction. This action would help avoid the spiraling costs caused by delays - sometimes more than \$1 million per day in interest costs alone.

Technical Tax Changes to Support Domestic Oil Production

In addition to the main initiatives discussed above, we urge Congress to consider several steps to reduce premature oil well abandonment and encourage oil exploration and development. These include the following:

- o Increase the net income limitation on the percentage depletion tax allowance for oil and gas from 50 percent to 100 percent per property. The "percentage depletion" allowance allows independent oil producers to deduct a percentage of oil and gas gross revenues from taxable income, in place of more restrictive "cost depletion", which limits the total depletion deduction to the unrecovered investment. The allowance is computed as 15 percent of the gross income from the property, but it is also limited to 50 percent of the net income from the property. This option would increase the limitation to 100 percent.
- o Repeal the transfer rule to permit use of the percentage depletion tax allowance for proven properties that have changed ownership. The percentage depletion allowance may not be used after proven oil properties have changed ownership. This means that otherwise eligible producers cannot use the allowance for production from proven properties which they have purchased. This option would repeal the ownership transfer restriction.

Improvements To Emergency Preparedness Programs

Finally, we recommend the continued fill of the Strategic Petroleum Reserve (SPR) toward the goal of 750 million barrels. . The SPR, which currently holds 555 million barrels (equivalent to over 90 days of imports) is intended to supplement the market in the event of a severe oil supply disruption. The SPR should be filled at a minimum rate of 50,000 barrels per day, and the fill rate should be increased to 100,000 barrels per day with the increase to be funded by the sale of the Naval Petroleum Reserve (NPR) at Elk Hills, California and Teapot Dome, Wyoming.

Proceeding pursuant to the Act (50 U.S.C. app. 2412(c)(1)).
Date: November 25, 1987.

W. Hoya.

Administrative Law Judge.

FR Doc. 87-29763 Filed 12-28-87; 8:45 am]

BILLING CODE 3510-07-01

**Investigation of National Security
Investigation of Imports of Crude Oil
and Refined Petroleum Products**

U.S. Department of Commerce,
International Trade Administration,
Office of Industrial Resource
Administration.

SECTION: Notice of an investigation under
section 232 of the Trade Expansion Act
of 1962, as amended (19 U.S.C. 1862),
and request for comments.

SUMMARY: This notice is to advise the public that an investigation is being conducted under section 232 of the Trade Expansion Act of 1962, as amended (19 U.S.C. 1862), to determine the effects on the national security of imports of crude oil and refined petroleum products. Interested parties are invited to submit written comments, opinions, data, information or advice relative to the investigation to the Strategic Analysis Division, Office of Industrial Resource Administration, U.S. Department of Commerce.

DATE: Comments must be received not later than Thursday 28, 1988. Written comments should be addressed to: Steven C. Goldman, Director, Strategic Analysis Division, Office of Industrial Resource Administration, International Trade Administration, U.S. Department of Commerce, Room 3878, Washington, DC 20230.

FOR FURTHER INFORMATION CONTACT: Steven C. Goldman, Director, Strategic Analysis Division, Office of Industrial Resource Administration, International Trade Administration, U.S. Department of Commerce, Room 3878, Washington, DC 20230, (202) 377-4060.

SUPPLEMENTARY INFORMATION: In an application submitted on December 1, 1987 by the National Energy Security Committee on behalf of a coalition of associations, companies and individuals, the Department of Commerce was requested to initiate an investigation under section 232 of the Trade Expansion Act of 1962, as amended (19 U.S.C. 1862), to determine the effect on the national security of imports of crude oil and refined petroleum products.

On December 23, 1987 the Department of Commerce confirmed receipt of and accepted the application requesting an

investigation. The findings and recommendations of the investigation will be reported by the Secretary of Commerce to the President no later than December 1, 1988.

The articles to be investigated include crude oil and refined petroleum products. Crude oil is currently classifiable in the Tariff Schedules of the United States (TSUSA) Annotated (1987) at items 475.05 (crude oil testing under 25 degrees A.P.L.) and 475.10 (crude oil testing 25 degrees A.P.L. or more).

The following refined petroleum products are classified under these specific TSUSA categories: 475.25 (motor fuel, including gasoline, leaded and unleaded; naphtha-type jet fuel and kerosene-type jet fuel); 475.30 (kerosene derived from petroleum, shale oil, or both—except motor fuel); 475.34 (naphtha derived from petroleum, shale oil, natural gas or combinations thereof—except motor fuel); 475.40 (mineral oil or medicinal grade derived from petroleum, shale oil, or both); 475.45, 475.55 and 475.60 (lubricating oils and greases, derived from petroleum shale oil, or both, with or without additives); 475.65 and 475.70 (mixtures of hydrocarbons not specially provided for, derived wholly from petroleum, shale oil, natural gas, or combinations thereof, which contain by weight not over 50% of any single hydrocarbon compound); 494.22 (paraffin and other petroleum waxes); 527.5120 (petroleum coke); and 521.11 (asphaltum, bitumen and limestone-rock asphalt).

This investigation is being undertaken in accordance with Part 359 of Title 15 of the Code of Federal Regulations (15 CFR Part 359). Interested parties are invited to submit written comments, opinions, data, information or advice relevant to this investigation to the Office of Industrial Resource Administration, U.S. Department of Commerce, no later than January 28, 1988.

All materials should be submitted with 10 copies. Public information will be made available at the Department of Commerce for public inspection and copying. Material that is national security classified information or business confidential information is subject to the provisions of § 359.6 of the regulations (15 CFR 359.6).

The public record concerning this investigation will be maintained in the International Trade Administration Freedom of Information Records Inspection Facility, Room 4104, Department of Commerce, 14th and Pennsylvania Avenue N.W., Washington, DC 20230. The records in this facility may be inspected and copied in accordance with regulations published

in Part 4 of Title 15 of the Code of Federal Regulations.

Information about the inspection and copying of records at the facility may be obtained from Patricia L. Mann, International Trade Administration's Freedom of Information Officer (202-377-3031).

If deemed appropriate by the Department, public hearings may be held to elicit further information as provided in § 359.8 (15 CFR 359.8) of the regulations. Notice will be published in the Federal Register, giving the time, place, and matters to be considered at such hearing(s) so that interested parties will have an opportunity to participate.

December 23, 1987.

Gilert B. Kaplan.

Acting Assistant Secretary for Import
Administration.

[FR Doc. 87-29807 Filed 12-28-87; 8:45 am]

BILLING CODE 3510-07-01

**National Oceanic and Atmospheric
Administration**

**Listing of Endangered and Threatened
Species and Designating Critical
Habitat; Petitions for the Adoption of
Rules and Regulations for the Granting
of Permits for Whale Watching**

AGENCY: National Marine Fisheries
Service (NMFS), NOAA, Commerce.

ACTION: Notice of receipt of petitions.

SUMMARY: NMFS has received two petitions from GreenWorld to issue regulations to control commercial whale watching.

FOR FURTHER INFORMATION CONTACT: Robert C. Ziobro, Protected Species Management Division, Office of Protected Resources and Habitat Programs, National Marine Fisheries Service, U.S. Department of Commerce, Washington, DC 20235, (202/673-5348).

SUPPLEMENTARY INFORMATION: On December 1 and 9, 1987, NMFS received petitions from GreenWorld to "promulgate regulations to control whale watching and to construct a permit system for it" and to protect right whales "from the harm of close-vessel approaches and especially from commercial whale watching." In accordance with the provisions of the Endangered Species Act of 1973 (16 U.S.C. 1531-1543) and the Administrative Procedure Act (5 U.S.C. 553(e)), the Service will review available information on whale watching to determine if the petitioned actions are warranted.

APPENDIX B
SUMMARY OF PUBLIC COMMENTS

The Department of Commerce received communications from a total of 60 commenters on the petition of the National Energy Security Committee. Comments were received from both domestic and foreign sources, and included members of Congress, state officials, foreign governments, individuals, trade and professional associations, energy consumer organizations, and energy and energy-related companies. Their comments are summarized in the following pages.

Most of those commenting acknowledged the decline in U.S. domestic oil production, the increased dependence of the U.S. on oil imports, and the difficulty of reducing that dependence. Their views diverged, however, on whether that situation could be significantly altered, and if so, by what means.

A number of commenters asserted that import adjustments would be contrary to U.S. international commitments made in the GATT, the International Energy Agency, and the U.S.-Canada Free Trade Agreement.

Some of those opposed to some form of import adjustment claimed that it would have little practical effect and might make the U.S. even more dependent on imports in the future. Others claimed that actions other than import adjustments would have a more stimulating effect on reducing production or reducing consumption. Repeal of the windfall profits tax, natural gas deregulation, opening federal lands to exploration, and filling the Strategic Petroleum Reserve were frequently mentioned.

Those in favor of import adjustments claimed that its effects would be beneficial for domestic production, and that it would reduce U.S. national security vulnerability. They claimed that higher prices would give much needed stimulation to the oil industry to stem the decline in production and bring forth new, replacement supplies.

There were a variety of other comments on the impact of import adjustments on domestic industry -- notably refiners and chemical manufacturers; on the various regions of the U.S.; on the national economy; and on our international relations. The possibility of exemptions from any import adjustment were also the subject of comments.

COMMENTERS ON NATIONAL ENERGY SECURITY COMMITTEE PETITION
UNDER SECTION 232 OF THE TRADE EXPANSION ACT OF 1972

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Mr. James L. Casey
Assistant General Counsel
Air Transport Association of America
1709 New York Avenue, NW
Washington, DC 20006-5206

Letter dated January 28, 1988 (COPP 35).

Comments:

"If airlines are to continue to perform efficiently the services that the travelling and shipping public require, they must have ready access to the most economic sources of jet fuel."

"Many of the bilateral international aviation agreements that the United States Government has entered into with foreign governments provide foreign-flag airlines with the right to introduce into the United States, not subject to customs duties or excises, petroleum products for use in their U.S. operations. We assume, because of those agreements and concerns about reciprocal treatment by foreign countries of U.S.-flag airlines, that this investigation will not affect those rights."

"All U.S.-flag airlines currently have bonded jet fuel supplied to them at U.S. gateway airports for use in their international operations....If U.S. airlines were denied access to fuel that is bonded, their costs would increase and they would be at a competitive disadvantage with respect to foreign-flag airlines."

Requests that "after the Department of Commerce reaches initial conclusions about jet fuel imports that it provide the airline industry and other interested persons the opportunity to respond to those conclusions."

Joseph F. Donchue
Attorney for Amerada Hess Corporation
26 Broadway, Suite 1111
New York, New York 10004

Comments dated January 27, 1988 (COPP 32).

Comments:

Takes issue with a statement on page 39 of the NESC petition that lumps imports from the Virgin Islands with imports from foreign countries. Asserts that the Amerada refinery at St. Croix is a U.S. refinery that delivers almost all its production to the East Coast.

Amerada does not address the substance of the NESC petition, but has a keen interest in the issues and "is ready to participate in any constructive manner related to the objects of the petition."

Mr. Charles J. DiBona
American Petroleum Institute
1220 L Street, NW
Washington, DC 20005

Letter dated January 28, 1988, enclosing an API study, "Domestic Petroleum Production and National Security," dated December 30, 1986 (COPP 26).

Comments:

Low prices have reduced domestic production and encouraged consumption, creating a higher and potentially dangerous dependence on imports.

"Unless a strong domestic oil and gas industry is maintained, the likelihood of facing a severe energy crisis in the 1990s will increase significantly."

"...positive steps to encourage domestic exploration and development must be taken now. Although all reasonable policy alternatives which would encourage greater domestic exploration and production should be considered, three actions clearly justify immediate action -- repeal of the Windfall Profit Tax, access to the Alaskan Coastal Plain and California Outer Continental Shelf and a cost effectiveness justification for any environmental regulations."

Mr. John J. Kelberer
Chairman of the Board
Arabian American Oil Company
Dharan, Saudi Arabia

Letter dated January 25, 1988 (COPP 21).

Comments:

Refutes allegation in the NSEC petition that Saudi Arabia intentionally destabilized the oil market in order "to reduce or eliminate competition from other forms of energy, to depress high cost oil production,...and to secure and maintain a dominant position in OPEC."

Cites "mutually beneficial U.S.-Saudi Arabian trade relationships" and asserts that DOC should "consider the potential negative impact on those relationships" if import restrictions were imposed.

"...continued access to the Arabian Gulf and good relations with reliable suppliers such as Saudi Arabia are important to the prosperity of the United States and the industrialized world."

"Saudi Arabia's "policy has been, and continues to be, one of stabilization. A healthy U.S. economy and a healthy world economy are a fundamental concern of the Kingdom. As a result, the Kingdom has in the past maintained oil production at high levels to offset shortages and has tried to moderate sharp price movements."

Saudi Arabia is closely allied with the U.S. in national security affairs in the Middle East and Southwest Asia.

Asserts that, while an oil import fee would raise the domestic price of oil, "there is no evidence that restricting imports will stimulate dramatically increased levels of U.S. production" because of high costs in the U.S.

The Honorable Joe Barton
House of Representatives
Washington, DC 20515

Letter dated February 2, 1988 (COPP-62).

Comments:

Asserts that if current trends continue, sixty percent of the oil we use will be produced in foreign countries by the year 2000.

Encloses a copy of H.R. 2200 which would reduce oil imports by imposing a fee on oil imported into the U.S.

Seventy-five percent of the revenue produced from the fee will go to reducing the federal deficit. The other twenty-five percent would be used to purchase U.S. stripper well oil to increase the Strategic Petroleum Reserve to 1 billion barrels.

The Honorable Lloyd Bentsen
U.S. Senate
Washington, DC 20510

Letter dated February 4, 1988 (COPP-61)

Comments:

"As Section 232 mandates, the Commerce Department should leave no stone unturned and should probably investigate how increasing oil imports impact all aspects of U.S. national security."

"As a threshold matter, the investigation must analyze the production capability of the domestic industry; its ability to provide sufficient "secure" oil is critical to determining whether the United States will be able to successfully defend itself in a conventional war or adequately respond to peacetime emergencies, including supply disruptions."

"Second, the investigation should analyze whether the United States will face an oil shortfall in a conventional war fought either now or several years in the future."

"... your Department should fully evaluate the broad array of options Section 232 affords the President to take action that would have an initial and direct effect on imports, and work to limit our dependence.

The Honorable John Bryant
House of Representatives
Washington, DC 20515

Letter dated January 7, 1988 (COPP 5)

Comments:

Asserts that growth of U.S. imports has increased our vulnerability to disruptions in supplies.

Cites from the petition that there would be about a 3 million barrel per day shortfall in the event of a three year conventional war.

Urges that extensive public hearings be held.

Mr. D. C. Burgess, Vice President
Cain Chemical, Inc.
Eleven Greenway Plaza, Suite 2700
Houston, Texas 77046

Letter dated January 28, 1988 (COPP 47).

Comments:

Supports greater energy self-sufficiency, but states that "This should be achieved by providing exploration and production incentives to the energy industry and not by a taxation of imported crude oil and refined products."

The chemical industry is an important export industry; an import tax would "seriously affect our ability to compete in the world market for our products."

Mr. L. H. Legault
Minister (Economic) and Deputy Head of Mission
Canadian Embassy
1746 Massachusetts Avenue, NW
Washington, DC 20036

Letter dated January 28, 1988 (COPP 37).

Comments:

Cites an exchange of letters accompanying the U.S.-Canada Free Trade Agreement on January 2, 1988, in which both countries stated their "mutual understanding of 'the need to exercise discretion in the period prior to entry into force so as not to jeopardize the approval process or undermine the spirit and mutual benefits of the Free Trade Agreement.' Canadian authorities emphasize their concern that the use of section 232 not result in any actions which would undermine the agreement."

Requests the U.S. "to indicate as soon as possible during the investigation that imports of crude oil and refined petroleum products from Canada would be excluded from the scope of any trade restrictions under section 232."

Mr. D. B. Macnamara, Vice President
Canadian Petroleum Association.
3800 150 Sixth Avenue SW
Calgary, Alberta T2P 3Y7

Submission dated January 28, 1988 (COPP 40).

Comments:

Canadian oil enhances rather than threatens U.S. security of supply.

Imposition of import restrictions on Canadian oil "would be counterproductive to U.S. security of supply and contrary to the Trade Agreement. It would also be inconsistent with the 1985 International Energy Agency, Ministerial resolution regarding energy trade..."

"Recommends against the imposition of any measures which would restrict the movement of Canadian crude oil or refined products to the United States."

Chemical Manufacturers Assn.
2501 M. Street, NW
Washington, DC 20037

Comments dated January 28, 1988 (COPP 23).

Comments:

"...urges the Department to complete its work in an expeditious manner."

CMA strongly opposes proposals such as import fee or tax which, "by weakening the nation's industrial base, represent a clear and present threat in their own right to the nation's economic vitality and national security."

"Typically, the chemical industry spends about \$20 billion per year for its energy needs, about 75 percent of which is consumed as oil and natural gas."

"Import levels alone do not constitute a security problem. The sources of supply, reserves, and demand levels during times of crisis also must be considered. For example, events that disrupt oil supplies will lead to price increases and reduced demand, as well as cause shifts to alternate fuel sources."

"It is implausible to suggest that the United States can be oil independent. The U.S. reserve base is declining....The U.S. has about 3.5 percent of world reserves....U.S. consumption represents about 27 percent of world demand. U.S. oil independence, then, cannot realistically be achieved."

CMA cites a November, 1987, DRI study and asserts that an oil import tax would be inflationary; GNP growth would be stifled, and business investment would decline. "...benefits to the domestic petroleum industry would be more than offset by the negative impacts on U.S. manufacturing, employment, international competitiveness, and GNP growth."

CMA suggests a number of policy options to encourage development of U.S. reserves:

Encourage stable sources of oil supplies; continue adding to the SPR; repeal the windfall profit tax; deregulate natural gas; reassess costly environmental regulations; and expand the availability of federal lands for exploration and development, "particularly in promising areas such as offshore California and the Arctic coastal plain of Alaska."

Mr. William F. Demarest Jr.
Citgo Petroleum Company
1001 Pennsylvania Ave., NW, Suite 310
Washington, DC 20004

Comments dated January 28, 1988 (COPP 54).

Comments:

"Citgo urges the Secretary to decline to recommend oil import adjustment relief."

SPR and IEA stockpiles make U.S. reliance on imports less critical than in the past.

"The decline in domestic production is not solely or even primarily attributable to the recent decline in oil prices."

"Ownership by foreign producers of refining and marketing assets in the U.S. does not pose a security risk for the U.S. To the contrary, participation by foreign oil producers in the U.S. refining industry reduces the national security risk associated with crude oil imports from those foreign producers.

"The threat to the U.S. economy and hence to national security that would result from any form of oil import adjustment would outweigh the threat to the national security posed by the level of imports."

There are ways to increase domestic production that do not result in increased prices of petroleum and the consequential negative macroeconomic effects.

Citizen/Labor Energy Coalition

Comments dated January 28, 1988 (COPP 36).

Comments:

Provides a short history of government restrictions on oil imports and concludes that restrictions:

Raise domestic prices, imposing substantial consumer costs.

Transfer wealth from energy consuming states to producing states.

Distort the structure of the oil industry and lessens competition.

Result in a "Drain America First" policy.

Result in reduced oil exploration and reduced reserves.

Energy dependence is not the same as energy vulnerability. Vulnerability can be addressed through the SPR, conservation measures, allocation, and fuel substitution can lessen vulnerability. Criticizes the NESC petition's military scenarios and its attribution of overwhelming power to OPEC.

Cites a number of authorities on the costs and benefits of an import fee.

The Coalition "believes that the federal government has adequate policy options to deal with the increasing dependence of the United States on imported oil without resorting to import restrictions of any kind."

Governor William P. Clements, Jr.
Office of the Governor
Austin, Texas 78711

Letter to Secretary Verity dated January 8, 1988, transmitted by Auburn L. Mitchell, Office of the Governor (COPP 7).

Comments:

Believes there is ample evidence that imports are threatening national security.

Urges the President to establish a floor price.

Urges public hearings.

Urges completion of the 232 study within six months, and recommends that studies recently prepared by the Department of Energy and the National Petroleum Council be included in the record to expedite the process.

Mr. Robert E. Moss, Vice President
The Coastal Corporation
1899 L Street, NW, Suite 500
Washington, DC 20036

Letter dated January 26, 1988 (COPP 60).

Comments:

Urges the Department to hold public hearings.

Refers to the growing level of dependence on oil imports and asserts that the relationship between "our country's dependence on imported oil and freedom of foreign policy options is a critical element."

Dr. Mark N. Cooper, Research Director
Consumer Federation of America
1424 16th Street, NW, Suite 604
Washington, DC 20036

Comments dated January 28, 1988 (COPP 34)

Comments:

Because the U.S. is "a high cost supplier with diminishing resources, dependence on imports is inevitable....National energy policy should be composed of domestic policies which minimize the impact of any future oil supply and price shocks and international policies which reduce the likelihood of shocks."

The current world oil price "is certainly not predatorily low....The fact that domestic U.S. resources are higher in cost than costs elsewhere in the world is a fact of economic life."

"The depletion of the domestic resource base is reflected in a steady decline of the reserve-to-production (R/P) ratio in contrast to a steady R/P abroad." The R/P in the U.S. declined from 30 years in 1947 to 11 in 1973. The decline since 1973 has been slower, but it continues.

The world R/P ratio increased from 22 years in 1947 to 40 years in 1960, then declined to 32 years in 1973 before increasing to about 36 years.

The oil import quota system that remained in effect from the late 50s to the early 70s "accelerated the drawdown of domestic reserves, dissuaded the U.S. from pursuing more appropriate policies, and rendered us more vulnerable to the price shocks of the 1970s."

The source of instability in world markets is not economics but politics, so the "pursuit of energy security must entail responses that address underlying political and demand-side problems."

Recommends diversification of supply sources, building of emergency reserves, and encouraging long term conservation.

Mr. Frederick Spreyer
Representative, Department of Business and
Economic Development (DBED) - (State of Hawaii)
1511 K Street, NW, Suite 519
Washington, DC 20005

Letter dated January 25, 1988 (COPP 16).

Comments:

Restrictions on oil imports would unfairly impact on the State of Hawaii because of its total dependence on foreign oil.

"Fuel needs of the military would be jeopardized by import restrictions,"...and "the support of civilians who work at military facilities in Hawaii might also be compromised."

Asserts that "neither an import quota nor an import fee is the way to assure our national security..."

Suggests the establishment of a regional petroleum reserve in Hawaii.

Mr. Matthew T. McGrath, Counsel for
Dow Chemical Company
1819 H Street, NW
Washington, DC 20006

Comments dated January 28, 1988 (COPP 51).

Comments:

Any import restrictions would jeopardize the availability of vital petrochemical feedstocks and increase Dow's reliance on more expensive alternative feedstocks, reducing Dow's competitiveness with fully integrated domestic oil petrochemical manufacturers.

Import restraints would undermine Dow's ability to compete with foreign suppliers having ready access to low-cost feedstocks.

The economic health of companies like Dow is vital to national security. Dow produces many strategically important products, and its R & D programs have important military applications.

Import restrictions would result in a significant increase in the trade deficit, discourage new investment, and result in higher unemployment.

There are better alternatives to import restrictions, such as the opening up of federal lands like ANWR; the removal of oil export restrictions, particularly on exports from Alaska and California; and government financial assistance to R & D for enhanced recovery operations.

"Dow strongly urges that the Secretary of Commerce recommend that the President take no action to institute trade restrictions of any type on any of the products covered by the petition."

Mr. John J. Kearney
Senior Vice President
Edison Electric Institute
1111 19th Street, NW
Washington, DC 20036-3691

Letter dated January 28, 1988 (COPP 25).

Comments:

EEI opposes both an import tariff or quota.

"As the trend-setter of all fossil fuel prices, oil prices have an influence on the ability of coal companies to raise the price of coal as well as the railroad industry to increase the price of coal transportation. Hence, artificial increases in oil prices or quotas on imported fuels that increase prices protect uneconomic domestic oil or natural gas producers thereby creating economic havoc in the entire energy markets."

"An investigation that only addresses crude oil imports and refined petroleum products and does not address the use of solid fuels (coal, lignite, shale oil) and uranium cannot be considered complete or adequate to consider national security implications."

EEI "trust[s] the Department will conduct extensive hearings...."

Empire State Petroleum Association
New England Fuel Institute
Independent Fuel Terminal Operators Assn.

Comments dated January 28, 1988 (COPP 45).

Comments:

"..current and projected levels of petroleum imports do not threaten national security." Imports are below the level of the 1970s and sources of imported oil have become diverse and secure; the SPR has ample supplies for an emergency.

Import restrictions would cause regional and sectoral distortions that would impair the economy.

Energy intensive industries "would be more vulnerable to foreign competition in U.S. markets and would have even greater difficulty in competing in foreign markets."

Oil import restrictions would slow growth, and increase unemployment, inflation, and interest rates.

Restrictions on imports will impair our diplomatic relations with allies, such as Canada, Venezuela and Mexico. They would also "contravene the energy policy advocated by the U.S. at the International Energy Agency."

Import restrictions would accelerate the depletion of U.S. reserves with the result of greater dependence and vulnerability in the future.

"[T]he Commerce Department should find that current and projected levels of petroleum imports do not threaten national security, and that restrictions on such imports would not serve national security objectives."

Delegation of the European Communities (EC)

Note Verbale of January 27, 1988 (COPP 59).

Comments:

U.S. import restrictions on oil "would be likely to harm the competitive position of U.S. industry and increase protectionist measures."

"Energy security cannot be enhanced by protectionist measures. Imports into the United States of crude oil and refined products have remained stable since 1982. Only during 1986 and 1987 has there been a slight increase from about 33 percent of supply to about 38.8 percent of supply."

"The EC and member states believe that recourse to Article XXI of the GATT should only be made in very exceptional circumstance....On no account should national security provisions be used for trade policy reasons. This was not the intent of GATT Article XXI."

"Any protectionist measures taken in response to the petition would be contrary to the standstill commitment which the United States undertook when they accepted the ministerial declaration of Punta del Este as well as with the conclusions reached at the most recent OECD ministerial meeting."

"Moreover, the European Communities and their states believe that any proposed restrictive measures would be incompatible with the recommendation made in 1985 by the International Energy Agency regarding liberalization of world trade in oil and oil products. They note that the Department of Energy's own energy security study, completed in March, 1987, opposed protectionist measures such as an oil import levy."

The EC urges the U.S. to refrain from adopting restrictive measures, but "If, nevertheless, the United States authorities should decide to do so, the European Community and their member states would have no option other than to take the necessary actions if their legitimate GATT rights were impaired."

Mr. J. T. McMillan
Senior Vice President
Exxon Company, U.S.A.
P.O. Box 2180
Houston Texas 77252-2180

Letter dated January 27, 1988 (COPP 28).

Comments:

"...strongly opposed to...oil import fees or tariffs (either flat or variable), quota limitations on imports or other, similar means of decreasing U.S. dependence on imported petroleum."

Recommends "the removal of existing impediments that inhibit the finding and development of indigenous petroleum supplies. "Specifically recommends natural gas deregulation, the opening of federal lands, and the elimination of the windfall profit tax.

"Mr. Patrick J. F. Gratton
2403 Thomas Avenue
Dallas, Texas 75201-2037

Letter dated January 25, 1988 (COPP 15).

Comments:

The sharp decline in U.S. oil production is "due exclusively to predatory energy policies of OPEC."

Suggests that an early hearing be held in response to the NESC petition.

Albert Hrubetz, President
Hrubetz Oil Company
5949 Sherry Lane, Suite 800
Dallas, Texas 75225
(Member of NESC)

Letter dated January 5, 1988 (COPP 3).

Comments:

OPEC can drive independents out of business by controlling prices.

Urges public hearings.

Mr. H. B. Scoggins, Jr.
President, Independent Petroleum
Association of America (IPAA)
1101 16th St., NW
Washington, DC 20036

Letter dated January 28, 1988, and attached comments (COPP 27).

Comments:

IPAA asserts that "The United States has lost control of its energy future."

The price and supply of oil is increasingly controlled by governments often hostile to the U.S.

The decline in the oil producing industry has been at a rate unprecedented in history. It cannot be restored quickly.

IPAA believes that when we depend on imports for 30% or more of our needs, we have reached a "peril point" where we begin to lose our energy and foreign policy independence."

UNCLASSIFIED

IPAA names a number of adverse contingencies in the Middle East and asks: "Should the United States spend millions of American military dollars and more important — American lives — protecting foreign oil when we could develop our own domestic sources?"

In a broader international context, IPAA asserts that as we become more dependent on imports, we will increasingly compete with our allies for the same supply, driving up prices and exacerbating our international relationships.

"At least 2,500 rotary rigs need to be at work to maintain sufficient petroleum supplies for national security." We are significantly below that threshold.

Independent oil companies were most damaged by the price drop and have traditionally been the leaders in drilling for oil. "Except for...[the] increased drilling by independents [in the eight years ending in 1985], domestic production would have been 1.3 million barrels per day less in 1985, and our costs for imported oil would have been almost \$15 billion greater."

The impact of falling prices has had significant effects beyond the oil industry, particularly in capital markets. The oil and natural gas industry "generally has accounted for between 12 and 15 percent of all capital investment....It is estimated that for each dollar of direct investment in oil and natural gas, another \$2 to \$2.50 of capital investment is generated elsewhere. As a result, from 20 to 30 percent of all capital investment is oil-related."

IPAA questions the effectiveness of the SPR to provide energy security, and is also skeptical of the effectiveness of the International Energy Agency supply-sharing agreement.

IPAA has doubts as to whether Canada and Mexico could or would provide the U.S. with additional supplies in an emergency.

In regard to recommended energy policies, IPAA asserts that "If...proof must be provided that benefits equal or exceed costs, then this is an unfair test that offers no real solution to our emerging energy crisis....We proved without a doubt in the 1970s that a secure supply of energy, regardless of price, is essential...."

Persian Gulf producers have used a "tactic of deliberately collapsing world oil prices and the prices of competing fuels..." "The dominant Arab OPEC oil producers proclaimed a two-fold purpose in their manipulation of petroleum markets and prices: (1) eliminate marginal, high cost production of conventional energy, and (2) prevent development of energy alternatives substitutable for oil."

UNCLASSIFIED

UNCLASSIFIED

IPAA lists four pages of recommended Presidential, legislative and regulatory actions, covering tax, environmental, banking and public issues. Under the heading "Extraordinary Issues," IPAA" urges a floor price for crude oil, and a variable import fee on crude oil and petroleum products, without exceptions or exemptions.

Mr. Roger A. Berliner, Esq.
Counsel to the Independent Petroleum
Association of Canada
1229 19th Street, NW
Washington, DC 20036

Letter dated January 28, 1988 (COPP 39).

Comments:

The source of the damage to the U.S. oil industry was the drop in the world oil price, not the competition from imported oil.

In the scenarios provided in the petition, imports from Canada must be viewed as relatively invulnerable to interruption, and therefore an enhancement to U.S. energy security.

The pending U.S.-Canada Free Trade Agreement when adopted will provide further assurance of Canadian supplies in any situation threatening U.S. national security.

Government intervention in the market to engineer higher prices could be counterproductive because of the effects on other economic sectors and because of the possibility of retaliation.

"(H)opes the investigation will not conclude that artificial limitations on U.S. imports of oil and products are advisable."

Mr. Charles K. Ebinger, Senior Consultant
Independent Refiners Coalition
1615 L Street, NW
Washington, DC 20036

Letter and Response to Petition dated January 28, 1988 (COPP 44).

Comments:

"Access to adequate refining capacity is as essential to the national security as crude oil."

UNCLASSIFIED

The coalition does not support any specific action by government. However, if the U.S. imposes an import fee on crude oil, the coalition asks that a fee be imposed on refined products at a rate that is 1.1 times the crude fee, plus an additional \$3 per barrel to offset environmental costs in the U.S.

U.S. refining capacity would be inadequate under the 1 year mobilization and 3 year conventional war scenarios to maintain national security.

"Current U.S. refinery capacity is insufficient to meet current civilian demand for aviation fuel and gasoline."

If the U.S. decides to take remedial action in response to the 232 petition, it should closely examine the impact of such actions on the refining industry.

Ambassador Soesilo Soedarman
Indonesian Embassy
2020 Massachusetts Avenue, NW
Washington, DC 20036

Letter dated January 28, 1988, with attachments (COPP 41).

Comments:

U.S.-Indonesia economic ties would be adversely affected. The U.S. is Indonesia's biggest oil customer after Japan. Oil import restrictions will reduce Indonesia's ability to buy U.S. exports; Indonesia's ability to repay its debts would be impaired.

If the U.S. stimulates its domestic oil production now, its reserves will be depleted more rapidly than is prudent. Increasing production does nothing to improve national security and may leave the U.S. more vulnerable in the future.

The U.S. Administration has numerous and workable policy alternatives to import restrictions such as natural gas deregulation, the opening of ANWR, repeal of the windfall profit tax, diversifying its supply sources, etc.

Profits of U.S. companies in Indonesia will be reduced by an oil import fee. Mobil gets 26% of its worldwide profits from Indonesia, Texaco 34%, and Chevron 25%.

Import restrictions will damage the U.S. economy, lower the standard of living, shift wealth to American oil producers, and lower employment. Because U.S. products will include the higher costs of oil, they will become less competitive abroad, and this will increase the balance of payments deficit.

Import restraints violate the spirit of the standstill and rollback commitments made at the start of the Uruguay round of GATT negotiations. They may invite claims for compensation or retaliation.

Expresses skepticism of the presentation made by the National Energy Security Committee in its Section 232 petition.

Mr. Arthur T. Downey; Mr. Jan B. Vlcek, Counsel
Industrial Oil Consumers Group
1275 Pennsylvania Ave., N.W.
Washington, DC 20004-2404

"Request for Extension of Comment Period," dated January 20, 1988 (COPP 11);
comments dated January 28, 1988 (COPP 43).

Comments:

Requests an extension of an additional 30 days for comments on the 232 petition.

"Whether or not the Department extends this comment period, the IOCG hereby requests that the Department provide either a new comment period or public hearings at a mid-way point in its investigation."

The NESC petition "represents a parochial effort to secure the transfer of resources from the energy consumers to domestic oil explorers and producers under the mask of protecting national security. The Application pleads for 'stability', when it really seeks the high oil prices which would result from restrictions..."

The NESC application was wrong in stating that regulations require an examination of a 1 year mobilization followed by a 3 year conventional war. Such a scenario is not probable, and the Department should examine more realistic possibilities.

A limitation on imports "would not only cause delight in the hearts of our industrial competitors and security adversaries, but also would injure our allies and friends who provide us with relatively secure supplies of oil."

Recommends filling the SPR and perhaps financial incentives for exploration and identification of new reserves.

Mr. Ted Warren
International Association of
Drilling Contractors
15810 Park Ten Place
Houston, TX 77084-5134

Letter dated January 22, 1988 (COPP-64)

Comments:

"The wide swings in the price of crude oil which the industry has recently experienced constitute a major threat to the survival of the domestic oil field service industry."

"The contract drilling industry is being devastated. More than 40 percent of the firms engaged in the oil and gas drilling just a few years ago are out of business."

"Higher import volumes greatly aggravate the nation's balance of payment position and heighten the costs of any disruption of the flow in internationally traded oil."

Mr. Leonard E. Santos, Counsel for
Irving Oil Corporation
1660 L Street, NW
Suite 1000
Washington, DC 20036

Comments dated January 28, 1988 (COPP-48)

"Irving retail operations in Maine are geographically closer to the Canadian sources of refined petroleum products on which Irving relies than are most domestic retailers to their American suppliers."

"Irving is entitled to rely on the pledge recently made by the United States not to restrict imports of Canadian oil for national security reasons."

Units on Irving's imports of refined petroleum products from Canada would injure both Irving and American consumers without enhancing United States national security.

Mr. Leonard E. Santos, Counsel for
Irving Oil Limited [Canada]
1660 L. Street, NW, Suite 1000
Washington, DC 20036

Comments dated January 28, 1988 (COPP 46).

Comments:

"Irving opposes the request contained in the petition submitted by Enserch Corporation on behalf of the National Energy Security Committee..."

Restrictions on imports should not be applicable to Canadian oil. Limits on U.S. imports of Canadian oil "would flatly violate the President's pledge as expressed in the January 2, 1988 standstill letter."

Import restrictions will accelerate consumption of domestic oil and result in much greater and permanent dependence on imported oil.

Mr. Donald P. Schnacke
Kansas Independent Oil & Gas Assn. (KIOGA)
105 South Broadway, Suite 500
Wichita Kansas, 67202

Letter dated January 22, 1988 (COPP 14).

Comments:

The Board of Directors of KIOGA voted unanimously to support the NESC petition.

KIOGA "is available to furnish detailed information about the plight of the industry and the effects of the current policy of reliance on imported crude...."

Mr. Thomas L. Eveland
Vice Pres.-Government Affairs
Kern Oil & Refining Co.
Rural Route 6 - 7724 Panama Lane
Bakersfield, CA 93307

Letter dated January 20, 1988 (COPP 12).

Comments:

Petroleum product imports have forced a number of small and independent refiners out of business, causing a "severe concentration of U.S. refining capacity in very large refineries located in a few major industrial complexes."

Asserts that the only way to limit petroleum product imports is through an import fee or quota, and expresses the view that a fee would be more desirable in that it raises revenues as well as stimulates the refining industry.

Windfall profit tax should be removed to help stimulate domestic oil production.

Mr. George P. Mitchell
President, Mitchell Energy &
Development Company
2001 Timberloch Place
P.O. Box 4000
The Woodlands, Texas 77387-4000
(Member NESC)

Letter dated January 19, 1988 (COPP 30).

Comments:

Urges the Commerce Department to give special consideration to:

Increasing petroleum imports that may pass the 50 percent level in the 1990s.

Falling domestic production, and the large losses in petroleum employment.

The decline in much-needed research on enhanced oil and gas recovery.

The threat to the economy of increased oil dependence.

Makes favorable mention of Sen. Bentsen's bill requiring federal action to keep oil imports below 50 percent of our needs.

Asserts that natural gas, which can be substituted for oil in many applications, "could supplant 5 million barrels a day of imported oil within 12 to 15 years. It is the most viable option to the problems we face."

R. Thomas Van Ardall
Vice Pres., National Council of
Farmer Cooperatives
50 F Street NW, Suite 900
Washington, DC 20001

Letter dated January 13, 1988 (COPP 9); letter of January 28, 1988, and enclosed Policy Resolution of 1988, and enclosures dated 1985 dealing with the Implications for U.S. Agriculture of Petroleum Product Imports (COPP 29).

Comments:

Requests an extension (length not specified) of the deadline for filing comments.

Requests public hearings. Reiterates the request in the second letter.

Supply cooperatives have a petroleum system that includes 5 refineries (337,700 barrels per stream day) that supplies nearly 40 percent of all on-farm fuel.

"U.S. agriculture must have uninterrupted access to equitably priced supplies of petroleum fuels in order to assure dependable supplies of food and fiber for the nation and the world....A disruption of even a short duration can result in crop losses for an entire year."

"The National Council is concerned that increasing petroleum product imports will displace domestic refining capacity to the extent that this nation may be unable to refine its strategic oil reserves in the next energy emergency."

"...we are philosophically opposed to an oil import fee...." "However, in the event that an oil import fee is necessary for national security reasons, we would maintain that the fee would fail to achieve its national security objective unless an equivalent or greater fee is imposed upon imported refined petroleum products."

The 1985 study cites a number of factors for growing imports, such as import barriers of other nations, the lack of overseas need for gasoline, OPEC quota subversion, dual pricing of crude oil, and an increase in OPEC refining capacity.

Mr. Milton R. Copulos
National Defense Council Foundation
L'Enfant Plaza Box 23397
Washington, DC 20026

Letter dated January 28, 1988, with comments (COPP 52).

Comments:

Cites growing imports from the Persian Gulf, particularly from Saudi Arabia, combined with declining U.S. exploration and production.

Constructs scenarios under full mobilization, relying on a May, 1986 study prepared by the Industrial College of the Armed Forces. The study foresaw full mobilization requiring 21.8 MBD of oil products, of which 2.2MBD were for direct military use and 2.6MBD for increased use by the civilian sector to meet defense production needs.

Examines scenarios involving simultaneous low-intensity conflicts in the philippines, Central America and the Middle East.

Concludes that "the current level of imports does indeed constitute a threat to the nation's security."

Mr. Robert C. Odle, Jr.
National Energy Security Committee
Weil, Gotshal & Manges
1615 L Street, NW
Washington, DC 20036

Memorandum in support of the 232 petition dated January 28, 1988 (COPP 50).

Comments:

Urges DOC to make a "full-scale and broad-based Section 232 investigation into all factors relating to a threat of impairment to U.S. national security. Urges that DOC " conduct full hearings and develop new economic projections and models, based on current data..."

DOC should analyze:

Whether the domestic industry is able to produce an adequate supply of secure oil in conventional wars and other national emergencies.

"Whether the U.S. will experience an oil supply shortfall in a series of simultaneous low-intensity conflicts that could occur now or in the future."

Whether a peacetime supply disruption would impair national security.

The adverse effect on U.S. foreign policy because of reliance on imported oil.

The effect of imports on the development of alternative energy sources.

The SPR cannot ensure an adequate supply of oil in a conventional war, nor can it operate at levels to prevent significant rises in prices that can damage the economy.

"The U.S. military presence in the Persian Gulf does not protect against supply cutoffs or oil shortages in other national emergencies."

The U.S. oil industry has been seriously damaged, production has declined, and further damage to industry is threatened, which "will likely result in even greater oil supply shortfalls in future national emergencies."

The IEA supply-sharing arrangements would not mitigate the effects of supply disruptions. "To the contrary, they would, in effect exacerbate any supply emergency faced by the United States..." because the U.S. "would be required to be a net contributor of oil to other participants..."

Conservation in an emergency is unlikely to be of much help because most of the conservation measures have already been taken.

"...the President should not defer action under Section 232 pending the enactment of remedial action by the Congress." "...the threat to national security has increased while Congress refused to act on the President's proposals."

"...the Administration should take all appropriate actions that can enhance U.S. production and, hence, alleviate the threat to national security posed by oil imports. The focus should be on remedial actions that provide sufficient certainty to domestic producers so as to encourage new oil exploration and development."

Mr. Urvan R. Sternfels, President
National Petroleum Refiners Association
1899 L Street, NW, Suite 1000
Washington, DC 20036

Letter dated January 28, 1988 (COPP 49).

Comments:

Imports of refined product threaten our domestic refining capacity, and a further loss of capacity "has serious implications for the economic well-being and national security of the nation."

"Our import control system must be examined in the light of..." import restrictions in foreign markets "so that U.S. refiners are not unfairly disadvantaged."

U.S. Customs should assure tighter and more effective enforcement of tariff schedules.

"Some combination of increased tariffs and quotas might ultimately be implemented, dictated by national objectives, with the goal of maintaining a secure domestic refining industry."

"If a crude oil import fee is adopted, there should be a corresponding fee on refined products, with an appropriate differential reflecting additional costs which domestic refiners bear..."

"[C]are should be taken that the competitiveness of the petrochemical industry which relies on imported petroleum products as raw materials and fuels is not disadvantaged."

Hopes the government will be willing to continue to receive comments and data after the January 28, 1988, closing date.

Glen Michel, Exec. Vice Pres.
National Stripper Well Association
P.O. Box 3373
Abilene, Texas 79604
(Member NESC)

Letter dated January 5, 1988 (COPP 4).

Comments:

Requests the chance for public testimony to delve more deeply into such things as "1) Loss of reserve producing capacity; 2) Loss of daily production; 3) The plugging of known reserves under stripper well leases...; 4) The yet unknown recovery techniques that may be afforded the nation in the next decade; and 5) the percent recovery from known reservoirs...."

Mr. Jack H. Morse, National President
Navy League of the United States
2300 Wilson Boulevard
Arlington, Virginia 22201

Letter dated January 21, 1988 (COPP 17).

Comments:

Urges public hearings and a "full-scale interagency investigation."

Urges an expedited examination of the oil import issue.

Does not "offer or endorse a specific remedy to reduce America's reliance on imported oil," but wants a study that outlines the available options if a threat to national security is threatened.

Mr. Glenn R. Schleede, Vice Pres.
New England Electric
25 Research Drive
Westborough, Massachusetts 01582

Letter dated January 25, 1988 (COPP 18).

Comments:

Urges that a study of the oil import issue take into account the following factors, which are exemplified in the text of the letter:

"1. The other sources of energy which have been, are or could be substituted for oil."

"2. The past, current and potential for reducing demand for oil through conservation measures."

"3. The substantially different oil market situations that currently exist, compared to the situations at the time Section 232 of the Trade Expansion Act was previously invoked."

"4. The adverse economic impact that would result if oil import taxes were imposed or quantitative limits on imports were adopted."

Urges that "oil import taxes or quantity limits not be imposed...."

Mr. C. A. Watts
North Central Oil Corporation
6001 Savay, Suite 600
Houston, TX 77036

Letter dated January 25, 1988 (COPP-63)

Comments:

"Support the petition brought by Enserch and TIFRO in encouraging a study of this problem to be completed within six months."

"We do not have the support of this proposed investigation by most of the majors because they are working hand in glove with the foreign national companies which are creating the oil glut problem. As long as refiners and marketers can make enough money from those segments of their business, it is not particularly important to them that production be profitable."

"The most direct and simple solution for this problem is to impose an import fee on the order of \$10 per barrel of crude oil and products which will stabilize domestic prices at a level that will cause the industry to step up its exploration activity."

Mr. Richard F. Hall, Vice President
Pacific Resources, Inc.
1700 K Street, NW, Suite 502
Washington, DC 20006

Letter dated January 28, 1988 (COPP 53).

Comments:

An import fee would have larger negative than positive impacts.

There are many ways to improve production that are preferable to an import fee: opening federal lands, repeal of the windfall profits tax, relief from unnecessarily burdensome environmental costs, and use of alternative fuels.

Mr. Charles F. Perry, President
Permian Basin Petroleum Association
P.O. Box 132
Midland, Texas 79702
(Member NESCA)

Letter dated January 12, 1988 (COPP 10).

Comments:

Urges public hearings.

Mr. Gordon Gooch, Counsel for
The Petrochemical Energy Group & Coalition to Oppose Energy Taxes
1100 15th Street NW, Suite 1200
Washington, DC 20005

Comments received on January 28, 1988 (COPP 33).

Comments:

[Members of PEG & COET are: Air Products & Chemicals, Inc.; Borg-Warner Chemicals; Dow Chemical, U.S.A.; Hercules Incorporated; Hoechst Celanese

Corporation; PPG Industries, Inc.; Rohm & Haas Company; Texas Eastman Company, Division of Eastman Kodak Co.; Union Carbide Corporation; and U.S. Industrial Chemicals Co.]

Opposes imposition of import fee, tax, tariff or quota. The net result would be that imports of products made abroad would gain an artificial advantage over domestic products, and exports of U.S. products would be disadvantaged abroad.

Mr. Arnold H. Weiss, Counsel for
Petroleos Mexicanos (PEMEX)
1050 Connecticut Avenue, NW
Washington, DC 20036-5339

Comments dated January 28, 1988 (COPP 42).

Comments:

The U.S. is PEMEX' largest market, accounting for about half of Mexican oil exports. The oil in the SPR is 91% Mexican oil.

If import restrictions are imposed, Mexican oils should be exempted.

The NESC petition "does not establish the necessary causal link between an adjustment of imports of crude oil and refined petroleum products and the removal of any threat to impair the security of the United States."

Cites the DOE Energy Security report on the various adverse effects of import restrictions on the U.S. economy.

Mexican oil imports would no be less secure than oil from Alaska, and can be shipped to the U.S. through Mexican and U.S. coastal waters, without entering the "high seas."

Import restrictions would undermine Mexico's economy, reducing its ability to pay its debts and to purchase imports from the United States.

The NESC petition is in effect requesting a price support program with a funding mechanism that is fundamentally inequitable. "Consumers with a greater-than-average reliance on petroleum products, such as homeowners in the Northeast who use heating oil, petrochemical companies, and transportation companies...would be required to pay more than their fair share of what the Enserch petition claims are purely national defense costs."

An analysis of the available evidence on the adverse economic effects of a fee or quota would "provide the basis for a recommendation to the President that he take no action."

Cites the DOE Energy Security study, a DRI study, a report by the National Petroleum Council and a Federal Trade Commission report that show an import fee causing serious harm to the U.S. economy.

Asserts that a study by Arthur D. Little "found that almost 31 percent of American industry was either petrochemical or dependent on the petrochemical industry."

"The statistics relied upon by Enserch suggest that price supports alone will not be effective even to increase the resource base. For example: 'Domestic production in 1985 was virtually equal to that in 1979, in spite of the fact that prices tripled.' Pet. at Tables 7, 10."

"Unpleasant as it is to accept, the basic premise underlying the oil import fee or quota no longer is operative. A reduction in imports can no longer be completely offset by present deliverability from domestic production."

W. E. Bradford, President
Petroleum Equipment Suppliers Association
9225 Katy Freeway
Houston, Texas 77024
(Member NESC)

Letter dated January 12, 1988 (COPP 8).

Comments:

Increased imports have seriously damaged the oil services industry: employment fell from 377,400 to 247,500 in one year; companies have lost over a billion dollars; the number of service companies fell from 314 to 192 as of Dec., 1987; personnel are not being trained in skills that might be necessary in the future.

"It will take five to seven years to match skilled personnel with demand should the U.S. be called upon to increase domestic exploration."

Mr. C. Richard Cahoon, Vice President
Petroleum Marketers Association of America
1120 Vermont Avenue, NW, Suite 1130
Washington, DC 20005

Comments dated January 28, 1988 (COPP 38).

Comments:

"(S)upports efforts targeted at increased domestic exploration, but is opposed to broad government intervention such as taxes or restrictions on imported oil..."

Objects to import taxes because they create competitive imbalances; encourages production but not exploration; and would be devastating to the economy.

Suggests that oil supply capability can be increased by diversifying sources of supply, increasing the size of the SPR, and exploring for new sources of oil.

Supports the Administration's energy initiatives and additional tax incentives for exploration and research & development.

"'War Games' should not be the basis for import taxes....FMAA does not believe that Commerce is bound by these classified scenarios. If they are, FMAA requests confirmation and time and information to respond to what otherwise is difficult to consider in any serious manner."

Mr. Kent Hance, Commissioner
Railroad Commission of Texas
1701 N. Congress Avenue
P.O. Drawer 12967
Austin, Texas 78711-2967

Letter dated January 22, 1988 (COPP 13).

Comments:

Urges regional public hearings, including one in Texas.

U.S. domestic production will decline and consumption will rise, causing imports to rise to as much as 65 percent of consumption in the early 90s. A disproportionately high level of imports increases our vulnerability.

Gasoline prices could rise to \$2.00 per gallon by the early 90s; inflation could rise to 10 percent per year.

Asserts that "the solution for national security and economic health is price stability."

Mr. John Sharp, Commissioner
Railroad Commission of Texas
1701 N. Congress Avenue
P.O. Drawer 12967
Austin, Texas 78711-2967

Letter dated January 28, 1988 (COPP 58).

Comments:

Requests that the Secretary "recommend appropriate remedial action."

Requests a public hearing, in which the Railroad Commission "would be pleased to participate."

Mr. Raymond R. Wright, Jr.
Executive Vice President
Seaview Petroleum Company
P.O. Box 231
Blue Bell, Pennsylvania 19422

Letter dated January 28, 1988 (COPP 22).

Comments:

The DOC investigation should conclude that "adequate refining capacity is as essential to national security as crude oil."

"...adoption of a crude oil fee without a concomitant product import fee would obviously further impair the industry's ability to respond to a national emergency."

"...the appropriate crude/product fee premium which takes into account differential environmental burdens, internalized regulatory costs, plus added fuel and working capital expenses is 10-20%."

R. Timothy Columbus, Counsel to SIGMA
Collier, Shannon, Rill & Scott
1055 Thomas Jefferson St. NW
Washington, DC 20007

Letter dated January 7, 1988 (COPP 2), and "Opposition to Petition..." dated January 28, 1988 (COPP 24).

Comments:

Requests extension of the deadline for comments from Jan. 28 to March 1, 1988 [from letter].

Requests a public hearing [from letter].

Requests that we "explicitly define 'national security' with respect to this investigation." [from letter]

SIGMA cites the DOE Energy Security study for its basic findings:

Because of high consumption and low reserves, the U.S. will always have to import much of its energy needs.

Dependence on oil imports does not necessarily equate with national security vulnerability; the key factors are 1) dependence on imports that are subject to disruption; 2) the risk that a disruption will occur; and 3) our capability to respond to a disruption.

In recent years, most crude and product imports have come from reliable Western Hemisphere sources, mainly Canada, Mexico, and Venezuela, which have considerable reserves and excess production capacity.

Our ability to respond to a supply disruption has improved substantially.

"Recent oil price declines benefitted this country by fueling the recent strong growth and expansion in the U.S. economy and by slowing down the gradual depletion of remaining U.S. oil reserves." "...a decline in U.S. production in the short-term actually enhances our security in the long-run by preventing a premature depletion of remaining accessible reserves."

Reserves of Canada, Mexico and Venezuela, which comprise 110 billion barrels "would provide more than adequate supplies in the event of a prolonged war."

"The Secretary of Commerce correctly declined to initiate an investigation." when Congressmen requested a Section 232 investigation on petroleum product imports in 1985.

The U.S. has ample refining capacity in case of an emergency because of the availability of idle operable capacity, the addition of NGLs, and overall refinery processing gains.

SIGMA refutes the NESC petition suggestion that investments by exporting countries in U.S. refineries makes the U.S. less secure. "If anything, these investments enhance the U.S. national security."

If DOC finds a national security threat, it should not impose import restraints, which "will not resolve our long term energy independence and, if anything, will exacerbate the problem by 'draining America first' of its most viable oil reserves. An oil import fee also would impair our security by discouraging future production by our reliable and secure foreign suppliers."

"An oil import fee would increase the cost to consumers not only of crude oil and petroleum products but also of all other energy sources." It would "also have substantial negative effects on the U.S. GNP and economy and on the inflation rate."

If DOC determines that some import restraint is advisable, it should not recommend a differential fee on crude oil and petroleum products. "In the absence of import competition, U.S. refiners could increase the price of all petroleum products up to the level of the fee.....The result would be even higher costs to the U.S. economy, compounding the problems of a flat fee."

William E. McCommons, Nat'l. Dir. & Treas.
Society of Independent Professional Earth Scientists
4925 Greenville Ave., Suite 170
Dallas, Texas 75206
(Member NESC)

Letter dated January 8, 1988 (COPP 6).

Comments:

Asserts that OPEC increases of production has caused devastation, "drowning U.S. independent producers in a flood of cheap, foreign, imported oil."

Requests an early public hearing to present its position and a program it believes would be a workable solution.

Mr. John E. Watson, President
Texas Independent Producers & Royalty Assn. (TIPRO)
1910 First Republic Bank Tower
515 Congress Avenue
Austin, Texas 78701
(Member NESC)

Letter with attached commentary dated January 28, 1988 (COPP 19).

Comments:

Urges public hearings in Washington and other areas across the nation.

TIPRO provides data on the drop in U.S. oil production and predicts "sagging industry activity in exploration, stripper well operation and enhanced recovery operations."

The consequences of low U.S. oil production are: 1) increased reliance on OPEC oil; and 2) an annual increase in the trade deficit of as much as \$110 billion beginning in 1992.

An enclosed TIPRO statement on oil import policy dated August 24, 1985, proposes an import fee on crude oil and petroleum products at a level high enough to offset the costs of: the strategic petroleum reserve; DOE budgetary items related to imports; synthetic fuels development; and DOD measures aimed at protecting the flow of imports.

Mr. James L. Henry, President
Transportation Institute
521 Arth Way
Camp Springs, Maryland 20746

Letter dated January 28, 1988 (COPP 55).

Comments:

"Increasing imports of crude oil and petroleum products affect the national security of this country because they reduce the demand for transportation of oil by U.S.-flag commercial vessels." The number of militarily useful tankers will decline, and create a shortfall in the number needed for national security emergencies.

"Increasing imports of oil to the gulf displaces the crude oil produced in Alaska and thus eliminated the need for producing and transporting the oil."

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"Another concern is the recently concluded U.S.-Canada Free Trade Agreement which authorizes exports to Canada of 50,000 b/d of crude produced in Alaska....This agreement is likely to lead to the renewal of requests from countries in the Pacific Rim for similar access to Alaskan crude oil."

"The negative effect of imports...could be mitigated if a percentage of the imports were required to be on U.S.-flag vessels."

Ms. Susan C. Moya
U.S. Chamber of Commerce
Washington, DC

Statement dated January 28, 1988 (COPP 20).

Comments:

Reliance on foreign oil should not be the only factor for determining energy vulnerability. Other factors to be considered are:

Worldwide emergency oil stocks are substantial.

The U.S. has diversified its sources of oil supplies.

Free World dependence on OPEC has declined.

The Chamber urges passage of the Administration's energy agenda, including deregulation of natural gas, repeal of the windfall profit tax, continued filling of the SPR, development of ANWR, retaining tax benefits for energy production, and reforming nuclear plant licensing procedures.

The Chamber cautions that an oil import tax or price floor might spur some domestic production, but would lead to higher prices for all forms of energy, raise the consumer price index, and reduce the annual gross national product.

An import tax may be GATT-illegal, it would run counter to U.S. free trade initiatives, and would contradict the 1985 IEA Ministerial agreement to maintain open energy trade and resist protectionist measures.

"The Chamber suggest that, rather than imposing restrictions on access to foreign and domestic oil, steps be taken to develop free world petroleum resources and alternative fuels."

Mr. Luis A. de la Garza
Vice President, Valero Energy Corporation
P.O. Box 500
San Antonio, Texas 78292-0500
(Member NESC)

Letter and attached comments dated January 27, 1988 (COPP 31).

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"...the higher the percentage dependence [on foreign energy], the more our national security is impaired."

"One thing that is less obvious about our import dependence is that a shortage of refining capacity is also currently impairing national security."

"We recommend that the response to the 232 petition include a proposed remedy to put domestic and foreign refiners on a level economic playing field....should the remedy for the overall oil dependency problem be a crude oil import fee, we recommend a higher fee be collected on certain refined products..." The fee on products should be at least 1.12 times the crude import fee and should apply only to the higher value products.

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Washington, D.C.

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Cites opposition to the United States imposing an oil import fee as a means of enhancing energy security. Argues that the "short term benefits to the US oil industry of an oil import fee would be far outweighed by the market distortions and diseconomies resulting from such a system, which would have serious negative effects on exploration and development of indigenous OECD petroleum resources outside the US."

The Norwegian Government also argues that an oil import fee or similar discriminatory measures would be: (1) in violation of present GATT rules; and (2) contrary to the stand-still commitment of the Punta del Este Declaration of 20 September 1987.

Finally, the Norwegian Government states that an oil import fee would be contrary to the declarations of the International Energy Agency concerning the need for IEA countries to remove barriers to energy trade.

"...we are philosophically opposed to an oil import fee...." "However, in the event that an oil import fee is necessary for national security reasons, we would maintain that the fee would fail to achieve its national security objective unless an equivalent or greater fee is imposed upon imported refined petroleum products."

The 1985 study cites a number of factors for growing imports, such as import barriers of other nations, the lack of overseas need for gasoline, OPEC quota subversion, dual pricing of crude oil, and an increase in OPEC refining capacity.

Mr. Milton R. Copulos
National Defense Council Foundation
L'Enfant Plaza Box 23397
Washington, DC 20026

Letter dated January 28, 1988, with comments (COPP 52).

Comments:

Cites growing imports from the Persian Gulf, particularly from Saudi Arabia, combined with declining U.S. exploration and production.

Constructs scenarios under full mobilization, relying on a May, 1986 study prepared by the Industrial College of the Armed Forces. The study foresaw full mobilization requiring 21.8 MBD of oil products, of which 2.2MBD were for direct military use and 2.6MBD for increased use by the civilian sector to meet defense production needs.

Examines scenarios involving simultaneous low-intensity conflicts in the Philippines, Central America and the Middle East.

Concludes that "the current level of imports does indeed constitute a threat to the nation's security."

Mr. Robert C. Odle, Jr.
National Energy Security Committee
Weil, Gotshal & Manges
1615 L Street, NW
Washington, DC 20036

Memorandum in support of the 232 petition dated January 28, 1988 (COPP 50).

Comments:

Urges DOC to make a "full-scale and broad-based Section 232 investigation into all factors relating to a threat of impairment to U.S. national security. Urges that DOC "conduct full hearings and develop new economic projections and models, based on current data..."

DOC should analyze:

Whether the domestic industry is able to produce an adequate supply of secure oil in conventional wars and other national emergencies.

"Whether the U.S. will experience an oil supply shortfall in a series of simultaneous low-intensity conflicts that could occur now or in the future."

Whether a peacetime supply disruption would impair national security.

The adverse effect on U.S. foreign policy because of reliance on imported oil.

The effect of imports on the development of alternative energy sources.

The SPR cannot ensure an adequate supply of oil in a conventional war, nor can it operate at levels to prevent significant rises in prices that can damage the economy.

"The U.S. military presence in the Persian Gulf does not protect against supply cutoffs or oil shortages in other national emergencies."

The U.S. oil industry has been seriously damaged, production has declined, and further damage to industry is threatened, which "will likely result in even greater oil supply shortfalls in future national emergencies."

The IEA supply-sharing arrangements would not mitigate the effects of supply disruptions. "To the contrary, they would, in effect exacerbate any supply emergency faced by the United States..." because the U.S. "would be required to be a net contributor of oil to other participants..."

Conservation in an emergency is unlikely to be of much help because most of the conservation measures have already been taken.

"...the President should not defer action under Section 232 pending the enactment of remedial action by the Congress." "...the threat to national security has increased while Congress refused to act on the President's proposals."

"...the Administration should take all appropriate actions that can enhance U.S. production and, hence, alleviate the threat to national security posed by oil imports. The focus should be on remedial actions that provide sufficient certainty to domestic producers so as to encourage new oil exploration and development."

Mr. Urvan R. Sternfels, President
National Petroleum Refiners Association
1899 I Street, NW, Suite 1000
Washington, DC 20036

Letter dated January 28, 1988 (COPP 49).

Comments:

Imports of refined product threaten our domestic refining capacity, and a further loss of capacity "has serious implications for the economic well-being and national security of the nation."

"Our import control system must be examined in the light of..." import restrictions in foreign markets "so that U.S. refiners are not unfairly disadvantaged."

U.S. Customs should assure tighter and more effective enforcement of tariff schedules.

"Some combination of increased tariffs and quotas might ultimately be implemented, dictated by national objectives, with the goal of maintaining a secure domestic refining industry."

"If a crude oil import fee is adopted, there should be a corresponding fee on refined products, with an appropriate differential reflecting additional costs which domestic refiners bear..."

"[C]are should be taken that the competitiveness of the petrochemical industry which relies on imported petroleum products as raw materials and fuels is not disadvantaged."

Hopes the government will be willing to continue to receive comments and data after the January 28, 1988, closing date.

Glen Michel, Exec. Vice Pres.
National Stripper Well Association
P.O. Box 3373
Abilene, Texas 79604
(Member NESCA)

Letter dated January 5, 1988 (COPP 4).

Comments:

Requests the chance for public testimony to delve more deeply into such things as "1) Loss of reserve producing capacity; 2) Loss of daily production; 3) The plugging of known reserves under stripper well leases...; 4) The yet unknown recovery techniques that may be afforded the nation in the next decade; and 5) the percent recovery from known reservoirs...."

Mr. Jack H. Morse, National President
Navy League of the United States
2300 Wilson Boulevard
Arlington, Virginia 22201

Letter dated January 21, 1988 (COPP 17).

Comments:

Urges public hearings and a "full-scale interagency investigation."

Urges an expedited examination of the oil import issue.

Does not "offer or endorse a specific remedy to reduce America's reliance on imported oil," but wants a study that outlines the available options if a threat to national security is threatened.

Mr. Glenn R. Schleede, Vice Pres.
New England Electric
25 Research Drive
Westborough, Massachusetts 01582

Letter dated January 25, 1988 (COPP 18).

Comments:

Urges that a study of the oil import issue take into account the following factors, which are exemplified in the text of the letter:

"1. The other sources of energy which have been, are or could be substituted for oil."

"2. The past, current and potential for reducing demand for oil through conservation measures."

"3. The substantially different oil market situations that currently exist, compared to the situations at the time Section 232 of the Trade Expansion Act was previously invoked."

"4. The adverse economic impact that would result if oil import taxes were imposed or quantitative limits on imports were adopted."

Urges that "oil import taxes or quantity limits not be imposed...."

Mr. C. A. Watts
North Central Oil Corporation
6001 Savay, Suite 600
Houston, TX 77036

Letter dated January 25, 1988 (COPP-63)

Comments:

"Support the petition brought by Enserch and TIPRO in encouraging a study of this problem to be completed within six months."

"We do not have the support of this proposed investigation by most of the majors because they are working hand in glove with the foreign national companies which are creating the oil glut problem. As long as refiners and marketers can make enough money from those segments of their business, it is not particularly important to them that production be profitable."

"The most direct and simple solution for this problem is to impose an import fee on the order of \$10 per barrel of crude oil and products which will stabilize domestic prices at a level that will cause the industry to step up its exploration activity."

Mr. Richard F. Hall, Vice President
Pacific Resources, Inc.
1700 K Street, NW, Suite 502
Washington, DC 20006

Letter dated January 28, 1988 (COPP 53).

Comments:

An import fee would have larger negative than positive impacts.

There are many ways to improve production that are preferable to an import fee: opening federal lands, repeal of the windfall profits tax, relief from unnecessarily burdensome environmental costs, and use of alternative fuels.

Mr. Charles F. Perry, President
Permian Basin Petroleum Association
P.O. Box 132
Midland, Texas 79702
(Member NESC)

Letter dated January 12, 1988 (COPP 10).

Comments:

Urges public hearings.

Mr. Gordon Gooch, Counsel for
The Petrochemical Energy Group & Coalition to Oppose Energy Taxes
1100 15th Street NW, Suite 1200
Washington, DC 20005

Comments received on January 23, 1988 (COPP 33).

Comments:

(Members of PEG & COET are: Air Products & Chemicals, Inc.; Borg-Warner Chemicals; Dow Chemical, U.S.A.; Hercules Incorporated; Hoechst Celanese

Corporation; PPG Industries, Inc.; Rohm & Haas Company; Texas Eastman Company, Division of Eastman Kodak Co.; Union Carbide Corporation; and U.S. Industrial Chemicals Co.]

Opposes imposition of import fee, tax, tariff or quota. The net result would be that imports of products made abroad would gain an artificial advantage over domestic products, and exports of U.S. products would be disadvantaged abroad.

Mr. Arnold H. Weiss, Counsel for
Petroleos Mexicanos (PEMEX)
1050 Connecticut Avenue, NW
Washington, DC 20036-5339

Comments dated January 28, 1988 (COPP 42).

Comments:

The U.S. is PEMEX' largest market, accounting for about half of Mexican oil exports. The oil in the SPR is 91% Mexican oil.

If import restrictions are imposed, Mexican oils should be exempted.

The NESC petition "does not establish the necessary causal link between an adjustment of imports of crude oil and refined petroleum products and the removal of any threat to impair the security of the United States."

Cites the DOE Energy Security report on the various adverse effects of import restrictions on the U.S. economy.

Mexican oil imports would no be less secure than oil from Alaska, and can be shipped to the U.S. through Mexican and U.S. coastal waters, without entering the "high seas."

Import restrictions would undermine Mexico's economy, reducing its ability to pay its debts and to purchase imports from the United States.

The NESC petition is in effect requesting a price support program with a funding mechanism that is fundamentally inequitable. "Consumers with a greater-than-average reliance on petroleum products, such as homeowners in the Northeast who use heating oil, petrochemical companies, and transportation companies...would be required to pay more than their fair share of what the Enserch petition claims are purely national defense costs."

An analysis of the available evidence on the adverse economic effects of a fee or quota would "provide the basis for a recommendation to the President that he take no action."

Cites the DOE Energy Security study, a DRI study, a report by the National Petroleum Council and a Federal Trade Commission report that show an import fee causing serious harm to the U.S. economy.

Asserts that a study by Arthur D. Little "found that almost 31 percent of American industry was either petrochemical or dependent on the petrochemical industry."

"The statistics relied upon by Enserch suggest that price supports alone will not be effective even to increase the resource base. For example: 'Domestic production in 1985 was virtually equal to that in 1979, in spite of the fact that prices tripled.' Pet. at Tables 7, 10."

"Unpleasant as it is to accept, the basic premise underlying the oil import fee or quota no longer is operative. A reduction in imports can no longer be completely offset by present deliverability from domestic production."

W. E. Bradford, President
Petroleum Equipment Suppliers Association
9225 Katy Freeway
Houston, Texas 77024
(Member NESC)

Letter dated January 12, 1988 (COPP 8).

Comments:

Increased imports have seriously damaged the oil services industry: employment fell from 377,400 to 247,500 in one year; companies have lost over a billion dollars; the number of service companies fell from 314 to 192 as of Dec., 1987; personnel are not being trained in skills that might be necessary in the future.

"It will take five to seven years to match skilled personnel with demand should the U.S. be called upon to increase domestic exploration."

Mr. C. Richard Cahoon, Vice President
Petroleum Marketers Association of America
1120 Vermont Avenue, NW, Suite 1130
Washington, DC 20005

Comments dated January 28, 1988 (COPP 38).

Comments:

"(S)upports efforts targeted at increased domestic exploration, but is opposed to broad government intervention such as taxes or restrictions on imported oil..."

Objects to import taxes because they create competitive imbalances; encourages production but not exploration; and would be devastating to the economy.

Suggests that oil supply capability can be increased by diversifying sources of supply, increasing the size of the SPR, and exploring for new sources of oil.

Supports the Administration's energy initiatives and additional tax incentives for exploration and research & development.

"'War Games' should not be the basis for import taxes....FMAA does not believe that Commerce is bound by these classified scenarios. If they are, FMAA requests confirmation and time and information to respond to what otherwise is difficult to consider in any serious manner."

Mr. Kent Hance, Commissioner
Railroad Commission of Texas
1701 N. Congress Avenue
P.O. Drawer 12967
Austin, Texas 78711-2967

Letter dated January 22, 1988 (COPP 13).

Comments:

Urges regional public hearings, including one in Texas.

U.S. domestic production will decline and consumption will rise, causing imports to rise to as much as 65 percent of consumption in the early 90s. A disproportionately high level of imports increases our vulnerability.

Gasoline prices could rise to \$2.00 per gallon by the early 90s; inflation could rise to 10 percent per year.

Asserts that "the solution for national security and economic health is price stability."

Mr. John Sharp, Commissioner
Railroad Commission of Texas
1701 N. Congress Avenue
P.O. Drawer 12967
Austin, Texas 78711-2967

Letter dated January 28, 1988 (COPP 58).

Comments:

Requests that the Secretary "recommend appropriate remedial action."

Requests a public hearing, in which the Railroad Commission "would be pleased to participate."

Mr. Raymond R. Wright, Jr.
Executive Vice President
Seaview Petroleum Company
P.O. Box 231
Blue Bell, Pennsylvania 19422

Letter dated January 28, 1988 (COPP 22).

Comments:

The DOC investigation should conclude that "adequate refining capacity is as essential to national security as crude oil."

"...adoption of a crude oil fee without a concomitant product import fee would obviously further impair the industry's ability to respond to a national emergency."

"...the appropriate crude/product fee premium which takes into account differential environmental burdens, internalized regulatory costs, plus added fuel and working capital expenses is 10-20%."

R. Timothy Columbus, Counsel to SIGMA
Collier, Shannon, Rill & Scott
1055 Thomas Jefferson St. NW
Washington, DC 20007

Letter dated January 7, 1988 (COPP 2), and "Opposition to Petition..." dated January 28, 1988 (COPP 24).

Comments:

Requests extension of the deadline for comments from Jan. 28 to March 1, 1988 [from letter].

Requests a public hearing [from letter].

Requests that we "explicitly define 'national security' with respect to this investigation." [from letter]

SIGMA cites the DOE Energy Security study for its basic findings:

Because of high consumption and low reserves, the U.S. will always have to import much of its energy needs.

Dependence on oil imports does not necessarily equate with national security vulnerability; the key factors are 1) dependence on imports that are subject to disruption; 2) the risk that a disruption will occur; and 3) our capability to respond to a disruption.

In recent years, most crude and product imports have come from reliable Western Hemisphere sources, mainly Canada, Mexico, and Venezuela, which have considerable reserves and excess production capacity.

Our ability to respond to a supply disruption has improved substantially.

"Recent oil price declines benefitted this country by fueling the recent strong growth and expansion in the U.S. economy and by slowing down the gradual depletion of remaining U.S. oil reserves." "...a decline in U.S. production in the short-term actually enhances our security in the long-run by preventing a premature depletion of remaining accessible reserves."

Reserves of Canada, Mexico and Venezuela, which comprise 110 billion barrels "would provide more than adequate supplies in the event of a prolonged war."

"The Secretary of Commerce correctly declined to initiate an investigation." when Congressmen requested a Section 232 investigation on petroleum product imports in 1985.

The U.S. has ample refining capacity in case of an emergency because of the availability of idle operable capacity, the addition of NGLs, and overall refinery processing gains.

SIGMA refutes the NESC petition suggestion that investments by exporting countries in U.S. refineries makes the U.S. less secure. "If anything, these investments enhance the U.S. national security."

If DOC finds a national security threat, it should not impose import restraints, which "will not resolve our long term energy independence and, if anything, will exacerbate the problem by 'draining America first' of its most viable oil reserves. An oil import fee also would impair our security by discouraging future production by our reliable and secure foreign suppliers."

"An oil import fee would increase the cost to consumers not only of crude oil and petroleum products but also of all other energy sources." It would "also have substantial negative effects on the U.S. GNP and economy and on the inflation rate."

If DOC determines that some import restraint is advisable, it should not recommend a differential fee on crude oil and petroleum products. "In the absence of import competition, U.S. refiners could increase the price of all petroleum products up to the level of the fee.....The result would be even higher costs to the U.S. economy, compounding the problems of a flat fee."

William E. McCommons, Nat'l. Dir. & Treas.
Society of Independent Professional Earth Scientists
4925 Greenville Ave., Suite 170
Dallas, Texas 75206
(Member NESC)

Letter dated January 3, 1988 (COPP 6).

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THE EFFECT OF IMPORTS OF CRUDE OIL AND REFINED PETROLEUM PRODUCTS ON THE NATIONAL SECURITY

An Investigation Conducted Under Section 232 of the
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U.S. Department of Commerce
Bureau of Export Administration
December 1994

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- III: Finding and Recommendations

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EXECUTIVE SUMMARY

Introduction

On March 11, 1994, the Independent Petroleum Association of America (IPAA) and various other industry associations, companies, and individuals filed a petition under Section 232 of the Trade Expansion Act of 1962, as amended (19 U.S.C. Section 1862 (1988)) requesting the Department to initiate an investigation of the impact on the national security of imports of crude oil and refined petroleum products.

The IPAA petition alleged that U.S. energy security worsened since the Department's last Section 232 oil import investigation in 1988 because oil imports grew both in absolute terms and as a percentage of U.S. oil consumption, leaving the United States further subject to an oil supply disruption with the resultant economic costs. The petition also alleged that imports of low-priced oil are weakening the domestic petroleum industry to such an extent that it will not be able to support U.S. security needs in the event of a major conventional war.

On April 5, 1994, the Department initiated the investigation and invited public comment. The Department held three public hearings in New York, New York; Dallas, Texas; and Santa Clara, California. During the comment period, 69 people presented comments reflecting both support for and opposition to the allegations made by the petitioner.

Under Section 232, the Department has 270 days, until December 31, 1994, from the date of initiation of an investigation to submit a report of findings and recommendations to the President.

Methodology

The Department chaired an interagency working group that included the Departments of Energy, Interior, Defense, Labor, State, and Treasury, the Office of Management and Budget, the Council of Economic Advisors, and the U.S. Trade Representative. This report is based on a number of agreed-upon economic assumptions including, inter alia, crude oil price levels, U.S. crude oil production, economic growth rates, and inflation.

The Department used a two-step process to evaluate the petition. In the first step, the Department reviewed key factors from the 1988 investigation to determine whether they improved or deteriorated. These factors included: 1) domestic oil reserves; 2) domestic oil production; 3) industry employment; 4) the impact of low oil prices on the economy; 5) the status of the domestic oil industry; 6) oil import dependence; 7) import vulnerability, including measures to offset an oil supply disruption; 8) foreign policy flexibility; and 9) U.S. military requirements. The

second step involved review of new factors that emerged since the last investigation, including: 1) the status of OPEC; 2) oil price transparency due to the emergence of a futures market; and 3) the demise of the Soviet Union.

The Department made use of the extensive data and analyses that were already available regarding the current and prospective status of the domestic petroleum industry and the world oil market. In view of this extensive body of available data, the Department determined that an industry survey was not necessary. The Department also drew upon the written comments and testimony from interested parties who participated in the public hearings.

Review of Key Factors From the 1988 Investigation

1. Domestic Oil Reserves

Petition: Low-priced oil imports (hereinafter referred to as low oil prices) were largely responsible for the decline in domestic oil reserves.

DOC Analysis and Conclusion: Since the 1988 investigation, U.S. proved crude oil reserves declined by 3.8 billion barrels. Low oil prices contributed to, but are not totally responsible for, the erosion of the U.S. oil reserves base. The underlying physical reality is that the U.S. already developed the bulk of its known and easily accessible low cost deposits and decided against developing other geological prospects such as the Arctic National Wildlife Refuge and the Outer Continental Shelf. Since the reserves base reflects the structural geological reality, given present technology, oil price increases at best can arrest, but not reverse this trend.

2. Domestic Oil Production

Petition: Low oil prices are responsible for the decline in U.S. production.

DOC Analysis and Conclusion: The production outlook remains essentially the same as in the 1988 investigation. The United States is a high-cost producer compared to other countries because we have already depleted our known low-cost reserves. Since 1986, low oil prices have exacerbated the cost-price squeeze facing U.S. producers. U.S. production declined by 1.7 million barrels per day (MB/D) and net imports increased. The dislocation undercut U.S. exploration activities and impaired the development of competing energy sources, thereby enabling OPEC to recapture part of the market it lost after the price shocks of the late 1970s.

3. Exploration and Industry Employment

Petition: Low oil prices are responsible for the massive falloff in drilling and in industry employment.

DOC Analysis and Conclusion: The Department found a sharp reduction in U.S. drilling and oil and gas industry employment between 1985 and 1993. The level of exploratory drilling, well completions, and rotary rigs in use for oil and gas exploration declined since 1988. Employment fell from 582,000 in 1985 to 351,000 in 1993. A large share of the lost jobs occurred in petroleum exploration and development sectors.

However, oil imports are not the only reason for the decline in exploratory drilling and well completions. U.S. companies are drilling less because they made substantial gains in total productivity by employing new exploration and drilling technology and focussing on the most productive geological opportunities.

4. The Impact on the Economy of Low Oil Prices

Petition: The petitioner did not specifically address the benefits to the economy of low oil prices.

DOC Analysis and Conclusion: The Department found that the economic consequences of low prices resulted in positive benefits to the U.S. economy. Because the United States is now a net importer of oil, lower prices on balance helped the economy. The public benefitted from lower prices for transportation fuels and heating oil. For the economy as a whole, low oil prices contributed to a reduction in inflation, a rise in real disposable income, and an increase in the Gross Domestic Product.

5. Current Status of the Domestic Oil Industry

Petition: Low oil prices and the uncertainty concerning future price drops were forcing small producers to abandon many fields prematurely. The possible loss of these reserves and production would result in increased dependence on foreign oil.

DOC Analysis and Conclusion: The Department found that, as world crude oil prices declined since 1986, the relatively smaller U.S. oil fields with higher cost production became uneconomical and the operators shut-in or abandoned some wells. The impact of low prices has been especially severe on small producers operating stripper wells with average production of 15 barrels per day or less. If small producers continue to shut-in production because of low oil prices, this could result in reduced cash flow to reinvest in exploration and increased dependence on lower-cost foreign oil.

6. Oil Import Dependence

Petition: U.S. national security worsened because oil imports have increased since 1988 both in absolute terms and as a percentage of U.S. oil consumption and our dependence on imported oil will continue.

DOC Analysis and Conclusion: The Department found that net U.S. imports have grown from 5.9 MB/D in 1987 to 7.5 MB/D in 1993. Imports currently account for 44 percent of domestic consumption compared to 37 percent in 1987. Imports from Persian Gulf countries increased from 1.07 MB/D in 1987 to 1.64 MB/D in 1993.

U.S. demand for imported oil is expected to continue growing because of declining production and increased economic growth. The Energy Information Administration of the U.S. Department of Energy (EIA/DOE) projects that net imports will increase to 11 MB/D by 2000 and account for approximately 51.5 percent of domestic consumption.

To the extent the United States and other countries import more oil in the future, EIA/DOE projects that they will turn increasingly to OPEC countries located in the Persian Gulf which has the largest amount of known low-cost reserves and surplus production capacity. The Persian Gulf producers will account for approximately 55 percent of world crude oil exports by 2000.

7. Vulnerability to a Supply Disruption

Petition: Increased reliance on low-priced oil imports will leave the United States subject to a supply disruption and resulting costs to the economy.

DOC Analysis and Conclusion: The Department found that political and economic problems in the Persian Gulf region make supply disruptions a possibility in the near-term. Disruptions are possible in other regions, but the risks to the U.S. and other importing countries are lower because oil production facilities elsewhere are not as concentrated as they are in the Persian Gulf.

The United States and the OECD countries have limited prospects to offset a major oil supply disruption because: 1) there is little surplus production outside the Persian Gulf; 2) U.S. and OECD government oil stocks today provide less protection from an interruption than was the case in 1988; and, 3) there is currently no substitute for liquid transportation fuels which account for approximately two-thirds of all oil consumption in the United States. During a major oil supply disruption, there could be substantial economic austerity as a result of the decreased availability of oil. This, in turn, could pose hardships for the U.S. economy.

8. Foreign Policy Flexibility

Petition: The petitioner did not raise this issue.

DOC Analysis and Conclusion: The Department found that our allies' and trading partners' dependence on potentially insecure sources of oil may affect their willingness to cooperate with the United States during a major oil supply disruption.

9. U.S. Military Requirements

Petition: Low oil prices are weakening the domestic petroleum industry to such an extent that it will not be able to support U.S. security needs in the event of a global conventional war.

DOC Analysis and Conclusion: The Department of Defense advised that the military requirements for petroleum fuels could be satisfied under current planning scenarios.

10. Other Factors

The Department evaluated several factors that served to improve the security of U.S. oil supplies since the 1988 investigation. Foremost among these factors are the following:

Status of OPEC - Low oil prices are in large part a symptom of the apparent disarray within OPEC. The ability of OPEC to manipulate prices has been impaired because its members have been unable to coordinate production levels among themselves.

Transparency of Oil Markets - The growth of the futures market into a full-fledged commodity market has made crude oil prices more transparent and less subject to manipulation. Computerized trading, options, and forward contracts have connected refined products and crude oil markets more closely than was the case in 1988.

Demise of the Soviet Union - The end of the Cold War and the breakup of the Soviet Union removed the risk of Middle East oil becoming a pawn in East-West competition. The demise of the Soviet Union also has reduced the probability of a conventional war that could jeopardize Western Europe's and Japan's access to Middle East oil.

Finding

Since the previous Section 232 petroleum finding in 1988, there have been some improvements in U.S. energy security. The breakup of the Soviet Union and the apparent disarray within OPEC have enhanced U.S. energy security. Lower oil prices on balance benefitted the U.S. economy. However, the reduction in

exploration, dwindling reserves, falling production, and the relatively high cost of U.S. production all point toward a contraction of the U.S. petroleum industry and increasing imports from OPEC sources. Growing import dependence, in turn, increases U.S. vulnerability to a supply disruption because non-OPEC sources lack surge production capacity; and there are at present no substitutes for oil-based transportation fuels. Given the above factors, the Department finds that petroleum imports threaten to impair the national security.

Recommendation

The Department does not recommend that the President use his authority under Section 232 to adjust imports. The Clinton Administration's other efforts to improve U.S. energy security are more appropriate than an import adjustment.

Section 232 requires the Secretary of Commerce and the President to recognize the close relationship between the economic welfare of the nation and U.S. national security. As energy security affects the economic welfare of the U.S., energy security must be considered in determining the effects on the national security of petroleum imports.

The Department concurs with the conclusions of the 1988 study that, on balance, the costs to the national security of an oil import adjustment outweigh the potential benefits. For example, an oil import adjustment such as a tariff would likely have an inflationary effect on the economy and would result in the loss of significant jobs in the nonpetroleum sectors. This, in turn, would reduce real Gross National Product (GNP). An import adjustment would diminish the competitiveness of energy-intensive export companies and strain relations with close trading partners who may seek an exemption from the adjustment.

The Clinton Administration recognizes the importance of U.S. energy security and is pursuing a series of policies to enhance that security. It is important to note that no cost-effective government action could eliminate U.S. dependence on foreign oil entirely, but the following supply enhancement and energy conservation and efficiency policies help limit that dependence. Thus, the Department recommends continuing the policies described below:

- o Increased Investment in Energy Efficiency - The Administration increased the budgets substantially over the last two years to achieve an enhanced energy efficiency level. There are extensive programs underway ranging from developing new appliance standards to working on innovative workplace solutions to decrease long-distance commuting. The goals of these extensive energy efficiency programs are to decrease consumption of oil.

- Increased Investment in Alternative Fuels - The Administration placed particular emphasis on improving the efficiency of the transportation sector where oil comprises about 98 percent of the fuel utilization. The Administration is among other things initiating a partnership with automobile manufacturers to design more energy efficient automobiles and developing a program to bring alternative transportation fuels and vehicles into the marketplace. These actions will reduce direct consumption of petroleum-based transportation fuels so that the need for imports will decrease.
- Increased Government Investment in Technology - The Administration more than doubled its investment with American industry in advanced technologies for the exploration and production of natural gas and oil. This is important because technological innovation can significantly decrease the domestic finding costs for natural gas and oil, thereby maintaining and expanding the domestic resource base and improving its economics.
- Expanded Utilization of Natural Gas - The Administration aggressively promoted expanded markets for natural gas at the expense of imported oil. In addition, reliance upon natural gas as one of the cornerstones of our Climate Change Action Plan provides benefits to our environment through the reduction of greenhouse gas emissions.
- Increased Government Investment in Renewables - The Administration increased investment in renewable resources because they offer great hope of replacing imported oil in selected end uses.
- Increased Government Regulatory Efficiency - The Administration is reducing the red tape and regulations that burden domestic industries. Various government agencies are conducting sweeping reviews to make their regulatory structures more responsive to domestic concerns.
- Increased Emphasis on Free Trade and U.S. Exports - Free trade, privatization, and promotion of American exports helps develop the world's energy resources and prevent overreliance on any single region of the world. These actions include: assisting energy conservation efforts and the development of new energy supplies in this hemisphere and other areas friendly to the United States.
- Maintaining the Strategic Petroleum Reserve - The Strategic Petroleum Reserve is the nation's stockpile of crude oil available in the event of an oil supply disruption. The 580 million barrels of crude oil under government ownership and control provides a bulwark against a supply disruption.

- Coordinating Emergency Cooperation Measures - The United States is coordinating oil emergency cooperation among the energy consuming countries through the International Energy Agency. Discussions are continuing to strengthen the existing market-oriented coordinated energy response measures for dealing with possible future disruptions.

SECTION I. INTRODUCTION AND METHODOLOGY

A. Introduction

On March 11, 1994, the Department of Commerce (the Department) received a petition under Section 232 of the Trade Expansion Act of 1962, as amended (19 U.S.C. Section 1862 (1988)), to initiate an investigation of the impact on the national security of imports of crude oil and refined petroleum imports.¹ The petition was filed by the Independent Petroleum Association of America (IPAA) (the petitioner) which represents a broad coalition of approximately 5,500 individuals and oil and natural gas producing companies involved in the exploration, development, and production of crude oil and natural gas in the United States. Also joining this petition were 31 domestic industry associations, companies, and individuals representing producers, royalty owners, drilling equipment manufacturers, field equipment suppliers, drilling contractors, and oil production service firms.

On April 5, 1994, the Department initiated the investigation. On April 12, 1994, published a notice in the Federal Register announcing initiation of the investigation and soliciting public comments. On May 11, 1994, the Department published a second notice in the Federal Register announcing public hearings and inviting public participation. Copies of the Federal Register notices are shown in Appendix A.

During the comment period, 69 interested parties submitted comments, including 53 witnesses who testified at the public hearings. A listing of the witnesses and a summary of their comments and testimony are included in Appendix B.

Under Section 232, the Department has 270 days from the date of initiation of an investigation to submit a report of findings and recommendations to the President. Therefore, this report is due to the President on December 31, 1994.

B. Summary of the Petition

The IPAA petition made the following allegations:

- o The energy security of the United States has worsened since 1988 because oil imports have grown both in absolute terms and as a percentage of U.S. oil consumption.
- o U.S. dependence on unreliable Persian Gulf suppliers has risen substantially and will continue to increase.
- o U.S. oil production has declined significantly. Domestic exploration, drilling, and oil reserves are at very low

levels compared to when the Department last conducted its investigation in 1988.

- o Low-priced oil imports will erode the domestic industry, especially in employment. The decline in industry activity has resulted in the loss of a substantial number of jobs in oil and natural gas extraction activities.
- o Increased reliance on low-priced oil imports will leave the United States vulnerable to a supply disruption and the resulting costs to the economy.

C. Criteria for Reviewing the Petition

Pursuant to Section 705.4 of the National Security Industrial Base Regulations (U.S. C.F.R. Section 705.4 (1994)), the Department considered the following regulatory criteria in determining the affect of imports on the national security:

- (1) domestic production needed for projected national defense requirements;
- (2) the capacity of domestic industries to meet projected national defense requirements;
- (3) the existing and anticipated availabilities of human resources, products, raw materials, production, equipment and facilities, and other supplies and services essential to the national defense;
- (4) the growth requirements of domestic industries to meet national defense requirements and the supplies and services including the investment, exploration and development necessary to assure such growth;
- (5) the impact of foreign competition on the economic welfare of any domestic industry essential to our national security;
- (6) the displacement of any domestic products causing substantial unemployment, decrease in the revenues to government, loss of investment or specialized skills and productive capacity, or other serious effects; and
- (7) any other relevant factors causing or will cause a weakening of our national economy.

D. Methodology for Interagency Study Process

The Department chaired an interagency working group that included the Departments of Energy, Interior, Defense, Labor, State, and Treasury, the Office of Management and Budget, the Council of

Economic Advisors, and the U.S. Trade Representative. This report is based on a number of agreed-upon economic assumptions including, inter alia, crude oil price levels, U.S. crude oil production, economic growth rates, and inflation.

The Department used a two-step process to evaluate the petition.

Step 1: Review Key Factors From the 1988 Investigation:

The Department reviewed the factors examined in the 1988 investigation to determine whether they improved or deteriorated. This provided benchmarks against which to assess the economic health of the domestic oil industry and our national security. These benchmarks included: 1) domestic oil reserves; 2) domestic oil production and exploration; 3) industry employment; 4) impact of low oil prices on the economy; 5) the status of the domestic oil industry; 6) oil import dependence; 7) import vulnerability, including measures to offset an oil supply disruption; 8) foreign policy flexibility; and, 9) U.S. military requirements.

Step 2: Evaluate New Factors:

The Department identified and evaluated three new factors that emerged since the 1988 investigation: 1) the status of OPEC; 2) oil price transparency due to the emergence of a futures market; and, 3) the demise of the Soviet Union.

In conducting this assessment, the Department relied upon the extensive body of data available on the world oil market and on the U.S. petroleum industry. Specifically, the Department drew heavily from data in the Annual Energy Outlook and International Energy Outlook, published by the Energy Information Administration, U.S. Department of Energy, and from data submitted by the petitioner. In view of this extensive body of available data, the Department determined that an industry survey was not necessary. The Department also drew upon the written comments and testimony from interested parties who participated in the public hearings.

E. Commodities to be Investigated

The commodities investigated for this study include crude oil and refined petroleum products. Crude oil is listed in the Harmonized Tariff Schedule (HTS) of the United States under HTS classification numbers 27100005-0 (crude oil testing under 25 degrees API) and 27100010-0 (crude oil testing 25 degrees API or more).²

The following refined petroleum products are listed under these HTS classification numbers:

| | |
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| 27100015-0 | Motor fuel, including both leaded and unleaded gasoline; naphtha-type jet fuel, and kerosene-type jet fuel. |
| 27100020-0 | Kerosene derived from petroleum, shale oil, or both (except motor fuel). |
| 27100025-0 36061000-1 | Naphthas derived from petroleum, shale oil, natural gas, or combinations thereof (except motor fuel). |
| 27100045-2 | Mineral oil or medicinal-grade derived from petroleum, shale oil, or both. |
| 27100030-0 34031110-3 34031150-3 34031910-0 34031110-3 34031150-3 34031950-1 27100040-0 34031110-3 34031150-3 34031950-1 | Lubricating oils and greases derived from petroleum, shale oil, or both, with or without additives. |
| 27100045-2 27121000-0 27132000-0 27139000-0 | Mixtures of hydrocarbons not specifically provided for, derived wholly from petroleum, shale oil, natural gas, or combinations thereof, which contain by weight not over 50 percent of any single hydrocarbon compound. |
| 27122000-0 27129020-0 34049050-0 | Paraffin and other petroleum waxes. |
| 27040000-2 27131200-0 | Petroleum coke. |
| 38011050-0 | Asphaltum, bitumen, and limestone rock asphalt. |

Endnotes

1. Letter from George Alcorn, President of the Independent Petroleum Association of America (IPAA), to Ronald H. Brown, Secretary of Commerce, dated March 11, 1994 (hereinafter referred to as the petition). On December 6, 1993, the IPAA filed an emergency petition on the basis of an affirmative determination that President Reagan made on January 3, 1989. On January 24, 1994, the Department advised IPAA that the Omnibus Trade and Competitiveness Act of 1988 amended Section 232 (c) (1) (B) to preclude the President from taking action later than 15 days after the presidential determination on which such an action is based. Therefore, the 1988 amendment did not permit the President to initiate action five years after such a determination. The Department also stated that IPAA may request a new investigation and incorporate by reference any material submitted with its December 6, 1993 petition. The March 11, 1994 petition incorporates the materials the IPAA submitted as part of its December 6, 1993 submission to the Secretary of Commerce.
2. American Petroleum Institute (API) gravity is an arbitrary scale expressing the density of liquid petroleum products. The measuring scale is calibrated in terms of degrees API. It is an accepted standard in the petroleum industry.

SECTION II. CURRENT U.S. ENERGY ASSESSMENT

The national security and economic health of the domestic oil industry differ today from 1988 when the Department conducted the last national security investigation.

This section evaluates the national security implications of U.S. dependence on imported oil in order to address the allegations raised by the petitioner. As noted in Section I, this section employs a two-step methodology which reviews the factors the Department examined in 1988 to determine whether they improved or deteriorated and evaluates any new factors that have emerged since 1988. The Department also drew upon the written comments and testimony from interested parties who participated in the public hearings and from analyses provided by the interagency working group.

Review of Key Factors From the 1988 Investigation

1. Domestic Oil Reserves

1988 Investigation: The Department found that the United States had modest oil reserves relative to current and projected production because we depleted a large share of the reserves. At that time, the Department recommended the exploration and development of important geological prospects in Alaska and on the Outer Continental Shelf to stem the decline in U.S. reserves and production.

Current Petition: The petitioner alleged that low-priced oil imports (hereinafter low oil prices) were largely responsible for the decline in domestic oil reserves, stating that if prices remain stable at approximately \$20 per barrel, the U.S. would have a large recoverable oil resource base.

A witness at one of the public hearings disagreed with the petitioner's assertion that low-priced imports were responsible for the rapidly declining reserves base.

The production decline was primarily of a geological nature and thus could not have been reversed or arrested through government policy.¹

Department Review: The Department found that U.S. proved reserves of crude oil dropped from 26.8 billion barrels in 1988 to 23.0 billion barrels in 1993. However, imports are not solely responsible for the declining resource base. The United States has a modest amount of proved reserves relative to world reserves and domestic consumption. Table II-1 shows that U.S. proved reserves of 23.0 billion barrels account for only 2.3 percent of

the world's proved reserves. However, in 1992, the U.S. accounted for 26 percent of world consumption.²

On the other hand, OPEC accounts for 77 percent of the total world reserves of 999 billion barrels. The six Persian Gulf countries have proved oil reserves of 662.9 billion barrels. While proved U.S. reserves declined by approximately 3.8 billion barrels since 1987, OPEC's reserves increased by 95.5 billion barrels.

This reserves situation in the U.S. is not surprising when one considers that the United States was one of the first countries to produce oil; and for many years, was the world's largest producer. The United States is the most heavily explored petroleum-bearing region in the world. Prior to 1986, approximately 80 percent of all wells drilled worldwide were drilled in the United States.³ According to the Department of Energy, U.S. companies produced 167 billion barrels of oil and 830.4 trillion cubic feet of natural gas through 1992.⁴

In recent years exploration for oil in the United States has not been very successful. Energy Department data show that between 1987 and 1993 over 82 percent of additions to oil reserves came from revisions and extensions of existing oil fields and new reservoir discoveries in old fields rather than from exploration and discovery of new fields.⁵ There remain some important oil prospects in Alaska and the Outer Continental Shelf, but the U.S. Congress prohibited exploration and development of these potentially productive areas because of environmental concerns. In addition, a large share of the oil reserves potential the petitioner discussed at the public hearing in Dallas is not recoverable at current prices and technology.

Conclusion: Low oil prices contribute to, but are not totally responsible for, the erosion of the U.S. oil reserves base. The underlying physical reality is that the United States already developed the bulk of its easily accessible low cost deposits and decided against developing other geological prospects such as the Arctic National Wildlife Refuge and the Outer Continental Shelf. Since the reserves base reflects the structural geological reality, given present technology, oil price increases at best can arrest but not reverse this trend.

2. U.S. Oil Production

1988 Investigation: The Department found that the United States was a high-cost producer compared to other countries because we have already extracted the bulk of our low-cost easily accessible reserves.

Current Petition: The petitioner alleged that low oil prices are responsible for the decline in U.S. production.

Department Review: The Department found that U.S. crude oil production has been falling since 1970. Table II-2 shows that production declined by 2.7 million barrels per day (MB/D) over the past 23 years and by 1.4 MB/D between the 1988 investigation and 1993.

Consistent with established natural resource extraction practices, U.S. companies exploited the bulk of the easily accessible reserves and then began to develop the smaller and more costly oil deposits. The companies made use of productivity gains resulting from advances in drilling technology, but they could not offset the higher per-barrel costs associated with smaller fields and more complicated geology. The following factors explain why oil production in the U.S. is high:

- o Production rates are low by world standards, averaging 12.5 barrels per day per well on average. (If we count only the lower 48 states, this figure further declines to 9.5 barrels per day per well). Iran, Iraq, and Saudi Arabia can produce approximately 8,000 barrels per day per well.⁶
- o Finding costs of \$6.88 per barrel are high compared with average Middle East costs of \$3.84 per barrel.⁷
- o Estimated production cost is \$15 to \$20 per barrel compared to less than \$1 per barrel for Iran, Iraq, and Saudi Arabia.⁸
- o Proved reserves of 23.0 billion barrels are small compared with Saudi Arabian, Iranian, and Iraqi reserves of 261, 93, and 100 billion barrels, respectively.⁹ The bulk of their reserves are in easily accessible, large fields; whereas the remaining U.S. reserves are likely to be in small onshore deposits, expensive offshore, and Arctic frontier areas.

These circumstances placed U.S. producers in a classic "cost-price squeeze" when world oil prices dropped 50 percent in 1986. Table II-3 shows that the landed cost of imported crude oil dropped 50 percent, from \$26.67 per barrel to \$13.49 per barrel, between 1985 and 1986. The landed price climbed back to \$21.13 in 1990, largely in response to the Iraq-Kuwait conflict; but it fell to \$15.76 by 1993. In November-December 1993, the landed cost of imports fell to \$13.01 per barrel.

The cost-price squeeze triggered by falling oil prices had severe consequences for the level of U.S. production and import dependence. Since 1986, it contributed to a 1.7 MB/D decline in U.S. production and a 2.1 MB/D increase in net imports.

This situation also poses problems for current and projected U.S. production and imports. First, when world oil prices are at \$18 to \$20 per barrel, U.S. production costs of \$15 to \$20 per barrel constrain the exploration and development of new reserves, particularly in the deep waters of the Gulf of Mexico. Second, small companies may cut back on operations or go out of business because low profitability makes it difficult for them to attract capital funds for exploration and development. Third, the firms that remain in business are likely to suffer because they lack the cash flow to maintain existing wells, conduct new exploration, or to develop small producing properties. Fourth, companies are increasingly unable to replace proved oil reserves; and domestic production continues to decline. In turn, U.S. companies will purchase more foreign crude to offset falling domestic production and to meet growing demand.

Conclusion: The production outlook remains essentially the same as in the 1988 investigation. The United States is a high-cost producer compared to other countries because we have already depleted our known low-cost reserves. Since 1986, low oil prices exacerbated the cost-price squeeze facing U.S. producers. U.S. production declined substantially and net imports increased. The dislocation also undercut U.S. exploration activities and impaired the development of competing energy sources, thereby enabling OPEC to recapture part of the market it lost after the price shocks of the late 1970s.

3. Exploration and Industry Employment

1988 Investigation: The Department found that low oil prices caused companies to reduce exploratory drilling and cutback on the number of oil field workers.

Current Petition: The petitioner alleged that low oil prices are responsible for the massive falloff in drilling and in industry employment.

These tremendous price declines strike directly at independent producers because all of their revenues come from the sale of oil and natural gas at the wellhead. Unlike major integrated firms, independents cannot depend on profits made in other operations such as transportation, refining, marketing, or international operations. Price volatility also adds to market uncertainty, thereby eroding the confidence of investors, financial institutions, and corporate planners whose decisions directly affect exploration and development budgets for the domestic industry.¹⁰

As an exploration and production company, the oil price instability of the past nine years has caused us to reduce

our exploration budget from over \$2,000,000 to less than \$500,000. The low oil price has caused abandonment of dozens of our stripper wells and has stopped the implementation of secondary recovery projects capable of producing hundreds of thousands of barrels of oil.¹¹

Department Review: The Department found a sharp reduction in U.S. drilling and employment between 1985 and 1993 (see Table II-4):

- o exploratory drilling declined from 312 million feet in 1985 to 127.7 million feet in 1992;
- o total wells completed dropped from 69,170 in 1985 to 23,959 in 1993;
- o the number of rotary rigs in use for oil and gas exploration dropped from 1,980 in 1985 to 754 in 1993; and,
- o employment fell from 582,000 in 1985 to approximately 351,000 in 1993.¹² The Department of Labor determined that a large share of the lost jobs occurred in the petroleum exploration and development sectors.

However, oil imports are not the only reason for the decline in exploratory drilling and well completions. U.S. companies are drilling less because they find more oil per foot drilled than they did in the past. For example, between 1986 and 1992, the U.S. oil industry achieved productivity gains that increased the finding rate from 8 barrels per foot drilled to approximately 12.5 barrels per foot drilled.¹³ The U.S. oil and gas industry made substantial gains in total productivity because they employed new exploration and drilling technology and focused on the most productive geological opportunities. The Energy Department found that U.S. companies more-than-doubled their productivity in terms of exploratory drilling for well extensions and discoveries of oil and gas.¹⁴

Conclusion: Advances in technology as well as low oil prices contributed to the large drop in industry employment and exploratory drilling.

4. The Impact on the Economy of Low Oil Prices

1988 Investigation: The Department found that low oil prices yielded positive benefits for the economy.

Current Petition: The petitioner did not specifically address the benefits to the economy of low oil prices.

Department Review: The Department found that the economic consequences of low prices resulted in positive benefits to the U.S. economy. Because the United States is now a net importer of oil, lower prices on balance helped the economy. The public benefitted from lower prices for transportation fuels and heating oil. For the economy as a whole, these lower prices contributed to a reduction in inflation, a rise in real disposable income, and an increase in the Gross Domestic Product (GDP).

The Energy Department found that oil and gas consumption in the U.S. is heavily concentrated within five manufacturing sectors: chemicals; paper; stone, clay and glass; primary metals; and refining.¹⁵ In 1988, these manufacturing sectors accounted for 78 percent of U.S. consumption of oil and gas. Energy costs represent a major component for manufacturers, and these industries have benefitted from reduced prices for their supplies. At the public hearings, the Petrochemical Energy Group stated:

Any action, such as the imposition of an oil import fee or quota, that would increase the price of U.S. petrochemical products, would create a subsidy for foreign producers. The ultimate result of this foreign producer subsidy would be a substantial loss of sales for U.S. producers that would, in turn, jeopardize a large number of jobs for U.S. workers and would create a further erosion in the U.S. balance of trade.¹⁶

Conclusion: Since 1986, low oil prices have yielded large positive benefits to the U.S. economy.

5. Current Status of the Domestic Oil Industry

1988 Investigation: The Department determined that low oil prices caused small producers to shut-in or abandon marginal wells. The Department also found that U.S. integrated oil companies began shifting their exploration efforts overseas since they were unable to access promising geological prospects or to reduce high production costs.

Current Petition: The petitioner alleged that low oil prices and the uncertainty concerning future price drops were forcing small producers to abandon many small fields prematurely. The possible loss of these reserves and production would result in increased dependence on foreign oil.

Department Review: The Department found that the major decline in prices since 1986 significantly impacted the U.S. oil industry, reducing both production and exploration, and forcing some companies to shift activities overseas.

The integrated companies responded to high costs, low prices, and the lack of access to prime exploration acreage by reducing their spending on domestic exploration and development. The American Petroleum Institute (API) found that the 18 integrated U.S. oil companies reduced spending on domestic exploration and development from \$29.9 billion in 1982 to \$7.4 billion by 1992.¹⁷ The API also stated that the large integrated companies now spend almost 65 percent of their exploration and development budgets overseas.¹⁸

A large number of integrated firms shifted their exploration efforts to non-OPEC countries. For example, Chevron is active in Canada and Kazakhstan. Phillips Petroleum is replacing its U.S. reserves at low cost by exploring in Gabon, Somalia, and New Guinea. ARCO shifted a large portion of its exploration program overseas, while Mobil is active in the Hibernia file in eastern Canada.¹⁹ Texaco signed agreements for large exploration and development projects in Russia and China.²⁰ Texaco recently announced plans to streamline its U.S. operations and sell off approximately 600 oil and gas producing properties. Domestically, the integrated companies are downsizing their exploration and production operations and emphasizing refining and marketing operations; while internationally they are emphasizing low cost, high yield exploration and production.

The Department concurs with the petitioner's allegation that the independent producer's income is dependent on the price it obtains for the crude oil sold. The small independent producers lack the diverse revenue opportunities of the integrated firms because they have no captive refining and marketing operations. In addition, the independents generally lack the capital and technical expertise to explore overseas.

The impact of low prices has been especially severe on small producers operating stripper wells. Oil wells with an average production of 15 barrels per day or less are called stripper wells. The U.S. Department of Energy estimates that in 1992 there were 478,588 stripper wells, accounting for approximately 1.4 MB/D of oil production.²¹ These wells accounted for 78 percent of all U.S. wells. At the public hearing in Dallas, the petitioner stated that stripper wells account for a large share of U.S. crude oil reserves:

According to the National Stripper Well Association there are 3.272 billion barrels of oil reserves accessed by stripper wells.²²

The National Petroleum Council's (NPC) study on "Marginal Wells" found that U.S. operators of such properties are especially at risk when oil prices decline. The NPC study found (Table II-5) that at a domestic price of \$18 per barrel, U.S. companies would not meet lease operating costs on 73,843 wells accounting for

12.6 percent of wells and 3 percent of production (61 million barrels of oil per year). This would increase to 130,691 wells accounting for 22.3 percent of wells and 7.6 percent of production (155 million barrels of oil per year) at a domestic price of \$10 per barrel.²³

An operator of stripper wells in Texas commented on the impact of low oil prices on his production:

Our average cost in producing a barrel of oil is \$11.50. Assuming a futures price of \$20 per barrel and a resultant posted price of \$18.50 for North Texas sweet crude, a \$2 drop in our price, or a 10-percent reduction, results in a net income decrease of 29 percent. A \$4 price drop, or a \$16 per barrel futures price results in a 57-percent decrease in our net.²⁴

The Department found that the price of oil also affected the exploration and development of natural gas. When petroleum producers engage in exploration, they often cannot predict whether they will find crude oil or natural gas, or both, because exploration is not oil specific. Low prices make drilling and development projects less attractive, regardless of whether the project involves crude oil or natural gas. It also creates a ceiling for natural gas prices because the two fuels compete for some of the most important end uses, the industrial boiler fuel market.

Conclusion: Low oil prices continue to exacerbate the chronic cost-squeeze problem faced by small producers. If small producers were to shut-in production because prices fall, this could result in increased dependence on foreign oil. Shutting-in production will, in turn, adversely impact the development of natural gas supplies.

6. Oil Import Dependence

1988 Investigation: The Department found that the long-term security of the United States is less promising because of the expectation of rising oil imports for the United States and the other Organization for Economic Cooperation and Development (OECD) countries.

Current Petition: The petitioner alleged that the national security of the United States worsened because oil imports have increased since 1988 both in absolute terms and as a percentage of U.S. oil consumption and our dependence on imported oil will continue.

Department Review: The petitioner's allegations concerning the trend of U.S. dependence on imported oil are accurate. The

Department found that net U.S. imports have grown from 5.9 MB/D in 1987 to 7.5 MB/D in 1993. Table II-6 shows that oil imports currently account for 44 percent of domestic consumption compared to 37 percent in 1987. The Department also found that imports from Persian Gulf countries increased from 1.07 MB/D in 1987 to 1.64 MB/D in 1993. Saudi Arabia and Kuwait accounted for the bulk of the increase, with imports growing from 642,000 B/D and 70,000 B/D, respectively, during 1987 to 1.28 MB/D and 343,000 B/D in 1993.²⁵

Based on assumptions adopted by the Energy Information Administration of the U.S. Department of Energy in making its forecasts, U.S. oil imports are likely to increase over the next decade.²⁶ During 1994, U.S. consumption of oil is expected to grow at a modest rate and reach approximately 17.7 MB/D.²⁷ Table II-7 shows that domestic oil supply is expected to decline by about 200,000 B/D to 8.4 MB/D. Net imports are expected to increase by 500,000 B/D and reach 8 MB/D. They will account for 45.2 percent of U.S. oil consumption during 1994, up from 44 percent in 1993.

The Energy Department forecasts that U.S. demand for imported oil is expected to continue growing because of declining production and increased economic growth. They project that net imports will increase to 11 MB/D by 2000 and account for approximately 51.5 percent of domestic consumption.

During 1994, total world demand (excluding the former Soviet Union) is expected to grow from 62 MB/D to 63 MB/D because of strong economic growth in the Far East and China. The increase in demand will not tax OPEC and is unlikely to lead to higher prices. This short-term outlook reflects sluggish Free World economic growth and the availability of surplus oil production capacity. If Iraq attempts to reenter the oil market in 1995 and other producers respond by expanding their own production to maintain their market share, this additional production could exert downward pressure on oil prices.

Other OECD countries are projected to increase their oil imports as well. Japan has no indigenous production and will continue to rely on imports. Western Europe's imports are likely to increase after 2000 because of growing demand and declining North Sea production. Table II-8 shows that between 1992 and 2000, world oil consumption is likely to increase to 77 MB/D. The fastest increase will occur in developing countries in Asia and Latin America. However, the OECD countries are expected to remain the largest consumers, with oil use in that group expected to grow from 39 MB/D in 1992 to approximately 45 MB/D by 2000. Oil will continue to remain the world's major energy source, accounting for 38 percent of all energy consumed.

The Energy Department also forecasts that non-OPEC production is likely to increase only slightly, from 41 MB/D in 1992, to about 42 MB/D in 2000. Table II-9 shows that OECD production is expected to remain flat at 17 MB/D. The decline in U.S. production of approximately 200,000 B/D will be offset by increasing North Sea output. Other non-OPEC producers, including Latin America, the Middle East, Africa, and Asia, will grow from 10.6 MB/D to 12.4 MB/D. Latin America will lead in production increases, followed by Asia.

The former Soviet Union and the other Republics are unlikely to expand exports substantially until 2005. Production is declining in Russia, and the other Republics' output remains flat. In the short-term, Russian demand also is falling. Russia is likely to continue reducing sales to the Republics in order to maintain hard currency exports. Barring a major increase in demand, Russian net oil exports are likely to remain in the 2.0 MB/D to 2.2 MB/D range. The future outlook is uncertain because Russia has large oil and gas resource potential but needs to upgrade its pipeline system and establish investment and trade laws that will attract foreign companies.²⁸

These consumption and production trends lead to the conclusion that world demand for OPEC (largely Persian Gulf) oil should rise from 26 MB/D in 1992 to 36 MB/D in 2000. The non-Persian Gulf producers are likely to increase production from 9.5 MB/D in 1992 to 11.2 MB/D in 2000. The Persian Gulf producers are expected to expand production capacity by 10 MB/D by the end of the decade. Iran, Iraq, Kuwait, Saudi Arabia, and United Arab Emirates (UAE) are expected to be the largest exporters. This will be the first major expansion of the vast Persian Gulf reserves discovered during the 1980's. This expansion of production will be needed to offset the decline of non-OPEC producers such as the United States.

The United States and the other OECD countries are likely to become more dependent on OPEC, particularly on the Persian Gulf members of OPEC, whose share of world crude oil exports is expected to increase from 42 percent in 1992 to 55 percent by 2000. With the exception of Venezuela, nearly all surplus production capacity is likely to be concentrated in the Persian Gulf. This forecast means that every year between 1992 and 2000 the Persian Gulf countries collectively will have to develop approximately 1.5 MB/D of crude oil production capacity to meet world demand in 2000 and beyond. This may be optimistic in light of current oil prices, capital requirements, and regional stability.

Conclusion: The Department finds that imports are expected to account for over 51 percent of U.S. oil consumption by the year 2000. The U.S. and the other OECD countries are likely to become increasingly dependent on the huge low-cost reserves of the

Persian Gulf producers that will account for approximately 55 percent of world crude oil exports by 2000.

7. Vulnerability to a Supply Disruption

1988 Investigation: The Department found that the growing import dependence of the United States increased its vulnerability to a supply disruption.

Current Petition: The petitioner alleged that "our increased reliance on low-priced oil imports will leave the United States subject to a supply disruption and resulting costs to the economy."²⁹

Department Review: The Department found that the security of the United States as well as that of the other OECD countries depends on the level of vulnerability to, and the likelihood of, significant supply disruptions (i.e., disruptions of at least 200,000 barrels per day lasting 3 months or more). The risk of a disruption is determined by the military, political, and economic situations facing the key exporting countries. The level of vulnerability is determined both by the degree to which importing countries depend on imported oil and by their ability to offset a disruption. Offsets to disruptions include the amount of available surplus global oil production capacity and oil inventories (e.g., private and government strategic stocks).

a. Risks of disruptions

The interagency group reviewed the post-World War II period and found that significant supply disruptions occurred 11 times and lesser disruptions (ranging from 100,000 B/D to 700,000 B/D) occurred at least ten times since 1951. Production losses ranged from as little as 200,000 B/D to as much as 5 MB/D.

Types: Table II-10 shows that five of the major interruptions were the result of internal political events (civil disturbances or revolutions), four were the direct result of wars, one involved a facility accident, and one was the result of the 1974 Arab oil embargo.

- o **Location:** Nine of the major interruptions occurred in the Middle East (including North Africa), and four of these occurred in the Persian Gulf.
- o **Magnitude:** Most of these disruptions were relatively small (less than 700,000 B/D), with only three disruptions of 3 MB/D or larger, and all occurred in the Persian Gulf.
- o **Duration:** Only three disruptions lasted longer than one year.

The impact of supply interruptions have varied. Most have not significantly disrupted world markets; however, three interruptions did have major economic implications:

- o The Arab oil embargo following the October 1973 Arab-Israeli War caused a loss of 1.6 MB/D in world supplies, more-than-tripled crude oil prices, and contributed to the abrupt reversal in the economies of OECD countries from about 6 percent growth in their Gross National Product (GNP) in 1973 to a GNP decline in 1975.
- o The Iranian Revolution caused losses of nearly 4 MB/D and more-than-doubled the price of crude oil between late 1978 and early 1980, and OECD members' GDP declined from 3.6 percent in 1979 to 1.3 percent in 1980.
- o Iraq's invasion of Kuwait removed almost 5 MB/D from world production (the largest disruption in history) and caused a more than 170-percent increase in prices between June and October of 1990, but the price increase was short lived because of the availability of surplus crude production capacity in Saudi Arabia and other key producing countries. In contrast to previous disruptions, OECD countries also had over 1 billion barrels in strategic stocks, which were not released during the crisis.

There are a number of unresolved regional conflicts in the Persian Gulf which could lead to war. A number of these countries are developing enhanced military capabilities that could be targeted against regional oil facilities during a conflict. An outbreak of hostilities could result in the destruction of oil production and transportation facilities (e.g., as happened in Kuwait during 1991). These developments, in turn, would eliminate production capacity, tighten supplies, and result in higher prices for consuming countries.

b. Offsets to disruptions

The ability to offset a disruption depends in large part on the availability of surge production capacity and strategic oil stocks. Surplus world production capacity declined from 9 MB/D-10 MB/D in 1988 to approximately 1 MB/D in 1992.³⁰ This decline resulted from: 1) higher demand for oil which, in turn, absorbed a large part of the Persian Gulf surplus capacity; 2) declining output in the United States; and, 3) the idling of Iraqi and Kuwaiti fields damaged during the 1991 Persian Gulf War. The Global Center for Energy Studies determined that surplus world production capacity had increased to 4 MB/D by 1994; but the bulk of the current surplus capacity is located in the Persian Gulf and Venezuela, and by 2000, most surplus capacity is likely to be located in Saudi Arabia, Iran, Iraq, Kuwait, and the Union of Arab Emirates.³¹ As noted in this section, U.S. production is

declining and there is little, if any, capacity to surge production during an emergency.

Government-owned oil stocks in all of the OECD countries declined slightly since the 1988 Commerce investigation. In 1988, the U.S. Strategic Petroleum Reserve's (SPR) inventory of 555 million barrels provided 96 days' protection based on net imports of 5.8 MB/D.³² The current SPR inventory of 590 million barrels would provide 77 days' protection based on 1993 net imports of 7.5 MB/D.³³ Similarly, other OECD countries' government-owned oil stocks declined by 27 percent from 400 million barrels in 1988 to 316 million barrels in 1992.³⁴

c. Impact on the economy

It also is necessary to consider U.S. oil requirements within the wider context of the civilian economy during a major oil supply disruption. For example, the transportation sector would experience many hardships because there are no substitutes for gasoline, diesel, and jet fuel. Despite conservation and reduced consumption resulting from higher prices, less oil would be available for civilian end uses during a major supply disruption. This, in turn, could pose hardships for the U.S. economy.

Conclusion: Political and economic problems in the Persian Gulf region make supply disruptions a possibility over the near-term. Disruptions are possible in other regions, but the risks to OECD countries are lower because oil production facilities elsewhere are not as concentrated as they are in the Persian Gulf.

The United States and the OECD countries have limited prospects to offset a major oil supply disruption because: 1) there is little surplus production outside the Persian Gulf; 2) U.S. and OECD government oil stocks today provide less protection from an interruption than was the case in 1988; and, 3) there is no substitute for liquid transportation fuels.

Interfuel substitution offers limited prospects to moderate a supply interruption because oil has limited interfuel competition. Approximately two-thirds of all oil consumption in the United States (11+ MB/D) is consumed by the transportation sector; and, at present, there are no widely available substitutes for gasoline, jet, or diesel fuel for internal combustion engines. During a major oil supply disruption, less oil would be available for civilian end uses. This could pose hardships for the U.S. economy.

However, the development of the North Sea gas fields, the Canadian gas pipeline, as well as liquefied natural gas, offers some prospects for substitution in the consumer heating and industrial boiler fuel markets. The availability of excess natural gas production/deliverability capacity would facilitate

interfuel substitution during a supply disruption. On the other hand, the substitution prospects for coal and nuclear electric power are limited because of demand and regulatory concerns.

8. Foreign Policy Flexibility

1988 Investigation: The national security risks associated with dependence on imports involve not only economic concerns, but include foreign policy flexibility.

Current Petition: The petitioner did not raise this issue in the petition.

Department Review: As the 1988 investigation noted, dependence upon unreliable sources of petroleum (i.e., subject to interruption) can constrain U.S. foreign policy flexibility.³⁵ The United States and its allies may find themselves constrained from pursuing either unilateral or multilateral foreign policy actions for fear of provoking producer countries into actions that could result in the manipulation of oil prices and increased prices for consumer countries. Further, the lack of flexibility could also impair international cooperation to avoid the bidding-up of world oil prices in the aftermath of an interruption in oil supplies (e.g., the Iranian Revolution).

Conclusion: Our allies' and trading partners' dependence on these potentially insecure sources of oil may affect their willingness to cooperate with the United States during a major oil supply disruption.

9. U.S. Military Requirements

1988 Investigation: The Department found that the United States would be able to meet both direct and indirect military requirements for petroleum during a major conventional war. However, the report noted that significant civilian austerity would be necessary to respond to decreased availability of oil.

Current Petition: The petitioner alleged that low oil prices will "even further erode the domestic industry, including its employment, technology, research and development, and available capital. This will weaken the industry's ability to surge production in the event of a crisis and will result in decreased production which leaves the United States even more vulnerable in the future."³⁶

Department Review: The Department of Defense (DOD) advised that the military requirements for petroleum fuels could be satisfied under current planning scenarios.

Conclusion: The United States would be able to meet both direct and indirect military petroleum requirements during a major conventional war or major supply disruption.

10. Other Factors

The Department also evaluated several factors that have served to improve the security of U.S. oil supplies since the 1988 investigation. Foremost among these factors are the following:

- o Status of OPEC - Low world oil prices are in large part a symptom of the apparent disarray within OPEC. The ability of OPEC to manipulate prices has been impaired because its members have been unable to coordinate production levels among themselves. The urgent financial requirements of many OPEC members has led them to compete for revenue and market share even if this meant that they accept a lower per-unit price for their resource.
- o Transparency of oil markets - The growth of the futures market into a full-fledged commodity market has made crude oil prices more transparent and less subject to manipulation. The use of computerized trading, options, and forward contracts has connected refined products and crude oil markets more closely than was the case in 1988.
- o Demise of the Soviet Union - The end of the Cold War and the breakup of the Soviet Union removed the risk of Middle East oil becoming a pawn in East-West competition. The demise of the Soviet Union also has reduced the probability of a conventional war that could jeopardize Western Europe's and Japan's access to Middle East oil.

11. Conclusions

Table II-11 shows that despite the demise of the Soviet Union and the apparent disarray within OPEC, the U.S. oil security position has eroded since 1988. The reduction in exploration, falling domestic production, dwindling reserves, relatively high cost of U.S. production, and the resulting low rates of return on investments (at current prices) point toward a contraction of the U.S. producing industry and increasing imports. Growing import dependence, in turn, increases U.S. vulnerability to a supply disruption because non-OPEC sources lack surge production capacity; and there are at present no substitutes for the transportation fuels which account for two-thirds of U.S. petroleum consumption. The above developments point toward a threat to the national security of the United States.

TABLE II-1
WORLD CRUDE OIL RESERVES, 1987 AND 1994
 (Billion Barrels)

| <u>Country</u> | <u>1987</u> | <u>1994</u> | <u>% Gain/Decline +/-</u> | <u>% share of world reserves</u> |
|-----------------------|--------------|--------------|-------------------------------|----------------------------------|
| North America | 82.7 | 79.8 | - 3.6 | 8.0 |
| of which U.S. | 26.8 | 23.0 | -14.2 | 2.3 |
| Central/South America | 65.7 | 74.1 | +12.8 | 7.4 |
| Western Europe | 22.4 | 16.6 | -25.9 | 1.7 |
| FSU/Eastern Europe | 60.8 | 59.2 | - 2.6 | 5.9 |
| Middle East | 564.7 | 662.9 | +17.4 | 66.3 |
| Africa | 55.2 | 62.0 | +12.3 | 6.2 |
| Far East/Oceania | <u>37.8</u> | <u>44.6</u> | +18.0 | <u>4.5</u> |
| Total | 889.3 | 999.2 | +12.4 | 100.0 |
| of which OPEC | 670.7 | 766.2 | +14.2 | 76.7 |
| of which Arab OPEC | 494.9 | 585.2 | +18.2 | 58.6 |
| of which Middle East | 564.7 | 662.9 | +17.4 | 66.3 |

SOURCES:

1987

United States: U.S. Crude Oil, Natural Gas, and Natural Gas Liquids Reserves, Advance Summary for 1987, Energy Information Administration.

Other Countries: Oil and Gas Journal, December 28, 1987.

1994

United States: Advance Summary, U.S. Crude Oil, Natural Gas, and Natural Gas Liquids Reserves, 1993 Annual Report, Energy Information Administration, August 1994, p. 8.

Other Countries: Oil and Gas Journal, December 27, 1993, pp. 44-45.

**TABLE II-2
PETROLEUM OVERVIEW, 1950-1993 (MILLION BARRELS PER DAY)**

| YEAR | CRUDE OIL | NATURAL GAS PLANT LIQUIDS | TOTAL PRODUCTION | OTHER DOMESTIC SUPPLY | CRUDE OIL IMPORTS | PETROLEUM PRODUCT IMPORTS | TOTAL IMPORTS | EXPORTS | NET IMPORTS | CRUDE OIL | CHANGE IN STOCKS | PETROLEUM PRODUCTS SUPPLIES |
|------|-----------|---------------------------|------------------|-----------------------|-------------------|---------------------------|---------------|---------|-------------|-----------|------------------|-----------------------------|
| 1950 | 5.41 | 0.50 | 5.91 | | 0.49 | 0.36 | 0.85 | 0.30 | 0.55 | 0.05 | 0.06 | 6.46 |
| 1955 | 6.81 | 0.77 | 7.58 | 0.04 | 0.78 | 0.47 | 1.25 | 0.37 | 0.88 | 0.04 | | 8.46 |
| 1960 | 7.04 | 0.93 | 7.97 | 0.15 | 1.02 | 0.80 | 1.82 | 0.20 | 1.62 | 0.01 | 0.08 | 9.80 |
| 1965 | 7.80 | 1.21 | 9.01 | 0.22 | 1.24 | 1.23 | 2.47 | 0.19 | 2.28 | 0.01 | 0.01 | 11.51 |
| 1970 | 9.64 | 1.66 | 11.30 | 0.35 | 1.32 | 2.10 | 3.42 | 0.26 | 3.16 | 0.01 | -0.10 | 14.70 |
| 1973 | 9.21 | 1.74 | 10.95 | 0.49 | 3.24 | 3.01 | 6.25 | 0.23 | 6.02 | 0.01 | -0.14 | 17.31 |
| 1974 | 8.77 | 1.69 | 10.46 | 0.49 | 3.48 | 2.64 | 6.12 | 0.22 | 5.89 | 0.01 | -0.18 | 16.65 |
| 1975 | 8.37 | 1.63 | 10.00 | 0.51 | 4.10 | 1.95 | 6.05 | 0.21 | 5.84 | 0.01 | -0.03 | 16.32 |
| 1980 | 8.60 | 1.57 | 10.17 | 0.68 | 5.26 | 1.65 | 6.91 | 0.54 | 6.37 | 0.01 | -0.14 | 17.06 |
| 1985 | 8.97 | 1.61 | 10.58 | 0.76 | 3.20 | 1.87 | 5.07 | 0.78 | 4.29 | | 0.10 | 15.73 |
| 1987 | 8.35 | 1.60 | 9.95 | 0.85 | 4.67 | 2.00 | 6.67 | 0.76 | 5.91 | | -0.04 | 16.67 |
| 1990 | 7.36 | 1.56 | 8.92 | 1.02 | 5.89 | 2.12 | 8.01 | 0.86 | 7.15 | | 0.11 | 16.99 |
| 1992 | 7.17 | 1.73 | 8.90 | 1.16 | 6.08 | 1.80 | 9.88 | 0.95 | 6.93 | | 0.07 | 17.03 |
| 1993 | 6.84 | 1.70 | 8.54 | 1.25 | 6.73 | 1.80 | 8.53 | 1.00 | 7.53 | | -0.15 | 17.19 |

SOURCE: Annual Energy Review, 1993, Energy Information Administration, July 1994, p. 141.

Note: Totals may not equal sum of components due to independent rounding.

TABLE II-3
LANDED COSTS OF U.S. CRUDE OIL IMPORTS, 1973-1993

| <u>YEAR</u> | <u>\$ PER BARREL</u> | <u>\$ VALUE OF IMPORTS (US BILLIONS)</u> |
|----------------|----------------------|--|
| 1973 | 6.41 | 7.6 |
| 1975 | 12.70 | 19.0 |
| 1980 | 33.67 | 64.9 |
| 1985 | 26.67 | 31.2 |
| 1986 | 13.49 | 20.6 |
| 1987 | 17.65 | 30.1 |
| 1988 | 14.08 | 26.3 |
| 1989 | 17.68 | 37.7 |
| 1990 | 21.13 | 45.5 |
| 1991 | 18.02 | 38.0 |
| 1992 | 17.75 | 39.5 |
| 1993 | 15.76 | 38.7 |
| Nov.-Dec. 1993 | 13.01 | |

SOURCES:

1973-1993, Annual Energy Review 1993, Energy Information Administration, April 1994, p. 175.

Nov. - Dec. 1993, Petroleum Marketing Monthly, April 1994, p. 41

TABLE II-4
U.S. OIL INDUSTRY INDICATORS
1973-1993

| Year | Rotary Rigs in Use for Oil & Gas Exploration | Crews Engaged in Seismic Exploration (Average) | Footage Drilled (Thousand Feet) | Employment ¹ (Thousands) | Total Wells Completed (Oil, Natural Gas, Dry Hole Exploratory & Development Wells) |
|------|--|--|---------------------------------|-------------------------------------|--|
| 1973 | 1,194 | 250 | 139,427 | 273.9 | 27,692 |
| 1980 | 2,909 | 530 | 312,303 | 559.7 | 69,838 |
| 1985 | 1,980 | 378 | 312,569 | 582.0 | 69,170 |
| 1990 | 1,010 | 125 | 149,378 | 395.1 | 28,055 |
| 1992 | 721 | 76 | 120,662 | 350.3 | 23,201 |
| 1993 | 754 | 79 | 127,738 | 351.4 | 23,959 |

SOURCE: Monthly Energy Review, March 1994, pp. 80-81, Energy Information Administration, U.S. Department of Energy.

¹SIC-13, Bureau of Labor Statistics, U.S. Department of Labor.

TABLE II-5**OIL WELLS AND PRODUCTION THAT DO NOT MEET LEASE OPERATING COSTS, FOR LOWER 48 STATES ONSHORE**

| DOMESTIC OIL PRICE | WELLS | WELLS (%) | DAILY PRODUCTION THOUSAND B/D O/E | PRODUCTION (PERCENT) |
|-------------------------------|--------------|----------------------|--|---------------------------------|
| \$20 | 66,225 | 11.3 | 145 | 2.6 |
| \$18 | 73,843 | 12.6 | 167 | 3.0 |
| \$16 | 82,048 | 14.0 | 197 | 3.5 |
| \$14 | 95,527 | 16.3 | 252 | 4.5 |
| \$12 | 110,179 | 18.8 | 320 | 5.7 |
| \$10 | 130,691 | 22.3 | 425 | 7.6 |
| \$ 8 | 161,752 | 27.6 | 589 | 10.5 |

NOTE 1: Based on 586,058 wells and production of 2,045.730 million BOE in 1992.

NOTE 2: These wells can no longer produce enough income to meet normal lease operating costs.

NOTE 3: Gas production was converted to barrel oil equivalent (BOE) on the basis of 6 thousand cubic feet of gas per BOE.

NOTE 4: Oil prices vary by region, oil gravity, and sulfur content. An average domestic price of \$16 per barrel is equivalent to a West Texas Intermediate spot price of \$20.70 and a California price of \$13.60 per barrel. For each domestic price, an equivalent regional price was used to determine the economic status of oil wells.

SOURCE: Marginal Wells Study, National Petroleum Council, July 1994, p. 97.

TABLE II-6
U.S. CRUDE OIL AND REFINED PRODUCT IMPORTS
1973-1993
(Thousand Barrels per Day)

| Year | Total OPEC | Total Arab OPEC | Non-OPEC Sources | Total Imports | Total Exports | Net Imports | Apparent Product Demand | Net Imports As % of Petroleum Product Supplied |
|------|------------|-----------------|------------------|---------------|---------------|-------------|-------------------------|--|
| 1973 | 2,993 | 915 | 3,263 | 6,256 | 231 | 6,025 | 17,308 | 34.8 |
| 1981 | 3,323 | 1,848 | 2,672 | 5,996 | 595 | 5,401 | 16,058 | 33.6 |
| 1985 | 1,830 | 472 | 3,237 | 5,067 | 781 | 4,286 | 15,726 | 27.3 |
| 1987 | 3,060 | 1,274 | 3,617 | 6,678 | 764 | 5,914 | 16,665 | 35.5 |
| 1988 | 3,520 | 1,839 | 3,882 | 7,402 | 815 | 6,587 | 17,283 | 38.1 |
| 1990 | 4,296 | 2,296 | 3,721 | 8,018 | 857 | 7,161 | 16,988 | 42.2 |
| 1991 | 4,092 | 2,064 | 3,535 | 7,627 | 1,001 | 6,626 | 16,714 | 39.6 |
| 1992 | 4,092 | 1,974 | 3,788 | 7,888 | 950 | 6,938 | 17,033 | 40.7 |
| 1993 | 4,331 | 1,994 | 4,196 | 8,526 | 1,003 | 7,523 | 17,193 | 43.8 |

Sources: For the years 1973-1985: Petroleum Supply Monthly, January 1988, pp. 2-9, Energy Information Administration, U.S. Department of Energy. For the years 1988-1993: Petroleum Supply Monthly, March 1994, pp. 3-15, Energy Information Administration, U.S. Department of Energy.

TABLE II-7
U.S. OIL OUTLOOK
(Million Barrels Per Day)

| | TOTAL DOMESTIC OIL SUPPLY² | OIL IMPORTS³ | NET IMPORTS | APPARENT PRODUCT DEMAND | NET IMPORTS AS % OF PETROLEUM PRODUCT |
|------|--|------------------------------------|------------------------|------------------------------------|--|
| 1992 | 8.9 | 7.8 | 6.938 | 17.033 | 40.7 |
| 1993 | 8.6 | 8.5 | 7.523 | 17.193 | 43.8 |
| 1994 | 8.4 | 9.2 | 8.0 | 17.7 | 45.2 |
| 2000 | 7.0 | 11.0 | 10.0 | 19.4 | 51.5 |

SOURCES:

1992-1993, Annual Energy Review 1993, Energy Information Administration, July 1994, p. 141.

1994, Short-Term Energy Outlook, 2nd Quarter 1994, Energy Information Administration, May 1994, Table 7, Mid World Oil Price Case, p. 28.

2000, Annual Energy Outlook 1994, Energy Information Administration, January 1994, Tables A-1 - A-19, pp. 55-76.

² Does not include refinery processing gains which amounted to 770,000 B/D during 1992.

³ Includes up to 100,000 B/D of annual acquisitions for the Strategic Petroleum Reserve.

TABLE II-8
WORLD OIL CONSUMPTION AND PRODUCTION, BASE CASE
(MILLION BARRELS PER DAY)

| SUPPLY AND DISPOSITION | <u>HISTORY</u> | | | <u>PROJECTION</u> |
|----------------------------------|----------------|--------------|--------------|-------------------|
| | 1990 | 1991 | 1992 | 2000 |
| PRODUCTION | | | | |
| United States ^a | 9.68 | 9.88 | 9.77 | 8.0 |
| Canada | 2.02 | 2.03 | 2.12 | 2.2 |
| OECD Europe | 4.58 | 4.81 | 5.08 | 6.4 |
| OPEC | 24.81 | 24.93 | 26.38 | 35.5 |
| Other Rest of World ^b | 11.12 | 11.43 | 11.72 | 13.0 |
| Total | 52.21 | 53.08 | 55.07 | 65.1 |
| Net Eurasia Exports | 2.17 | 1.36 | 1.58 | 1.2 |
| CONSUMPTION | | | | |
| United States ^a | 16.99 | 16.71 | 17.03 | 19.3 |
| U.S. Territories | 0.21 | 0.24 | 0.21 | 0.3 |
| Canada | 1.69 | 1.62 | 1.64 | 1.9 |
| Japan | 5.14 | 5.28 | 5.45 | 6.8 |
| Australia and New Zealand | 0.82 | 0.81 | 0.82 | 1.0 |
| OECD Europe | 12.90 | 13.38 | 13.61 | 15.5 |
| Rest of World ^b | 16.07 | 16.49 | 17.56 | 22.0 |
| Total | 53.82 | 54.53 | 56.32 | 66.8 |
| Stock Draw & Discrepancy | -0.57 | 0.08 | -0.32 | 0.3 |
| EURASIA | | | | |
| PRODUCTION | | | | |
| China | 2.77 | 2.83 | 2.84 | 3.1 |
| Former Soviet Union | 11.40 | 10.41 | 8.91 | 8.5 |
| Eastern Europe | 0.34 | 0.29 | 0.25 | 0.4 |
| Total | 14.51 | 13.53 | 12.00 | 12.0 |
| CONSUMPTION | | | | |
| China | 2.30 | 2.50 | 2.63 | 3.2 |
| Former Soviet Union | 8.39 | 8.35 | 6.70 | 6.2 |
| Eastern Europe | 1.65 | 1.33 | 1.09 | 1.3 |
| Total | 12.34 | 12.18 | 10.42 | 10.7 |
| World Oil Consumption | 66.16 | 66.71 | 66.75 | 77.4 |

^a Includes the 50 States and the District of Columbia.

^b Includes Australia, New Zealand, and the U.S. Territories.

OECD = Organization for Economic Cooperation and Development.

OPEC = Organization of Petroleum Exporting Countries.

NOTES: Production includes crude oil, natural gas liquids, refinery gains, hydrogen, and other hydrocarbons. Totals may not equal sum of components because of independent rounding.

SOURCES: History: Energy Information Administration (EIA), International Energy Annual, DOE/EIA-0219(92), Tables 8 and D2. Projections: EIA, Annual Energy Outlook 1994, DOE/EIA-0383(94), Table A19, and World Energy Projection System, 1994. International Energy Outlook 1994, Energy Information Administration, p. 13.

**TABLE II-9
WORLD OIL PRODUCTION CAPACITY ASSUMPTIONS
(MILLION BARRELS PER DAY)**

| REGION/COUNTRY | ESTIMATES | | | ASSUMPTIONS | |
|-----------------------|-------------|-------------|-------------|-------------------|-------------|
| | 1990 | 1992 | BASE CASE | SENSITIVITY RANGE | |
| OPEC | | | | | |
| PERSIAN GULF | | | | | |
| Iran | 3.2 | 3.6 | 4.6 | 4.3 | 5.0 |
| Iraq | 2.2 | 0.4 | 4.7 | 4.0 | 5.5 |
| Kuwait | 1.7 | 1.1 | 3.1 | 3.0 | 3.3 |
| Qatar | 0.5 | 0.4 | 0.6 | 0.5 | 0.7 |
| Saudi Arabia | 8.5 | 9.6 | 11.0 | 10.5 | 12.3 |
| United Arab Emirates | 2.5 | 2.6 | 3.2 | 2.9 | 3.4 |
| TOTAL | 18.6 | 17.7 | 27.2 | 25.2 | 30.2 |
| OTHER OPEC | | | | | |
| Algeria | 1.4 | 1.3 | 1.6 | 1.4 | 1.9 |
| Gabon | 0.3 | 0.3 | 0.3 | 0.3 | 0.4 |
| Indonesia | 1.5 | 1.7 | 1.4 | 1.2 | 1.6 |
| Libya | 1.6 | 1.6 | 2.0 | 1.8 | 2.3 |
| Nigeria | 1.8 | 2.0 | 2.5 | 2.3 | 2.7 |
| Venezuela | 2.6 | 2.6 | 3.4 | 3.0 | 3.9 |
| TOTAL OTHER | 9.2 | 9.5 | 11.2 | 10.0 | 12.8 |
| TOTAL OPEC | 27.8 | 27.2 | 38.4 | 35.2 | 43.0 |
| NON-OPEC | | | | | |
| OECD | | | | | |
| United States | 9.7 | 9.7 | 8.0 | 7.6 | 8.3 |
| Canada | 2.0 | 2.1 | 2.2 | 2.1 | 2.3 |
| Australia | 0.7 | 0.6 | 0.9 | 0.7 | 1.0 |
| North Sea | 4.2 | 4.6 | 5.9 | 5.8 | 6.0 |
| Other OECD | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| TOTAL OECD | 17.1 | 17.5 | 17.5 | 16.7 | 18.1 |
| EURASIA | | | | | |
| China | 2.8 | 2.8 | 3.5 | 3.4 | 3.6 |
| Former Soviet Union | 11.5 | 9.1 | 8.2 | 7.4 | 9.1 |
| Eastern Europe | 0.3 | 0.2 | 0.2 | 0.2 | 0.3 |
| TOTAL EURASIA | 14.6 | 12.1 | 11.9 | 11.0 | 13.0 |
| OTHER NON-OPEC | | | | | |
| Latin America | 5.2 | 5.5 | 6.4 | 6.0 | 6.8 |
| Middle East | 1.4 | 1.5 | 1.9 | 1.8 | 2.3 |
| Africa | 1.8 | 1.9 | 1.8 | 1.5 | 2.0 |
| Asia | 1.7 | 1.7 | 2.4 | 2.1 | 2.8 |
| TOTAL | 10.1 | 10.6 | 12.5 | 11.4 | 13.9 |
| TOTAL NON-OPEC | 41.8 | 40.2 | 41.9 | 39.1 | 45.0 |
| WORLD TOTAL | 69.6 | 67.4 | 80.3 | 74.3 | 88.0 |

OPEC = Organization of Petroleum Exporting Countries.

OECD = Organization for Economic Cooperation and Development.

NOTES: Capacity is defined as maximum sustainable production capacity adjusted to reflect current operable capacity in selected countries. Production includes crude oil, natural gas liquids, refinery gains, hydrogen, and other hydrocarbons. Totals may not equal sum of components because of independent.

SOURCES: ESTIMATES: Energy Information Administration, Energy Markets and Contingency Information Division. ASSUMPTIONS: EIA, Oil Market Simulation Model Spreadsheet, 1994. International Energy Outlook 1994, Energy Information Administration, p. 20.

**TABLE II-10
HISTORICAL REVIEW OF OIL SUPPLY DISRUPTIONS**

| EVENT | YEAR | MAGNITUDE Maximum Disrupted Volume (mb/d) ^a | DURATION | | LOCATION/REGION | | | | TYPE | | |
|-----------------------------------|------|---|------------------------|------------------------|-----------------|---------------|--------------|----------------|-----------------------|-----------------------|-----------------------|
| | | | More than 1 year | Less than 1 year | Persian Gulf | Mediterranean | North Sea | West Africa | Facility ^b | Internal ^c | External ^d |
| Iranian oilfields nationalized | 1951 | 0.7 | X | | X | | | | | | X |
| Suez war | 1956 | 2.0 | | X | | X | | | | X | |
| Syria transit fee dispute | 1966 | 0.7 | | X | | X | | | | | X |
| Nigerian civil war | 1967 | 0.5 | X | | | | | X | | X | |
| Libyan price controversy | 1970 | 1.3 | | X | | X | | | | X | |
| Algerian-French struggle | 1971 | 0.6 | | X | | X | | | | X | |
| October Arab-Israeli War | 1973 | 1.6 | | X | X | X | | | | | X |
| Iranian revolution | 1978 | 3.7 | | X | X | | | | | X | |
| Outbreak of Iran-Iraq war | 1980 | 3.0 | | X | X | | | | | | X |
| UK Fulmer storage vessel accident | 1988 | 0.2 | | X | | | | X | X | | |
| Persian Gulf war | 1990 | 5.0 | X | | X | | | | | | X |
| TOTALS | | | 3 | 8 | 5 | 5 | 1 | 1 | 1 | 5 | 5 |

^a This table includes only supply disruptions of at least 200,000 b/d and lasting three months or more. At least 10 other disruptions - ranging in size from 100,000 b/d to 700,000 b/d - have occurred since 1951, but all lasted less than three months. Most of these disruptions were caused by facility accidents, pipeline bombings, bad weather, and delays in Russian export permits. Five disruptions, ranging in size from 200,000 b/d to 500,000 b/d and each lasting about one month, have occurred since 1991, including bombings of the export pipeline in Colombia, bad weather at the Russian export terminal of Novorosslysk and in the North Sea, and delays in Russian export permits.

^b Accidents

^c Civil disorder, revolution, bureaucratic disorder

^d War between two or more countries

TABLE II-11

OVERVIEW OF KEY FACTORS

CHANGES IN KEY BENCHMARKS SINCE THE 1988 INVESTIGATION

| <u>BENCHMARKS</u> | <u>IMPROVE</u> | <u>WORSE</u> | <u>SAME</u> |
|--|-----------------------|---------------------|--------------------|
| 1988 INVESTIGATION | | | |
| 1. Domestic oil reserves | | ✓ | |
| 2. U.S. oil production | | ✓ | |
| 3. Oil infrastructure, employment | | ✓ | |
| 4. Impact of low oil prices on the economy | ✓ | | |
| 5. Status of U.S. oil companies | | ✓ | |
| 6. Import dependence | | ✓ | |
| 7. Import vulnerability | | | |
| -surge production | | ✓ | |
| -government owned oil stocks | | ✓ | |
| -interfuel substitution | | ✓ | |
| -geopolitical risk of disruption | | | ✓ |
| 8. Foreign policy flexibility | | | ✓ |
| 9. Military requirements | | | ✓ |
| NEW FACTORS-1994 INVESTIGATION | | | |
| 1. Status of OPEC | ✓ | | |
| 2. Emergence of energy futures market-oil price transparency | ✓ | | |
| 3. Demise of the Soviet Union | ✓ | | |

APPENDIX TO SECTION II
Assumptions Behind this Energy Scenario

| <u>Year</u> | <u>World Oil Price Base Case</u> <u>(1992 dollars per barrel)</u> |
|-------------|--|
| 1990 | \$23.20 |
| 1991 | \$19.19 |
| 1992 | \$18.20 |
| 1993 | \$16.69 |
| 1994 | \$16.40 |
| 1995 | \$17.00 |
| 1996 | \$17.70 |
| 1997 | \$18.30 |
| 1998 | \$19.10 |
| 1999 | \$19.90 |
| 2000 | \$20.70 |

| <u>Countries</u> | <u>Average Annual GDP Growth Rates,</u> <u>1990-2000 (Percent)</u> |
|------------------|---|
| United States | 2.2 |
| Canada | 2.5 |
| Japan | 4.5 |
| OECD Europe | 3.2 |

| <u>Years</u> | <u>U.S. OIL PRODUCTION*</u> <u>(Million barrels per day)</u> |
|--------------|---|
| 1992 | 8.9 |
| 1993 | 8.6 |
| 1994E** | 8.4 |
| 2000E** | 7.0 |

- * Does not include refinery processing gains
- ** Estimated

| <u>Years</u> | <u>U.S. Net Oil Imports</u> <u>(Million barrels per day)</u> |
|--------------|---|
| 1993 | 7.5* |
| 1994 | 8.0 |
| 2000 | 11.0 |

- * Actual

Sources: International Energy Outlook, 1994, pp. 7-11, Energy Information Administration, July 1994; and Annual Energy Outlook, 1994, pp. 55-76, Energy Information Administration, January 1994.

ENDNOTES

1. Testimony of John H. Lichtblau on behalf of the Petroleum Industry Research Foundation, New York public hearing, June 6, 1994, p. 2 of the written statement.
2. International Energy Outlook 1994, Energy Information Administration, U.S. Department of Energy, July 1994, p. 13 (hereinafter IEO 1994).
3. Energy Security: A Report To The President of the United States, U.S. Department of Energy, March 1987, p. 53 (hereinafter referred to as DOE Energy Security 1987).
4. Hodel, Donald P. and Robert Deitz, Crisis in the Oil Patch, Washington, 1994, p. 5 (hereafter referred to as Hodel and Deitz).
5. Advance Summary: U.S. Crude Oil, Natural Gas and Natural Gas Liquids Reserves, 1993 Annual Report, Energy Information Administration, U.S. Department of Energy, August 1994, p. 8 (hereinafter referred to as EIA Crude Oil Reserves).
6. Stauffer, Thomas R., Indicators of Crude-Oil Production Costs: The Gulf Versus Non-OPEC Sources, International Research Center for Energy and Economic Development, Occasional Papers, Number 19, pp. 4-5 (hereafter Stauffer). Actual production rates in Saudi Arabia and Iran are lower than the peak rates in the late 1970's and early 1980's because of OPEC countries' prorationing schemes.
7. Hodel and Deitz, p. 5.
8. Stauffer, p. 9.
9. Oil and Gas Journal, Vol. 91, No. 52, December 27, 1993, pp. 44-45.
10. Testimony of Roy Willis on behalf of the Independent Petroleum Association of America, New York public hearing, June 6, 1994.
11. Testimony of Mark P. Metzler on behalf of Felderhoff Brothers Drilling Company, Inc. at the Dallas public hearing, June 13, 1994.
12. Labor Aspects of the Section 232 Investigation of the Effect of Crude Petroleum and Refined Petroleum Products on the National Security, Office of International Economic Affairs, U.S. Department of Labor, December 1994, Appendix I, p.25.

13. This figure was obtained by dividing the total footage drilled during 1992--120.7 million feet--into the reserve additions--1.509 billion barrels. EIA Crude Oil Reserves, p. 8.
14. Oil And Gas Are Crucial To Our Economy, Now And In The Foreseeable Future, Energy Information Administration, U.S. Department of Energy, August 13, 1993, p. 22.
15. Oil And Gas Are Crucial To Our Economy, Now And In The Foreseeable Future, Energy Information Administration, U.S. Department of Energy, August 13, 1994, p. 18.
16. Testimony of David R. Damron, Manager Government Affairs, Hoechst Celanese Chemical Group, on behalf of the Petrochemical Energy Group and the Coalition on Energy Taxes, Dallas public hearing, June 13, 1994.
17. Salpukas, Agis, (1994, July 7). Striking Oil but Straining Families, The New York Times, pp. D1-D2 (hereafter Salpukas).
18. Salpukas.
19. Nulty, Peter, (April 22, 1991), Oil's Prospects: A Better Decade, Fortune, pp. 139-148.
20. Salpukas, Agis, (1994, July 6). Texaco Plans More Cutbacks, The New York Times, pp. D1 and D4.
21. Marginal Wells, A Report of the National Petroleum Council, Prepared by the Committee on Marginal Wells, Washington, DC, July 1994, p. 83 (hereinafter referred to as Marginal Wells Study).
22. Testimony of George Alcorn on behalf of the Independent Petroleum Association of America, at the Dallas public hearing, June 13, 1994.
23. Marginal Wells Study, p. 97.
24. Testimony of Paul Clark, Clark Operating, Inc., Dallas public hearing, June 13, 1994.
25. Petroleum Supply Monthly, Energy Information Administration, U.S. Department of Energy, March 1994, pp. 8-9 (hereinafter referred to as PSM).
26. Annual Energy Outlook, 1994, Energy Information Administration, U.S. Department of Energy, Tables A1-A19, pp. 55-76, and IEO 1994, pp. 1-20.

27. 1994 Short Term Energy Outlook, 2nd Quarter 1994, Energy Information Administration, U.S. Department of Energy, Table 7, Mid World Oil Price Case, p. 28.
28. IEO, 1994, pp. 8-20.
29. The Petition, p. 14.
30. The Effects of Crude Oil and Refined Petroleum Product Imports on the National Security, An Investigation Conducted Under Section 232 of the Trade Expansion Act of 1962, as amended (19 U.S.C. 1962), U.S. Department of Commerce, November 1988, p. III-1 (hereinafter 1988 Commerce Oil Investigation). 1992 estimate derived from IEO, 1994, p. 20; and International Petroleum Statistics Report, Energy Information Administration, July 1994, p. 9.
31. Tippee, Bob, Questions Cloud Outlook For Oil Production Capacity Growth In The Middle East, Oil and Gas Journal, Volume 92, Number 28, July 11, 1994, pp. 33-36.
32. 1988 Commerce Oil Investigation, p. III-1.
33. International Petroleum Statistics Report, Energy Information Administration, July 1994, p. 11 (hereinafter referred to as IPS).
34. IPS, p. 11, and 1988 Commerce Oil Investigation, p. III-1.
35. 1988 Commerce Oil Investigation, p. IV-10.
36. The Petition, pp. 14-15.

SECTION III. FINDING AND RECOMMENDATIONS

A. Finding

Since the previous Section 232 Petroleum Finding in 1988, there have been some improvements in U.S. energy security. The breakup of the Soviet Union and the apparent disarray within OPEC have enhanced U.S. energy security. Lower oil prices on balance benefitted the U.S. economy. However, the reduction in exploration, dwindling reserves, falling production, relatively high cost of U.S. production, and the resulting low rates of return on investments all point toward a contraction of the U.S. petroleum industry and increasing imports from OPEC sources. Growing import dependence, in turn, increases U.S. vulnerability to a supply disruption because non-OPEC sources lack surge production capacity; and there are at present no substitutes for oil-based transportation fuels which account for two-thirds of U.S. petroleum consumption. Given the above factors, the Department finds that petroleum imports threaten to impair the national security.

Section 232 requires the Secretary of Commerce and the President to recognize the close relationship between the economic welfare of the nation to U.S. national security. As energy security effects the economic welfare of the United States, energy security must be considered in determining the effects on the national security of petroleum imports.

B. Recommendations

In light of the finding that petroleum imports threaten to impair the national security, the Department has the following recommendations:

1. Trade Actions

The Department does not recommend that the President use his authority under Section 232 to adjust imports. The Clinton Administration's other efforts to improve U.S. energy security are more appropriate than an import adjustment.

The Department concurs with the conclusions of the 1988 study that, on balance, the costs to the national security of an oil import adjustment outweigh the potential benefits.¹ For example, an oil import adjustment such as a tariff would likely have an inflationary effect on the economy and would result in the loss of significant jobs in the nonpetroleum sectors. This, in turn, would reduce real GNP. An import adjustment would diminish the competitiveness of energy-intensive export companies and strain relations with close trading partners who may seek an exemption from the adjustment.

2. Clinton Administration Energy Policy

The Clinton Administration recognizes the importance of U.S. energy security and is pursuing a series of policies to enhance that security. It is important to note that no cost-effective government action could eliminate U.S. dependence on foreign oil entirely, but the following supply enhancement and energy conservation and efficiency policies help limit that dependence. Thus, the Department recommends continuing the policies described below.

Increased Investment in Energy Efficiency:

The Administration places renewed emphasis on increasing the energy efficiency of the domestic economy by the following:

- o Increasing the budgets substantially over the last two years to achieve an enhanced energy efficiency level.
- o Conducting a substantial program to provide weatherization grants to the states for insulation and other building improvements to increase their energy efficiency and reduce the consumption of oil and other energy sources. This is important in the northeast where a significant amount of fuel oil consumption goes toward space heating.
- o Developing new appliance standards that will save energy and further reduce demand for oil.
- o Working on innovative workplace solutions to decrease long-distance commuting through the use of telecommuting programs.

These actions provide some examples of the extensive energy efficiency programs currently underway. The goals of these programs are to decrease consumption of oil.

Increased Emphasis on Alternative Fuels:

The Administration places particular emphasis on improving the efficiency of the transportation sector where oil comprises about 98 percent of the fuel utilization and where petroleum-based transportation consumption exceeds domestic crude oil production.

- o Initiating a partnership with automobile manufacturers to design a prototype automobile that can achieve levels of 80 miles per gallon or more by the year 2000.
- o Establishing a program to bring alternative transportation fuels and vehicles into the marketplace by:

-- Committing to purchase substantial numbers of vehicles over the next several years; and by the year 2000, most new Federal vehicle purchases will be alternative fuel vehicles.

-- Establishing the Clean Cities Program where at least 18 cities and states will coordinate their purchase requirements to introduce alternative-fueled vehicles.

-- Encouraging industry to respond by constructing service stations that provide fuels for alternative-fueled vehicles.

These actions will reduce direct consumption of petroleum-based transportation fuels so that the need for imports will decrease.

Since 1973, the United States added 48 million vehicles with only a small increase in gasoline consumption because of increased automobile energy efficiency. Over the past 20 years, our consumption of gasoline increased by only 100,000 barrels per day. If the 1973 consumption trends had continued, we would be consuming 3 MMB/D more gasoline today, all from imports.

Increased Government Investment in Technology:

The Administration more than doubled its investment with American industry in advanced technologies for the exploration and production of natural gas and oil. This is important because technological innovation can significantly decrease the domestic finding costs for natural gas and oil, thereby maintaining and expanding the domestic resource base. This program includes:

- o Accelerating the advanced oil recovery program, by providing technology for the private sector, to increase the productive capacity of our domestic resources.
- o Increasing the budget for technology partnerships with the private sector over the last two years.

These programs are maintaining the domestic resource base and improving its economics.

Expanded Utilization of Natural Gas:

The Administration aggressively promotes expanded markets for natural gas at the expense of imported oil and to the benefit of air quality. The Administration developed the following initiatives:

- o Increasing the research budgets for natural gas utilization in areas such as fuel cells and advanced turbines.
- o Developing an integrated natural gas strategic plan that brings together all research and regulatory efforts. This

entails focusing on expanded technology investment programs and identifying regulatory barriers inhibiting increased utilization of this domestic fuel.

- o Expanding cooperation with the Gas Research Institute to advance research efforts in a more cooperative way.
- o Making reliance upon natural gas one of the cornerstones of our Climate Change Action Plan by providing benefits to our environment through the reduction of greenhouse gas emissions.

Thus, the emphasis on natural gas, a clean and plentiful domestic fuel, will make us less dependent upon imported oil as an energy source.

Increased Government Investment in Renewables:

The Administration increased investment in renewable resources because they offer great hope of replacing imported oil in selected end uses.

The government increased the budget to continue aggressive partnerships with industry to develop low-cost renewable technologies. Renewable energy sources offer another way to reduce the oil intensity and dependency of the domestic economy.

Increased Government Regulatory Efficiency:

The Administration is reducing the red tape and regulations that burden domestic industries. Various government agencies are taking the following actions:

- o The Department of the Interior's Bureau of Land Management is conducting a sweeping review to make its regulatory structure more responsive to domestic concerns. It reduced the royalty burden on stripper well production from Federal lands. Interior's Minerals Management Service is offering to lease additional oil and gas acreage in the producing areas of the Gulf of Mexico, especially those areas where industry expressed its greatest interest (the subsalt shallow water prospects).
- o The Department of Energy is working with the Interstate Oil and Gas Compact Commission to identify the various state laws and regulations that impact domestic production. Energy will provide guidance on how to streamline the application of these laws and regulations.
- o The Environmental Protection Agency began a Common Sense Initiative that includes domestic refineries as one of the

six industries targeted for review and reform of current environmental regulations.

Increased Emphasis on Free Trade and U.S. Exports:

As noted earlier, the concentration of the world's energy resources in the Middle East poses significant security risks. This is why the United States is ready to assist American firms and their employees through encouraging the export of goods, services, technology, and fuels by:

- o Assisting energy conservation efforts and the development of new energy supplies in this hemisphere and other areas friendly to the United States.
- o Emphasizing free trade, privatization, and promotion of American exports helps develop the world's energy resources and prevent overreliance on any single region of the world.
- o Allowing the export of low-sulfur Western steam coal and liberalizing restrictions on the export of California heavy crude to world markets.
- o Encouraging our companies to negotiate mutually beneficial sales of low-sulfur coal and heavy crude oil to foreign customers because these exports will further diversify world energy supplies.

Maintaining the Strategic Petroleum Reserve:

The Strategic Petroleum Reserve (SPR) is the nation's stockpile of crude oil available in the event of an oil supply disruption.

- o The 580 million barrels of crude oil under government ownership and control provides a bulwark against unforeseen circumstances that can affect crude oil supplies, impact upon crude oil prices, and severely disrupt the domestic economy.
- o The Energy Department is correcting problems associated with SPR deliverability and ensuring that the facilities comprising the SPR complex operate as expected.
- o The Energy Department is seeking innovative methods to increase the size of the SPR to meet future oil needs.
- o Although the pattern of U.S. dependence on petroleum imports is growing and is expected to continue to do so, currently the SPR is not being filled to capacity and is not being filled at all.

-- In part, this is because alternative financing methods are not financially feasible due to above-market costs that would have to be incurred for otherwise normal commercial activity.

-- To fill the SPR to capacity, and thereby enhance national security, the President should encourage the Secretary of Energy to take whatever measures are necessary to make use of alternative financing approaches to filling the SPR cost-effective.

- o The United States is coordinating oil emergency cooperation among the energy-consuming countries through the International Energy Agency. Discussions are continuing to strengthen the existing market-oriented coordinated energy response measures for dealing with possible future disruptions.

Endnote

1. 1988 Commerce 232 Report, Section V, pp. 2-5, U.S. Department of Commerce.

APPENDIX A:

Federal Register Notices Accepting Petition and Inviting Public
Comments, and Announcing Public Hearings.

Agency Form Under Review by the Office of Management and Budget

DOC has submitted to the Office of Management and Budget (OMB) for clearance the following proposal for collection of information under the provisions of the Paperwork Reduction Act (44 U.S.C. chapter 35).

Agency: Bureau of the Census.
Title: Survey of Income and Program Participation - 1993 Panel Wave 6.
Form Number(s): SIPP-13600.
Agency Approval Number: 0607-0759.

Type of Request: Revision of a currently approved collection.
Burden: 63,000 hours.
Number of Respondents: 42,000.
Avg Hours Per Response: 30 minutes.
Needs and Uses: The Survey of Income and Program Participation (SIPP) is a longitudinal, demographic, household survey in which the Census Bureau interviews sample households in waves occurring every 4 months over a 2 1/2 year period. The survey is molded around a central "core" of labor force and income questions that remain fixed during each wave of a panel. The core is periodically supplemented with questions designed to answer specific needs. These supplemental questions are referred to as "topical modules." The topical modules for Wave 6 include the following: 1) Work Schedule, 2) Child Care, 3) Child Support Agreements, 4) Support for Nonhousehold Members, 5) Functional Limitations and Disabilities-Adults, 6) Utilization of Health Care Services-Adults, 7) Functional Limitations and Disabilities-Children, 8) Utilization of Health Care Services-Children, and 9) Children's Well-Being. Wave 6 interviews will be conducted from October 1994 through January 1995.

Affected Public: Individuals or households.

Frequency: Once during the panel.

Respondent's Obligation: Voluntary.
OMB Desk Officer: Maria Gonzalez, (202) 395-7313.

Copies of the above information collection proposal can be obtained by calling or writing Edward Michals, DOC Forms Clearance Officer, (202) 482-3271, Department of Commerce, room 5312, 14th and Constitution Avenue, NW, Washington, DC 20230.

Written comments and recommendations for the proposed information collection should be sent to Maria Gonzalez, OMB Desk Officer, room 3208, New Executive Office Building, Washington, DC 20503.

Dated: April 7, 1994.

Edward Michals,
 Departmental Forms Clearance Officer, Office of Management and Organization.
 [FR Doc. 94-8773 Filed 4-11-94; 8:45 am]
 BILLING CODE 3510-07-F

DATES: Comments must be received by May 12, 1994.

ADDRESSES: Written comments (ten copies) should be sent to Brad Botwin, Director, Strategic Analysis Division, Office of Industrial Resource Administration, Department of Commerce, room 3878, U.S. Department of Commerce, 14th Street and Pennsylvania Avenue NW., Washington, DC 20230.

FOR FURTHER INFORMATION CONTACT: Bernie Kritzer, Senior Policy Advisor, Office of Foreign Availability, Telephone: (202) 482-5305.

Karen Swasey, Section 232 Program Manager, Strategic Analysis Division, Office of Industrial Resource Administration, Telephone: (202) 482-3795.

SUPPLEMENTARY INFORMATION:

Background

In a petition submitted by the Independent Petroleum Association of America, on March 11, 1994, the Department of Commerce was requested to initiate an investigation under section 232 of the Trade Expansion Act of 1962, as amended (19 U.S.C. 1862), to determine the effects on the national security of imports of crude oil and petroleum products.

On April 5, 1994, the Department of Commerce formally accepted the application and initiated an investigation. The findings and recommendations of the investigation are to be reported by the Secretary of Commerce to the President no later than December 31, 1994 (i.e., within 270 days).

The items to be investigated have distinct Harmonized Tariff System (HTS) tariff classification numbers. They include the following HTS numbers and earlier TSUS numbers:

Bureau of Export Administration

Initiation of National Security Investigation of Imports of Crude Oil and Petroleum Products

AGENCY: Bureau of Export Administration, Commerce.

ACTION: Notice of initiation of national security investigation and request for public comments.

SUMMARY: This notice is to advise the public that an investigation is being initiated under section 232 of the Trade Expansion Act of 1962, as amended (19 U.S.C. 1862), to determine the effects on the national security of imports of crude oil and petroleum products. Interested parties are invited to submit written comments, opinions, data, information, or advice relative to the investigation to the Strategic Analysis Division, Office of Industrial Resource Administration, U.S. Department of Commerce.

| Name | TSUS | HTS |
|---|--------|------------|
| Crude oil, under 25 degrees API | 475.05 | 27100005-0 |
| Crude oil, 25 degrees API or more | 475.10 | 27100010-0 |
| Motor fuel, including gas, leaded and unleaded; naphtha-type jet fuel and kerosene-type jet fuel | 475.25 | 27100015-0 |
| Kerosene derived from petroleum, shale oil, or both, except motor fuel | 475.30 | 27100020-0 |
| Naphthas derived from petroleum, shale oil, natural gas, or combinations thereof, except motor oil | 475.35 | 27100025-0 |
| | | 36061000-1 |
| Mineral oil of medicinal grade derived from petroleum, shale oil, or both | 475.40 | 27100045-2 |
| Lubricating oils and greases, derived from petroleum, shale oil, or both, with or without additives | 475.45 | 27100030-0 |
| | | 34031110-3 |
| | | 34031150-3 |
| | | 34031910-0 |
| | 475.55 | 34031110-3 |
| | | 34031150-3 |
| | | 34031950-1 |
| | 475.60 | 27100040-0 |
| | | 34031110-3 |
| | | 34031150-3 |
| | | 34031950-1 |

| Name | TSUS | HTS |
|--|------------------|--|
| Mixtures of hydrocarbons not specially provided for, derived wholly from petroleum, shale oil, natural gas, or combinations thereof, which contain by weight not over 50% of any single hydrocarbon compound | 475.65 475.70 | 27100045-2 27121000-0 27132000-0 27139000-0 |
| Paraffin and other petroleum waxes | 494.22 | 27122000-0 27129020-0 34049050-0 |
| Petroleum coke | 517.5120 | 27040000-2 27131200-0 |
| Asphaltum, bitumen, & limestone-rock asphalt | 517.11 | 38011050-0 |

This investigation is being undertaken in accordance with Part 705 of the National Security Industrial Base Regulations (15 CFR parts 700 to 709) (the "regulations"). Interested parties are invited to submit written comments, opinions, data, information, or advice relevant to this investigation to the Office of Industrial Resource Administration, U.S. Department of Commerce, no later than May 12, 1994.

The Department is particularly interested in comments and information directed to the criteria listed in § 705.4 of the regulations as they affect national security, including the following:

(a) Quantity of the circumstances related to the importation of the articles subject to the investigation;

(b) Domestic production and productive capacity needed for these articles to meet projected national defense requirements;

(c) Existing and anticipated availability of human resources, products, raw materials, production equipment, and facilities to produce these items;

(d) Growth requirements of domestic industries to meet national defense requirements and/or requirements to assure such growth;

(e) The impact of foreign competition on the economic welfare of the domestic industry; and

(f) The displacement of any domestic products causing substantial unemployment, decrease in the revenues of government, loss of investment or specialized skills and productive capacity, or other serious effects.

All materials should be submitted with 10 copies. Public information will be made available at the Department of Commerce for public inspection and copying. Material that is national security classified information or business confidential information will be exempted from public disclosure as provided for by § 705.6 of the regulations (15 CFR 705.6). Anyone submitting business confidential information should clearly identify the business confidential portion of the

submission, file a statement justifying nondisclosure and referring to the specific legal authority claimed, and provide a non-confidential submission which can be placed in the public file. Communications from agencies of the United States Government will not be made available for public inspection.

The public record concerning this notice will be maintained in the Bureau of Export Administration's Records Inspection Facility, room 4525, U.S. Department of Commerce, 14th Street and Constitution Avenue, NW., Washington, DC 20230, telephone (202) 482-5653. The records in this facility may be inspected and copied in accordance with the regulations published in part 4 of title 15 of the Code of Federal Regulations (15 CFR 4.1 *et seq.*). Information about the inspection and copying of records at the facility may be obtained from Ms. Margaret Cornejo, the Bureau of Export Administration's Freedom of Information Officer, at the above address and telephone number.

Dated: April 8, 1994.
Sue E. Eckert,
Assistant Secretary for Export Administration.
 [FR Doc. 94-8627 Filed 4-11-94; 8:45 am]
BILLING CODE 3510-07-P

National Institute of Standards and Technology

[Docket No. 940386-4086]
FIN-0693-AB22

Proposed Revision of Federal Information Processing Standard (FIPS) 172, VHSIC Hardware Description Language (VHDL)

AGENCY: National Institute of Standards and Technology (NIST), Commerce.
ACTION: Notice; request for comments.

SUMMARY: This proposed revision of Federal Information Processing Standard (FIPS) 172, VHSIC Hardware Description Language (VHDL), will adopt the standard hardware

description language of the ANSI/IEEE 1076-1993, IEEE Standard VHDL Language Reference Manual. This proposed revision is for use by computing professionals involved in high level digital hardware specification, development and implementation.

Prior to submission of this proposed FIPS to the Secretary of Commerce for review and approval, it is essential to assure that consideration is given to the needs and views of manufacturers, the public, and state and local governments. The purpose of this notice is to solicit such views.

This proposed FIPS contains two sections: (1) An announcement section, which provides information concerning the applicability, implementation, and maintenance of the standard; and (2) a specifications section which deals with the technical requirements of the standard. Only the announcement section of the standard is provided in this notice. Interested parties may obtain copies of the technical specifications (ANSI/IEEE 1076-1993) from the IEEE Service Center, 445 Hoes Lane, P.O. Box 1331, Piscataway, NJ 08855-1331, telephone 1-800-678-4333.

DATES: Comments on this proposed FIPS must be received on or before July 11, 1994.

ADDRESSES: Written comments concerning the proposed FIPS should be sent to: Director, Computer Systems Laboratory, ATTN: Proposed FIPS 172-1, VHDL, Technology Building, room B-154, National Institute of Standards and Technology, Gaithersburg, MD 20899.

Written comments received in response to this notice will be made part of the public record and will be made available for inspection and copying in the Central Reference and Records Inspection Facility, room 6020, Herbert C. Hoover Building, 14th Street between Pennsylvania and Constitution Avenues, NW., Washington, DC 20230.

FOR FURTHER INFORMATION CONTACT: Dr. William H. Dashiell, National Institute of Standards and Technology.

COMMISSION ON CIVIL RIGHTS**Agenda and Notice of Public Meeting of the Oklahoma Advisory Committee**

Notice is hereby given, pursuant to the provisions of the rules and regulations of the U.S. Commission on Civil Rights, that the Oklahoma Advisory Committee to the Commission will hold a community forum on Wednesday, June 1, 1994, from 9 a.m. until 5 p.m. at the Clarion Hotel, 4345 North Lincoln Boulevard in Oklahoma City and Thursday, June 2, 1994, from 9 a.m. until 5 p.m. at the Doubletree Hotel at Warren Place, 6110 South Yale in Tulsa. The purpose of the community forum is to obtain information on selected education and employment issues in Oklahoma as they affect minorities, women, and persons with disabilities.

Persons desiring additional information, or planning a presentation to the Committee, should contact Melvin L. Jenkins, Director of the Central Regional Office, 816-426-5253 (TTY 816-426-5009). Hearing-impaired persons who will attend the meeting and require the services of a sign language interpreter should contact the Regional Office at least five (5) working days before the scheduled date of the meeting.

The meeting will be conducted pursuant to the provisions of the rules and regulations of the Commission.

Dated at Washington, DC, May 3, 1994.
Carol-Lee Hurley,
Chief, Regional Programs Coordination Unit.
[FR Doc. 94-11463 Filed 5-10-94; 8:45 am]
BILLING CODE 6330-01-P

DEPARTMENT OF COMMERCE**Bureau of Export Administration****Public Hearings on Section 232 National Security Investigation of Imports of Crude Oil and Petroleum Products**

AGENCY: Bureau of Export Administration, Commerce.

ACTION: Notice of public hearings.

SUMMARY: The Bureau of Export Administration (BXA) is holding public hearings on the investigation that the Department of Commerce initiated, on April 5, 1994, to determine the effects on the national security of imports of crude oil and refined petroleum products under section 232 of the Trade Expansion Act of 1962, as amended. This notice identifies the issues on which the Department is interested in

obtaining the public's views. It also sets forth the procedures for public participation in the hearings.

DATES: The hearings will be held in New York, New York, on Monday, June 6, 1994; in Dallas, Texas, on Monday, June 13, 1994; and in Santa Clara, California, on Thursday, June 16, 1994. Requests to speak are due by Monday, May 23, 1994. The hearing in New York will be held in the Ceremonial Courtroom of the U.S. Court of International Trade, One Federal Plaza. The hearing in Dallas will be held at the Joe C. Thompson Amphitheatre, Cityplace Center East, 2711 N. Haskill. The hearing in Santa Clara will be held at the City of Santa Clara Council Chambers, 1500 Wurburton Avenue.

ADDRESSES: Send requests to speak and written copies of the oral presentation to Steven C. Goldman, Deputy Director, Office of Industrial Resources Administration, room 3876, U.S. Department of Commerce, 14th Street and Pennsylvania Avenue, NW., Washington, DC 20237.

FOR FURTHER INFORMATION CONTACT: Bernard Kritzer, Senior Industry Analyst, Office of Foreign Availability, Telephone: (202) 432-0077.

SUPPLEMENTARY INFORMATION:**I. Background and Specific Comments Requested**

On March 11, 1994, the Independent Petroleum Association of America petitioned the Department of Commerce to initiate an investigation under section 232 of the Trade Expansion Act of 1962, as amended (19 U.S.C. 1862), to determine the effects on the national security of imports of crude oil and petroleum products.

On April 5, 1994, the Department of Commerce formally accepted the petition and initiated an investigation. The findings and recommendations of the investigation are to be reported by the Secretary of Commerce to the President no later than December 31, 1994 (i.e., within 270 days). For further details on this investigation, see the Federal Register of April 12, 1994 (59 FR 17335).

Consistent with the interest of the U.S. Department of Commerce in soliciting public comments on issues affecting U.S. industry and national security, the Bureau of Export Administration (BXA) is holding public hearings as part of the investigation. The presentations at the hearings will assist the Department in determining whether imports of crude oil and petroleum products constitute a threat to the national security and in formulating

remedies if such a threat is found to exist.

The Department is particularly interested in comments and information directed to the criteria listed in § 705.4 of the National Security Industrial Base Regulations (15 CFR parts 700 to 709) (the "regulations") as they affect national security, including the following:

(a) Quantity of the articles subject to the investigation and other circumstances related to the importation of such articles;

(b) Domestic production and productive capacity needed for these articles to meet projected national defense requirements;

(c) Existing and anticipated availability of human resources, products, raw materials, production equipment, facilities, and other supplies and services needed to produce these articles;

(d) Growth requirements of domestic industries needed to meet national defense requirements and the supplies and services (including investment, exploration and development) necessary to assure such growth;

(e) The impact of foreign competition on the economic welfare of the domestic industry;

(f) The displacement of any domestic products causing substantial unemployment, decrease in the revenues of government, loss of investment or specialized skills and productive capacity, or other serious effects; and

(g) Any other factors that are causing, or will cause, a weakening of our national economy.

II. Public Hearings and Comment Procedures

The public hearings are scheduled to be held in New York, New York on Monday, June 6, 1994; in Dallas, Texas, on Monday, June 13, 1994; and in Santa Clara, California, on Thursday, June 16, 1994. The hearings will commence at 8:30 a.m. and end at 5 p.m. The New York hearing will be held in the ceremonial courtroom of the U.S. Court of International Trade, One Federal Plaza. The Dallas hearing will be held at the Joe C. Thompson Amphitheatre, Cityplace Center East, 2711 N. Haskill. The Santa Clara hearing will be held at the City of Santa Clara Council Chambers, 1500 Wurburton Avenue.

A. Procedure for Requesting Participation

The Department encourages interested public participants to present their views orally at the hearings. Any person wishing to make an oral presentation at

the hearings must submit a written request to the Department of Commerce at the address indicated in the ADDRESS section of this notice. The request to participate in the hearings must be accompanied by 10 copies of a summary of the oral presentation. The written request and summary must be received by the Department no later than Monday, May 23, 1994. In addition, the request to speak should contain a daytime phone number where the person who will be making the oral presentation may be contacted before the hearing. Please note that the submission of comments for presentation at the public hearings is separate from the request for written comments contained in the April 12, 1994, Federal Register notice.

Since it may be necessary to limit the number of persons making presentations, the written request to participate in the public hearings should describe the individual's interest in the hearings and, where appropriate, explain why the individual is a proper representative of a group or class of persons that has such an interest. If all interested parties cannot be accommodated at the hearings, the summaries of the oral presentations will be used to allocate speaking time and to ensure that a full range of comments are heard.

Each person selected to make a presentation will be notified by the Department of Commerce no later than 5 p.m. on Thursday, May 26, 1994. The Department will arrange the presentation times for the speakers. Attendees will be seated on a first-come, first-served basis. On the day of the hearing, persons selected to be heard should bring 100 copies of the summary of their oral presentation to the hearing address indicated in the DATES section of this notice.

Copies of the requests to participate in the public hearings and the summaries of the oral presentations will be maintained at the Bureau of Export Administration's Freedom of Information Records Inspection Facility, room 4525, U.S. Department of Commerce, 14th Street and Pennsylvania Avenue, NW, Washington, DC 20230, telephone (202) 482-5653. The records in this facility may be inspected and copied in accordance with the regulations published in part 4 of title 15 of the Code of Federal Regulations (15 CFR 4.1 *et seq.*) Information about the inspection and copying of records at the facility may be obtained from Ms. Margaret Cornejo, the Bureau of Export Administration's Freedom of Information Officer, at the above address and telephone number.

between the hours of 8:30 a.m. and 4:30 p.m., Monday through Friday.

B. Conduct of the Hearing

The Department reserves the right to select the persons to be heard at the hearings, to schedule their respective presentations, and to establish the procedures governing the conduct of the hearing. Each speaker will be limited to 10 minutes, and comments must be directly related to the criteria listed in § 705.4 of the "regulations".

A Commerce official will be designated to preside at the hearings. Representatives from the Departments of Energy and Interior will also participate in the hearings. This will not be a judicial or evidentiary-type hearing. Only those conducting the hearing may ask questions, and there will be no cross-examination of persons presenting statements.

Any further procedural rules for the proper conduct of the hearing will be announced by the presiding officer.

Dated: May 6, 1994.

Sue E. Eckert,

Assistant Secretary for Export Administration.

[FR Doc. 94-11410 Filed 5-11-94; 3:08 pm]

BILLING CODE 3510-07-P

Foreign-Trade Zones Board

[Docket 79-91]

Foreign-Trade Zone 72, Indianapolis, IN; Withdrawal of Application for Subzone Status for Hurco Machine Tool Plant

Notice is hereby given of the withdrawal of the application submitted by the Indianapolis Airport Authority, grantee of FTZ 72, requesting special-purpose subzone status for the machine tool manufacturing facility of Hurco Companies, Inc. located in Indianapolis, Indiana. The application was filed on November 6, 1991 (56 FR 65040, 12/13/91).

The withdrawal is requested by the applicant because of changed circumstances, and the case has been closed without prejudice.

Dated: May 3, 1994

John J. Da Ponte, Jr.,
Executive Secretary.

[FR Doc. 94-11447 Filed 5-10-94; 8:45 am]

BILLING CODE 3510-08-P

[Docket 4-94]

Foreign-Trade Subzone 59A, Lincoln, NE; Request for Expanded Manufacturing Authority; Kawasaki Motors Manufacturing Corporation U.S.A. Plant (Utility Work Trucks); Extension of Public Comment Period

The comment period for the above case, requesting authority to manufacture utility work trucks under zone procedures within Subzone 59A (59 FR 2592, 1/18/94; 59 FR 14687, 3/29/94), is further extended to June 2, 1994, to allow interested parties additional time in which to comment on the proposal.

Comments in writing are invited during this period. Submissions should include 3 copies. Material submitted will be available at: Office of the Executive Secretary, Foreign-Trade Zones Board, U.S. Department of Commerce, room 3716, 14th and Pennsylvania Avenue NW., Washington, DC 20230.

Dated: May 3, 1994.

John J. Da Ponte, Jr.,
Executive Secretary.

[FR Doc. 94-11448 Filed 5-10-94; 8:45 am]

BILLING CODE 3510-08-P

International Trade Administration

Export Trade Certificate of Review

ACTION: Notice of application to amend certificate.

SUMMARY: The Office of Export Trading Company Affairs, International Trade Administration, Department of Commerce, has received an application to amend an Export Trade Certificate of Review. This notice summarizes the proposed amendment and requests comments relevant to whether an amended Certificate should be issued. **FOR FURTHER INFORMATION CONTACT:** W. Dawn Busby, Director, Office of Export Trading Company Affairs, International Trade Administration, (202) 482-5131. This is not a toll-free number.

SUPPLEMENTARY INFORMATION: Title III of the Export Trading Company Act of 1962 (15 U.S.C. 4001-21) authorizes the Secretary of Commerce to issue Export Trade Certificates of Review. A Certificate of Review protects the holder and the members identified in the Certificate from state and federal government antitrust actions and from private, treble damage antitrust actions for the export conduct specified in the Certificate and carried out in compliance with its terms and conditions. Section 302(b)(1) of the Act

APPENDIX B
SUMMARY OF PUBLIC COMMENTS

In response to the Department's request for comments as part of its investigation under Section 232 of the Trade Expansion Act of 1962, as amended (19 U.S.C. 1862), to determine the effects on the national security of imports of crude oil and petroleum products, the Department received 69 comments. Among those submitting comments were members of Congress, foreign government officials, state government officials, trade and professional associations (including those representing petroleum producers, refiners, distributors of refined petroleum products, or energy-intensive industries), energy consumer organizations, company executives, union officials, and individuals. This Appendix summarizes those comments.

Most commenters acknowledged the decline in U.S. oil production and our increased dependence on imported oil. They held varying opinions, however, on the causes for the decline of production and on the extent to which increased dependence on imports would adversely affect U.S. national security.

Some commenters who represented independent oil producers emphasized the role of inexpensive imported oil in the decline of U.S. oil production. They cited the large number of high-cost marginal wells that have been shut-in or abandoned and explained why the availability of low-cost foreign oil made it difficult for domestic producers to secure the necessary capital to explore for and to develop new reserves. They also stated that the decline in domestic production and exploration was destroying the infrastructure of the U.S. petroleum industry (e.g., related service industries) and that this, along with the failure to develop new reserves, would make it difficult to surge domestic production in the event of a significant and prolonged supply disruption.

Other commenters, who opposed import fees, import quotas, or any other restrictions on oil imports, argued that the decline in U.S. crude oil production was due largely to geological factors. They claimed that most low-cost domestic reserves have already been developed. Many of these commenters argued that import fees, quotas, or other restrictions would help domestic producers only at a steep cost to other sectors of the U.S. economy (e.g., energy-intensive industries, including the petrochemical industry). Most of those who opposed import restrictions, however, were not opposed to other kinds of assistance (e.g., tax incentives, opening additional areas to exploration, etc.).

PRESENTING COMMENTS:

| <u>NAME</u> | <u>BXA FOIA NO.</u> | <u>PAGE NO.</u> |
|--|---------------------|-----------------|
| Ackell, Mr. Joseph J. (Independent Fuel Terminal Operators Assoc.) | 232NY-10 | B-6 |
| Alcorn, Mr. George A. (Chairman, Independent Petroleum Assoc. of America) | 232TX-1 | B-6 |
| Bennett, Mr. John (Bennett Production Corporation) | 232TX-6 | B-7 |
| Biggs, Mr. Danny (President, Kansas Independent Oil & Gas Assoc.) | 232TX-4 | B-7 |
| Boyce, Mr. Albert G. (Managing General Partner, Tannehill Oil Co.) | 232CAL-7 | B-7 |
| Burks, Mr. Herchel (President, Local Union 4134, United Steelworkers of America) | 232TX-7 | B-8 |
| Burns, Mr. Timothy F. (Vice President, Federal Government Relations, Chemical Manufacturers Association) | OIL232-4 | B-8 |
| Caperton, The Honorable Gaston (Governor of West Virginia) | 232TX-27 | B-9 |
| Chenoweth, Mr. James W. (Director, of Corporate Affairs, Lone Star Steel Co.) | 232TX-29 | B-9 |
| Clark, Mr. Paul (President, Clark Operating, Inc.) | 232TX-8 | B-10 |
| Crippen, Mr. Dick (Exec. Dir., Conservation Committee of California Oil & Gas Producers) | 232CAL-5 | B-10 |
| Damron, Mr. R. David (Petrochemical Energy Group and the Coalition on Energy Taxes) | 232TX-3 | B-11 |
| Dunlop, Mr. Charles L. (Independent Refiners Coalition) | 232NY-2 | B-11 |
| Embassy of Venezuela | OIL232-5 | B-12 |
| Ernst, Mr. Paul (V.P., Johnson & Ernst Operating Co.) | 232TX-9 | B-12 |
| Fields, Congressman Jack (Texas) | 232TX-28 | B-13 |
| Fox III, Mr. David (Independent Oil & Gas Assoc. of W. VA) | 232NY-5 | B-13 |
| Garlick, Mr. David M. (Director, Oil and Gas Division, Railroad Commission of Texas) | 232TX-25 | B-13 |
| Giglotti, Mr. Michael A. (Independent Oil & Gas Assoc. of PA) | 232NY-13 | B-14 |
| Ginnings, Mr. J.I. (Ginnings Co.) | 232TX-10 | B-14 |

| <u>NAME</u> | <u>BXA FOIA NO.</u> | <u>PAGE NO.</u> |
|---|---------------------|-----------------|
| Godown, Mr. Lee R. (Chief of Staff for Legislative Affairs, Congressman Bob Wise of West Virginia) | 232NY-15 | B-14 |
| Hall, Mr. James C. (President, Drilling and Production Co.) | 232CAL-3 | B-15 |
| Hanson, Ms. Christine (Exec. Dir., Interstate Oil & Gas Compact Commission) | 232TX-20 | B-15 |
| Hatch, Mr. Raymond L. (V.P., Corporate Development, Berry Petroleum Co.) | 232CAL-8 | B-16 |
| Henderson, Mr. Kenneth P. (Chief Deputy, Division of Oil, Gas, & Geothermal Resources, California Dept. of Conservation) | 232CAL-2 | B-17 |
| Hickel, The Honorable Walter J. (Governor of Alaska) | 232CAL-13 | B-17 |
| Huber, John J. (Government Relations Counsel, Petroleum Marketers Association of America) | OIL232-8 | B-18 |
| Hupp, Mr. Donald J. (President, North Texas Oil & Gas Assoc.) | 232TX-5 | B-18 |
| Hurt, Mr. Clint (Independent Oil & Gas Assoc. of W. VA) | 232NY-6 | B-19 |
| Independent Fuel Terminal Operators Association | OIL232-2 | B-19 |
| Independent Refiners Coalition | OIL232-6 | B-19 |
| Junco, Mr. Gary J. (President, Enserch Exploration, Inc.) | 232TX-21 | B-20 |
| Kirk, Mr. Ronald (Secretary of State, Texas) | 232TX-26 | B-20 |
| Kozlowski, Mr. Eugene C. (President, Nakoil, Inc.) | 232CAL-9 | B-21 |
| Kramer, Mr. Daniel P. (Exec. Dir., California Independent Petroleum Assoc.) | 232CAL-6 | B-21 |
| Lazenby, Ms. Virginia B. (National Stripper Well Assoc.) | 232NY-12 | B-22 |
| Lichtblau, Mr. John H. (Petroleum Industry Research Foundation, Inc.) | 232NY-3 | B-22 |
| Linn, Mr. Michael C. (Independent Oil & Gas Assoc. of NY) | 232NY-9 | B-23 |
| Martineau, Mr. David F. (Exploration Manager, the Pitts Energy Group, & V.P., North Texas Oil & Gas Assoc.) | 232TX-11 | B-23 |
| McCarley, Mr. Lon A. | OIL232-12 | B-24 |
| McDougall, Mr. Robert E. (President, Phoenix Production Co.) | 232CAL-4 | B-24 |

| <u>NAME</u> | <u>BXA FOIA NO.</u> | <u>PAGE NO.</u> |
|---|---------------------|-----------------|
| McFadden, Mr. Mike (Western Area Sales Mgr., Pride Petroleum Services, Inc.) | 232CAL-10 | B-24 |
| Metzler, Mr. Mark P. (Chief Admin. Officer, Felderhoff Bros. Drilling Co., Inc.) | 232TX-12 | B-25 |
| Mogan, Mr. James E. | OIL232-1 | B-25 |
| Nelson, Mr. R.D. (Manager, Planning and Pricing, Mobil Sales and Supply Corporation) | OIL232-11 | B-26 |
| New England Fuel Institute | OIL232-3 | B-26 |
| Petrochemical Energy Group and Coalition on Energy Taxes | OIL232-7 | B-27 |
| Polk, Mr. Jim M. (President, West Central Texas Oil & Gas Assoc.) | 232TX-22 | B-27 |
| Powers, Mr. Louis W. (President, Powers Petroleum Consultants) | 232TX-2 | B-28 |
| Ryall, Mr. Philip L. (President, Stockdale Oil & Gas, Inc.) | 232CAL-11 | B-28 |
| Schafer, The Honorable Ed (Governor of North Dakota) | 232CAL-12 | B-28 |
| Schwager, Mr. John L. (Independent Oil & Gas Assoc. of W. VA) | 232NY-4 | B-28 |
| Setzler, Mr. Bill (President, Trio Operating Co., Inc.) | 232TX-13 | B-29 |
| Shadle, Mr. Jack M. Jr. (Executive Director, Oklahoma Commission on Marginally Producing Oil & Gas Wells) | 232TX-15 | B-29 |
| Sheffield, Mr. Scott (Parker & Parsley Petroleum Co.) | 232NY-14 | B-29 |
| Society of Independent Gasoline Marketers of America | OIL232-10 | B-30 |
| Spannaus, Mr. Harry A. (Exec. V.P., Permian Basin Petroleum Assoc.) | 232TX-16 | B-30 |
| Spiller, Mr. J.A. (Texas Independent Producers & Royalty Owners Assoc.) | 232TX-18 | B-31 |
| Steffes, Mr. Dale W. (President, Planning & Forecasting Consultants) | 232TX-24 | B-31 |
| Sternfels, Mr. Urvan R. (President, National Petroleum Refiners Association) | OIL232-9 | B-31 |
| Talley, Mr. Jimmy L. (President, Talley & Assoc., P.C.) | 232TX-19 | B-32 |
| Thacker, Mr. W.M., Jr. (V.P., Texas Mid-Continent Oil & Gas Assoc.) | 232TX-14 | B-32 |
| Townsend, Mr. James (New England Fuel Institute) | 232NY-11 | B-33 |

| <u>NAME</u> | <u>BXA FOIA NO.</u> | <u>PAGE NO.</u> |
|---|---------------------|-----------------|
| Westfall, Mr. Gary (Independent Oil & Gas Assoc. of W. VA) | 232NY-7 | B-33 |
| White, Mr. Rex H. Jr. (President, Texas Independent Producers and Royalty Owners Association) | 232TX-17 | B-34 |
| Williams, Mr. Steven R. (Independent Oil & Gas Assoc. of W. VA) | 232NY-8 | B-34 |
| Willis, Mr. Roy W. (Independent Petroleum Association of America) | 232CAL-1 | B-35 |
| Willis, Mr. Roy W. (Independent Petroleum Association of America) | 232NY-1 | B-35 |
| Zecchi, Mr. Paul J. (President, Independent Petroleum Assoc. of Mountain States) | 232TX-23 | B-36 |

**COMMENTS RECEIVED AS PART OF NATIONAL
SECURITY INVESTIGATION OF IMPORTS OF CRUDE OIL
AND PETROLEUM PRODUCTS**

Mr. Joseph J. Ackell

Vice President

Independent Fuel Terminal Operators Association (IFTOA)

Comments dated May 23, 1994 (232NY-10):

The IFTOA strongly opposes oil import fees or duties, the mandatory adjustment of import levels, or any other "action that would artificially increase the price of petroleum products available for domestic consumption."

"Oil import restrictions, regardless of their form or structure, will increase the price of both foreign and domestic oil....U.S. businesses that are energy intensive will lose their competitive edge because foreign producers will not be subject to these fees." "...IFTOA supports fair, equitable measures to assist the domestic producing sector, such as production tax incentives and non-tax incentive programs."

Mr. George A. Alcorn

Chairman

Independent Petroleum Association of America

Comments dated June 13, 1994 (232TX-1):

"The primary reasons given in 1989 for finding that oil imports threaten to impair U.S. national security are still valid:

- Declining domestic production (down 1.3 MM/D between 1988 and 1993)
- Rising oil imports (up more than 1 MM/D between 1988 and 1993)
- Growing Free World dependence on potentially insecure sources of supply (U.S. reliance on OPEC sources increased between 1988 and 1993 from 47.6 percent to 51.1 percent of total oil imports. In 1993, the U.S. imported more barrels of oil from Arab OPEC and Persian Gulf suppliers than in 1988.)
- "Vulnerability to a major supply disruption" (The Office of Technology Assessment, in a study conducted 3 years ago, found that U.S. "oil replacement capability had eroded significantly".)

In developing a remedy, "we urge the Administration to look at all options." For example, a bipartisan group of Congressmen and Senators are discussing a production-based

tax credit. "To be useful to producers, however, these tax credits must be fully creditable against Alternative Minimum Tax. They have to be easily monetized, preferably refundable, if they are to be a substitute for the price levels needed to preserve existing production and to encourage new investment in drilling and expanded recovery technology."

Mr. John E. Bennett
Vice President
Bennett Production Corporation

Comments dated June 13, 1994 (232TX-6):

"It is our hope that the Commerce Department will urge the Congress and the Administration to provide tax credits or other incentives to our industry..."

Mr. Danny Biggs
President
Kansas Independent Oil & Gas Association

Comments dated May 26, 1994 (232TX-4):

"Our infrastructure is in shambles. Rigs are being cannibalized or cut up for junk. The industry has lost thousands of employees since the last price collapse in December of 1993. Kansas oil production is the lowest since 1934." "...The major oil companies are pulling out of Kansas by shutting their headquarters, reducing employment, and selling their oil producing properties." "The oil refineries in Kansas are quickly disappearing...Kansas had 11 refineries operating during the 1960-1980 period when our nation did not encourage imports of crude oil and refined products. Now Kansas has four." "Another underlying negative impact on the oil and gas energy industry that remains behind is the dramatically increased number of unfunded but mandated environmental laws and restrictions imposed on the industry..."

Mr. Albert G. Boyce Jr.
Managing General Partner
Tannehill Oil Company

Comments dated June 8, 1994 (232CAL-7):

"The cost of obtaining and renewing permits and complying with laws and regulations is becoming a substantial economic burden." "...these costs are at the expense of drilling new or replacement wells, and hence, increased production and jobs...The most immediate impact for California oil prices would be to repeal the ban on the export of Alaska North

Slope (ANS) oil. This will give California producers a projected \$1.00 to \$2.50 price increase by eliminating the glut of this oil coming into our state...Tax incentives and credits would be useful in generating capital for development and operational improvements, but the fact remains this only works if there is taxable income. The alternative minimum tax could not be applicable to these incentives in order for them to be of benefit...Some type of 'floor price for California and domestic oil production' would give independents a basis upon which we could plan for the future, make investments and expenditures to increase production, hire people back, and create more business and jobs for affiliated supporting industries."

Mr. Herchel Burks

President

Local Union 4134, United Steelworkers of America

Lone Star, Texas

Comments dated June 10, 1994 (232TX-7):

"About ten years ago Lone Star had more than 6,500 employees. Now we're down to about 1,500...The only way to rebuild our workforce, in case of an emergency, would be to train them on the job. This could easily take years to regain the expertise we have already lost...If the domestic oil and gas industry continues to deteriorate, plants like Lone Star will cease to exist. The support infrastructure that the oil and gas industry cannot exist without is now disappearing."

Mr. Timothy F. Burns

Vice President

Federal Government Relations

Chemical Manufacturers Association

Comments dated May 12, 1994 (OIL232-4):

"An oil import fee, tax, or quota would not only raise the price of imported oil, but also that of domestic oil and natural gas as well. U.S. manufacturing costs would increase disproportionately to those of foreign manufacturers with whom the U.S. competes in domestic and world markets. This situation would jeopardize sales and jobs as well as deepen the country's trade deficit. Energy-intensive industries would be hardest hit, including the chemical industry...The chemical industry would be negatively impacted by an oil import fee or related mechanism due to its unique reliance on oil and natural gas for both power and raw material uses, and therefore, strongly opposes such proposals...There are actions that the federal government can take that would benefit both the

domestic oil and natural gas industries and the country's economy. These actions include:

- Create policies which encourage diverse import options
- Expand the availability for exploration and development of those federal lands with the most promising potential for oil and gas
- Implement supply-enhancing proposals in the Department of Energy's Domestic Natural Gas and Oil Initiative."

The Honorable Gaston Caperton
Governor of West Virginia
Chairman, Interstate Oil & Gas Compact Commission

Comments dated June 13, 1994 (232TX-27):

An IOGCC study, entitled The Potential of Enhanced Oil Recovery in Oklahoma, that was published in 1987, concludes that "there is a great deal of oil remaining in the ground in simply the KNOWN reservoirs, and with proper price incentives that oil will be produced...The IOGCC has long been an advocate for increased use of technological recovery enhancements for oil and gas...Increased attention to technology transfer by both the states and the federal government will yield positive results in terms of petroleum resources recovered."

Mr. James W. Chenoweth
Director of Corporate Affairs
Lone Star Steel Company

Comments dated June 13, 1994 (232TX-29):

Supports the package of emergency measures to help domestic petroleum industry described in the IPAA Newsfax of March 28, 1994, including:

- Tax credit to preserve marginal production
- Tax credit to encourage new drilling
- Deductions of geological and geophysical costs
- Elimination of net income limitations on percentage depletion
- Abolishment of existing prohibitions against the export of oil (with provisions to protect the domestic merchant marine industry)
- Tax credit to encourage new production from the Outer Continental Shelf and frontier areas
- Reduce financial responsibility provisions of the Oil Pollution Act of 1990
- Reassess royalty laws and extend royalty reductions to marginal production and frontier areas
- Revise regulations on royalty collections so that natural gas production is not unfairly penalized

- Minimize additional burdens in regulations being considered by the Administration for underground injection control and natural resources damage assessment
- Persuade Interior Department not to change land management policies from multiple use to a new approach called "ecosystem management"

Mr. Paul Clark
President
Clark Operating, Inc.

Comments dated May 23, 1994 (232TX-8):

"The premature abandonment of stripper wells caused by the low oil price coupled with the pessimism in our industry today tell me that the level of imports is not going to do anything but increase unless something is done to see that the producer receives a viable price for his crude oil... Like most small companies, Clark Operating, Inc., cannot afford the big drilling budget needed to find new reserves by wildcatting. Instead, it buys properties that are no longer economical for the big companies to operate and attempts to obtain a profit through its lower overhead and direct cost containment. Recently, Clark Operating, Inc., has been unable to find such properties to purchase, because the larger companies have begun to plug wells as a result of low oil prices or potential environmental liability. Failure to acquire additional properties has caused the company's production and its income to decline significantly. Prolonged continuation of this pattern could eventually force Clark Operating, Inc., out of business.

Mr. Dick Crippen
Executive Director
Conservation Committee of California Oil & Gas Producers

Comments dated June 7, 1994 (232CAL-5):

"Even though posted prices are up from the low of December 1993 and January 1994, 19 percent of the State's production is still uneconomic...750 M/D becomes unprofitable on a cash basis at \$5 per barrel, and the break-even point of 100 percent profitable is in the \$14 to \$15 range."

Mr. R. David Damron

Manager, Government Affairs

Hoechst Celanese Corporation

(on behalf of The Petrochemical Energy Group and
the Coalition on Energy Taxes)

Comments dated May 23, 1994 (232TX-3):

"An oil import tax or fee operates to drive the price of both foreign and domestic oil above the world oil price. This directly affects the ability of domestic enterprises to compete with foreign sources, thereby reducing domestic jobs and the ability of domestic companies to compete in both the American marketplace and the world marketplace...The petrochemical industry's unique vulnerability to an oil import fee is derived from the fact its production costs reflect the cost of the oil and natural gas derivatives used as raw materials in the manufacture of the products, together with the cost of the fuel used in the manufacturing process...Unpleasant as it is to accept, the basic premise underlying the oil import fee or quota no longer is operative. A reduction in imports can no longer be completely offset by present deliverability from domestic production."

Mr. Charles L. Dunlop

President and Chief Operating Officer

Crown-Central Petroleum Corporation

(on behalf of the Independent Refiners Coalition)

Comments dated May 18, 1994 (232NY-2):

"...if any import fee is placed on imported crude oil or if any other remedial action is taken that increases the cost of crude oil, a proportionally higher fee must be placed on imported gasoline such that the existing tariff differential is preserved...Without corresponding action on imported gasoline, domestic refiners would be severely disadvantaged by action on imported crude oil which would raise the cost of refiners' raw material. Furthermore, without companion action on imported gasoline, the goal of a crude oil import fee could be thwarted by a shift of U.S. imports from crude oil to gasoline...Ample justification exists for a finding that imports of gasoline and blending stocks alone pose a threat to national security. According to recent reports, domestic refining capacity declined by 20 percent in the 1980s and is expected to decline by an additional 10 percent by the year 2000. These refinery shutdowns can be attributed to the high environmental compliance costs accruing to U.S. refiners and to the competitive advantage of lower cost gasoline accruing to foreign refiners based on the absence of similar compliance costs...The Secretary

should recommend that the President impose an import fee on gasoline and blending stocks amounting to the difference between U.S. and foreign environmental compliance costs, \$.07 cents per gallon and increasing \$.01 per gallon until it reaches \$.12 per gallon in the year 2000."

Embassy of Venezuela
Washington, DC

Comments dated May 12, 1994 (OIL232-5):

"Oil imports do not constitute a threat to U.S. energy security per se; rather, oil imports originating from reliable suppliers, particularly those in the Western Hemisphere, contribute to the energy security of the United States...Venezuela believes that development of the Orinoco Belt and other reservoirs in the Western Hemisphere will strengthen U.S. energy security in the long run...In terms of reliability, the expansion of supplies in the Western Hemisphere is tantamount to developing domestic supplies in the United States...Should proposals to limit oil imports be actively considered, they should contain an exemption for Western Hemisphere countries...Because almost 70 percent of Venezuelan crude oil and petroleum product exports are destined for the United States, any program that would limit oil imports, either by tax or by quota, would have a severe economic effect on Venezuela."

Mr. Paul Ernst
Vice President
Johnson & Ernst Operating Company

Comments dated May 23, 1994 (232TX-9):

"Because of the producing characteristics of the wells we have shut-in (high water cut, corrosion, and scale deposition tendencies), it is very improbable that we will return them to production without a stable oil price of around \$25.00/bbl...The erosion of oil prices has had a devastating effect upon our ability to replace our oil reserve base. In an eight year period prior to 1986, we drilled 293 wells. This exploration effort helped to maintain our reserve base. Since 1986, we have drilled only 18 wells. This lack of exploration is totally due to a lack of investment capital...A stable, I emphasize stable, oil price of \$20 to \$25 per barrel would be the best incentive to revive our domestic oil industry, particularly the stripper producing segment of our industry."

Congressman Jack Fields of Texas
2228 Rayburn House Office Building
Washington, DC 20515

Comments dated June 20, 1994:

"Congressman Fields introduced legislation in the 103rd Congress that would have allowed the President to lease certain Outer Continental Shelf (OCS) areas, provided that a number of stringent conditions were met:

- The Energy Information Agency determines that the level of crude oil imports exceeds 50 percent for more than four consecutive months
- The only areas to be leased would be those OCS planning areas that have undergone sufficient environmental review to fully comply with the National Environmental Policy Act
- The Minerals Management Service certifies that the proposed planning area has significant quantities of oil or gas resources."

"While much has been written about OCS leasing and development, there is no evidence that OCS leasing is a danger to our environment. In fact, the OCS program is our nation's safest energy extraction program...According to the National Academy of Sciences, oil from tankers and other forms of transportation account for 45 percent of oil pollution in the sea, while oil from offshore production is less than two percent...At a minimum, the President should be given the authority to lease certain offshore areas when the level of imports reaches 50 percent."

Mr. David Fox III
Executive Vice President
McJunkin Appalachian Oil Field Supply Co., Inc.

Comments dated May 25, 1994 (232NY-5):

Mr. Fox discusses the massive reductions in revenues and workforce in the oil field service industry.

Mr. David M. Garlick
Director, Oil and Gas Division
Railroad Commission of Texas

Comments dated June 7, 1994 (232TX-25):

"We have determined that one of the most serious distortions caused by low world oil prices is the premature abandonment of producing oil fields...The Commission has also determined that low world oil prices have distorted the incentives to explore new fields...The Texas Railroad Commission

recommends that the Federal government provide income tax credits to encourage domestic production."

Mr. Michael A. Giglotti
President
Independent Oil and Gas Association of Pennsylvania

Comments dated May 20, 1994 (232NY-13):

"...single most important reason for the decline of the Pennsylvania petroleum industry is the price available at the wellhead for our oil and gas production. This price is directly affected by the market forces impacted by imported crude oil prices...In addition, ... more than 90 percent of the wells in Pennsylvania are stripper wells...These wells are especially sensitive to any changes in price paid for production. This is due to the level of costs necessary to operate the wells compared to any change in wellhead price..."

Mr. J.I. Ginnings
Ginnings Company

Comments dated May 23, 1994 (232TX-10):

"Increasing imports are necessitated by the precipitous decline in domestic production, which is the result of an indifferent National Government to the predatory pricing of oil exporting nations and the unfriendly business climate here in the United States, particularly in the area of Environmental Rule...The domestic oil industry has a good record of environmental performance, but environmental regulation must be based upon demonstrated need, scientific integrity, and positive cost/benefit results. The only possibility to both comply with environmental mandates and preserve our domestic oil production is an adequate and stable price for oil."

Mr. Lee R. Godown
Chief of Staff for Legislative Affairs,
Congressman Bob Wise, 2nd District, West Virginia
2434 Rayburn House Office Building
Washington, DC

Comments dated June 6, 1994 (232NY-15):

"Cheap foreign oil and gas have and continue to undercut the ability of" domestic oil and gas producers, and collateral businesses in the steel and supplier areas, "to attract the investors they need to create the capital pools to keep their businesses healthy...Our domestic oil and gas industry ... is hanging on by its fingernails. Soon, the ability to

attract capital, to have the collateral supplier industries in place, to keep up with technology, and to be able to react quickly to future energy crises will be gone. This is not an industry that we can resuscitate overnight should the emergency need arise."

Mr. James C. Hall
President
Drilling and Production Company

Comments dated June 8, 1994 (232CAL-3):

"...the lower valued crude oil and higher operating costs make the California petroleum industry vulnerable to any price fluctuation...The collapse in oil prices has had a dramatic effect on California production...Much of the damage that has been done to the industry is irreversible. Many of the solutions that are available can only provide greater longevity of existing fields."

Mr. Hall makes the following recommendations:

- Provide more favorable tax treatment for marginal well production such as that proposed by Senator David Boren, D-Oklahoma.
- Refrain from passing new legislation that would place an undue burden on the industry until a thorough review of the impact of such legislation can be conducted.
- Review existing local, state, and Federal regulations to identify those that are unnecessarily burdensome on the domestic petroleum industry.
- Remember that "there are regional differences that require specific solutions".
- Require Energy Impact Reports, as proposed by former Congressman Dannemeyer, to ensure that, when changes in land use ordinances and the imposition of fees and regulations are contemplated, "the need for a strong domestic oil and gas industry and the importance of crude oil supply for national security is considered."
- "Industry and government cost sharing programs such as the newly created Petroleum Technology Transfer Council (PTTC) can accelerate the time it takes to implement new and available technology below the current ten to fifteen years."

Ms. Christine Hanson
Executive Director
Interstate Oil and Gas Compact Commission

Comments dated May 20, 1994 (232TX-20):

" Marginal production has dropped steadily from the 1984 high of 463 million barrels to 368 million barrels in

1992...The IOGCC National Stripper Well Survey shows "an average annual abandonment of 16,326 wells per year over the last decade...The factors which have forced many of these small wells to be idled or sealed are still at work -- low world oil price and high operating costs."

Ms. Hansen enclosed a copy of the December 1993, IOGCC resolution that identified various measures to encourage domestic production:

- Act to "relieve domestic crude oil producers of excessive and regressive taxes and regulations"
- Enact energy tax initiatives, credits and deductions to "reward and stimulate private investment in increased exploration, drilling and production of domestic crude oil, including but not limited to:
 - a) full deductibility for federal income tax purposes of actual exploration drilling and completion costs; and
 - b) income tax credit for all crude oil produced from new field discovery wells, and enhanced recovery projects.
- Exercise restraint in "instituting new regulatory initiatives that restrict and penalize and which charge the cost thereof to the domestic oil produced".
- Adopt any of the following measures to stimulate new domestic exploration, drilling, and production and to prevent premature abandonment of existing stripper wells:
 - a) A federal import tariff or transportation tax on all non-North American crude oil and refined petroleum products to be activated only when the price of crude oil falls below the minimum fair price and reflecting only the price differential between domestic and non-North American crude.
 - b) A federal tax credit or transferable voucher payable to producers of domestic crude oil of sufficient size to ensure that domestic producers receive an amount equal to the differential between imported and domestic crude oil to ensure the greatest benefit to the energy consumer."

Mr. Raymond L. Hatch
Vice President, Corporate Development
Berry Petroleum Company

Comments dated June 9, 1994 (232CAL-8):

"As a result of the Alaskan North Slope export ban, artificially low prices exist for crude oil in California. A study by Professor Martin Carnoy of Stanford University in December 1993 shows that lifting the ban on the export of Alaskan North Slope Crude could add as much as \$2.50 to the

price of crude oil in Alaska and California." In addition, Dr. Carnoy estimates production increases of 300,000 BOPD in Alaska, when foreign markets are opened, and an increase of 100,000-200,000 BOPD of heavy oil in California...Lifting the ban on the export of ANS and the resulting increase in crude price may result in a somewhat lower refinery margin but will not result in an increase in gasoline price to the California consumer."

Mr. Hatch also commented on the significantly higher cost of doing business in California because of regulatory requirements.

Mr. Kenneth P. Henderson

Chief Deputy, Division of Oil, Gas, & Geothermal Resources
California Department of Conservation

Comments dated June 8, 1994 (232CAL-2):

Mr. Henderson blames the long-term decline in California crude oil production on "the drop in the price of crude oil" and on the costs of producing crude oil in California, including the extra costs of producing heavy crude and regulatory compliance costs.

The Honorable Walter J. Hickel
Governor of Alaska

Comments dated June 15, 1994 (232CAL-13):

Governor Hickel urges that the export ban on Alaskan North Slope (ANS) crude oil be lifted: "An obvious and simple part of the remedy to the continued decline in national petroleum production is to lift the export ban on Alaska North Slope crude oil...To do so will enhance the nation's petroleum security because it will encourage development and production of domestic supplies in both Alaska and California." Governor Hickel also urges that oil exploration be permitted in certain parts of the Arctic National Wildlife Refuge (ANWR): "The State of Alaska would like to see the Coastal Plain of the Arctic National Wildlife Refuge developed in a responsible manner...The area of interest for development is small, given the size of the Coastal Plain, and Alaskans have proven that we can supervise resource development with environmentally high standards."

Mr. John J. Huber
Government Relations Counsel
Petroleum Marketers Association of America (PMAA)

Comments dated May 10, 1994 (OIL232-8):

The PMAA strongly opposes "the imposition of an oil import fee or other unequal assessment on imported crude oil and finished products. If such an assessment is levied, it will inevitably result in regional inequalities, competitive inequalities within the petroleum industry, hardships on persons using home heating oil, and increased friction with our trading partners...Rather than imposing import fees or other assessments on crude oil or finished products, we should provide drilling incentives, allow for the expensing of environmental costs, or provide credits for environmental compliance. We should also encourage our trading partners to adopt the environmental standards which American refiners and producers are expected to uphold."

Mr. Donald J. Hupp
President
North Texas Oil and Gas Association

Comments dated May 23, 1994 (232TX-5):

Stripper wells "make up the vast majority of North Texas wells, almost 90 percent...A flood of imported oil drove the price down to levels where many high-cost wells became uneconomical...As major oil companies have taken opportunities to explore for new reserves outside of the U.S., independent producers, their families, their employees, their businesses, and their communities remain at the heart of the domestic industry...They are the ones whose production has been lost and replaced by imported oil. They are the ones who, because of inadequate and unstable prices, have been forced to prematurely plug and abandon their wells and reserves--the true strategic reserves of the U.S. They are the ones who have been forced to take people's jobs away from them by the thousands. They are the ones who have come up empty handed when trying to secure capital to drill new wells. They are the ones with secondary recovery projects sitting on the shelf because the high cost of such recovery techniques cannot be justified with low unstable prices. They are the ones who struggle to survive daily under the burden of onerous regulatory and environmental costs...Texas recently implemented tax incentive programs that have encouraged the drilling of hundreds of new wells and the production of sizable quantities of oil and natural gas that can work on the national level."

Mr. Clint Hurt
President
Clint Hurt and Associates
(on behalf of the Independent Oil and
Gas Association of West Virginia)

Comments dated May 24, 1994 (232NY-6):

"As we depend more and more on imported oil, the infrastructure required for domestic production is rapidly being destroyed. Our industry has lost more than 400,000 skilled drilling jobs in the past decade and our drilling equipment is falling into disrepair or being sold to foreign owners."

Independent Fuel Terminal Operators Association (IFTOA)

Comments dated May 11, 1994 (OIL232-2):

"IFTOA does not oppose fair and equitable measures to restore the domestic producing sector. Members need strong domestic producers and refiners to provide a secure supply of product at a competitive price. However, IFTOA adamantly opposes an import fee or other similar measures, which may help the domestic producing industries but at the direct expense of marketers and consumers by forcing price increases and supply restrictions. If the Department's study indicates that measures must be taken to fortify the domestic sector, IFTOA encourages the Department to consider alternatives such as production tax incentives and non-tax incentive programs."

Independent Refiners Coalition (IRC)

Comments dated May 12, 1994 (OIL232-6):

The IRC urges the Department to take action, not only on crude oil imports, but on imported gasoline, as well: "Without corresponding action on imported gasoline, domestic refiners would be severely disadvantaged by action on imported crude oil which would raise the cost of refiners' raw material. Furthermore, without companion action on imported gasoline, the goal of a crude oil import fee could be thwarted by a shift of U.S. imports from crude oil to gasoline." Absent any determination with regard to imports of crude oil, the IRC would still support remedial action on imported gasoline (i.e., motor fuel and motor fuel blending stock). "In the U.S., refiners must comply with strict environmental laws, and the cost of such compliance is severely injuring the domestic industry because cheaper imports, not subject to such environmental compliance costs, have entered the U.S. market with the marginal barrel of

imported gasoline setting the market price. This situation creates a significant domestic competitive disadvantage because domestic refiners cannot recover their capital costs associated with environmental compliance...We propose that the President place an import fee on imported gasoline approximately equalling the embedded cost differential of environmental costs starting at \$.07 cents per gallon in 1994 and increasing \$.01 cent per year thereafter until it reaches \$.12 cents per gallon in 2000."

Mr. Gary J. Junco
President
Enserch Exploration, Inc.

Comments dated June 9, 1994 (232TX-21):

Mr. Junco urges the U.S. to impose an import fee on foreign crude oil. He considers this option to be preferable to a floor price for domestic crude oil, because a floor "would price domestic crude at the margin, insuring that it is the last barrel purchased." In lieu of an import fee or floor price, Mr. Junco suggests the following:

- Allow environmentally sound exploration of Federal lands, including the Arctic National Wildlife refuge and the Outer Continental Shelf.
- Eliminate tax disincentives.
- Adopt tax policies to encourage hydrocarbon exploration and to promote the use of natural gas as an alternative to imported oil.
- Adopt a comprehensive national energy policy that recognizes the important role the domestic energy industry plays in the U.S. economy."

Mr. Ronald Kirk
Secretary of State, Texas

Comments dated June 13, 1994 (232TX-26):

"We have allowed ourselves to become increasingly dependent on cheap foreign oil. Our national addiction has become so powerful that we have developed foreign and trade policies which actually undercut our own domestic oil industry and threaten our national security...We need a national energy policy."

Mr. Eugene C. Kozlowski
President
Makoil, Inc.

Comments dated June 8, 1994 (232CAL-9):

"Our company is a small independent oil company which is being forced to survive by forming a joint venture in the Republic of Georgia for the purpose of drilling and producing crude oil...The funds we will spend in the Republic of Georgia are funds that would normally have been spent in the United States ...The United States has no shortage of crude oil reserves. The finding of these reserves, however, are being stifled by excessive taxation, instability in commodity pricing, excessive environmental controls, government agency harassment, and a long standing impression that the oil industry is basically 'bad'...If a quota system was initiated in which the U.S. would not import more than 50 percent of its crude and product requirements, the price of domestic crude would increase and more drilling and exploration would be promoted."

Mr. Daniel P. Kramer
Executive Director
California Independent Petroleum Association

Comments dated June 7, 1994 (232CAL-6):

"Of the approximately 42,000 producing wells in California, about half are classified as stripper wells. Generally, these wells have high operating costs per barrel of production. This fact, along with the high energy costs associated with producing heavy oil, results in much higher operating costs for California production when compared with other producing regions in the United States...With 38 separate government agencies to report to, and 150 specific regulations to adhere to, it is a testament to the remaining producers' business acumen, environmental consciousness and, unfortunately, just plain luck that they are still in the arena. Couple these costs with an historical 40 percent to 60 percent price differential between the California benchmark crude oil Kern River/Midway-Sunset and U.S. benchmark West Texas Intermediate and you have a recipe for economic disaster...When the price for heavy oil in the early '80's was in the mid and low \$20 range, many California reserves could be economically developed. Now, with the extreme price fluctuations between \$8 and \$15, many companies are having significant difficulty making an adequate return on investment."

Ms. Virginia B. Lazenby
President
National Stripper Well Association

Comments dated June 6, 1994 (232NY-12):

"Nearly 78 percent of the nation's oil wells are stripper wells, with an average production per well in 1991 of 2.2 barrels per day. Most of these wells are now uneconomic, operating at a loss. These marginal wells, defined in the tax code as those wells that daily produce less than 15 barrels of oil (or the natural gas equivalent) or which produce heavy oil. are essential to our domestic energy supply. They provide approximately 20 percent of domestic oil production in the lower 48 states...Price is everything. The NSWA firmly believes that oil imports need to be adjusted directly through a floor price and import fee on oil. Indirect methods of adjusting imports, for instance, increasing domestic production through tax incentives, can only be useful if they are designed to get operating capital into the hands of stripper well producers when prices fall below a certain level. The primary goal should be to maintain our vital existing marginal production as well as to encourage new drilling. In addition, to assist marginal production, the National Stripper Well Association has recommended that the Department of Energy establish an emergency program to purchase stripper well production for the strategic petroleum reserve."

Mr. John H. Lichtblau
Chairman and C.E.O.
Petroleum Industry Research Foundation, Inc.

Comments dated May 23, 1994 (232NY-3):

"Any measure imposed to achieve a significant reduction in oil imports from their current or projected level under existing market conditions would raise the price of oil to the point where it would cause measurable damage to the U.S. economy...the decline in U.S. production since 1985 is clearly due, at least directionally, to a structural geological reality, given the present state of technology...Our current import dependency of 43 percent is quite low relative to that of most other industrial and industrializing nations...The risk of Middle East oil becoming a pawn in the East-West contest has, of course, ended with the Cold War...Future disruptions, if any, will come mainly out of local conflicts. They could still be large, but they will be limited in scope and duration...From an historical perspective these occasional future disruptions may not appear significant. But at the time of their occurrence, their impact on major importers such as

the U.S. could be severe. Thus, the ability to offset the temporary loss of imports, not only for domestic economic reasons, but even more to give the freedom to act during such a disruption, may be in the national interest. Our Strategic Petroleum Reserve (SPR) program has been created for precisely this purpose...The right policy at the present time would be to fill our SPR as rapidly as possible, while world oil prices are relatively low, to the 750 million barrel level for which the capacity and infrastructure are already in place...Acceptance of the argument that oil imports do not present a threat to U.S national security does not mean that the government should be unconcerned with the domestic oil producing industry. A proactive policy to stimulate additional oil and gas drilling through tax incentives and royalty waivers for specifically defined new wells, as well as removal of existing federal and state offshore acreage restrictions, could be viewed as being in the national interest, not because of its potential impact on oil imports but because of its significant real economic impact on a core regional industry."

Mr. Michael C. Linn
Director
Independent Oil & Gas Association of New York

Comments dated May 25, 1994 (232NY-9):

"Because of low gas and oil prices, and their volatility, activity in terms of new wells drilled and completed has declined dramatically...When domestic producers are trying to finance future drilling, it is through raising capital from investors or from bank or bank-like institutions. Volatility in oil prices...curtails most lending or investment. As a result, fewer and fewer wells are drilled ... more reliance on foreign imported oil...can lead to catastrophic results such as the destruction of infrastructure and shutting in marginal or stripper wells, thereby losing reserves from wells that had been producing."

Mr. David F. Martineau
Vice President
North Texas Oil and Gas Association
Exploration Manager
Pitts Energy Group

Comments dated June 13, 1994 (232TX-11):

"By depending too heavily on foreign oil supplies, we are once more vulnerable to foreign policy and economic blackmail, or to an eruption of hostilities in the Middle East...The break-even clearing price for oil today is \$22.00 per barrel. Middle Eastern producers know it, and the

cartel price of oil will continue to be set by them. There are those who talk of the 'oil commodity price,' but to treat the price of oil as anything but a cartel-controlled price is a lie and a stab in the heart to our national security...Price stability and elimination of tax disincentives for oil are two important ingredients required for the U.S. to improve national security."

Mr. Lon A. McCarley

Comments dated May 10, 1994 (OIL232-12):

Mr. McCarley cites regulatory costs, environmental costs, and higher costs of production as hurting domestic oil and gas producers, making it difficult for them to compete with low-priced imported oil.

Mr. Robert E. McDougall
President
Phoenix Production Company

Comments dated May 26, 1994 (232CAL-4):

"Most of our Company's production, and approximately 75 percent of Wyoming's oil production, is low- to mid-gravity sour crude. As a result, our actual wellhead prices are substantially less than the West Texas Intermediate Benchmark Crude prices...Imports from Canada have a further impact on our price problems...During 1993, the Canadian oil and gas industry had high activity and increased oil and gas production as a result of Canadian Government-sponsored royalty holidays and sliding scale wellhead royalties. These subsidies allowed Canadian producers to sell oil in the Billings market at an approximate \$1.50 per barrel advantage over Wyoming producers...During the past ten years, Canadian oil imports into the United States have increased from approximately 200,000 barrels per day to nearly 1,000,000 barrels per day. Wyoming and Montana independent producers call for...quota or tariff relief on Canadian subsidized oil imports."

Mr. Mike McFadden
Western Area Sales Manager
Pride Petroleum Services, Inc.

Comments dated June 16, 1994 (232CAL-10):

Mr. McFadden cites a number of statistics to demonstrate the current plight of independent oil producers in California:
"Since 1985, over 61 drilling and well servicing rig companies have gone out of business, either going bankrupt or selling out. Due to the decline of the oil industry,

there are now only 390 production rigs working in the state, compared to almost 600 in 1991. Likewise, the current drilling rig count in California is 35 rigs working, compared to 150 at the height of the industry...The total number of jobs lost in the California oil industry is approximately 31,000...The artificially low price of California crude, due to the ANS export ban coupled with ever-increasing environmental regulations, has caused the premature plugging of thousands of wells. The number of producing wells has declined by 23 percent over the last few years."

Mr. Mark P. Metzler

Chief Administrative Officer

Felderhoff Brothers Drilling Company, Inc.

Comments dated June 13, 1994 (232TX-12):

"As an exploration and production company, the oil price instability of the past nine years has caused us to reduce our exploration budget from over \$2,000,000.00 annually to less than \$500,000.00. The low oil price has caused abandonment of dozens of our stripper wells and has stopped the implementation of secondary recovery projects capable of producing hundreds of thousands of barrels of oil...The reduction of exploration activity which has resulted from price instability is causing major changes that cannot be easily reversed. This diminished state of the service infrastructure threatens our country's ability to increase domestic exploration and production...With continued price instability clouding business prospects, small service companies must rely solely on internally generated working capital as bank financing is difficult to obtain...Price stability coupled with restoration of tax incentives encouraging domestic exploration will put the U.S. industry in a position to attract capital from private sources and maintain the service and production infrastructure necessary to secure our country's energy needs."

Mr. James E. Mogan

Comments dated April 24, 1994 (OIL232-1):

Mr. Mogan expressed his opposition to initiating a national security investigation of imports of crude oil and refined petroleum products.

Mr. R.D. Nelson
Manager, Planning and Pricing
Mobil Sales and Supply Corporation

Comments dated May 17, 1994 (OIL232-11):

"The U.S. reserve base has matured and since 1985 and domestic production has steadily declined. This decline is inevitable, but could be delayed if the domestic industry were allowed to explore and develop the country's most promising prospects, such as in the Arctic National Wildlife Reserve (ANWR) or on the Outer Continental Shelf...The decline in production could also be slowed if there were rewards for industry to explore in less prospective areas or to continue production from marginal wells...We believe any attempt by government to intervene in the market through tariffs or fees on imported crude or petroleum products will be counterproductive and costly to the U.S. economy."

New England Fuel Institute (NEFI)

Comments dated May 11, 1994 (OIL232-3):

"NEFI is categorically opposed to any Federal response that would lead to import fees, duties or tariffs, mandatory adjustments of the level of petroleum imports, or any other initiatives that will increase the price of petroleum products for U.S. consumers..Oil import fees will increase the prices of foreign and domestic oil in the United States above the world oil price. Consumers will suffer higher energy bills. Furthermore, energy-reliant industries will need to absorb these higher costs...Oil import fees "also place a disproportionate burden on certain regions of the country. The Northeast...will be hard hit by an import fee because it must endure increased energy costs yet not benefit as a domestic producing state...The United States' use of foreign oil imports does not make the nation vulnerable to threats of supply interruption...Today, the vast majority of this nation's oil imports are supplied by secure and friendly sources, such as Mexico, Canada, the United Kingdom, Venezuela, Nigeria and Indonesia...NEFI does not object to measures to restore the domestic producing sector...NEFI is not opposed to tax code measures that, for example, allow for full deductions for actual costs. And, NEFI supports several non-tax incentives."

Petrochemical Energy Group (PEG)
(Brian Ferguson)
Coalition on Energy Taxes (COET)
(Pete Sipple)

Comments dated May 12, 1994 (OIL232-7):

"The petrochemical industry is one of the industries that is vulnerable to increases in oil prices. When the price of oil goes up, so does the price of the basic raw materials that are derived from oil and natural gas, and are used in the production of all petrochemicals...Production costs would be increased for U.S. petrochemical companies but not for foreign petrochemical producers. The foreign suppliers would be given a significant competitive advantage over U.S. companies...Without a significant increase in access to potential reserves in this country for the purposes of exploration and production, imports are bound to increase in volume, and the question is not whether, but from where, the imports come...The problem involving exploration and production of new oil reserves is not going to be solved or even addressed by a tariff on imported oil or any indirect subsidy to some or all domestic oil production and refining. What is needed is access to promising new sources of domestic supply for the purpose of exploration and production...The Department's investigation should include a thorough review of a number of alternatives to expand our security, such as those discussed in the DOE Domestic Natural Gas and Oil Initiative, other than merely pushing up oil prices through a price support program."

Mr. Jim M. Polk
President
West Central Texas Oil & Gas Association

Comments dated May 26, 1994 (232TX-22):

"When oil dipped below \$14 a barrel on the WTI posted price, over 40 percent of the producing wells on my books became unprofitable...I cannot survive on oil prices below a posted price of \$15 a barrel."

Mr. Louis W. Powers
President
Powers Petroleum Consultants, Inc.

Comments dated June 13, 1994 (232TX-2):

"Our total imports of crude and refined products are at 8.3 MMB/D in 1993, up nearly 73 percent since the low in 1983...Basically, since 1985 the Middle East price setters have orchestrated a low price for world oil in the \$13 to

\$20 per barrel range except when the security of our oil supplies was threatened by the Gulf War."

Mr. Philip L. Ryall
President
Stockdale Oil and Gas, Inc.

Comments dated June 8, 1994 (232CAL-11):

"The historically low oil price along with higher costs, especially environmental costs, has placed the upstream oil sector in a very weak position. We cannot create enough capital from our current cash flow to keep up with declining production by drilling replacement wells, let alone develop new reserves...In order to grow, we must have a higher oil price and some stability...To this end I am asking for a joint study by the Department of Commerce, Department of Energy and Industry as to how we can best save our domestic upstream industry."

The Honorable Ed Schafer
Governor of North Dakota

Comments dated June 13, 1994 (232CAL-12):

"In North Dakota today we have 2,200 people employed in the oil patch. That is a loss of 2,956 jobs in just a decade (total oil jobs in 1985 stood at 5,156) and a loss of 8,010 jobs since our high employment in that sector in 1981, when North Dakota had 10,210 jobs in the oil patch...The known remaining oil resource in the United States is large; about 350 billion barrels will remain trapped in reservoirs after conventional recovery operations end. Advanced technology recovery projects could double the amount of reserves currently estimated as producible...Too few people are being trained in" EOR (enhanced oil recovery) and ASR (advanced secondary recovery) techniques because of the current low demand for those skills."

Mr. John L. Schwager
President, Independent Oil & Gas Association of W. VA
President and C.E.O., Alamco, Inc.

Comments dated May 26, 1994 (232NY-4):

"The inability of our industry to attract capital or generate sufficient cash flow has caused the precipitous decline we have seen in domestic production levels and drilling activity...The three worst years for U.S. drilling activity since World War II have been the last 3 years...The price of oil is the culprit...Even if we wanted to raise our domestic oil production, we couldn't. The oil field service

industry is a shadow of its former self. If it weren't for their overseas operations, I wonder whether the major service companies would even exist to perform services for the domestic industry."

Mr. Bill Setzler
President
Trio Operating Company, Inc.

Comments dated May 23, 1994 (232TX-13):

"The most dramatic problem I believe we presently face is the non-replacement of our crude oil reserve base...Our drop in drilling activity...is the result of investor inability to believe that a decent rate of return on their investment is possible at this time because of the low and unstable price of crude oil...The decline in crude oil reserves "most certainly will affect the industry's ability to respond to any national security crisis which would require even a nominal increase in crude oil production."

Mr. Jack M. Shadle Jr.
Executive Director
Oklahoma Commission on Marginally Producing Oil & Gas Wells

Comments dated June 8, 1994 (232TX-15):

The Oklahoma Commission on Marginally Producing Oil and Gas Wells commissioned the University of Oklahoma's Center for Economic and Management Research (CEMR) to conduct a survey of Oklahoma oil producers and an economic analysis of the results. "According to Oklahoma Corporation Commission figures in 1993, there were 93,192 oil wells. The Survey determined that 69,823 were strippers...The average stripper well's break-even point is \$19.57 per barrel when pulling, remedial and workover-recompletion costs are included...32,000 stripper wells are now shut down...This 32,000 shut down category is 46 percent of the total stripper wells...It is 34 percent of the total oil wells...Price is why most of the 32,000 shut down wells are idle. They need \$20 oil, which allows an accumulation of capital to return wells to operation."

Mr. Scott Sheffield
Chief Executive Officer
Parker & Parsley Petroleum Company

Comments dated May 27, 1994 (232NY-14):

"Our domestic industry as a whole is in shambles and will continue to decline until action is taken to reduce our import levels through increased drilling activity and

preserving our marginal well industry...The economics to develop the properties have been largely unprofitable due to the continuing fluctuation of low oil and gas prices. This has resulted in a continuing decline in our rig count and U.S. production." Mr. Sheffield urges that imports be restricted to the 50 percent level and supports "any initiatives to preserve our marginal well industry, such as the Boren proposal."

The Society of Independent Gasoline Marketers of America (SIGMA)

Comments dated May 13, 1994 (OIL232-10):

"SIGMA opposes the IPAA petition. It urges the Department of Commerce to recommend against any presidential action that would place artificial limits on import levels...In recent years the United States has diversified its sources of supply, turning increasingly to secure, reliable sources of supply in the Western Hemisphere to satisfy its energy needs...The United States has developed a workable and effective mechanism for responding to any supply disruptions that may occur...The development of such programs as the Strategic Petroleum Reserve and the International Energy Agency Sharing Program have greatly improved the United States' ability to respond quickly to supply disruptions and other crises...Imports of petroleum products are not the cause of the higher costs facing the domestic refining industry today. The government has imposed environmental costs on the domestic refining industry, but, to date, such costs have not rendered the industry uncompetitive...The government could offer beneficial tax treatment for investments incurred by domestic refiners to comply with environmental regulations and could improve the industry's access to capital through the elimination of the 'lender liability' requirements...and perhaps through the institution of Federal loan guarantees for domestic refiners."

Mr. Harry A. Spannaus
Executive Vice President
Permian Basin Petroleum Association

Comments dated May 26, 1994 (232TX-16):

"The primary reason why the Permian Basin Drilling Rig count has decreased from over 500 rigs working in 1982 to just 114 rigs working as of last Friday, June 10, 1994, a 43 percent decrease in drilling rig availability since 1982, is because of price and price alone...To believe that the domestic crude oil explorer and producer can continue to serve the energy needs of this nation while not receiving a

fair price, tax incentives or even subsidies to encourage business is unrealistic."

Mr. J.A. Spiller

Texas Independent Producers & Royalty Owners Association

Comments dated May 26, 1994 (232TX-18):

"As a rule, I can barely break even operationally with oil prices at the \$14 level. To maintain my production through well workovers and other remedial measures, I need a \$14 to \$16 price. To put together drilling deals and drill wells for more reserves, I need prices ranging from \$18 to \$20 (depending on the prospect) in my area of operations...If I'm going to continue my contribution to the nation's domestic production, I must have economic stability. If that means a floor price system, an oil import tariff or a tax credit system tied to price, then I'm for it."

Mr. Dale W. Steffes

President

Planning and Forecasting Consultants

Comments dated May 23, 1994 (232TX-24):

Mr. Steffes recommends adopting a National Energy Security Policy (NESP) that would involve the creation of a type of import quota system, differing from the 1959 quota system in that benefits would be distributed to domestic producers, instead of domestic refiners, the right to import cheaper foreign crude oil would be earned proportionally by domestic energy producers. "While I do not agree with the other suggested forms of market intervention (tax relief, floor prices, or consumption taxes), they are much better than letting the United States become overly dependent on foreign oil supplies."

Sternfels, Mr. Urvan R.

President

National Petroleum Refiners Association (NPRA)

Comments dated May 12, 1994 (OIL232-9):

"NPRA supports government policies which enhance domestic energy production, petroleum refining capacity, and petrochemical manufacture, but which do not raise energy and feedstock costs...Those domestic industries heavily dependent on petroleum-based energy and feedstocks should not be disadvantaged relative to foreign competition...NPRA is opposed to crude oil import fees or taxes in any form. Such measures would encourage capital investment in refining and petrochemical facilities to be made outside the U.S."

with the result that the world market share of foreign producers would increase while U.S. market share declines."

Mr. Jimmy L. Talley
President
Talley & Associates, P.C.

Comments dated June 13, 1994 (232TX-19):

"In its recently released study, Federal Oil Research: A Strategy for Maximizing the Producibility of Known U.S. Oil, the Energy Department concludes that the wholesale abandonment of marginal wells may already have rendered economically inaccessible as much as 40 percent of the country's remaining oil resources...DOE contends that at \$16 per barrel, fully two-thirds of the domestic oil resource could be abandoned by 1995 and that within 15 years, the U.S. could have economic access to less than 25 percent of its remaining known oil reserves...The United States must decide whether a 50-percent import level will protect the country from a major disruption in the world marketplace. Then the country must decide on how big a domestic industry it needs...The policy we need to pursue in the United States is not to completely reduce our dependence on imports, but to maintain the industry as a viable entity to slow down our dependency and be there in case of an emergency."

Mr. Talley suggests a number of "alternative actions that should be considered" in order "to stimulate drilling activity":

- Reinstate tax credits for hard-to-produce reserves.
- Impose a fee on imported oil (both crude and refined).
- Permit immediate expensing of geological and geophysical costs.
- Establish a per barrel tax credit to encourage frontier exploration, and make changes in the tax laws to keep marginal wells producing.
- Establish a ceiling on oil imports.
- Other possible actions include import quotas, establishment of a floor price, restructuring of the depletion allowance, and tax credits for new wells drilled (20 percent) and for workover and/or secondary recovery wells (10 percent).

Mr. W.M. Thacker Jr.
Vice President
Texas Mid-Continent Oil & Gas Association

Comments dated June 13, 1994 (232TX-14):

"In the past, investors, both in and out of our industry, have been available on a reasonable basis when the price of

oil was \$20.00 or more, and there was some appearance of stability as to prices...As investors in this country, including the major oil and gas companies, expend substantial sums in exploration efforts in foreign countries such as Russia, it will continue to reduce the exploration efforts in this country and further reduce domestic reserves and cause increased imports...Most independent oil and gas operators would be considered small businesses; and such businesses, not only in our industry but throughout the country, are being devastated by unwise, unneeded, and unreasonable rules and regulations that do not produce economic results to the public."

Mr. James Townsend
New England Fuel Institute

Comments dated May 23, 1994 (232NY-11):

"Oil import fees designed to protect the domestic oil and gas industry would severely strain the U.S. economy...On a regional level, import fees will unfairly impact the northeast, where consumers are most oil-dependent for heat, power generation and process use...Import fees will cause an increase in manufacturing costs and impair the ability of U.S. companies to export manufactured products, an especially difficult problem for energy-intensive industries such as chemicals, agriculture, steel, wood and paper products, mining and plastics...U.S. oil imports do not make the nation vulnerable...Today, the stability and diversity of U.S. suppliers, including Canada, the United Kingdom, Mexico, Venezuela and Nigeria, provide many reliable sources of product without any threat of interruption. Moreover, our experience of the 1970s and '80s tell us that oil cannot be effectively denied to the U.S. for political purposes; the world market is far too complex and interdependent...NEFI does not object to measures designed to improve opportunities for domestic producers...NEFI would support tax code incentives, for example, as well as the opening of frontier areas to production, such as the ANWR and the OCS."

Mr. Gary Westfall
Sales Manager
Dowell Schlumberger

Comments dated May 26, 1994 (232NY-7):

Mr. Westfall cites the lack of stability in oil prices over the past decade as the major reason for the current state of the domestic oil industry.

Mr. Rex H. White Jr.
President
Texas Independent Producers and Royalty Owner Association

Comments dated May 23, 1994 (232TX-17):

"Price instability...is contributing to dismemberment of the basic infrastructure of the U.S. independent petroleum producing industry...Once the domestic producing industry loses the ability to find capital, knowledgeable personnel, and equipment to explore for and produce domestic reserves, this infrastructure cannot be easily or quickly regained, leaving the nation vulnerable to the policies of foreign importers." Mr. White suggests a number of "options that could be taken to alleviate some of the burden on domestic producers and to allow them to compete with foreign sources of energy":

- Require importers of foreign crude oil to donate a certain portion of their imports to the Strategic Petroleum Reserve.
- Place a \$.07 per gallon environmental fee on imported gasoline to help offset environmental costs incurred by domestic refiners.
- Create tax incentives to encourage exploration for new reserves or the reactivation of old wells.
- Eliminate the \$.05 cent per barrel Federal excise tax on-shore domestic production.
- Take action to stabilize oil prices (e.g., oil import fee).

Mr. Steven R. Williams
President
Petroleum Development Corporation

Comments dated May 26, 1994 (232NY-8):

"Our ability to attract investment capital is directly related to our ability to generate attractive financial returns for potential investors. Even though our programs have focused on natural gas development for environmental and other reasons, it is clear that bargain basement oil imports have had an adverse impact on the performance of our drilling programs, and threaten our future ability to attract additional risk capital for our development activities...Perhaps my greatest fear, given the low level of drilling activity, is that the service companies which we rely on to develop the reserves in our area will find it economically impossible to continue on with their operations. While we may squeak by operating wells on a shoestring, once they no longer find business viable, and shut down their operations, we will have no easy or economic

way to return to a reasonable level of activity when and if prices do recover."

Mr. Roy W. Willis

Vice President for Government Relations
Independent Petroleum Association of America

Comments dated June 16, 1994 (232CAL-1):

Mr. Willis disagreed with the argument that the problems facing the U.S. domestic oil producers are the result of geological factors that have nothing to do with government policies. He asserted that the U.S. still has a vast resource base in jackrabbit fields (i.e., fields with a limited amount of potential resources of only 2 million or 3 million recoverable barrels, instead of the normal 10 million to 20 million barrels of recoverable oil). Mr. Willis also challenged the argument that the risk of a major disruption in oil supplies has decreased in recent years because the U.S. has developed more diverse foreign sources of oil (e.g., Canada, Mexico, and the North Sea). He asserted that recent changes in production in these areas indicates that their production is likely to decline. Mr. Willis recommended that Commerce consider a remedy that "not only sustains current production, but also gives the industry the wherewithal to continue to search for and find new oil and natural gas and to sustain that very infrastructure (i.e., related service and supply industries) that we need in order to do it." Mr. Willis discussed the effectiveness of production-based tax credits as a remedy. He argued that, "to be useful to producers, particularly at times of low prices when producers are not likely to have taxable income...the tax credits then must become some way of substituting for cash flow. To do that, they have to be transferrable...They have to be easily monetarized so they can become a source of income with which producers can maintain existing production and continue to search for new oil and natural gas." He recommended that the tax credits be counted against the alternative minimum income tax.

Mr. Roy W. Willis

Vice President for Government Relations
Independent Petroleum Association of America

Comments dated May 12, 1994 (232NY-1):

"The primary reasons given in 1989 for finding a threatened impairment of U.S. national security are still valid, declining domestic production, rising oil imports, growing Free World dependence on potentially insecure sources of supply, vulnerability to a major supply disruption, and the need to maintain U.S. access to sufficient supplies of

petroleum essential to U.S. economic security, foreign policy flexibility, and defense preparedness...Since the 1970's, we have diversified suppliers of crude oil imports into the United States, but crude oil production already has or is expected to begin to decline in many of our non-OPEC suppliers within this decade." Mr. Willis, citing a 1991 report by the Office of Technology Assessment entitled U.S. Oil Import Vulnerability: The Technical Replacement Capability, argues that "the ability of our economy to adjust to oil import disruptions has actually become weaker over the last decade...Among the recommendations OTA made to reduce our nation's vulnerability to oil import disruptions was to preserve the domestic oil-producing industry..."Unfortunately, our weakened domestic oil industry cannot be regarded as a ready source of oil to deal with supply disruptions...After nearly a decade of relatively low prices, marked with increased price volatility, American crude oil production continues to decline, and current exploration efforts are not sufficient to slow the depletion of domestic reserves, much less expand them...The United States has just under 600,000 operating oil wells and a per-well production average of about 12 barrels per day. Of total oil wells, nearly 78 percent of them are so-called marginal wells, with an average production per well in 1991 of 2.2 barrels per day...If we are to maintain this production and, equally important, bring new reserves on line, the Clinton Administration and Congress must provide measures that improve the economics of investment in marginal wells and in new drilling...In our petition we did not specify a particular remedy...We, nonetheless, urge the Administration to look at all options, including import fees, indirect actions (e.g., tax incentives), and "some combination of direct and indirect action...For instance, small increases in existing fees on imported crude oil and refined petroleum products can be made without anti-competitive impacts and those revenues used to fund a wide array of domestic energy initiatives."

Mr. Paul J. Zecchi

President

Independent Petroleum Association of Mountain States (IPAMS)

Comments date June 11, 1994 (232TX-23):

"Rocky Mountain production has been dramatically affected by falling crude prices. From January 1993 to January 1994, monthly production has declined 2,392,324 barrels or 8.3 percent...At today's prices, many vital reserves are uneconomic; and there is no incentive to drill for new reserves...From 1988 to 1992, approximately 600 service companies left the state of Wyoming. This shows further the destruction of the industry's infrastructure in the Rocky

Mountain region...American refining capacity is expected to decline significantly in the next few years primarily because of the Clean Air Act (CAA)...Our industry stands a good chance of losing up to 2 million BPD of refining capacity between now and the end of the century due to the requirements of the CAA. Most of this loss will occur from the smaller refineries and could have a significant impact on the independent producer particularly in the Rocky Mountain and Mid-Continent areas..." IPAMS makes the following recommendations:

- Establish a floor price of \$20 per barrel for crude oil.
- Establish an import fee, or variable rate import fee on imported crude oil.
- Establish a limit on total imports of foreign crude oil at 50 percent of total consumption.
- Require all tankers delivering foreign crude oil to U.S. ports to be registered and operated as U.S. flagships for environmental and national security reasons.
- Allow tax deductions for geological and geophysical costs.
- Eliminate the percentage depletion limitation against net income.
- Establish a production tax credit against Alternative Minimum Tax that is applicable to all drilling costs.
- Require that the costs of implementing and complying with environmental regulations be considered before such regulations are put in place.
- Increase access to public lands for oil and gas development.
- Increase funding to the fluid mineral programs of the Bureau of Land Management and Minerals Management Service.
- Revise Federal oil and gas lease terms to permit leases to be shut-in for more than 60 days.
- Develop royalty incentives for Federal leases.

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March 11, 1999

The Honorable William M. Daley
Secretary of Commerce
14th Street and Constitution Ave. NW
Washington DC 20230

Dear Secretary Daley:

I request that you immediately undertake an investigation, under section 232 of the Trade Expansion Act of 1962, of the impact that imported oil is having on the domestic oil industry, as well as on the National Security of our country.

Currently, the domestic oil industry is enduring the longest sustained period of low prices since 1978. This is having a devastating impact on the domestic oil industry. While all oil companies have been affected by the low price of oil, those hurt the most are the domestic independent producers.

At the end of 1978, the United States imported 43% of the oil we consumed, whereas today we import about 55%. Additionally, in 1979 there were 52,204 new wells drilled, whereas in 1998 there were only 22,892 new wells drilled. Even this number underestimates the problem. Most of the drilling occurred in the early part of the year; December saw only 1,473 new wells drilled. In 1979, there were 2,177 rotary rigs in operation, whereas by the end of 1998 there were only 647, 71% less.

The rise in imported oil is most striking when compared to the decline in domestic production. In 1982 the United States produced 8.6 million barrels of crude oil per day. By 1998 this had dropped to 6.3 million barrels per day, a decline of more than 27%. But while domestic production has dropped over 2 million barrels per day, imports increased from 3.4 million barrels per day in 1982 to over 8.5 million barrels per day in 1998, an increase of 250% in just 17 years. Additionally, the low price of oil has had an impact on the available qualified workforce. In 1981, 1.9 million people worked in the domestic oil industry. By 1996 this number had been reduced to 1.4 million. If oil prices remain at current levels for much longer this number will decrease even more dramatically. Oil producing states estimate that nearly 11,000 jobs were lost in the oil and gas exploration and production sector in the first three quarters of 1998.

Currently, there are about 573,000 oil wells operating in the United States (excluding Alaska and offshore production). However, about 436,000 of these wells, or

76%, are marginally economic, called marginal wells. These marginal wells are the most at risk from the low price of oil. While marginal wells produce only 2.2 barrels per day on average, they account for about 25% of the total oil produced in the United States. Further, while marginal wells account for only 25% of total domestic oil production, marginal wells account for about 75% of the oil produced by the small independent oil companies.

For the first six months of 1998 an estimated 48,702 wells were idled or shut in, according to a recent survey of 23 oil producing states. As low prices continue, more and more marginal wells, that would be economical at \$14.00 per barrel, are being capped because oil has been averaging \$11.16 for too long to justify operating. Once an oil well is capped it can never be reopened and would most likely be uneconomical to re-drill. Thus, what was once a national asset is lost forever.

Many states and localities rely upon revenues raised from the domestic oil patch for their annual budget. In the first six months of 1998, Wyoming estimates low oil prices will cost \$100 million in lost revenue, Louisiana estimates the direct loss to their treasury at over \$98 million, and in Texas oil severance tax revenues fell \$94 million. In Oklahoma gross production tax collections were 57% lower than expected for the first six months of 1998. In addition to the losses suffered by the state treasuries from low prices, states must pay increased unemployment claims and retraining costs due to the related loss of jobs in the oil patch.

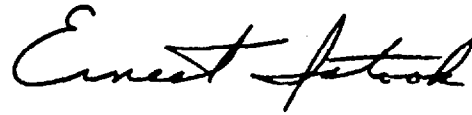
Without the immediate action by the federal government, more wells will be capped which will further erode our national security. Without immediate action most of the domestic oil industry will be lost, which will further increase our dependence on imported oil from 55% to over 70%. Although there are limits to what the federal government can do to increase the security of the domestic oil industry, some remedies can be pursued, such as restricting foreign aid or other benefits to foreign countries that are overproducing in violation of agreed-to limits, enacting a marginal well tax credit, allowing a percentage of loss carryback such as is already allowed for farmers (and which the administration has proposed for the steel industry). Additionally, the Administration should immediately drop the proposed changes in the valuation of oil by the Minerals Management Service oil and also drop other proposed new burdensome regulations that would further hurt the domestic oil industry.

Additionally, part of the problem is the current administrative policy of allowing Iraq to export oil, which, only further strengthens our leading foe. In fact, while we were bombing Iraq in December we were importing 486,000 barrels of Iraqi oil per day. This number increased to 510,000 barrels per day in January. Importing oil from Iraq -- now the fourth largest source of foreign oil for the U.S.-- is contrary to America's national security and should be curtailed.

Therefore, I request that you immediately begin an investigation of the impact that imported oil is having on the domestic oil industry and provide a report within 60 days.

If you have any questions about this request you may contact me, or John
Albaugh, of my staff, at 225-2132.

Very Truly Yours,

A handwritten signature in black ink, reading "Ernest Istook". The signature is written in a cursive style with a large initial "E" and a long, sweeping underline.

Ernest J. Istook, Jr.
Member of Congress

United States Senate

WASHINGTON, D.C. 20510

March 12, 1999

The Honorable William M. Daley
Secretary of Commerce
U.S. Department of Commerce
Washington, D.C. 20230

Dear Secretary Daley:

For over a year now, the world oil market has been glutted with excess supply, which has severely depressed oil prices. The crash in oil prices has resulted in record low gasoline prices and shaved at least half a point off the inflation rate. At the same time, the impact on domestic oil production has been devastating. According to a January survey by the Independent Petroleum Association of America (IPAA), 193,000 marginal oil and gas wells have been shut down with a loss in oil production of 360,000 barrels per day since November of 1997. Even if oil prices were to increase to \$14 for the next six months, another 184,000 oil wells would likely be shut in. Once marginal wells, wells that produce less than 10 barrels per day, are shut in they rarely come back into production. With 1 million barrels per day of U.S. production coming from marginal wells, loss of that production would have a dramatic impact on U.S. oil imports.

The future implications of a slowdown of this magnitude are severe and long lasting. New drilling is down nearly 50 percent. In general, the only wells being drilled are those required to maintain a lease. The major oil companies have announced significant cuts in capital spending, averaging 20 percent. The impact on the United States, a high-cost province, is expected to be a reduction in capital spending on the order of 40 percent. The absence of new drilling means that for several years we are going to have declining production as old fields are depleted without new fields being brought into production. Oil development requires long lead times and oil production cannot be brought back up in short order.

According to press reports, oil industry bankruptcy filings started to accelerate late last year. The courts in Texas alone are expecting over 80 Chapter 7 oil industry bankruptcies as a result of the crisis. Over 24,000 jobs directly in the oil industry have already been lost, with another 17,000 expected. In the short run, the economic impacts in some areas are staggering. In the long run, the risk is the lost capability for domestic production. As companies go out of business, equipment is taken out of service and people are forced to find other lines of work. As the United States discovered after the last price downturn, once the expertise and capability disappear, they are costly to replace when prices do recover.

The total U.S. trade deficit last year for goods and services was \$168.6 billion, up from \$110.2 billion in 1997. The petroleum contribution to the deficit was \$20 billion less than in 1997, even though imports of crude oil were up 6 percent and all petroleum products 8 percent. When oil prices recover, and they will as non-OPEC supplies decline and developing country economies emerge from recession, our trade deficit figures will see a sharp increase. The Energy Information Administration, in its Annual Energy Outlook 1999, is projecting oil imports as high as 71 percent of consumption by 2020 at a cost of \$100-\$158 billion. While low oil prices have provided obvious benefits to the economy in the short run, we believe it is reckless not to be taking immediate action to mitigate the future impact of our increasing dependence on imported oil.

In 1994, your Department conducted a review under section 232(b) of the Trade Expansion Act of 1962 (19 U.S.C. 1862) and found that the nation's growing reliance on imports of crude oil and refined petroleum products threatened the nation's security because they increase U.S. vulnerability to oil supply interruptions. On February 16, 1995, President Clinton concurred with the finding, but took no action. In 1994, the U.S. was 51 percent dependent on foreign oil; in 1998 it was 56% dependent. Clearly, the security threat that was found in 1995 has increased along with those imports.

With all these factors in mind, we are hereby requesting that you conduct an expedited review and investigation into the impact of low oil prices and ever increasing oil imports on the United States national security under the authorities granted to you under Sec. 232 of the Trade Expansion Act of 1962. A finding that the level of oil imports is a threat to our national security will put the focus on a national policy to respond to the crisis. We respectfully request that you complete your investigation and send your findings to the President within 60 days.

Sincerely,

W. Clinton

Samuel H. Johnson

John Bremer

Robert L. Anderson

James G. Ford

Michael B. Egan

Max Bensusan

Samuel R. Bensusan

Beyond L. Fargo

Blanche L. Lincoln

Frank Lott

Management and Budget (OMB) for clearance the following proposal for collection of information under the provisions of the Paperwork Reduction Act (44 USC Chapter 35). This request is being submitted under the emergency clearance procedures.

Agency: Bureau of Export Administration.

Title: Chemical Weapons Convention, Amendment to the Export Administration Regulation (End-Use Certificates, Advance Notifications and Annual Reports).

Agency Form Number(s): None.

OMB Approval Number: None.

Type of Request: New Collection—
EMERGENCY APPROVAL
REQUESTED.

Burden: 178 hours.

Number of Respondents: 134
(multiple responses).

Avg. Hours Per Response: 30 minutes for notifications, annual reports and end-use certificates.

Needs and Uses: The United States is under obligation by this international treaty to impose certain trade controls. State Parties may only export Schedule 1 chemicals to other State Parties, must provide advance notification of exports of any quantity of a Schedule 1 chemical, and must submit annual reports of exports of such chemicals during the previous calendar year. The Convention also requires that prior to the export of a Schedule 2 or Schedule 3 chemicals to a non-State Party, the exporter must obtain an End-Use Certificate issued by the government of the importing country.

Affected Public: Businesses or other for-profit organizations, not-for-profit institutions.

Frequency: On occasion, annually.

Respondent's Obligation: Mandatory.

OMB Desk Officer: Dave Rostker, (202) 395-3897.

Copies of the above information collection proposal can be obtained by calling or writing Linda Engelmeier, DOC Forms Clearance Officer, (202) 492-3272, Department of Commerce, Room 5033, 14th and Constitution Avenue, NW, Washington, DC 20230 (or via the Internet LEngelme@doc.gov).

Written comments and recommendations for the proposed information collection should be sent by Friday, May 7, 1999 to David Rostker, OMB Desk Officer, Room 10202, New Executive Office Building, 725 17th Street, NW, Washington, DC 20503. This collection is being submitted under the emergency Paperwork Reduction Act procedures.

Dated: April 27, 1999.

Linda Engelmeier,

Departmental Forms Clearance Officer, Office of the Chief Information Officer.

[FR Doc. 98-11095 Filed 5-3-99; 8:45 am]

BILLING CODE 3510-33-P

DEPARTMENT OF COMMERCE

Bureau of Export Administration

[Docket No. 990427107-9107-01]

Initiation of National Security; Investigation of Imports of Crude Oil and Petroleum Products

AGENCY: Bureau of Export Administration, Commerce.

ACTION: Notice of initiation of national security investigation and request for public comments.

SUMMARY: This notice is to advise the public that an investigation has been initiated under section 232 of the Trade Expansion Act of 1962, as amended (19 U.S.C. 1862), to determine the effects on the national security of imports of crude oil and petroleum products. Interested parties are invited to submit written comments, opinions, data, information, or advice relative to the investigation to the Bureau of Export Administration, U.S. Department of Commerce.

DATES: Comments must be received by June 3, 1999.

ADDRESSES: Written comments (three copies) should be sent to Bernard Kritzer, Manager, Special Projects, Office of Chemical and Biological Controls and Treaty Compliance, Bureau of Export Administration, U.S. Department of Commerce, Room 2093, Washington, D.C., 20230.

FOR FURTHER INFORMATION CONTACT: Scott Hubinger, Senior Policy Analyst, Office of Chemical and Biological Controls and Treaty Compliance, Bureau of Export Administration, U.S. Department of Commerce, (202) 482-3825.

SUPPLEMENTARY INFORMATION:

Background

On April 28, 1999, the Department of Commerce initiated an investigation under section 232 of the Trade Expansion Act of 1962, as amended (19 U.S.C. 1862), to determine the effects on the national security of imports of crude oil and petroleum products. The findings and recommendations of the investigation are to be reported by the Secretary of Commerce to the President not later than January 29, 2000.

The imported crude oil and refined petroleum products to be investigated include:

- Crude oil, under 25 degrees API
- Crude oil, 25 degrees API or more
- Motor fuel, including motor gasoline, naphtha-type jet fuel, and kerosene jet fuel
- Motor fuel blending components
- Kerosene derived from petroleum, shale oil, or both, except motor fuel
- Naphthas derived from petroleum; shale oil, natural gas, or combinations thereof, except motor oil
- Fuel oils, under 25 degrees API
- Fuel oils, 25 degrees API or more
- Mineral oil of medicinal grade derived from petroleum, shale oil, or both
- Lubricating oils and greases, derived from petroleum, shale oil, or both, with or without additives
- Mixtures of hydrocarbons not specifically provided for, derived wholly from petroleum, shale oil, natural gas, or combinations thereof, which contain by weight not over 50% of any single hydrocarbon compound
- Paraffin and other petroleum waxes
- Petroleum coke
- Bitumen
- Asphaltum, bitumen, and limestone-rock asphalt
- Petroleum gases (natural gas liquids) and other hydrocarbons

This investigation is being undertaken in accordance with part 705 of the National Security Industrial Base Regulations (15 CFR parts 700 to 709) (the "regulations"). Interested parties are invited to submit written comments, opinions, data, information, or advice relevant to this investigation to the Office of Chemical and Biological Controls and Treaty Compliance, U.S. Department of Commerce, no later than June 3, 1999.

The Department is particularly interested in comments and information directed to the criteria listed in § 705.4 of the regulations as they affect national security, including the following:

(a) Quantity of the article in question or other circumstances related to the importation of the articles subject to the investigation;

(b) Domestic production and productive capacity needed for those articles to meet protected national defense requirements;

(c) Existing and anticipated availability of human resources, products, raw materials, production equipment, and facilities to produce these items;

(d) Growth requirements of domestic industries to meet national defense requirements and/or requirements to assure such growth;

(e) The impact of foreign competition on the economic welfare of the domestic industry; and

(f) The displacement of any domestic products causing substantial unemployment, decrease in the revenues of government, loss of investment or specialized skills and productive capacity, or other serious effects.

All materials should be submitted with three copies. Public information will be made available at the Department of Commerce for public inspection and copying. Material that is national security classified information or business confidential information will be exempted from public disclosure as provided for by § 705.6 of the regulations. Anyone submitting business confidential information should clearly identify the business confidential portion of the submission. File a statement justifying nondisclosure and reference to the specific legal authority claimed, and provide a non-confidential submission which can be placed in the public file.

Communications from agencies of the United States Government will not be made available for public inspection.

The public record concerning this notice will be maintained in the Bureau of Export Administration's Records Inspection Facility, room 6883, U.S. Department of Commerce, 14th Street and Constitution Avenue, NW, Washington, DC 20230, telephone (202) 482-5653. The records in this facility may be inspected and copied in accordance with the regulations published in part 4 of title 15 of the Code of Federal Regulations (15 CFR 4.1 *et seq.*). Information about the inspection and copying of records at the facility may be obtained from Mr. Henry Gaston, the Bureau of Export Administration's Freedom of Information Officer, at the above address and telephone number.

Dated: April 28, 1999.

R. Roger Majak,
Assistant Secretary for Export
Administration.

[FR Doc. 99-11090 Filed 5-3-99; 8:45 am]

BILLING CODE 3510-33-P

DEPARTMENT OF COMMERCE

International Trade Administration

Export Assistance Center Internet Website Form; Proposed Collection; Comment Request

SUMMARY: The Department of Commerce, as part of its continuing effort to reduce paperwork and respondent burdens, invites the general public and other Federal agencies to take this opportunity to comment on the continuing information collections, as

required by the Paperwork Reduction Act of 1995, Public Law 104-13 (44 U.S.C. 3506(c) (2) (A)).

DATES: Written comments must be submitted on or before July 6, 1999.

ADDRESSES: Direct all written comments to Linda Engelmeier, Departmental Forms Clearance Officer, Department of Commerce, Room 5033, 14th & Constitution Avenue, NW, Washington, DC 20230. Phone number: (202) 482-3272.

FOR FURTHER INFORMATION CONTACT:

Request for additional information or copies of the information collection instrument and instructions should be directed to: Thomas Mottley, U.S. Department of Commerce, Export Assistance Center, 6 World Trade Center, Room 635, New York, NY, 10048; Phone number: (212) 466-5220, and fax number: (212) 264-1356.

SUPPLEMENTARY INFORMATION:

I. Abstract

The New York Export Assistant Center, which is a combined effort of the U.S. Department of Commerce, Export-Import Bank, and Small Business Administration provides a comprehensive array of export counseling and trade finance services to small and medium-sized U.S. exporting firms. In 1998, it launched an interactive website, www.nyuseac.org that is geared to the needs of New York and New Jersey metropolitan industry. One electronic form is proposed to be added to the website in order to improve the usefulness of the site. The form will ask U.S. exporting firm respondents to provide general background information and identify which service(s) they are interested in.

II. Method of Collection

The form is submitted via internet, telephone, fax, or email.

III. Data

OMB Number: 0625-xxxx (New).
Form Number: Not applicable.
Type of Review: Regular submission.
Affected Public: Business or other for-profit.

Estimated Number of Respondents: 120.

Estimated Time Per Response: 5 minutes.

Estimated Total Annual Burden Hours: 10 hours.

Estimated Total Annual Costs: The estimated annual cost for this collection is \$600.00 (\$350.00 for respondents and \$250.00 for federal government).

IV. Request for Comments

Comments are invited on (a) whether the proposed collection of information is necessary for the proper performance

of the functions of the agency, including whether the information shall have practical utility; (b) the accuracy of the agency's estimate of the burden (including hours and costs) of the proposed collection of information; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or forms of information technology. Comments submitted in response to this notice will be summarized and/or included in the request for OMB approval of this information collection; they also will become a matter of public record.

Dated: April 28, 1999.

Linda Engelmeier,

Departmental Forms Clearance Officer, Office
of the Chief Information Officer.

[FR Doc. 99-11094 Filed 5-3-99; 8:45 am]

BILLING CODE 3510-FF-P

DEPARTMENT OF COMMERCE

International Trade Administration

[A-533-502]

Certain Welded Carbon Steel Pipes And Tubes From India: Notice of Final Results of the Antidumping Duty Administrative Review

AGENCY: Import Administration,
International Trade Administration,
Department of Commerce.

ACTION: Notice of final results of
antidumping duty administrative
review.

SUMMARY: On February 8, 1999, the Department of Commerce published the preliminary results of its administrative review of the antidumping duty order on certain welded carbon steel pipes and tubes from India. This review covers one manufacturer/exporter, Rajinder Pipes Ltd. The period of review is May 1, 1997, through April 30, 1998. We gave interested parties an opportunity to comment on the preliminary results of review but received no comments. Therefore, these final results of review have not changed from those presented in the preliminary results of review, in which we applied total adverse facts available.

EFFECTIVE DATE: May 4, 1999.

FOR FURTHER INFORMATION CONTACT:

Larry Tabash at (202) 482-5047 or Robin Gray at (202) 482-4023, Import

OIL-006

RECEIVED
May 11, 1999

George Mercier

To: Mr. Bernard Kritzer, Manager of Special Projects
Office of Chemical and Biological Controls and Treaty Compliance
Bureau of Export Administration
Department of Commerce
UNITED STATES OF AMERICA
Washington DC

Reference: 64 Federal Register 85, at page 23820 (May 4th, 1999)
Bureau of Export Administration Docket Number: 990427107-9107-01

Action: The solicitation of Public Comments on probable violations of National Security, denominated in the area of Oil and Credeue Oil Imports.

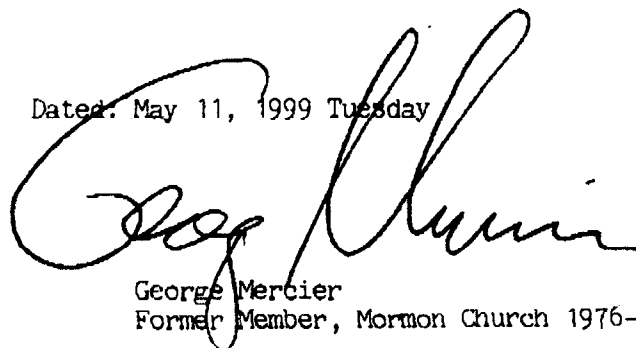
To: The United States of America:

This is to advise the United States that earlier this year, Mormon management personnel Gordon B. Hinckley and Dallin Oakes made arrangements through their Contracting to cause the Holy Ghost to instruct me to file a petition under 31 CFR 575, soliciting an oil importation license from the Office of Foreign Assets Controls of the United States Treasury Department.

I refused the commandment, and notified the Treasury Secretary of my refusal.

In the future, other persons may not refuse, and this way the Mormons may be able to acquire some degree of influence in the sphere of oil importation (or alternatively, other subject matter areas, since an alert to oil may preclude active Mormon intercession in that industry).

Dated: May 11, 1999 Tuesday



George Mercier
Former Member, Mormon Church 1976-1996

100 Sandringham Drive
Rochester, New York 14610

OIL-007
RECEIVED
May 18, 1999

Dale W. Steffes

Box 820228, Houston, TX 77282 Tel 713 467 4732 Fax 281 497 4128

May 13, 1999

Mr. Bernard Kritzer
Manager, Special Projects
Office of Chemical and Biological Controls and Treaty Compliance
Bureau of Export Administration
U.S. Department of Commerce, Room 2093
Washington, DC 20230

Reference: Initiation of National Security: Investigation of Imports of Crude
Oil and Petroleum Products. Docket 990427107-9107-01

Dear Mr. Kritzer:

Per the May 4, 1999 Federal Register request for public comments, I am submitting three sets of two documents each with this letter for the above investigation:

- 1: Trend Discontinuity 19-4 U.S. Foreign Energy Dependency reaches a new all time high, 25%, issued March 1999
- 2: A collection of seven historical papers on the proposed National Energy Stability Policy. Assembled in February 1999

I commend the Department of Commerce for undertaking this important investigation. You will see from my submittals that I have been concerned about national oil security for the past 13 years, since 1986. Please list me as a party to this investigation.

With today's low gasoline prices and abundant supplies, oil supply security is not a prominent public concern. That could change quickly with a foreign politically inspired supply disruption. Looking out for potential politically inspired economic disruption is a legitimate government obligation.

All proposed solutions to reduce future United States oil dependency require some form of market intervention. Our National Energy Stability Policy is the least intrusive and most effective solution. I am available to answer any questions that might arise.

The last paper in the second submittal is a good summary of the U.S. oil dependency activities as of April 1997. Since then, OPEC increased exports 2 mmbpd (late 1997), the price fell to \$10 and an expanded OPEC curtailed oil exports 4.7 mmbpd with the oil price returning to the high teens.

Sincerely

Dale Steffes

two enclosures with letter

(one of three copies submitted)



Dale Steffes, 3-8-99
713 467 4732

News Release

U.S. Foreign Energy Dependency reaches a new all time high, 25%

TD 19-4 *Trend Discontinuity* March 1999
Planning & Forecasting Consultants Box 820228 Houston, TX 77282 Tel 713 467 4732

The United States has reached an all time high in total energy dependency. The previous high was 23% in 1977. In 1998, the nation's foreign energy dependency rose to 25%. In the mid eighties, the country's energy dependency was in the 12% range. See Figure 1, which show historical and forecasted energy dependency with little intervention.

Our forecast is that U.S. energy dependency will reach 33% by the year 2010, unless some major form of market intervention is taken. One of the major reasons the United States is the world superpower was because of abundant and low cost energy. That major advantage is now disappearing.

Energy dependency is not bad in itself, especially if it is on cheaper foreign energy. However, today, one of the tools of international diplomacy is trade sanctions, especially with oil and by the United States. If and when world oil becomes scarce, sanctions against U.S. oil supply could become very real and economically disruptive.

Figure 2 shows our proposed National Energy Stability Policy, whereby the dependency would be held at the 25% rate by Presidential edict.

Implementation of this NESP will not lessen the U.S. energy consumption, but will cause the U.S. energy production to increase.

History of NESP

In 1987, when the NESP was initially proposed, the recommended dependency rate was set at 15%. In 1993, in our very formal proposal to the incoming Clinton Administration, the recommended setting was 20%. Now, the recommended implementation is 25%.

Implementation of this National Energy Stability Policy **will not raise the cost of energy to the United States consumer**. The NESP will cause the world to have two oil prices, one for the United States and one for the rest of the world. The differential between these two costs will represent the actual difference in cost between the two. In actuality, the foreign energy producers will subsidize the U.S. domestic producers. This works because "they may own the oil but the U.S. still owns the market".

Figure 1

U.S. Energy Dependency w/o NESP

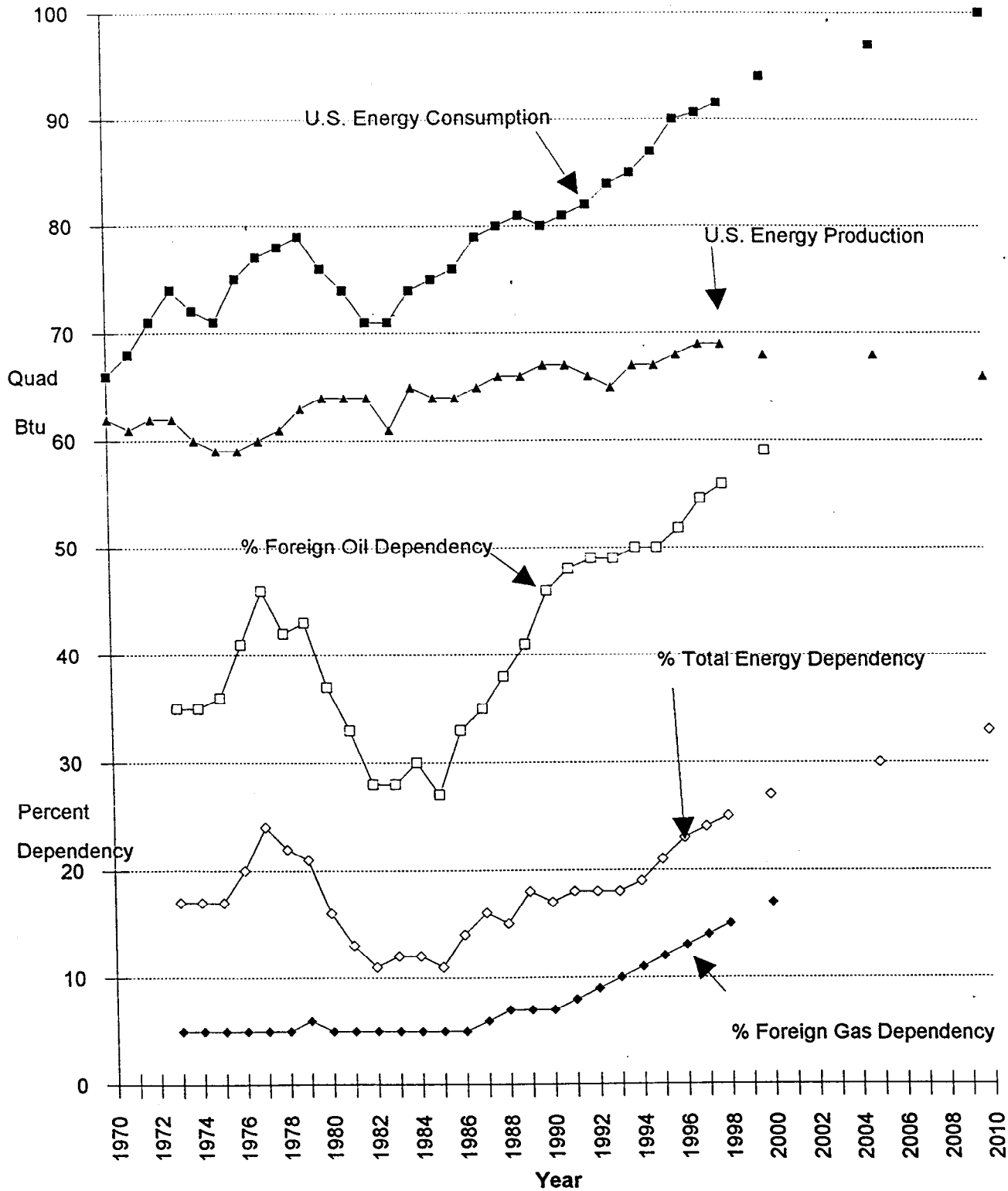
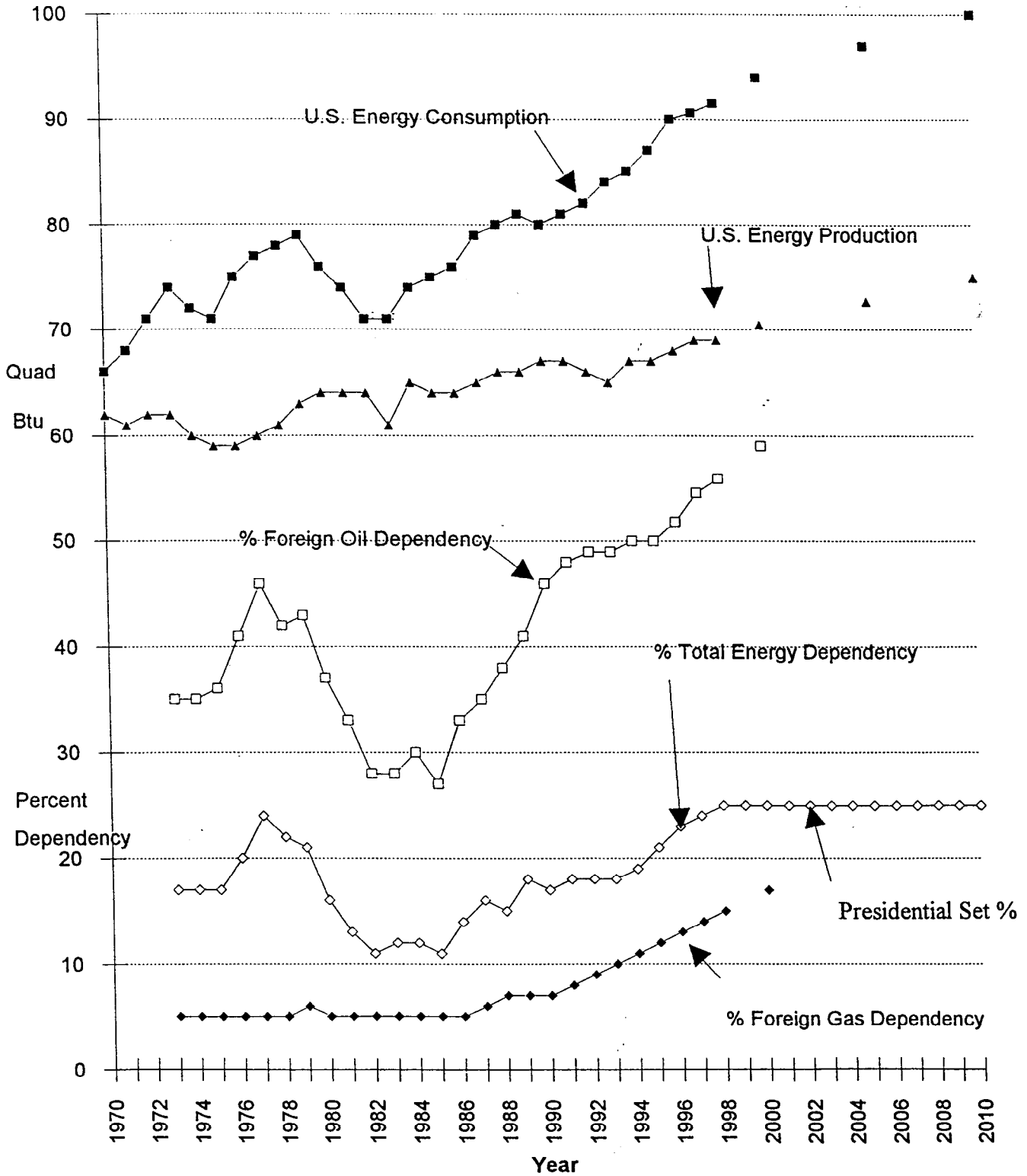


Figure 2

U.S. Energy Dependency w/ NESP



RECEIVED
May 18, 1999

A collection of
Seven historical papers on the
Proposed
National Energy Stability Policy

Assembled: February 1999

- | | | |
|-------------------|---------------------------------------|----------|
| 1. Houston Post: | NESP Proposal to President Clinton | Jan. 93 |
| 2. TD 15-4: | Clinton confirms oil security problem | Apr. 95 |
| 3. IAEE: | NESP Presented in Boston | Oct. 96 |
| 4. TD 16-16: | Status Report on NESP | Aug. 96 |
| 5. TD 16-17: | "Mother" of all Exploration Prospects | Sept. 96 |
| 6. Study Request: | For USITC 332 trade study | Oct. 96 |
| 7. TD 17-3: | A review of U.S. Oil Dependency | Apr. 97 |

Dale W. Steffes
Private National Energy Stability Agency
Box 820228
Houston, TX 77282
Tel 713 467 4732
Fax 281 497 4128

ENERGY

Houston energy consultant pitching his plan to Clinton

BY SAM FLETCHER
POST ENERGY WRITER

Houston energy consultant Dale Steffes has a different plan for curbing the country's dependence on imported oil and to stimulate the oil patch economy. But it's a plan he wants to administer himself to keep it free from politics.

Steffes plans to deliver his National Energy Stability Policy to President Clinton. The letter should reach Washington early this week.

"Everyone is trying to get his or her ideas in to the new administration," Steffes said. "I'm trying to do the same. But I'm convinced mine will work better than any other approach for reducing oil imports."

Under Steffes' plan, anyone producing energy from any domestic source — oil, natural gas, coal, nuclear, hydropower or any alternative — would receive a federal license or "ticket" to import one unit of oil for each four units of domestic energy produced. Units would be measured in British thermal units.

Because most energy producers in this country are not integrated companies involved in importing oil, Steffes expects a market to develop for those tickets.

He claims the trade in import tickets will transfer to domestic energy producers about \$12 billion a year that otherwise would go to foreign oil producers. Steffes said it shouldn't raise consumers' cost.

"The cartel will try to set oil prices as high as they can, but it won't work," Steffes said. "OPEC may own the oil, but we own the market. It's possible to decide the maximum amount of oil that we'll import based on a percentage of our national energy demand."

Steffes would put that import level at 20 percent of our total demand for all energy — about the same as it is today.

Steffes has already outlined his plan to representatives of the Department of Interior, the Bechtel Corp., the National Coal Association and the U.S. Council for Energy Awareness, among others, during a briefing at the National Press Club in Washington in October.

He claims his plan would provide the necessary feedback to monitor how much the United States is paying for energy compared to the rest of the world. "We need a higher price for our domestic oil than the rest of the world," he said, because of higher production costs.

But Steffes wants to be the one to administer the program through a proposed Private Energy Stabilization Commission, rather than leave it to politicians



Ira Strickstein/The Houston Post

Dale Steffes of Planning & Forecasting Consultants hopes to offer his idea to help the energy industry to President Clinton.

tries such as Mexico, Canada or others.

"I would make it a clean system with no political exceptions," Steffes said. He claims America's nearest oil- and gas-producing neighbors enjoy "a logistical advantage" anyway.

Steffes says he can manage the program at no cost to the federal government and with the possibility of saving billions of dollars from Energy Department operations. "All I want is 10 percent of the tickets," he said. "Ten percent is not much for an idea."

Steffes claims his plan will produce additional savings by reducing Defense Department expenses for protecting oil supplies in the Middle East. But it's too soon to say by how much, he said.

Boosting income for domestic producers will result in their paying more federal and state taxes, he said, as opposed to foreign production, which con-

BUSINESS HOUSTON

Consultant pitches plan

Houston energy consultant Dale Steffes has a different plan for curbing dependence on imported oil, and he seeks to deliver his National Energy Stability Policy to President Clinton early this week. His idea: Anyone producing energy from any domestic source would get a federal "ticket" to import one unit for each four units of domestic energy produced.

Details/page, C-4.

❖ Trend Discontinuity ❖

Volume 15 Issue 4

Political Influence

April 1995

President Clinton reconfirms U.S. Energy Security Problem

President Clinton reconfirmed two months ago that the United States really does have an energy security problem, but then took no new presidential actions to address or resolve this potentially serious future energy problem. All he did was continue the identical energy policies that have not lessened our energy dependence since the last national energy security review seven years ago.

If you have ever run out of gas in your automobile, you realizes how helpless one can be without fuel for your car. All activity just shuts down until the problem is resolved. Remember how angry you were with yourself for not having more foresight.

For the first time ever, in 1994, the United States became more than 50% dependent on foreign oil supplies. The previous high level of oil imports was in the late 1970's when the United States oil dependency peaked at 47%. President Carter's energy actions during his term, however reduced that level to about half (23%) by the early 1980's. He accomplished this reduction in oil dependence by causing world oil prices to increase, so domestic production increased and domestic consumption decreased. \$34 oil in 1980\$ was above the necessary U.S. equilibrium price. With world oil prices again low, the U.S. oil dependency has risen to over 50% and is headed much higher, unless the federal government takes some action to prevent our increase on foreign oil dependency.

President Clinton's energy announcement about the nation's energy security problem was instigated by the Independent Petroleum Association of America (IPAA) which required the Department of Commerce to conduct an investigation on "The Effect of Imports of Crude Oil and Refined Petroleum Products on the National Security". This mandated study was conducted under the authority of the Trade Expansion Act of 1962, Section 232.

Under that specific trade law, the President has the authority to adjust oil imports if he finds they threaten to impair U.S. national security. The Dept. of Commerce study did find that petroleum imports threaten to impair U.S. national security. The Commerce study however recommended no new actions, other than to continue and

enhance existing federal energy actions. President Clinton echoed Commerce's recommendations.

Clinton/Commerce Study Recommendations

These Dept. of Commerce study energy recommendations were very weak, generally wrong and sometimes counter productive. All are some form of domestic market intervention. They assume the government bureaucrats know what is needed better than the domestic free market. The President's energy recommendations to address the nation's energy security problem were:

- Spend more federal money on energy efficiency
- Spend more federal money on alternative fuels
- Spend more federal money on energy technology
- Spend more federal money on energy renewables
- Promote the use of natural gas
- Increase government regulatory efficiency
- Subsidize energy related exports, technology,
western coal, Calif. heavy oil.
- Maintain the Strategic Petroleum Reserve
- Coordination with IEA members in times of a
world oil shortage

These recommendations are a continuation of past and current energy policy, which have not proven successful. With these current policies essentially in place since the last requested similar study (1988), the U.S. has become even more dependent on foreign oil. Which indicates that our national energy security has lessened. I do admit that without these policies, the U.S. could probably have been even more energy dependent.

Unless our domestic energy policy is radically changed, the U.S. is forecasted to become even more oil dependent and the nation will become ever more energy vulnerable.

While the recommendations listed no specific dollar expenditures, the government is planning to increase the expenditures for many of the recommendations.

Comments on Recommendations

The following are commentary on the specific administration recommendations:

- * By definition, the domestic free market will establish the best energy efficiency. If efficiencies have to be federally mandated, it is probably because the wrong oil price
-

signal is being used.

* Renewable fuels and alternative fuels will come about automatically in a domestic free market, whenever they become truly economical.

* Industry technology will develop more efficiently in a domestic free market. Government expenditures for technology stymie private investments in petroleum technology.

* Natural gas has less than 15 years of reserves, while coal has over 100 years of reserves. Why should the government promote consumption of a fuel with limited domestic reserves over another fuel with huge domestic reserves? Isn't security of supply the issue here.

* Increasing government regulatory efficiency sounds paradoxical. Does this mean regulations will be imposed more efficiently. Hopefully it means regulations will have less detrimental effects. Why wouldn't this be done anyway? Does this mean some regulations today are just vindictive?

* A governmental oil storage system is about as un free market as you can get. This government action hinders efficient private oil storage. The federal SPR interferes with the normal operations of a futures market, and private storage incentives.

* Agreeing to share oil shortages with unequals that do not have to carry a world class military responsibility is not exactly what I would call a very smart national energy strategy. Carrying most of the world's armament cost is bad enough, but carrying their oil security risk also, is more than the U.S. consumers should bear, especially when it isn't necessary.

Many of these recommendations are somewhat shaded by environmental concerns. But this study was not intended to address the environmental issues facing the nation.

There were 69 submitted comments to this Dept. of Commerce exercise. Most everyone agreed that the U.S. was becoming more and more dependent on foreign oil, making the country even more vulnerable. Most agreed that the decline of the U.S. petroleum resource base was the principal cause for the U.S. increasing oil dependence.

Collectively, the producing side begged for some form of economic help, i.e. favorable market intervention: (oil price floors, oil import tariffs or oil depletion tax benefits), while the consuming side wanted to keep cheap energy available for the sake of their personal economy or for international competitiveness reasons.

The Department of Energy took a year to issue their first energy study in December 1993. The "Natural Gas & Oil Initiative" report said the Oil Security Issue would

be addressed by an Interagency task force, which would have a report completed by December 1994. As of this date, the critical issue is still unaddressed. DOE has effectively stalled for two years without any policy improvements and U.S. dependency continuing to increase.

The Commerce study did not adequately address these key intangible questions: The political stature of the world's remaining superpower without a secure oil supply? They did not attempt to quantify the dollar relationship between our military expenditures and the security of our oil imports? The study did not reconcile the U.S. balance of trade deficits for oil with our current economic status in the world?

These are presidential questions only the President can address. As it now looks, the country will become 5 to 7% more dependent on foreign oil on President Clinton's watch. Eventually, the U.S. could get to the position of having to play the child's game of "may I" with the foreign oil producing countries.

How could this happen? Whenever U.S. oil dependency reaches a critical stage, the economic oil weapon can be turned against us. Quite often, oil is used as an economic weapon, and the U.S. is one of the worst offenders. The first action our State Department considers is to interfere with a foe's oil trade, i.e. Iraq, Iran, Libya, Haiti, N. Korea. Then when State gets in over its head, they call the Defense Department, i.e. Iraq/Kuwait. The recent book, Victory, insinuates that oil played a key role in winning the Cold War with the former USSR. Just recently, the Administration invoked a 1917 act, Trading with the Enemy Act, forbidding Conoco to legally deal with Iran.

Understanding U.S. Energy Dependence

The primary reason U.S. foreign oil dependency is increasing must be recognized and understood.

All internationally traded oil in the world is priced in U.S. dollars, with a small differential for logistics and quality. This universal world oil price is metered in New York, Rotterdam, Singapore, etc. However, this one universal world oil price is generally wrong.

This universal world oil price is normally too low for most U.S. oil producers and higher than necessary for most foreign oil producers. This anomaly comes about because of the natural differential between today's various petroleum resource bases. The actual cost of finding and producing crude oil in the Middle East region is much less than \$5/ barrel, while in the United States, the comparable crude oil cost could be well over \$15/ barrel.

Because petroleum is fungible, a world free oil market will find an equilibrium price somewhere in the middle ground. Under this oil cost scenario, over time, the cheaper foreign oil will continually gain world market share over higher cost U.S. domestic produced oil.

The Power of a World Energy Model

Having oil cost higher than the rest of the world is not all bad, if the system can be manipulated to benefit the United States. The fact remains "OPEC may own the oil but the U.S. still owns the market". In times of world oil surplus, the market side has more control than the supply side. The rest of the world will always have an oil surplus as long as the price is artificially held higher than their necessary supply and demand equilibrium price. This is OPEC's perennial pricing problem. Holding the world oil price too high, allows other low cost foreign oil to gain market share against OPEC producers.

Therefore, by limiting energy imports into the U.S., the foreign oil producers can be forced to subsidize domestic energy producers. OPEC Secretary General Subroto confirmed this fact in a written response to the author about our proposed National Energy Stability Policy.

The President has the authority to control U.S. energy dependency under the 1962 trade law. All the President has to do, is to limit the number of BTU's of energy imported into this country. The recent Commerce study conclusions authorize him to limit energy imports in the name of national security.

This will create a world system with two oil prices, one price for the U.S and a lower price for the rest of the world. Both of these oil prices will be more correct for their specific part of the world, based on the cost differential between the two different petroleum resource bases.

The question that immediately arises is: Who should be allowed to import this lower cost oil into the U.S., because it will clearly have an economic advantage over domestic oil. Under our NESP, the President would allocate these valuable import rights to all domestic energy producers proportional to their domestic energy production. This will effectively subsidize all domestic energy producers, including coal, nuclear, hydro, oil, gas, etc. Our initial estimate is fifteen cents per BTU subsidy for all domestic energy produced.

The U.S. energy policy should incorporate a method to utilize the most correct domestic energy price signals and then let the domestic free market determine the best domestic solution among our available domestic fuel sources

and energy conservation. Then the environmental considerations could also be economically decided between domestic fuels.

Under this U.S. energy import limitation, the cost of foreign oil imports will be reduced. Our model indicates that the United States would save \$12 billion per year on the current volume of oil imports. Instead of paying \$44 billion/yr, our energy importers would only pay \$32 billion/yr for an equal amount. This \$12 billion/yr saving would be effectively distributed to the domestic energy producers, raising their revenue to \$155 billion/yr from the current \$143/yr billion. This increased revenue for domestic energy producers would enhance all domestic energy production. The overall total cost for U.S. energy supplies would not change. All this policy would do is transfer some of the money presently going to foreign producers to domestic energy producers.

Implication of this National Energy Stability Policy by the President would effectively maintain the energy consumers' bills at the current level.

This NESP has an added benefit. It effectively eliminates the threat of low oil prices on domestic oil producers. If the rest of the world oil price goes down, this policy effectively subsidizes the domestic producers even more. If the rest of the world oil price goes up, the policy subsidizes the domestic producers less, but that will also be okay, because our energy dependency level will be automatically maintained at this presidentially set level.

With this policy, the need for the current Dept. of Commerce's energy recommendations and associated expenditures would be eliminated. Also, the expense for the principal DOE energy functions could be eliminated, saving even more of taxpayer's money.

The potential big savings could be in the reduced military expenditures needed to maintain insecure future foreign oil supplies for the United States.

P&FC has formally and officially offered to create, design, and operate this NESP at no cost to the federal government.

Recommendations for the President

President Clinton should adopt P&FC's National Energy Stability Policy of limiting energy imports into the United States to a level that balances our needs between concerns for national security, balance of trade, and international competitiveness.

Our initial recommendation to the President would be for him to limit the U.S. energy imports at the present level of about 20 percent (oil 50%). After the policy has operated for a while, the President would have more factual data on the oil price differential, so he could adjust the import percentage up or down gradually, depending on our other U.S. international relationships.

The day after his inauguration, I formally offer the President this energy policy option. His administration has yet to respond.

The first thing that must be done is: somebody needs to explain all of the real U.S. energy options to the President. The recent Department of Commerce study did not inform him of all of his energy options. In Mr. Clinton's campaign for the Presidency, he promised the petroleum industry that all energy options would be examined, which has not yet been done.

With this in mind, I am actively soliciting the various energy related organizations (Texas Railroad Commission, IOGCC, Congressional Energy Caucus, etc.) to encourage the President to adopt P&FC's proposed National Energy Stability Policy.

Summary

* I implore the Texas Railroad Commissioners to use their prestigious position to encourage President Clinton to accept our offer to create, design and operate the NESP. Hopefully, you will carry this message to others, such as the IOGCC, Congressional Caucus, etc.

Benefits

* Implementation of this NESP would not raise the cost of energy for domestic consumers.

* Implementation of our NESP would eliminate the threat of low oil prices on domestic energy producers.

* Implementation of our NESP would subsidize all domestic energy produced 15 cents per million BTU.

Offer

* I offer to make an oral presentation to explain this NESP to any individual or organization that truly wants to better understand the U.S. energy dependency problem and the best political solution. I will explain why begging for tax benefits, price floors and subsidies are only a second best policy. The loss of industry employment is not an issue in today's competitive world.

Trend Discontinuity

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P&FC is not a management consulting firm, but a strategy consulting firm. There is a major difference: Good management is doing things right - good strategy is doing the right things.

A National Energy Stability Policy

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Abstract

Planning & Forecasting Consultants (P&FC) have designed a National Energy Stability Policy (NESP) for the United States. This NESP will bring greater price and volume stability to the domestic energy industry. This NESP is a "market intervention" to keep the United States from becoming too dependent on foreign energy sources. This national energy stability policy can be privately administered by a Private National Energy Stability Agency (PNESA).

One of the U.S. President's jobs is to protect the nation against economic and social disruptions by outside forces. He is responsible for the security of the nation, including oil supply security.

This NESP would allow the President to limit the amount of energy imported into the United States to a prescribed percentage. He would set this percentage based on his judgment of the national security implications, the balance of trade considerations and the international economic competitiveness. Our initial recommendation is that the President freeze the nations total energy imports at today's current level of 20%, with oil being at the 50% level.

Limiting the amount of energy imported, will create a dual-price world energy system, one price for the United States and another, lower price for the rest of the world. The party with the right to import this cheaper foreign energy into the U.S. would receive an economic benefit.

The beneficial rights to import this cheaper energy will be distributed proportionally to the domestic energy producers on a BTU basis. This policy in effect would subsidize domestic energy producers, enhancing domestic production.

A secondary benefit of this policy would be the elimination of the threat of low oil prices on domestic producers. This factor will allow oil producers better financing terms. Also, with the import percentage set correctly, the policy will not increase the cost of energy to the U.S. domestic consumer.

Implementation of this NESP will bring greater stability to the domestic energy system, replacing volatility. With a stable, reliable national energy supply and demand, all will be able to make better economic, political, technological, geographical, social, and ecological decisions.

United States Energy Problem

The twentieth century can be called the "oil century." Henry Ford created the Model T and the assembly line at the beginning of the century, while at the same time the great oil strikes were found in the Southwest. The automobile industry and the oil industry marriage made the U.S. a world industrial and military superpower. This Industrial Might, along with abundant oil supplies played no small part in allowing the United States to be victorious in World War II.

However, during the last quarter century, the U.S. domestic oil production has fallen dramatically. Domestic yearly crude oil production peaked in 1970 at 3.51 billion barrels and trended downward for the last 25 years. Last year, domestic yearly crude oil production was down to 2.38 billion barrels.

An even bigger discontinuity is in the oil imports. In 1971, total oil imports (crude and products) were 1.43 billion barrels. Twenty-five years later, total yearly oil imports are 3.32 billion barrels and still increasing. **This U.S. rising oil dependency becomes the critical threat to the United States hegemony.**

In 1971, the known U.S. reserve of crude oil in the ground was 38 billion barrels. Today, the known crude oil reserves stand at 22 billion barrels, which equates to a reserve life index of about six years. However, the United States' domestic petroleum industry produced about 65 billion barrels of oil during the last 25 years.

The United States principal energy problem is simply defined: **"Crude oil has one universal world price, in U.S. dollars, with a small price differential based on logistics and quality. Because of the world's differing existing natural resource endowment, this one universal price is generally wrong. It is normally too low for United States producers and higher than necessary for foreign producers, especially for the Middle East crude oil."** This NESP makes the oil price more representative of the true oil cost for both, the U.S. and the rest of the world.

As long as this world free market in oil exists, the United States will continue to become more dependent on the less costly foreign oil supply, which should be unacceptable to the world's remaining superpower. Over dependence on foreign oil supplies make the United States vulnerable to a threat of disruption in oil supplies.

Some form of market intervention is required to overcome this U.S. energy dependency. Many independents want an oil import tariff or price floor implemented. Others want some form of tax incentives and benefits. Still others want to force conservation on consumers. All of these are also, a form of market intervention and they would tend to work, but most would increase the cost of energy to the consumer, either directly or indirectly.

The President is the Key Energy Regulator

The President of the United States most important job is to protect the nation from disruptions inflicted by foreign powers. This is commonly known as foreign policy. It is the one governmental task that a state governor, or bureaucrat cannot perform. The only practical, and constitutional arrangement is for the President to be ready to dispatch a diplomat or an army to some trouble spot to look after America's interests. The security of the nation is in his hands; and the security of the oil import supply for this nation, is also in the President's hands.

It is critical that the President not wait till a pending import threat to act on an oil import policy. Preventive action now will avoid an oil supply crisis later.

Congress created the Department of Energy (DOE) to assist the President with his oil security task. This nation's foreign oil supply security will always remain one of the President's task, with or without the DOE. It certainly would be wrong for the President to have to rely on the Department of Defense for securing the U.S. oil supply. Is this being done in Saudi Arabia today? Should the loss of nineteen lives in Saudi Arabia be considered as one of the costs of the nation's oil supply?

Authority of the U.S. President

The President currently has the authority to act if the nation or its citizens are being harmed or threatened. The basis of this authority is existing trade law. The law requires the President to investigate if domestic producers are being harmed or if there is an oil security threat. Every investigation so far has found there is a threat or harm. The most recent case was when the Department of Commerce study found the same, but the recommendations to rectify (the situation) were ineffective. The nation's oil dependency will continue to increase, even with these recommendations implemented.

P&FC's Consulting Specialty

Planning & Forecasting Consultants is a 24 year old consulting firm specializing in establishing strategy in the energy industry for companies and for countries alike. We have written a 50-page manual on the forecasting and planning process. With this manual, a company or country can create effective and beneficial strategies.

Our documented energy forecasting track record is unsurpassed. Our energy models mirror the energy industry better than others. Figure 1 is P&FC's basic model of the U.S. Energy Industry. The BTU's flow downward, while the dollars flow upward. In 1996, the United States will require 90 quadrillion BTUs of energy. The energy consumers will pay \$530 billion for this energy.

Simplified Model for Explaining NESP.

Figure 2 is a Simplified Energy Model we have created to illustrate the national energy stability policy. The commentary on the model explains the model. The domestic energy producers supply 71 quads of energy, for which they receive \$144 billion. The U.S. net imports of energy are 19 quadrillion BTUs, for which they receive \$48 billion.

Market Intervention Model

Figure 3 is a model of our National Energy Stability Policy. Our import control system is incorporated into this model. With this market intervention tool, the President can maintain any level of energy dependency he feels prudent for the nation. The commentary explains how the policy would work. If the President sets the maximum energy imports at twenty percent, then imports will be limited to 18 quadrillion BTUs. Domestic producers will then supply 72 quadrillion BTUs. One quadrillion BTUs are equal to a little less than 500,000 barrels per day. This is almost the amount Iraq wants to start re-supplying to the world market. Changing the ratio to 80/20 would tend to depress foreign oil prices and

raise domestic oil prices. This control system would establish a differential between the oil prices, which would tend to be the value of the energy import ticket.

This policy is designed on today's fact that "OPEC may own the oil, but the United States still owns the market". If the United States becomes too dependent, this fact will become fiction.

Value of Import Tickets

The value of the tickets would be set in a public market between importers and domestic producers. They would tend toward the differential between foreign cost and domestic energy cost. The value of the tickets would be highly dependent on the percentage the President sets. For instance, if the percentage is 25% the tickets would have little value because we are not yet at that level of imports. However, if the President set the percentage at 15%, the import ticket would be very valuable. However, the domestic producers would not be likely to produce that amount without higher unit cost. This would raise the overall domestic cost, increasing the total cost to the domestic consumers. Any increase in domestic energy costs would not be tolerated politically.

If set a little below current levels, the cost of energy to the domestic energy consumer would not increase. Then the domestic producers would effectively be subsidized about \$11 billion per year, all of which would come from lower foreign oil costs. This change in energy cost is illustrated on Figure 3 from Figure 2 data.

Cost to Operate NESP Privately

In our original proposal to President Clinton, we estimated that the control system can operate privately for \$30,000,000 annually. Today, our estimate is \$50,000,000 annually. For operating this private control system, the Private National Energy Stability Agency (PNESA) would earn 10 percent of the import tickets. These tickets will sell through the public clearinghouse. PNESA would be government audited.

Venture Management Model

This NESP is being formally developed with our Venture Management Model. Figure 4 is P&FC's Venture Management Decision Process. We have completed the *Identification Level* study (plus or minus of 30% range) and are now ready to continue with the *Investigation Level* study. We estimate the *Investigation Level* study to cost \$1,000,000 and the results to decide if the *Recommendation Level* study should be conducted. The *Investigation Level* study will improve the confidence, accuracy level to the plus or minus 15% range. P&FC will sell limited partnership shares to fund the *Investigation Level* study. A limited partnership share will earn a set share of all future net profits. This has the potential to Centuplicate their investment annually.

It is the author's intention to work full time on this proposal during the *Investigation Level* study. Also, we will be seeking knowledgeable advice on this policy from reliable sources, industry, governmental and non-governmental.

We intend to have an updated proposal ready for the next President's inauguration, no matter which candidate wins in November.

FIGURE 1

P&FC's Basic Energy Industry Model

Energy Cost of Service/Revenue Requirement Centers

U.S. Energy Required
1996 90 Quadrillion BTU

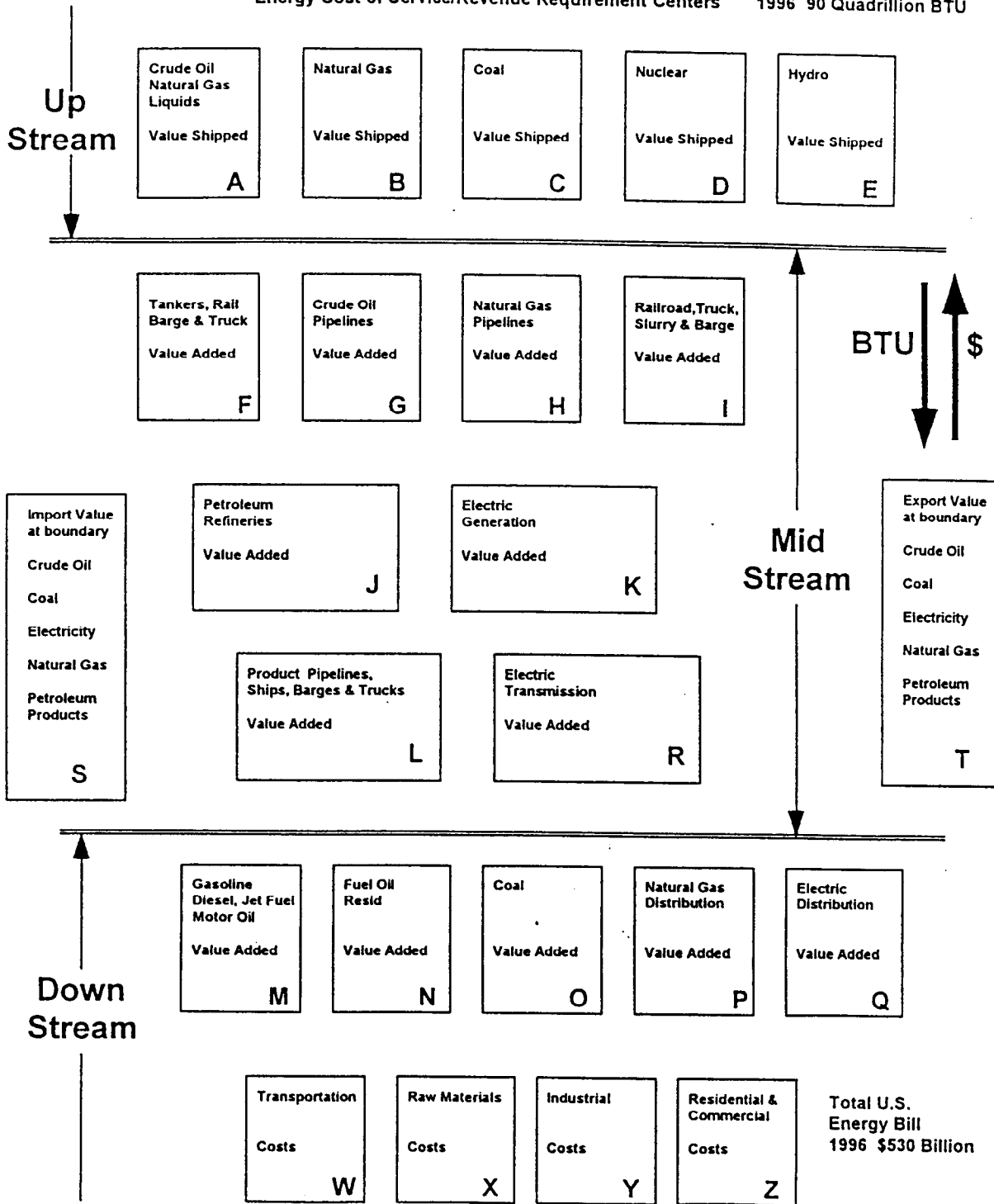
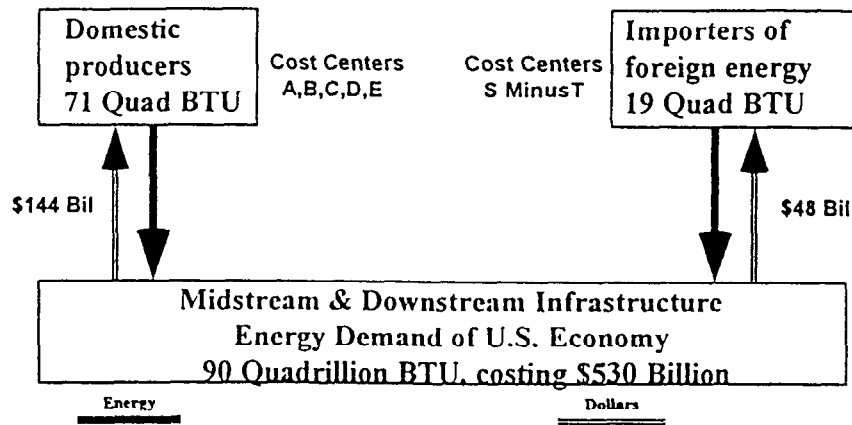


FIGURE 2

A Simple United States Energy Model
(Based on P&FC's Basic Energy Model, Fig. 1)



The United States Energy Situation

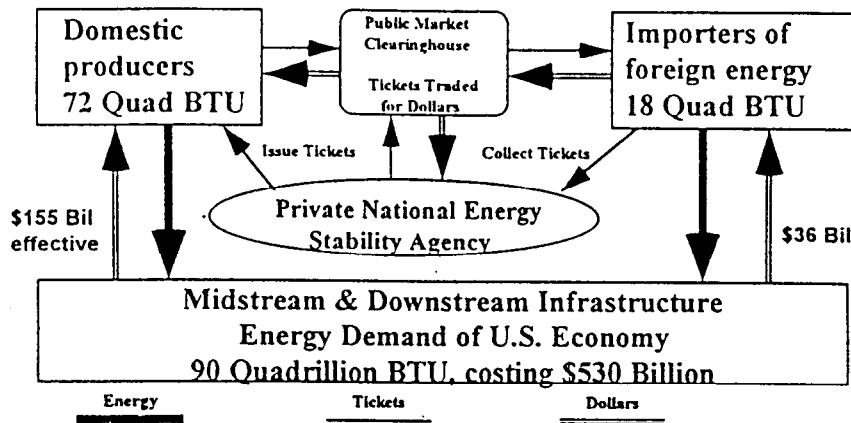
1. The United States foreign energy dependency is increasing, especially oil dependency. Today, total energy dependency is over 20%, with oil dependency over 50%. An interruption in our foreign oil imports would disrupt our economy and our American way of life. Of the 19 Quads of energy imported, 3 Quads are natural gas from Canada, with the balance oil, 16 Quads.
2. The interruption of the U.S. foreign oil supply can be used as a weapon against us. When the U.S. become overdependent, this weapon will be turned on us. The U.S. is guilty of using the intervention in oil trade weapon frequently. It is the President's responsibility to protect the American citizens from harm by foreign influences.
3. The above model illustrates today's energy situation. Society and the economy consume 90 Quads of energy, for which the consumers pay \$530 Billion. The domestic energy producers received \$144 billion for their 71 Quads, while the foreigners received \$48 billion for their 19 Quads. The Midstream and Downstream cost centers share the \$338 billion difference.
4. The domestic oil producer's problem is that oil is fungible, making for a universal oil price. This one price is always wrong: it is too low for domestic producers and higher than necessary for most foreign oil producers, especially those in the Middle East. Given this natural resource fact, the domestic oil production will continue to decrease and oil imports will continue to increase, causing the U.S. to become more and more oil dependent and more vulnerable.
5. To overcome this situation, several forms of market intervention have been suggested. All would work to some extent, but would be more costly to the American consumer, either directly or indirectly.
 - A. Install a tariff or floor price on imported oil
 - B. Increase tax on energy consumption to reduce volume to domestic production levels
 - C. Assist domestic producers through tax advantages and/or technology
6. The National Energy Stability Policy would limit energy imports to a set percentage of domestic consumption. This percentage would be set by the President. See Figure 3.

FIGURE 3

National Energy Stability Policy

(Performs DOE's principal function, maintaining U.S. oil supply security)

A Simple U.S. Import Energy Control Model

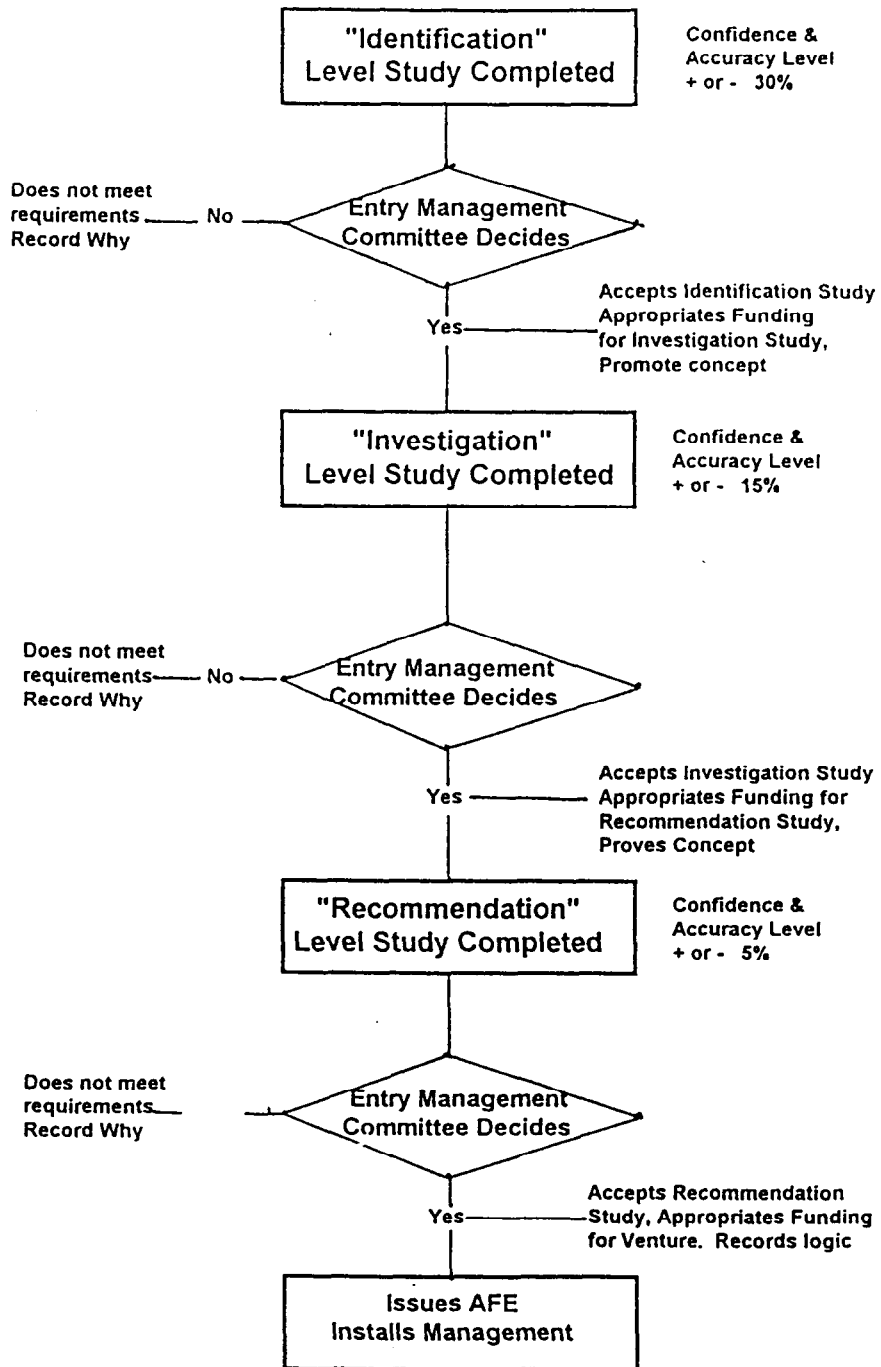


Required actions to implement NESP.

1. U.S. President implements a regulation that all energy imported into the U.S. must have an energy import ticket. The President currently has this legal authority, under existing trade laws.
2. U.S. President sets national maximum energy percentage dependency based on national security, balance of trade and international competitiveness considerations. (For example, assume the President sets United States foreign energy dependency at 20%)
3. U.S. Government accepts the Private National Energy Stability Agency's (PNESA) offer to operate the policy at zero cost to the government. Domestic producers would report their monthly production to the PNESA. PNESA would then issue import tickets proportional to their production. All producer's production data would be audited by the PNESA.
4. These energy import tickets would be earned by producing domestic energy. (Using the example dependency, for every 4 BTU produced, the producer would earn the right to import 1 cheaper foreign BTU. These import rights would have value, which would subsidize domestic energy production. The producers could import energy themselves or sell their earned tickets to other importers. A public market would soon develop to establish the value of the import ticket. This control system automatically limits energy imports to the percentage level determined safe and reasonable by the President.
5. PNESA would collect import tickets for each unit imported. Imports would be limited to the amount of import tickets earned. Also, the energy imports would be audited by PNESA.
6. PNESA would retain 10 percent of the import tickets to operate the NESP control system as a private enterprise. The federal government would audit the PNESA.
7. When U. S. consumers required additional energy, it will automatically come at this ratio, four from domestic and one from foreign. This policy automatically guarantees domestic producers a fixed percentage of the total domestic energy market. This system removes the threat of low oil prices on domestic producers and also lessens the threat of future disruption by foreign oil suppliers.

FIGURE 4

P&FC's Venture Management Decision Process National Energy Stability Policy



❖ Trend Discontinuity ❖

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Political

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STATUS REPORT ON NATIONAL ENERGY STABILITY POLICY

This **Trend Discontinuity** is an update on our National Energy Stability Policy efforts. I have just returned from a week in Washington, meeting the staffs of the Senate and House about energy policy. I also met with the leadership of the congressional 'Oil & Gas Forum.' We have made some progress, and though it's a huge challenge, I will eventually win. The reason I will win is that I have an energy model that best mirrors the real energy world. Our twenty-five year track record proves this model's insight and accuracy.

I have actively championed this specific national energy policy for nearly a decade. The nation's total energy foreign dependency went up 5.8% and the oil foreign dependency increased 13.6% during that time.

Changing the way the world energy system works is no small task. This energy policy is now becoming more known. In January of 1993, I formally forwarded a 35 page offer to the Clinton Administration.

We are now preparing an updated offering for the next administration, no matter which candidate wins. There seems to be a movement in the U.S. to get the government out of the energy industry and out of regulation of energy.

Abolishment of DOE, Deregulation of Energy

Both houses of congress have bills introduced to abolish the Department of Energy. Senator Rod Grams of Minnesota submitted SR 1678 and Representative Todd Tiahrt of Kansas submitted HR 1993. These bills are not anti energy as much as they are just trimming the federal budget.

There certainly is a definite movement today in this country toward deregulation of energy. Oil deregulation at the wellhead generally came under President Reagan. The FERC started natural gas deregulation in the late 1980's, and electric deregulation is now being implemented.

Our definition of energy regulation is 'any form of market intervention to cause some desired response.' Less intervention generally means less regulation. Deregulation

works best when you have competitive fuels to compete and anti trust laws to overcome monopolistic practices.

Energy deregulation only works when is it completely internal to the United States. Energy imported into the United States is not always subject to the free market. Foreign governments sometime intervene or threaten to intervene. Our federal government needs to control its own destiny by controlling the oil imports from our side of the equation.

It is important to remember this key fact: "OPEC may own the oil but the United States still owns the market." When the U.S. becomes over dependent, this fact will become irrelevant.

Today's domestic energy deregulation movement does not relieve the need for some type of national energy intervention policy to protect against foreign manipulation of our imported oil supplies. The United States is always quick to interfere in other nation's oil trade.

The President Remains the Key Energy Regulator

The President of the United States most important job is to protect the nation from disruptions inflicted by foreign powers. We know this as foreign policy. It is the one governmental task that a governor or bureaucrat cannot perform. The only practical, and constitutional, arrangement is for the President to be ready to dispatch a diplomat or an army to some trouble spot to look after Americas interests. The security of the nation is in his hands; and the security of the oil import supply for this nation, is also in the President's hands.

It is critical that the president not wait till a crisis to act on an oil import policy. Preventive action now will avoid an oil supply crisis later.

Congress created the Department of Energy to assist the president with his oil security task. This nation's foreign oil supply security will always remain one of the president's task, with or without the DOE. It certainly would be wrong for the President to have to rely on the Department of Defense for securing the U.S. oil supply. Is this being done in Saudi Arabia today?

Authority of the President

The president currently has the authority to act if the nation or its citizens are being harmed or threatened. The basis of this authority is on existing trade law. The law requires the president to investigate if domestic producers are being harmed or if there is an oil security threat. Every investigation so far has found there is a threat or harm. The most recent case was when the Department of Commerce study found the same, but the recommendations were ineffective. The oil imports continued to increase.

Design of a Privatized Energy Policy Control Model for the President

The National Energy Stability Policy is a control methodology that would allow the president to use his powers to limit energy imports to a safe and prudent volume. Implementation of this policy would not raise the cost of energy to the U.S. Consumer, based on our energy model.

We have designed this policy so that a private organization could operate it, saving a major government expense. The operating expenses will come from claiming ten percent of the benefits that will be transferred to the domestic producers from the foreign oil suppliers.

We use the following three Figures to develop the controlling mechanism. Figure 1 is P&FC's basic energy model. In 1996, the U.S. will consume 90 quadrillion BTU's of energy, for which they will pay \$530 billion.

From this, Figure 2 is an even more simplified United States energy model version. This model shows 1996 energy consumption and dollars paid for this energy. The U.S. producers receive \$144 billion for the 72 quadrillion they supplied. (Represented by A,B,C,D,E centers on Figure 1) The foreign producers receive \$48 billion for the 18 quadrillion they supplied. (Represented by S minus T centers on Figure 1) The commentary on this Figure briefly describes the current U.S. energy situation.

We add a privatized control mechanism to Figure 2 to create the National Energy Stability Policy as illustrated on Figure 3.

Implementing the policy, the consumer would always have all the energy he wants, but the supply would come at the percent foreign and percent domestic the president decides. Figure 3 commentary briefly describes how the model works.

When implemented, our model says the same amount of imported energy will only cost \$36 billion, and the domestic producers will effectively receive \$155 billion for

their same eighty percent supplied. This means the energy consumer's bill will not change. This control of energy imports does two important things: First it transfers part of the money that was going for imported energy to domestic producers, and second it eliminates the threat of low oil prices on our domestic oil producers. These two factors will allow domestic producers to easily supply the percentage specified by the President.

Formal Replies

To date, I have two key analysis of this policy. Secretary General Subroto of OPEC responded in writing with the commentary that the policy would work, and would be very detrimental to OPEC. His response is shown in Figure 4.

Mr. Len Coburn, Office of Oil Policy for the Department of Energy also responded. His analysis was that in general, the policy would not be favorable for the United States. His response is shown in Figure 5.

It is gratifying to have the benefit of these two analysis. Both re-enforce my convictions that the policy would perform as the model forecasts.

Additional Analysis by Others

It is our intent to have additional knowledgeable, influential people and organizations formally review and analyze this policy.

- * I personally asked the Secretary of Energy last week for a private meeting to discuss our energy proposal to the Clinton Administration.
- * Two congressman would like the Congressional Budget Office to "score" this NESP proposal.
- * I have requested that the Office of Management and Budget to analyze the policy.
- * The United States International Trade Commission will review the effects of the policy.
- * I believe the Energy Information Administration should evaluate the policy, based on their new energy NEMS model.
- * We welcome all energy trade associations to review this policy in depth. Also to present what they desire in the way of national energy policy.
- * It would be nice if the International Energy Agency in Paris would provide their analysis of this policy.

Lastly, in late October, I am chairing a session on U.S. energy policy. This will be at the annual meeting of En-

Figure 1

P&FC's Basic Energy Industry Model

Energy Cost of Service/Revenue Requirement Centers

U.S. Energy Required
1996 90 Quadrillion BTU

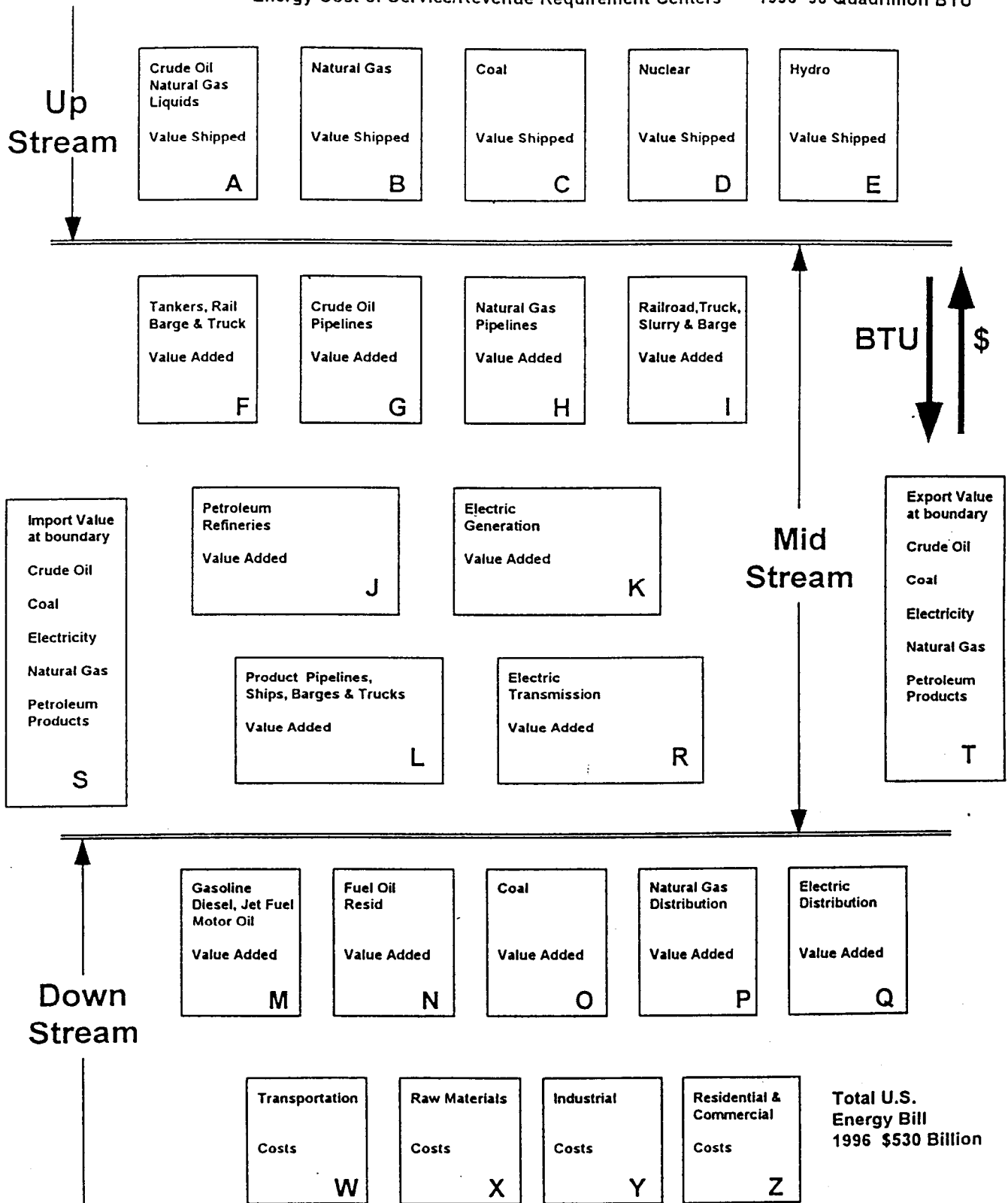
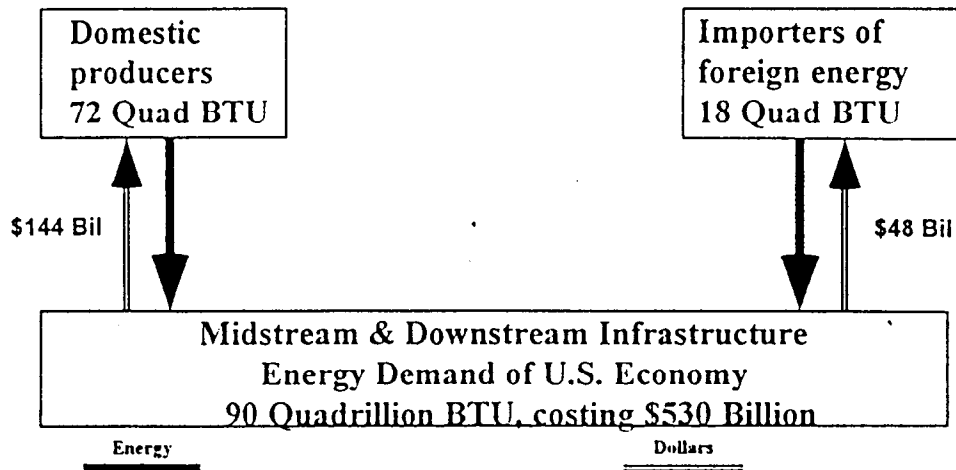


Figure 2

A Simple United States Energy Model (Based on P&FC's Basic Energy Model, Fig. 1)



The United States Energy Situation

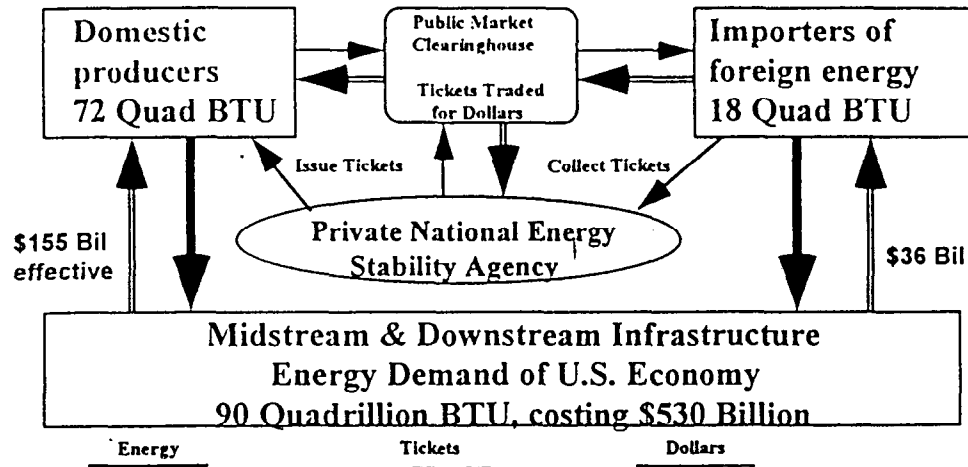
1. The United States foreign energy dependency is increasing, especially oil dependency. Today, total energy dependency is over 20%, with oil dependency over 50%. An interruption in our foreign oil imports would disrupt our economy and our American way of life. Of the 18 Quads of energy imported, 3 Quads are natural gas from Canada, with the balance oil, 15 Quads.
2. The interruption of the U.S. foreign oil supply can be used as a weapon against us. When the U.S. become overdependent, this weapon will be turned on us. The U.S. is guilty of using the intervention in oil trade weapon frequently. It is the President's responsibility to protect the American citizens from harm by foreign influences.
3. The above model illustrates today's energy situation. Society and the economy consume 90 Quads of energy, for which the consumers pay \$530 Billion. The domestic energy producers received \$144 billion for their 72 Quads, while the foreigners received \$48 billion for their 18 Quads. The Midstream and Downstream cost centers share the \$338 billion difference.
4. The domestic oil producer's problem is that oil is fungible, making for a universal oil price. This one price is always wrong: it is too low for domestic producers and higher than necessary for most foreign oil producers, especially those in the Middle East. Given this natural resource fact, the domestic oil production will continue to decrease and oil imports will continue to increase, causing the U.S. to become more and more oil dependent and more vulnerable.
5. To overcome this situation, several forms of market intervention have been suggested. All would work to some extent, but would be more costly to the American consumer, either directly or indirectly.
 - A. Install a tariff or floor price on imported oil
 - B. Increase tax on energy consumption to reduce volume to domestic production levels
 - C. Assist domestic producers through tax advantages and/or technology
6. The National Energy Stability Policy would limit energy imports to a set percentage of domestic consumption. This percentage would be set by the President. See Figure 3

Figure 3

National Energy Stability Policy

(Performs DOE's principal function, maintaining U.S. oil supply security)

A Simple U.S. Import Energy Control Model



Required actions to implement NESP.

1. U.S. President implements a regulation that all energy imported into the U.S. must have an energy import ticket. The President currently has this legal authority, under existing trade laws.
2. U.S. President sets national maximum energy percentage dependency based on national security, balance of trade and international competitiveness considerations. (For example, assume the President sets United States foreign energy dependency at 20%)
3. U.S. Government accepts the Private National Energy Stability Agency's (PNESA) offer to operate the policy at zero cost to the government. Domestic producers would report their monthly production to the PNESA. PNESA would then issue import tickets proportional to their production. All producer's production data would be audited by the PNESA.
4. These energy import tickets would be earned by producing domestic energy. (Using the example dependency, for every 4 BTU produced, the producer would earn the right to import 1 cheaper foreign BTU. These import rights would have value, which would subsidize domestic energy production. The producers could import energy themselves or sell their earned tickets to other importers. A public market would soon develop to establish the value of the import ticket. This control system automatically limits energy imports to the percentage level determined safe and reasonable by the President.
5. PNESA would collect import tickets for each unit imported. Imports would be limited to the amount of import tickets earned. Also, the energy imports would be audited by PNESA.
6. PNESA would retain 10 percent of the import tickets to operate the NESP control system as a private enterprise. The federal government would audit the PNESA.
7. When U. S. consumers required additional energy, it will automatically come at this ratio, four from domestic and one from foreign. This policy automatically guarantees domestic producers a fixed percentage of the total domestic energy market. This system removes the threat of low oil prices on domestic producers and also lessens the threat of future disruption by foreign oil suppliers.

ergy Economists in Boston, where I will publicly present this policy.

Key Data and Assumptions that Need Further Scrutiny

The following is some key data that needs further verification and documentation:

- * First, the differential estimate between the domestic oil price and the foreign oil price will need verification. (ie, the value of the import tickets) Also, some sensitivity analysis based on various levels of dependency the President may set, such as 18% or 22%. We recommend he starts out at 20%, which is about where our energy dependency is today. After a year or two, he can modify the percentage dependency, as he views international competitiveness, balance of trade and national security.
- * Review the implications on NAFTA, World Trade Organization agreements. Our present reading is that this policy can be implemented under the existing agreements.
- * Review the economic implications for competitiveness on international trade, especially petrochemicals.
- * Determine the potential government reductions in expenditures with this policy implemented.

Figure 4

Organization of The Petroleum Exporting Countries

10th March, 1993

Dear Mr. Steffes,

I should like to acknowledge, with thanks, receipt of your letter dated 21st January, 1993, addressed to the President of the United States and copied to me. It was very kind of you to send me that copy.

I assume that you are interested to know OPEC's reaction to your proposal, and it is with this in mind that I write you this letter.

The acceptance by President Clinton of your proposal would have far-reaching implications for OPEC: The immediate impact would be that demand for OPEC oil would be reduced. Furthermore, the price of international crude would decline, and the annual loss for OPEC would be that the Organization would have less investable funds for modernization and expansion. Since demand, world-wide, is expected to increase due to a growing world population and higher energy need for development, a decrease in oil supply would result in a higher oil price later on. This roller coaster movement of oil prices is what OPEC tries to prevent, convinced that this would be detrimental to both producers and consumers, including the U.S. I do not know whether you have taken into consideration the effect your proposal, if implemented, could have on others, for instance, on OPEC: as far as our Organization is concerned, the effect would certainly be negative.

Yours sincerely,

Subroto
Secretary General

Figure 5

Department of Energy

April 23, 1996

Dear Dale:

I enjoyed talking to with you during your visit to the Department on March 28, 1996. I asked my staff to look over your intriguing proposal for a Private Energy Stability Commission or PESC. While there is little doubt that such a plan could reduce imported energy and revitalize some segments of the U.S. energy producing sector in the future, we believe the cost to consumers and to the U.S. economy would far outweigh any energy security benefit.

Stripped to its essentials, the PESC is a trigger-based quota policy with the rights to import given to domestic energy producers. The suggested trigger is energy imports reaching 20 percent of energy consumption, which is about what the United States imported in 1995. Consequently, there would be only small economic effects in the very short run in PESC were implemented now.

In the longer term, however, PESC would have considerable bite. The Annual Energy Outlook for 1996 forecasts total energy consumption in 2015 of 108 quads, with imports of 32.25 quads or about 30 percent. Substantial energy, primarily oil, price hikes would be required to increase domestic production and back out imports to maintain energy imports at 20 percent of consumption. Unfortunately consumers would foot the entire bill for the increase in domestic oil prices, which would be substantial. Domestic producers would receive a triple windfall: higher prices for their products, outright cash subsidies in the form of quota rights, and a fall in world oil prices that would increase the value of the quota rights.

The U.S. economy would suffer several different ways under a quota scheme like PESC. First, higher oil prices would reduce the production potential of the U.S. economy and make oil intensive export goods less competitive on world markets. Second, substantial distortions would be induced into the energy sector by quota right subsidies handed out on a BTU basis. Only oil of the primary energy sources faces substantial import competition. Thus, quota right subsidies would send the wrong signals to natural gas, coal, nuclear, and renewable industries, for which there are no energy security concerns, and lower their costs for no net social benefit. Third, large bureaucracies would be needed to verify energy production, issue the quota rights, and enforce the trade restrictions. Fourth, a system of energy import quotas would violate international trade agreements that the United States was instrumental in negotiating.

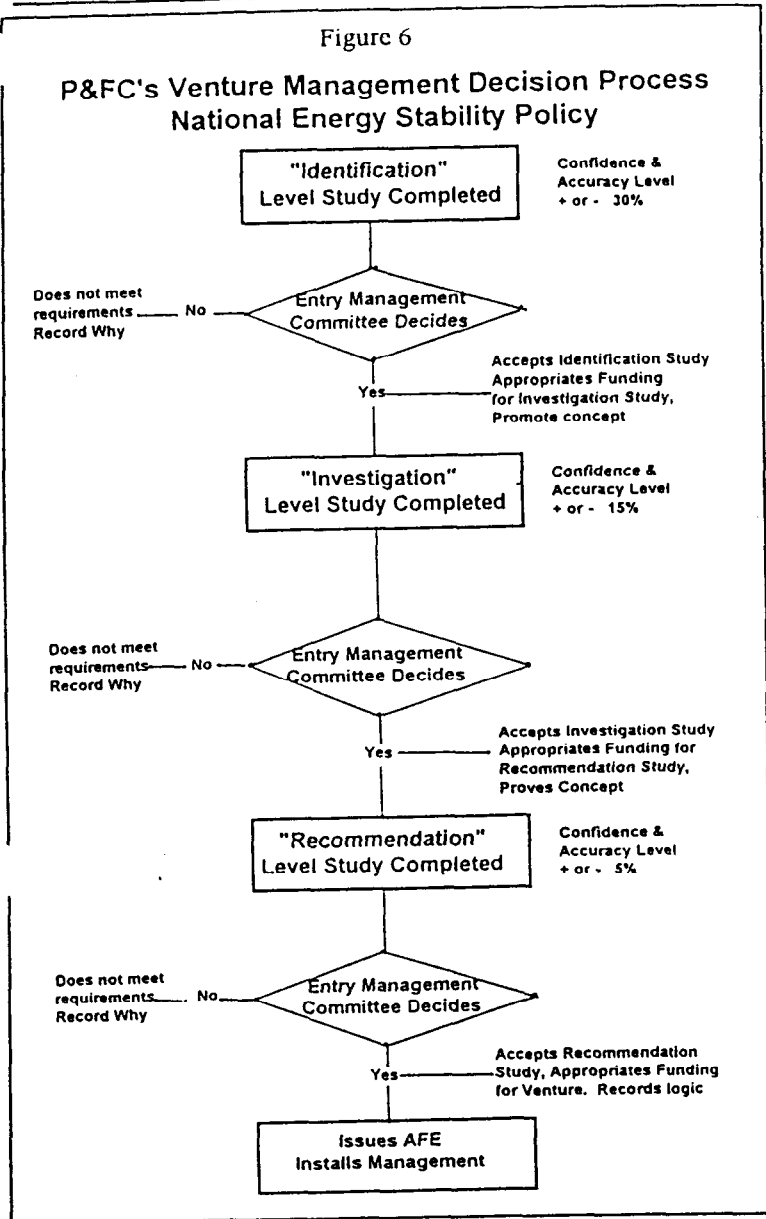
There would be, however, some potential benefits from PESC. The United States would be less oil intensive, so that in the event of a future oil price shock, the U.S. economy would suffer less economic damage. And to the extent that there are other external costs of oil use, higher prices for petroleum products could move the economy towards greater economic efficiency.

On balance, while there may be some benefits from PESC, the overwhelming evidence is that it would do far more harm than good. Moreover, there is no popular support for such a massive government intrusion into the energy sector. With unfavorable economics and politics, the PESC is an idea whose time has not yet come.

Thank you for your comments and interest in energy policy.

Sincerely,

Leonard L. Coburn
Director
Office of Oil Policy



Department of Energy
Department of Defense

* Hopefully, Article 10.1 of DOE's Initiative will soon be completed. This is an inter-agency study of the nation's oil security. It was due in December 1994, but is yet to be completed. I agree with the Secretary of Energy, it is needed!

* Evaluate the NESP from a U.S. 'balance of trade' and 'flow of funds' point of view.

* Compare the cost and benefits of other proposed energy policies, such as:

- Oil Import Tariff
- Oil Price Floors
- Energy Taxes on Consumption
- Give oil producers tax benefits
- Provide government technology

* Improve the operating cost estimate to the plus or minus 15% range for the next level for this private energy control system.

* Draft a regulation for the President to implement this policy.

Venture Management System

Figure 6 is P&FC's Venture Management Decision Process. It is a step process for developing a new major project. The information and the knowledge improve with each level in this process, but at a higher cost level. The final decision can eventually be reached, with complete confidence. Figure 7 is an abbreviated specification's table for each level of the venture management process. The next level to be undertaken is the Investi-

Figure 7

Specifications for Venture Management Decision Process

| Level of Study | Purpose of Study | Confidence Level/ Accuracy | Cost of Study | Data Source |
|---------------------------------|---|-------------------------------|---------------|---------------------------------------|
| Identification | "To Determine if Investigation level should be done." | +/-30% | \$250,000 | Public Data, Our Model |
| Investigation | "To Determine if Recommendation level should be done" | +/-15% | \$1,000,000 | Purchase Data, Research, Analysis |
| Recommendation | "To Decide to Do or Not to do" | +/-05% | \$5,000,000 | Actual Survey's, Lobby Administration |
| Issue AFE Install Management | Implement | | \$50,000,000 | |

gation level. Presently, we are seeking the necessary funds to conduct the "Investigation" level.

We are offering limited partnership shares. We intend to sell 10 percent of the future net profits to fund the "Investigation" level study. We will sell additional shares to fund the "Recommendation" level study if and when it is called for.

Planning & Forecastings Consultants are offering an in-house presentation to those entities that are sincerely interested in helping to resolve this national energy dependence problem.

Benefits for Funding the NESP

- * Each limited partner will be involved with the latest energy models and data. Much of this data comes from our annual study *"To Define The Energy Industry to the Year 2000"*. This could be a big opportunity to improve your assumptions for your next planning cycle.
- * Each limited partner will become much more knowledgeable about the possible forthcoming national energy policy.
- * Each limited partner could **Centuplicate** his financial investment for funding this "Investigation" level study of the NESP.

Conclusion

Some government bureaucrats and energy trade associations are very content with the status quo. They feel "owning" the energy problem provides them with job security. I am pleased that Planning & Forecasting Consultants "owns" the solution.

The time to implement this energy policy is now, before our dependency on imported oil reaches the point where it seriously threatens the American way of life.

Trend Discontinuity

Planning & Forecasting Consultants

P.O. Box 820228

Houston, TX 77282

Trend Discontinuity (TD) is an irregular monthly publication by Planning and Forecasting Consultants (P&FC) for decisionmakers only. The subjects are categorized into one of seven prime Influences (Natural Resources, Social, Political, Ecological, Economic, Geographical, and Technological) found in our "Assumption Generator" Model. Each deals with future trends foreseen. When no clear substantial trend discontinuities are visible, this publication will review/critique energy related books, articles, projects and proposals. When required, we will issue special additional editions. A minimum of 12 editions per year are expected.

TD is primarily published for the benefit of our retainer clients and to publicly document our energy forecasts. We also exchange/reciprocate subscriptions with other newsletters and energy publications. This networking enhances the holistic nature of our publication. TD welcomes both pro and con feedback from our readers. P&FC has scheduled for 1996, four public one day seminars on our management system and energy models.

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TD is a publication of P&FC, a for-profit 24-year old single proprietorship located in Houston, TX, USA. The editor and publisher is Dale W. Steffes. The editorial office is Box 820228, Houston, TX 77282-0228. Telephone: (713)467-4732 FAX: (713)497-4128.

P&FC is not a management consulting firm, but a strategy consulting firm. There is a major difference: Good management is doing **things right** - good strategy is doing **the right things**.

❖ Trend Discontinuity ❖

Volume 16 Issue 17

Political

September, 1996

The "Mother" of all Exploration Prospects

The Private National Energy Stability Agency (PNESA) is offering the rights to one percent of the U.S. energy import tickets. We will use the funds we generate by this offering to conduct the "Investigation" level study (See TD 16-16), and to promote the acceptance of this policy by the public and federal government.

For the estimated \$1 million in funding that we raise, the limited partners would receive ten percent (shares) of PNESA annual net profits, with a potential worth of \$100 million per year. This means a limited partnership's one percent share could Centuplicate* his investment annually. See Figure 1, PNESA Certificate of Ownership. The general partner has a buy back provision that caps the earnings at one hundred times.

The value of a limited partner's share most likely will increase when additional shares are issued to fund the "Recommendation" level study. This is not unlike buying seismic data to enhance the prior knowledge of an exploration well.

Normally, any substantial U.S. wildcat petroleum exploration well would cost more than one million dollars each. The maximum return expected would be a one time potential of \$ 20 million.

Each energy production company funding this NESP would also receive additional windfall benefits on all existing domestic production of about 8 percent. For example, if a company had 12.5 million dollars as an annual wellhead revenue, they would receive a one million dollar windfall of energy import tickets.

An additional benefit for each limited partner would be the information gained from P&FC's annual macro energy studies and unique energy models. (A \$48,000 value).

All independent domestic energy producers (oil, gas, coal, nuclear, and hydro) will be remiss if they don't seriously consider investing in this "Mother" of all oil prospects.

Brief Outline of National Energy Stability Policy

Figure 2 depicts P&FC's proposed National Energy Stability Policy. This model (policy) was developed in previous Trend Discontinuities over the last decade. For review, the President of the United States would set the percentage of energy to be produced domestically and the corresponding percentage to be imported. Currently that percentage is approaching 79% domestic and 21% imported with the oil dependency now exceeding 50% and increasing. The imported energy share is growing and needs to be stabilized at a prudent and safe percentage. Our recommendation is for the President to initially set the percentage at 80% domestic and 20% imported. After operating at this level for a while, the President will be able to adjust the import percentage as he sees necessary.

By limiting U.S. imports, the world oil price will tend to decline and the domestic oil price will tend to increase. This will cause two oil

prices, one for the U.S. and a lower one for the rest of the world. This means the limited oil imports will cost less. The economic rights to these less costly imports will be distributed to the domestic producers proportionally to their production. This will essentially subsidize domestic producers, at the cost of foreign producers. See ticket and dollar flows on Figure 2.

Our model indicates that U.S. foreign energy imports' cost will be reduced \$12 billion, which will be transferred to the domestic energy producers, less the cost for operating the PNESA system. The domestic producers will then effectively increase their revenues about eight percent. This increased revenue will enhance domestic energy production to the level set by the President.

General Benefits for the United States

1. Could save the U.S. Department of Defense \$??? Billion/yr. The military will not have to use oil supply as a crutch for a reason to go to war.
2. Could save the Department of Energy \$3 billion per year.
3. Will transfer to the U. S. Domestic energy producers \$11 billion per year, essentially from foreign producers.
4. Will allow federal government to collect an additional \$3 billion in FIT
5. Will eliminate the threat of OPEC induced low oil prices on domestic producers.
6. The operation of the NESP would come at no cost to the government. It would operate privately and funded by claiming ten percent of the energy import tickets.
7. With the energy import percentage set correctly by the President, the consumer's energy bill will not increase from the current \$530 billion per year.

The Management Agreement

The Administration will authorize the Private National Energy Stability Agency to operate this policy for ten percent of the energy import tickets. The Administration will implement a federal rule requiring all energy imports to have an import ticket. PNESA will have the authority to collect these tickets from the importers. PNESA will also have the authority to issue import tickets to energy producers proportional to their production. The total import tickets issued will be based on the percentage the President decides is safe and prudent for the United States. Both, the 1,000 importers and the 20,000 producers will be audited by PNESA for compliance. Non compliance will have federal judicial penalties.

The following is the agreement between Private National Energy Stability Agency (PNESA), a Limited Partnership and Planning & Forecasting Consultants (P&FC), a Single Proprietorship.

P&FC will provide overall management for PNESA (specifically, Dale W. Steffles) at a rate of \$10,000 per month.

* Centuplicate means a return of 100 times. Not one hundred percent, but one hundred times, or ten thousand percent annually.

Figure 1

Certificate of Ownership

A Registered Limited Liability Partnership
 State of Texas
 A One Percent Share
 of all net profits

Private National Energy Stability Agency

Planning & Forecasting Consultants (P&FC) has an offer pending with the United States Government to privately operate the National Energy Stability Policy (NESP). P&FC has organized this Private National Energy Stability Agency (PNESA) as a 'registered limited liability partnership' to operate this national energy policy.

Funds provided by the limited partners to the PNESA will be used to promote acceptance of this NESP by the U.S. Government and for the initial start-up expenses.

The PNESA will issue energy import tickets to all domestic energy producers, proportional to their production and collect energy import tickets from all energy importers for each unit imported into the United States. For operating this national energy policy, the PNESA would earn ten percent of the energy import tickets.

The President of the United States would set the amount of energy import tickets to be issued, as a percentage of energy dependency he deems prudent for the United States.

The PNESA would operate as a limited partnership. A limited partner will not be liable for any future obligations. Limited partnership shares are transferable.

For a \$ _____ investment, _____ will be a limited partner, and will receive one percent of all future net profits of the PNESA.

The general partner reserves the right to re-purchase this one share for \$10,000,000.

General Partner
 Planning & Forecasting Consultants

 Dale W. Steffes, Principal & Founder
 Box 820228, Houston, Texas, 77282

Limited Partner's Official Address

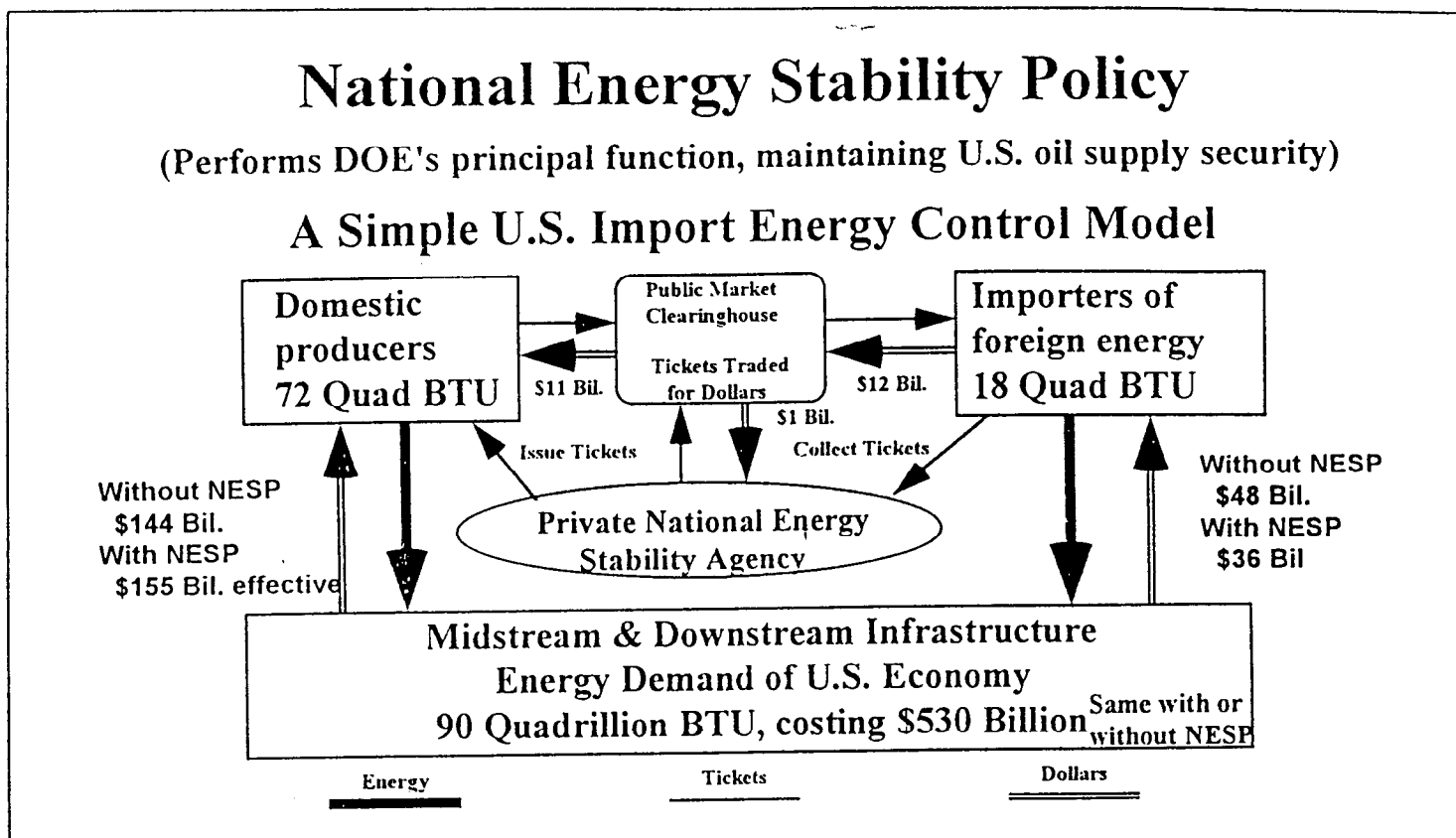
St. or Box _____

City _____ St. ___ Zip _____

Date _____

Certificate Number _____

Figure 2



PNESA will supply P&FC an automobile, plus direct expenses, postage, telephone & communications services, travel, out of town lodging, entertaining expenses, first class office space in Houston, subscriptions, memberships in trade associations and clubs, medical insurance. PNESA will provide secretarial services. PNESA will provide a CPA accounting and a quarterly audit of books. All expenditures will be reasonable and fully accounted for.

PNESA's "Investigation" Level Study

PNESA will contract for independent studies to improve the Venture Management "Investigation" to a confidence level of plus or minus 15%. The following eight studies and efforts will depend on the funding received.

1. PNESA will hire a Washington lobbyist, law firm, etc., to represent PNESA to the Administration. Congress. They are expected to provide P&FC with adequate office space and office services when they are in Washington D.C.
2. PNESA will fund a political PAC for lobbying the Administration and Congress.
3. PNESA will hire energy analysts to critique P&FC's energy model.
4. PNESA will hire a firm to verify U.S. energy importers and points of entry. PNESA will hire a firm to verify U.S. energy producers and points of production. See TD 15-10.
5. PNESA will hire a firm to review the NAFTA and WTO commitments, and determine their relationship on this policy.
6. PNESA will hire a firm to design a computer model to disperse energy import tickets and collect energy import tickets. Also, improve the cost estimate to operate this import ticket system.

(Presently, we estimate the PNESA operational cost at \$50 million per year.)

7. PNESA will hire a firm to draft an import regulation for the President to implement the National Energy Stability Policy, including its legality.

8. PNESA will work to have the various agencies "score" this policy: i.e. Congressional Budget Office, Office of Management and Budget, United States International Trade Commission, International Energy Agency, Energy Information Administration.

Product of "Investigation" Studies

PNESA will present to the next Administration, either Clinton or Dole, an updated proposal the day after their January inauguration. The initial proposal was hand delivered on January 21, 1993, by the then designated Deputy Secretary of Energy.

The results of the "Investigation" level study will be used to decide if the "Recommendation" level study (+ or -5%) should be undertaken. Then additional shares of the PNESA will be issued to fund that effort.

Why Should Federal Government Contract with Private National Energy Stability Agency to Operate Policy?

The reason the Administration should contract with the PNESA is that P&FC created the policy, P&FC nurtured the policy. P&FC has a reliable energy model that best mirrors the energy industry and this energy policy would operate at no cost to the federal government. It is quite evident that P&FC is the only one that has an energy model that truly understands the U.S. energy dependency dilemma. Our historical 25 year energy forecasting record most certainly proves this claim.

To overcome the U.S. energy dependency problem will require some form of market intervention. All proposed solutions are some form of market intervention, including this one. What is unique about our policy is that it is essentially paid for by foreign energy producers. Having to maintain our military in the Middle East is a very costly form of market intervention.

P&FC's principal consultancy is to provide energy strategies for companies and countries. The energy strategy we have designed for OPEC and IEA is complimentary to this policy. We have assisted several energy companies determine new energy strategies. (Our standard fee is \$96,000 per forecasting and planning cycle.)

Adoption of this energy policy will help maintain the superpower status of the United States, no small feat in itself.

Why Should You or Your Company Invest in This Oil Exploration Prospect?

Our energy model indicates that PNESA's right to import ten percent of the U.S. energy imports could be worth \$1 billion per year. A one percent share of PNESA could be worth \$10 million/yr forever. The initial asking price for a one percent share of PNESA is only \$100,000. Later ones will no doubt be worth more.

The PNESA has an opportunity to earn substantial money by privately operating this national energy policy. We are willing to share some of these potential profits with those investors that are willing to fund the "Investigation" level of this venture.

There is the possibility that the President would set the energy dependency level inappropriately. If he sets it too high, the tickets will have little value until the country reaches that level of imports. If

the President sets it to low, the tickets will have a high value, but the energy bill to the domestic consumer will increase, which is presently politically unacceptable. There is also the possibility that the President will not accept this energy policy offer.

Exxon is the largest U.S. producer of domestic energy with 3.83% of U.S. domestic energy, which would make their energy import rights worth about \$380 million per year. All domestic producers would share proportionally. See TD 15-10 for the 400 largest energy producers in the United State and their respective shares of U.S. energy production. These import ticket rights will increase all of your existing domestic production revenues about eight percent.

This national energy stability policy will eliminate the threat of low oil prices on the domestic producers. This fact alone will cause them to be much more productive.

Texas produces about 19 percent of the domestic energy. The Texas energy producing companies would have a windfall of \$1.9 Billion.

Your participation in this policy will place you and your company at the forefront of national energy policy. You will be tuned to the finest energy model and forecast. The energy information gained will materially assist with your energy strategy. You will recoup your investment by using better strategic planning for your company.

This national energy policy will help the United States retain their superpower status. Your company can take pride in the part they played in solving our national energy dependency dilemma.

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P&FC is not a management consulting firm, but a strategy consulting firm. There is a major difference: Good management is doing things right - good strategy is doing the right things.

Date October 18, 1996

To Don Carlson, Fax 202 225 4381 Tel 202 225 2571

From Dale Steffes Fax 713 497 4128 Tel 713 467 4732

- Bill ARCHER'S A/A

Request for USITC to conduct a 332 study of the proposed NATIONAL ENERGY STABILITY POLICY

USITC contact Ms. Cynthia Foreso Fax 202 205 1859 Tel 202 205 3348

Ref: Offer to President Clinton, dated January 21, 1993 to privately operate the National Energy Stability Policy.

The proposed National Energy Stability Policy would have the President limit the amount of energy imported into the United States to a specific, prudent percentage of domestic energy consumption. The current U.S. energy imported is between 20 and 21 percent of total consumption. If this energy policy was implemented, it would create two world oil prices, one for the United States and one for the rest of the world.

The request is for the USITC to project the various effects if the President implemented this policy at the various energy dependency percentages: 16%, 18%, 20%, 22%, 24%.

What will the world oil price be?, what will the domestic oil price be?
Estimate the import ticket rights trading value?

What effect will implementing this policy have on the U.S. economy?

What effect will implementing this policy have on the U.S. budget?

What effect will implementing this policy have on the U.S. consumer's energy bill?

What effect will implementing this policy have on the other domestic energy supplies?

What effect will implementing this policy have on the U.S. military budget?

Present trade laws allow the President to implement this policy. What will the WTO and NAFTA implications be?

This policy will protect domestic producers from low foreign oil prices. What is this worth to domestic energy producers? financial lenders?

P&FC has offered to physically operate this policy privately for ten percent of the import tickets. Please estimate the cost of issuing the import tickets to the domestic producers and collecting the import tickets from the energy importers.

Planning & Forecasting Consultants
Houston, Texas

A background paper
on
studies, efforts
addressing

United States Oil Dependency

To analyse this
potential national threat

and if it is a threat, move it to the
National Public Agenda

Not for publication or distribution
(713) 467 4732

A brief on U. S. oil (energy) dependency studies, efforts to determine if this is a threat to U.S. hegemony

United States domestic oil production peaked in 1970 at 3.5 billion barrels, and oil imports that year were 1.4 billion barrels. By 1995, annual domestic oil production declined to 2.4 billion barrels, while oil imports rose to 3.3 billion barrels, causing the United States dependency on foreign oil supply to be much higher. Shown on Figure 1.

During that same time period, the U.S. oil reserves decreased from 38 billion barrels in 1970 to 22 billion barrels in 1995. Reserves are defined as known oil deposits that are producable in the future with today's economics and technology. A bank will lend money on oil reserves as collateral.

Domestic oil production over this 25 year period was 65 billion barrels. This was possible because the petroleum industry is an ongoing entity, which continually searches for new reserves as those previously found are depleted.

Figure 1

| Year | U.S. Oil Dependency | | |
|------|------------------------------|-------------|---------|
| | Reserves | Production* | Imports |
| | ------(Billion Barrels)----- | | |
| 1970 | 38 | 3.5 | 1.4 |
| 1995 | 22 | 2.4 | 3.3 |

* Over this 25 year period, the U.S. produced 65 billion barrels of oil.

This level of oil dependency could be a possible threat to United States' world hegemony. This national oil dependency is not a concern of the general public at this time, but this national oil dependency needs to be made better known to the general public and within the energy industry in general.

Overview of Past & Current Studies, Efforts on the U.S. Oil Dependency

However, this public complacency does not mean that the energy dependency subject is not being debated in select circles. The following are some briefs on current work and reviews of past efforts on addressing the oil dependency of the United States.

1. Past Secretary of Energy, Hazel O'Leary attempted to formally address this issue in her Oil & Natural Gas Initiative of 1993. The specific initiative was article 10.1, which called for a governmental inter-departmental task force to address the oil dependency of the U.S. within the following twelve months. Nothing ever came of this effort because some select departments in the federal government chose not to participate, therefore no report was ever completed. P&FC authored an exclusive newsletter, Oil Security Newsletter, for just these inter agency members.

2. The 1977 energy legislation establishing the Department of Energy requires a bi-annual report on the U.S. energy situation, including the energy dependency problem. The last report issued was August 1996. The title was Sustainable Energy Strategy. It was a none event when issued. However, the house budget committee then asked the General Accounting Office to review this DOE report. The title of the GAO report was ENERGY SECURITY: Evaluating the U.S. Vulnerability to Oil Disruptions and Options for Mitigating Their Effects. This GAO report did cause some energy industry discussion, because it indicated that the United States was better off economically using cheaper, imported foreign oil.

3. The James A. Baker III Institute for Public Policy at Rice University recently completed a year long study (April 1997) related to the availability and reliability of oil from the Middle East. It was an academic effort and will be a valuable addition to the dialogue. There were seven sub reports. Amy Jaffee, formerly with PIW, coordinated this study effort. The full title of this year long study is: Political, Economic, Social, Cultural, and Religious Trends in the Middle East and the Gulf and Their Impact on Energy Supply, Security, and Pricing.

4. The Interstate Oil & Gas Compact Commission has an on going effort to address the subject energy dependency. Five governors along with a select member of congress have taken the responsibility of 5 task reports to address select facets on the subject. Their efforts are based on IOGCC's recent report A Dependent Nation: How Federal Oil and Gas Policy is Eroding America's Economic Independence.

Governor George Bush of Texas and Rep Lee Hamilton of Indiana will address the cost of imported oil, including military related expenditures. Governor Geringer of Wyoming and Sen. Jeff Bingaman of New Mexico will address improving recovery from existing U.S. resources. Governor Gary Johnson of New Mexico and Rep J.C. Watts of Oklahoma will address the use of incentives for encouraging domestic exploration and production. Governor Bill Graves of Kansas will address energy conservation. Governor Tony Knowles and Sen. Don Nickles of Oklahoma will address the impact of oil imports on the trade deficit.

5. The trade laws of the United States includes a clause that states if an import harms a domestic industry or is a threat to national security, the President has the authority to intervene. The IPAA and TIPRO petitioned the Administration to investigate the role of oil imports on the domestic industry and national security. In 1994, the Department of

Commerce conducted an investigation on the matter. The Commerce Department report found that oil imports are a threat and made some recommendations. The recommendations were non effective, as oil imports have continued to increase.

6. Independent Petroleum Association of America and American Petroleum Institute, along with several state oil and gas associations have proposed a joint public education effort, similar to the milk, beef and plastic industry public relations efforts.. This policy would have a small tax on the first sale of oil and natural gas and these moneys would be spent on public relations advertising, etc. The state of Oklahoma has recently implemented a similar program. However just recently, the API decided not to participate

7. President Carter's "Moral Equivalent of War" policy was very successful in reducing the U.S. oil dependency. During his administration, the total U.S. energy dependency went from 23%, down to 12%. He essentially accomplished this with higher oil prices, i.e. the windfall profits tax. Figure 2, which is a R&FC graph issued in 1987, shows the total energy dependency from 1970 to the year 2000. From 1987 on was forecasted and appears to be a fairly accurate forecast. Also shown is "Nixon's Project Independence".

Figure 2

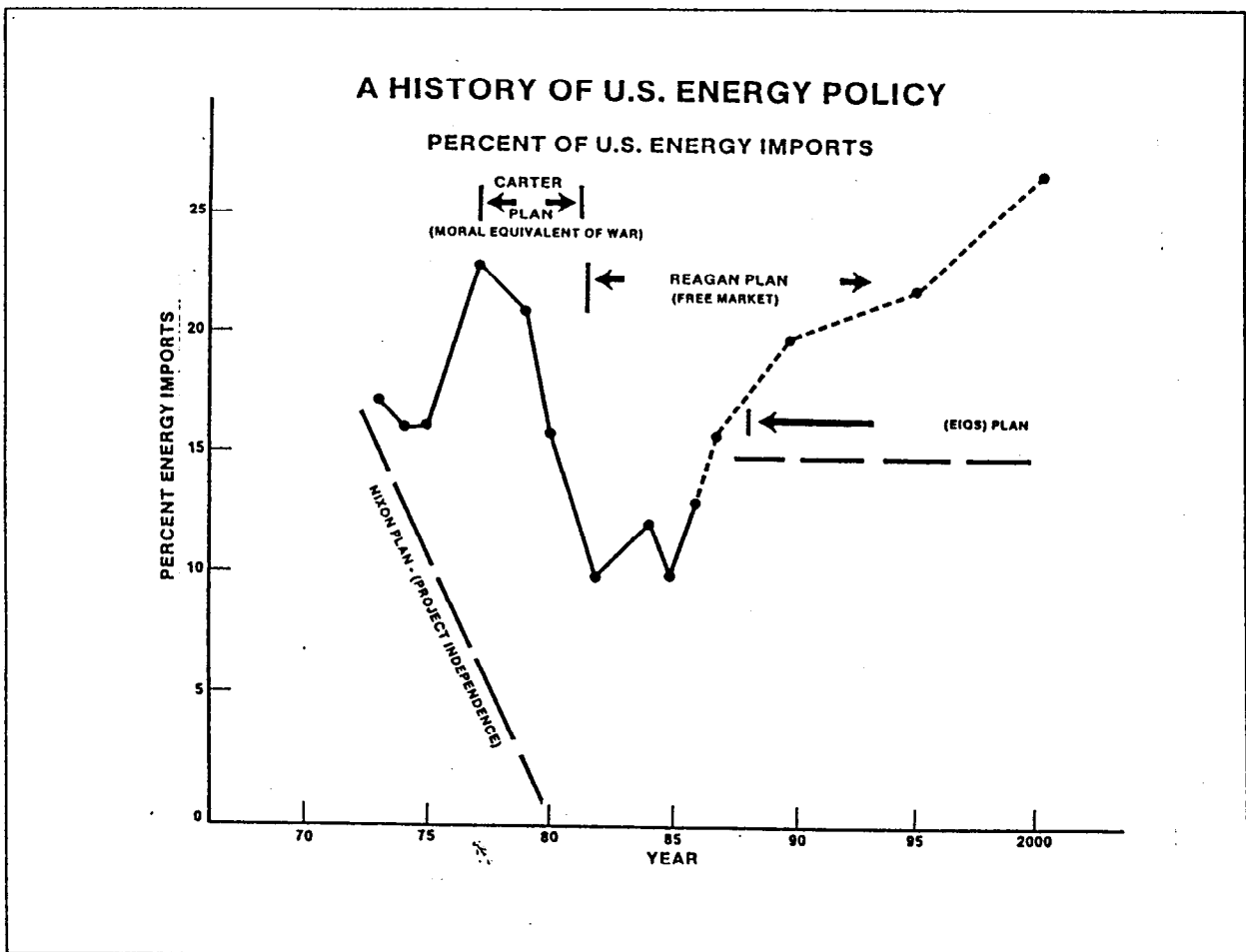
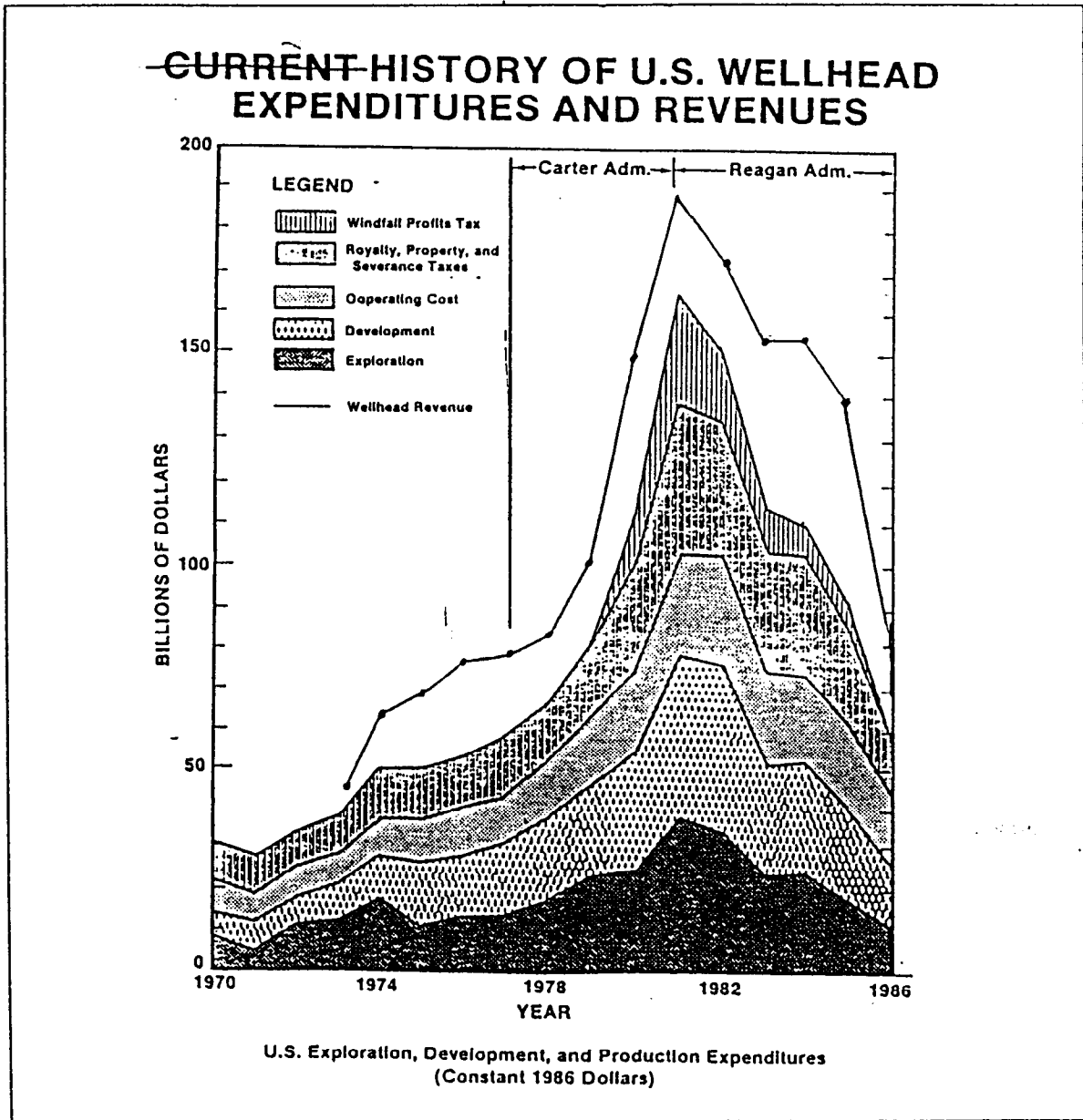


Figure 3 is a history of U.S. wellhead expenditures and revenues from 1970 to 1986. When President Carter took office in 1977, the value of the domestic oil and gas produced that year was about \$75 billion. In his last year in office, 1981, the value for the oil and gas production was \$191 billion. Under President Reagan, the wellhead revenues fell to \$80 billion by 1986, and the percentage of energy imports started rising again.

It is P&FC's analysis, that the windfall profits tax caused the world oil price to peak at \$34 a barrel in 1981. Without this tax, the world oil price would have peaked at \$25/barrel.

With these high oil prices, U.S. demand declined and supply increased, lowering oil dependency during the Carter years, as shown on Figure 2.

Figure 3



8. Members of congress formed an Oil & Gas Caucus in 1995 (107 congress) to address this issue. However, very little ever came out of this caucus. That caucus has been re instituted this session, with about 207 senators and 607 congress as members. Sen. Kay Bailey Hutchinson of TX. and Sen., John Breaux of LA are the Senate leaders and Rep Poshard? of IL and Rep McCery? of LA are the House leaders.

There is filed legislation in congress to eliminate the Department of Energy. Sen. Grams of Minnesota and Representative Tiahrt of Kansas are leading this effort.

9. The major oil companies have made a conscious, unanimous decision not to get involved in the U.S. oil dependency debate. I concur with their public position, because it is a "no-win" situation for them. Also, the majors have much oil production overseas, which they want to be able to import into the United States energy market.

10. The International Energy Agency was founded in 1974 to represent the energy consuming countries. This was a response to the formation of OPEC. IEA's two main functions are to have members maintain a stockpile of oil supplies and implement an sharing agreement in the event of a supply disruption. The other service they perform is to compile and disseminate information on oil stocks, consumption & production trends.

The DOE is holding hearings again on the Strategic Petroleum Reserves. (O&GJ, 5 5 97)

11. The recent Gulf War (1990), which was estimated to cost \$50 billion plus, was really about world oil supply availability and reliability.

12. The State Department must continually take into consideration the world oil prices when it implements actions to disrupt foreign countries oil trade, i.e. Iraq, Iran, Libya. Without these sanctions, world oil daily supplies could easily be two million barrels more, changing the world oil supply and demand balance. The National Association of Manufacturers has taken a lead role against international sanctions by the U.S. government. (O&GJ May 5, 1997) Mobil has been issuing paid editorials against economic sanctions.

13. In 1993, Samuel Huntington wrote The Clash of Civilizations for Foreign Affairs. This basic article alludes to the Cold War being over and the new conflict will be between civilizations, those with oil and those without oil.

14. Many organizations are encouraging energy conservation. The basis for their efforts normally are for either energy security reasons and/or environmental reasons. The Energy Foundation has been formed by three large charitable foundations to promote conservation and alternative fuels, with a \$10 million per year budget. Of course the Department of Energy also has an energy conservation effort that effects energy demand. Some efforts are mandatory and others are voluntary. The Rocky Mountain Institute (Lovins) has been advocating energy conservation since its inception. There is a government-industry effort to improve automobile mileage by a factor of three.

15. Many states and even the federal government are providing some tax relief and incentives to stimulate marginal oil and gas production. This movement started in Texas when the Texas Railroad Commission and the Comptroller pushed legislation to provide

incentives to keep marginal production in service. The logic is based on an input-output model, which says even uneconomical local oil production enhances the local economy. The federal government granted deep offshore royalty relief to encourage that production.

16. The Chairman of the Texas Railroad Commission, in a Houston Chronicle op-ed, Dec. 30, 1996, stated "Energy Independence is well within our grasp" meaning the U.S.

17. On May 14, 1996, the Houston Chronicle carried an article by the World Resources Institute of D.C., headlined "End of the oil era is now in plain sight".

18. On May 5, 1997, the Secretary of Energy visited the Offshore Technology Conference in Houston. He stated that instead of making an energy policy, the department would be establishing an energy strategy. His eight recommendations were somewhat the standard litany of government want list. His traveling aides indicated that Mr. Kyle Simpson, Office of the Deputy Secretary and Mr. Jay Hakes, EIA Administrator would be the lead people to address U.S. oil dependency.

19. The United States Energy Association issued May 6, 1997, their tenth annual report on U.S. energy policy. It contains eight somewhat standard recommendations.

Planning & Forecasting Consultant's Past and Current Efforts on U.S. Energy Dependency

A. P&FC has designed and promoted a unique National Energy Stability Policy for the past decade. It operates similar to President Eisenhower's 1959 Oil Import Quota system. I've invested ten years and a lot of money in this energy dependence resolution. So far, this policy has not been accepted nor even seriously debated. However, OPEC Secretary General Subroto indicated it would hurt OPEC. Eventually, it will be recognized as the best solution to the U.S. Energy Dependency problem. (See figure 2). In 1987, P&FC wanted to cap energy imports at 15%. Our formal offer on Jan. 21, 1993, to President Clinton was to cap them at 20%. It won't be long until total domestic energy dependency will surpass 25%. This means oil dependency will soon be approaching 60%.

B. P&FC's current efforts are concentrated on informing the energy consumers and energy investors about this energy supply vulnerability and what to expected in energy prices.

We are repeating a 1971 seminar held to inform the National Association of Business Economists about the vulnerable U.S. energy situation. This time, the seminar will be held under the auspices of the Houston Energy Chamber of Commerce. It is specifically designed for energy consumers and energy investors. It will be offered as a "member service" through various professional societies and trade associations. As of this date, the local chapters of the National Association of Business Economist, the Strategic Leadership Forum, the Institute of Management Consultants, and the American Society of Heating, Refrigeration and Air Conditioning Engineers are offering this seminar to their local and national members. We are seeking several more national societies or associations to offer this seminar as a "member service".

This public energy seminar will be held in late Aug. 1997 in the energy capital of the world, Houston, Texas. We believe any energy consumer with an annual energy bill of over \$100,000 per year or investor with over \$100,000 invested in energy companies can prudently justify attending this seminar.

C. We will also search out other's proposed solutions and comments on U.S. oil dependency, and also determine how much of a threat is it.

D. P&FC intends to move the United States Oil Dependency to a higher level on the national agenda if it proves to be a threat to the nation's hegemony. We will do this by distribution of this TD via mail and public talks to interested parties.

Summary

We have only briefly summarized the many efforts to address U.S. oil dependency. Our files contain an in-depth background on each of these efforts. We will be issuing a final Trend Discontinuity on this subject when a factual conclusion is reached. We will be using our Mirror Energy Model for analysis.

If you are aware of other unique efforts on the subject of U.S. oil dependency, please bring them to our attention, and we will share them with others, as well as include them in our analysis.

The answer to this U.S. oil dependency question will directly affect the oil prices in the future. Both, the energy producers and the energy consumers need to know the answer.

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OIL-008
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JUN 3, 1999



You may be interested.

PIRINC has prepared the enclosed report entitled, *Oil and National Security*. The report has been submitted to the U.S. Department of Commerce, which has initiated a new investigation under Section 232 of the Trade Expansion Act of the effects on the national security of imports of crude oil and petroleum products.

Oil and national security have been the subject of government investigations over many years. All have found that oil imports threaten to impair national security. This report places these investigations in the context of oil market developments and then focuses on the issue of appropriate actions.

The most recent investigations, those of 1988 and 1995, led to recommendations in line with then prevailing Administration philosophies. Neither investigation recommended any direct presidential action to adjust imports, concluding that the costs would far exceed benefits. But in 1988 the Commerce Department recommended legislative actions to improve domestic supply and to add to the SPR and was silent on energy conservation. The 1995 investigation highlighted current Administration policies to promote efficiency and alternatives to oil, but virtually dismissed the supply-side of the equation. The new investigation should address both. Price developments over the past year should encourage the current investigation to recognize the vulnerability of domestic production to short term price declines and to consider measures such as more flexible royalties to address it.

If you have any questions or comments, please call John Lichtblau, Larry Goldstein or Ron Gold.

May 1999

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Oil and National Security

On April 28, the Commerce Department initiated a new investigation, under section 232 of the Trade Expansion Act of 1962 to determine the impact of imports of crude oil and refined petroleum products on the national security. Oil and national security have been the subject of a number of government investigations over many years. This will be the fifth Section 232 investigation of oil imports, following earlier investigations in 1975, 1979, 1988, and 1995. These are in addition to a 1959 investigation conducted under the Trade Agreements Extension Act of 1958. All prior investigations reached the same finding, that oil imports threaten to impair national security. The new investigation is likely to reach the same conclusion.

The rationales for the findings have differed over the years as have the actions taken in response. If a finding is made that imports represent a threat to national security, the President can then determine whether to use his statutory authority to "adjust imports." Under current law, this determination must be made within 90 days. In 1959, President Eisenhower used his authority to establish mandatory oil import quotas. In 1975, President Ford imposed oil import fees. The 1979 finding was used by President Carter to proclaim an embargo on imports of crude oil from Iran and later by President Reagan to proclaim an embargo on imports of crude from Libya.

The investigations of 1988 and 1995 led to recommendations in line with then prevailing Administration philosophies. Since the Executive Branch sits in as part of the study team, they are unlikely to be surprised by the findings. In neither case did the Commerce Department recommend any direct presidential action to adjust imports, (through quotas, tariffs or fees) concluding that the costs would far exceed benefits. But in 1988 the Commerce Department recommended legislative actions to improve domestic supply, including permitting exploration and development of the Arctic National Wildlife Refuge and the Outer Continental Shelf, to ease the licensing procedures for nuclear power, and to add to the SPR. In 1995, recommendations focused on continuing current Administration policies to promote energy efficiency and alternatives to oil. The current investigation would serve the public interest best if it addressed both supply and demand considerations in formulating its recommendations.

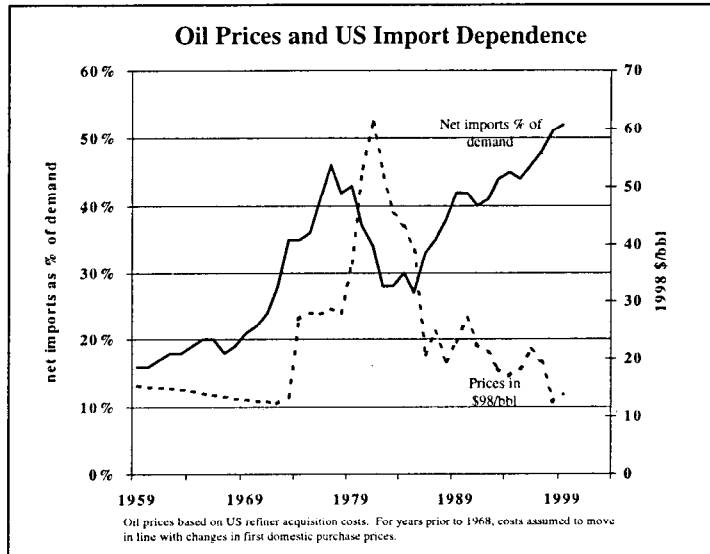
This report places these investigations in the context of oil market developments and reviews the various criteria for determining effects on national security. It then focuses on the issue of appropriate actions. Any such discussion must start with the recognition that a continued, high level of oil imports is inevitable and not necessarily undesirable. As previous investigations have pointed out, attempts to significantly curtail imports through tariffs or quotas would impose very high costs on the US economy. Moreover, there are more efficient ways of improving oil supply security: diversification of sources, and strategic inventories. The past year however has highlighted an additional concern; the vulnerability of the domestic industry to temporary sharp declines in world oil prices.

Here there is a case for limited action to minimize permanent losses in secure domestic supply from temporary price developments.

National Security in the Context of Long-Term Oil Market Developments

Oil Imports and Prices

While everyone can agree there is a linkage between oil and national security, it is not clear exactly what the linkage is. In the narrowest sense, the US military has always been able to meet its needs and would continue to have first claim on resources in time of emergency. The issue would seem to be broader, namely the vulnerability of the US economy to sudden supply shortfalls and unanticipated sharp increases in prices. Here, the disruptions and recessions following the 1973-74, the 1979, and the 1990-91 oil



crises would seem to prove the case. Even so, it doesn't follow that import levels per se are an indicator of vulnerability to such developments. The chart on the right summarizes trends in imports as a share of consumption and oil prices since the 1959 finding. In that year, net oil imports accounted for about 16% of demand and crude prices in 1998 dollars were about \$15.50/barrel. Last year, net imports reached 51% of demand; about three times the 1959 figure while the real price of oil was lower, about \$12.50. Even the recent price increases bring this year's average level (as estimated by the US Department of Energy's May Short Term Outlook) approximately back to 1959 while net imports are projected to rise to 52% of consumption.

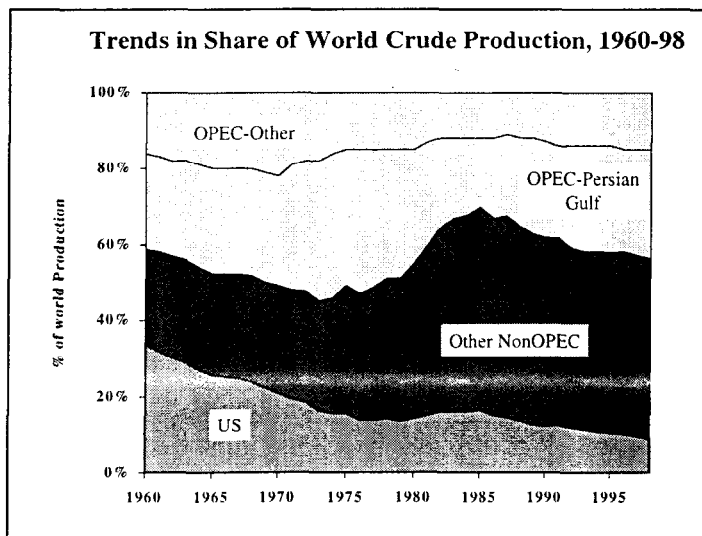
The 1975 and 1979 Section 232 findings highlighted growing import dependency and risk of disruption from politically unstable areas, as well as balance of payments pressures associated with high prices and high volumes of imports. In 1977, imports reached 46% of demand, a share not reached again until 1996, while prices in 1998 values rose to peak of \$61 in 1981. The 1988 and 1995 findings came under very different circumstances. Imports were again rising, after reaching a low of 28% in 1982-3, but prices were lower and the studies now considered, in addition to ongoing concerns about supply disruption, adverse effects on domestic supply, a concern raised in the earlier, 1959 investigation. On the other hand, neither study raised balance of payments considerations. The current investigation takes place at a time of even higher imports, and still lower prices---and while the US and allied NATO forces are engaged in military action against Yugoslavia with no apparent problems of fuel supply.

In certain respects, oil's role in the economy is far less prominent than in the turbulent 70's. US oil consumption in 1998 was about the same as in 1978 (18.8 versus 18.7 million barrels a day) while GDP was up by 68%. Payments for imported oil approached 3% of GDP in 1980 but now are less than 1%. Nonetheless, oil is still important. While demand today in total is about the same as 20 years ago, its composition has changed significantly. Consumption of residual fuel oil, which competes with coal and gas for the bulk fuels market fell by 75% (from 3.1 to 0.8 million barrels a day) between 1978 and 1998 but other, less substitutable uses of oil-- particularly transport and chemical feedstocks---have increased by nearly 15%. The 1998 decline in oil prices held down consumer price inflation by 0.6 percentage points, encouraging lower interest rates and raising economic growth by perhaps 0.5%.¹ The recent recovery in oil prices contributed to the recent, strong increase in the consumer price index and raises prospects of slower economic growth.

Trends in World Supply

Clearly, any consideration of oil and national security must look beyond US import levels. The next chart looks at the long-term changes in world sources of supply, specifically, the changing shares of world crude supplies produced by OPEC, the US, and other non-OPEC sources.

At the time of the 1959 report and the beginning of the mandatory oil import program, the US was by far the most important single supply source



for crude. In 1960, US production accounted for about one-third of world supply. The OPEC countries collectively accounted for 41%, and within that group, the Persian Gulf accounted for 25%. By the time of the first oil crisis, OPEC's share of world production had grown to 55%, with the Persian Gulf countries alone accounting for just under 40% of the total. The US share had fallen to about 16%. The world supply disruptions and price increases of 1973-4 and 1979-81 both originated in what had become the largest, fastest growing supply source, the Persian Gulf. Reflecting these developments, the Section 232 investigations of 1975 and 1979 highlighted dependence on these sources of supply and risks of future disruptions in their findings.

The 1980s saw major changes from the patterns of the 1970s, with the rise in share of supply from non-OPEC sources. Supply from non-OPEC sources apart from the US rose

¹ Last year the consumer price index rose 1.6%. "Core" inflation as measured by the CPI ex energy and food rose 2.3%. Since food prices were relatively stable, the difference between the two was due to lower oil prices.

from about 30% of world supply in the early 1970's to about one-half of world supply in the mid-1980s. At the time of the 1988 investigation, OPEC's share of world production was 35%, while the Persian Gulf share was down to 23%. The US share was roughly stable. The 1990's have seen renewed growth in OPEC and Persian Gulf shares of world production, although at a far slower pace than in the 1960's and early 1970's. Their shares remain well below levels reached on the eve of the first oil crisis² The US share has declined further while other non-OPEC sources also show a modest decline in share. The substantial growth in new sources of supply since the 1970s contributed to the more relaxed oil price environment that with one exception, discussed below, has prevailed since the mid-1980s. Greater diversity of world supply means more options for sources of US imports. Last year, net imports reached 10.4 million barrels a day, up from 8 in 1978. But imports from OPEC were lower, 4.8 million barrels a day in 1998 versus 5.8 20 years earlier. Net imports from the Persian Gulf were about the same, 2.1 million barrels a day in 1998 versus 2.2 in 1978.

The 1990s opened with yet another supply interruption in the Persian Gulf, triggered by the Iraqi invasion of Kuwait. This interruption also produced immediate price increases since, although the region's market importance was less than in the 1970s, a significant loss of supply from any source impacts world markets i.e. a supply shortfall anywhere, is a price increase everywhere. But this time, the immediate price increases were far less severe and there were no disruptive shortages at home. There were certain critical differences between this crisis and the earlier two, reliance on market forces rather than price and allocation controls, the existence of strategic stocks, and availability within a short period of time of additional supply, mainly from Saudi Arabia.³

The Strategic Petroleum Reserve

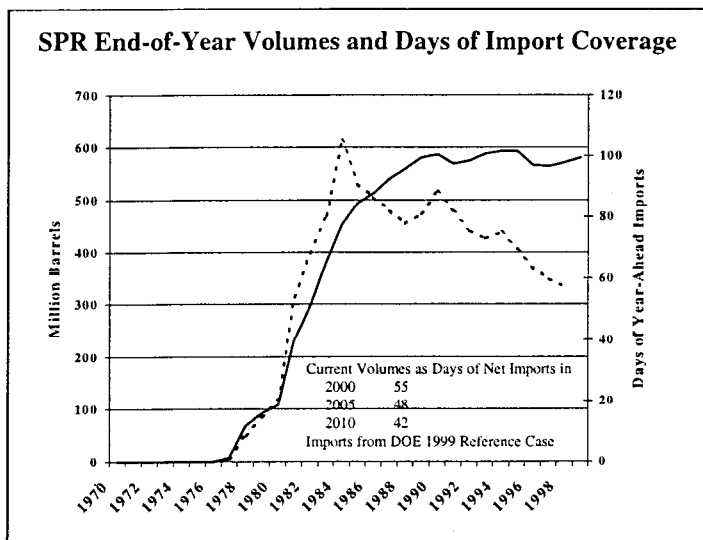
When oil supplies are interrupted, the first instinct of market participants is to secure whatever immediate supplies they can. Private inventories, even if they seemed adequate before, suddenly take on new value as a hedge against future supply uncertainties. The result is a more intense scramble for available supply, and further upward pressure on prices beyond what normal supply-demand relationships would produce. These pressures can be moderated to the extent there is a clear source of potential emergency supply, whether or not in fact actually used. This is of course the role of the Strategic Petroleum Reserve.

² It should be kept in mind that OPEC's share of the world's proven reserves is much higher than its share of crude production, 77% versus 43%. For the Persian Gulf countries, the discrepancy is even greater, about 65% of proven reserves versus about 30% of production. Given the availability of these relatively low-cost resources, OPEC's share of world production, and especially the share of the Persian Gulf countries will almost certainly rise further.

³ While Saudi Arabia was able to raise production by nearly 2 million barrels/day between August and September of 1990, making up about half of the initial loss in Persian Gulf supply, Saudi supplies themselves appeared to be under threat from Iraq, especially in the early months of the crisis.

The chart on the right shows two measures of the SPR over time, the end-of-year volumes of crude oil and the same volumes in terms of days supply of imports, where imports are those of the year ahead.

The first barrels did not enter the SPR until 1977. At the beginning of the second oil crisis, the SPR held only about one-week's worth of net oil imports. But by 1990, the SPR held about 580 million barrels of oil, equivalent to nearly three months



of total net oil imports. The existence of such a large potential source of emergency supply (plus the existence of emergency stocks in other consuming countries and the standby emergency sharing agreements administered by the International Energy Agency) kept oil prices well below the peaks reached in earlier crises.

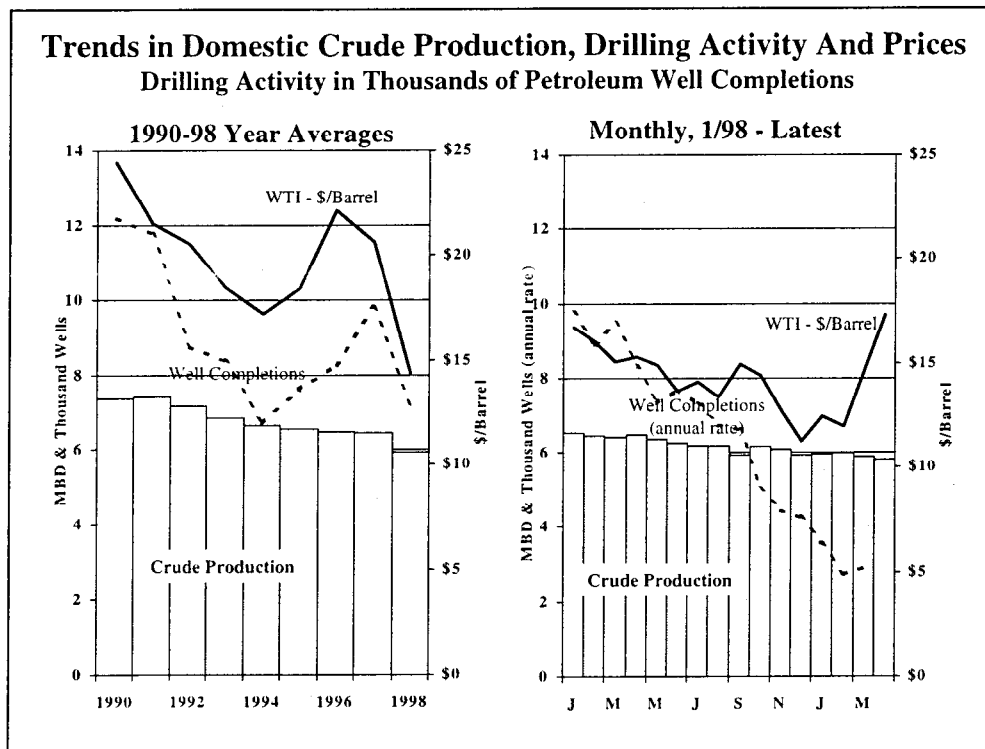
In recent years, the volume of oil in the SPR has fluctuated in a narrow range of between about 560-590 million barrels. While volumes have remained roughly stable, they have declined substantially in terms of their import coverage, from nearly 3 months of net imports at the end of 1990 to less than two at the end of 1998. Without further increases in the SPR, days of import coverage will fall further. Based on the Department of Energy's 1999 Reference Case Forecast for net imports, current SPR volumes will provide 48 days of import coverage in 2005 and only 42 in 2010. The existing capacity of the SPR is 680 million barrels. Filling that capacity would raise import coverage in 2010 to only about 50 days. That about half the import cover we had in the early 1980's. Thus, filling the existing capacity ought to be the minimum policy objective for the SPR.

Recent Trends in Domestic Production

All of the investigations to date have recognized the role of domestic production as a source of secure supply and its vulnerability to low prices. The investigations since the 1970s have also recognized that given the maturity of the US resource base, protectionist measures could be very expensive for the US economy relative to any prospective increase in domestic oil production. The arguments against protectionist measures are most compelling in environment of long-term, stable prices. But oil, as with other commodities, is subject to significant near-term price fluctuations and these fluctuations in themselves can have important consequences. Over the past year, oil prices first moved down to extremely low levels and then, since March, moved back up.

The temporary depression in prices has had significant adverse effects on the domestic petroleum industry that will not be fully reversed with recovery in prices.

The left panel of the chart below shows annual averages for 1990-98 domestic crude production, oil prices as measured by WTI, and, as an indicator of activity, number of oil exploration and development well completions. The right panel shows monthly developments in these same items since January 1998. The annual figures show a gentle decline in production in the first half of the 1990s, averaging about 160 KBD per year, rough stabilization in 1996-97 when prices moved up, and a new decline, this time of about 200 KBD, in 1998. However, over the second half of the year, production declined at a 500 KBD annual rate, consistent with the timing of price declines. Well completions moved broadly in line with prices of WTI, with both measures showing declines in 1998 vs. 1997. The changes in 1997-98 averages understate the impact of the 1998 oil price declines on the industry. As shown in the right panel, the price of WTI at the beginning of 1998 was about \$17 a barrel. By the end of the year, the price fell to about \$11 barrel. Prices moved up after the OPEC agreement to cut production in March, averaging over \$17 in April. Activity levels, as measured by (annualized) well completions fell by nearly 70% from the beginning of 1998 through February-March of 1999. Crude production itself has fallen by about 11% or 700 KBD since the beginning of 1998. As indicated by the trends in activity level, the recent production decline reflects the cutbacks in efforts made by the industry, not any inherent lack of oil prospects.



These cutbacks were made in response to the severe financial pressures facing domestic producers, especially the independents, as a result of low prices. The table below summarizes selected 1998 financial data for the majors and independents as reported in the latest Department of Energy survey. For 1998 as a whole, the Majors reported a 63% decline in net income from domestic oil and gas production versus 1997 and a somewhat

smaller, 44% decline in net income from foreign production. The situation for independents was far worse, with net income from production down by 96% from 1997.⁴

Although the price of oil as measured by WTI has recovered to early 1998 levels, the damage done to domestic production will not be so easily reversed. The current higher price levels will have to be sustained for some time in order for the industry to recover its financial health, and confidence, to support higher investment. Some losses are permanent, in particular production from stripper wells shut in by low prices.

| | 1998 | 1997 | % Change |
|------------------------------|-------------|-------------|-----------------|
| Majors | | | |
| <i>Domestic</i> | 3.1 | 8.3 | -63% |
| <i>Foreign</i> | 4.2 | 7.5 | -44% |
| Independent Producers | 0.05 | 1.3 | -96% |

A Limited Role for Government

The investigations of 1988 and 1995 both recognized that the U.S. is a mature area in terms of oil production but it is important not to confuse maturity with exhaustion. At the beginning of 1990, the US proven reserves of oil, as published by the Oil & Gas Journal stood at 25.9 billion barrels. From 1990 through 1998, the US produced a cumulative total of 28 billion barrels of crude and natural gas liquids, yet proven reserves at the beginning of 1999 stood at 22.5 billion barrels. In effect, the industry through its exploration and development activity was able to add nearly as much to its inventory of economically recoverable reserves as were produced. Maintaining this performance depends on industry effort and opportunity. Access to acreage must remain a key policy tool. As shown above, industry effort, and production were severely impacted by the price decline of 1998.

While there are strong arguments against protecting the domestic industry from long-term low oil prices, there is a case for recognizing the vulnerability of the industry, and potential, permanent losses of secure supply, from temporary price declines. Federal royalty policies could be modified to incorporate a sliding scale, with lower rates when prices are depressed and normal rates otherwise.⁵ Costs of adopting such an approach are likely to be minimal, first because rates would fall only if and when prices are exceptionally low, and second, at least some long-term production losses would be avoided. At the state level, some adjustments in this direction have already taken place. Earlier this year, Oklahoma amended its gross production tax to establish a variable rate

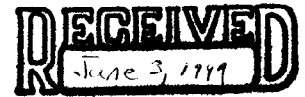
⁴ Low prices aggravated budgetary and international payments problems of major exporting countries, many of whom have few other sources of revenue. The severity of their problems prompted the agreement in March among OPEC and other major producers to cut production in a so far successful effort to raise prices from their previously depressed levels.

⁵ The Federal onshore royalty rate on leases issued after December 22, 1987 is 12.5%. Flat rates of 12.5% or 16.7% apply to Federal offshore leases. In 1997 the Federal government collected \$4.3 billion in royalties from oil and gas production on Federal offshore and onshore leases.

tied to the average monthly price of oil. At a price of \$17/barrel or above, the tax rate is 7%, between \$14 and \$17, the rate is 4%, and below \$14, the rate is 1%.

While there are still opportunities in the onshore lower 48 states, the least mature, and most promising, areas of the country are to be found in the Outer Continental Shelf and in Alaska. Parts of both, including ANWR, are currently off-limits to the oil industry. Permitting environmentally sound exploration and development in these areas was a prominent recommendation of the 1988 investigation. The current prohibitions should not stand in the way of new efforts to reconcile environmental concerns with access to potential new sources of domestic supply.

The latest investigation is being undertaken at a time of calm world oil markets and therefore should face no pressures to rush to conclusions. The study should take the time needed to formulate policy recommendations that avoid the limitations of the prior two. The 1988 investigation was silent on energy conservation. The 1995 investigation properly highlighted actions to promote efficiency and alternatives to oil, but virtually dismissed the supply-side of the equation. The new investigation would serve the public interest best by focusing on both.



**THE EFFECTS OF CRUDE OIL AND PETROLEUM
PRODUCT IMPORTS ON U.S. NATIONAL SECURITY**

Testimony Submitted by

AMERICAN PETROLEUM INSTITUTE

TO THE

U.S. DEPARTMENT OF COMMERCE

JUNE 3, 1999

Comments of the
American Petroleum Institute
to the
Department of Commerce Investigation of the
Effects of Crude Oil and Petroleum Product Imports on U.S. National Security

June 3, 1999

Introduction

The American Petroleum Institute (API), a national trade association representing about 400 companies involved in all aspects of the petroleum industry, including exploration and development, production, manufacturing, distribution, and marketing, is pleased to present its views on the challenges to U.S. national security posed by growing dependence on imported crude oil and petroleum products.

It is now more than 25 years since the 1973 oil embargo shocked us into awareness of our dependence on the global marketplace for a growing share of our energy needs, and the vulnerability of our economic system to hazards associated with that dependence. Since then, the world has greatly changed, principally for the better. In general, it is our view that the U.S. has adapted successfully to the challenges of growing dependence. As a result, although the United States today is more dependent on the global oil market for its primary energy sources than it was 25 years ago, the nation is less vulnerable to the market's inherent risks. This is attributable in part to the successful implementation of policies designed to reduce these risks, particularly the risks associated with short term supply interruptions. Even more importantly, it is attributable to a massive expansion of non-OPEC supplies, which have greatly diversified the sources of global oil supply in general, and U.S. imports in particular. This view is consistent with the conclusions of the last Section 232 investigation on this topic, done in 1995, and we believe that those conclusions continue to be generally valid.

However, our past success in reducing vulnerability in an environment of growing import dependence should not give rise to complacency. We recognize that sustaining future energy security will continue to require adaptation to both old and new challenges. Periodic investigations such as this one provide a useful forum to monitor new developments, and to develop appropriate remedies to these challenges.

Vulnerability can be managed

In the early 70's, the U.S. took its first steps into irreversible interdependence with evolving global energy markets. Those first steps were awkward, full of fears born of cold war anxieties, false notions of global resource scarcity, and the ominous prospect of what seemed to be OPEC's inevitable domination of oil markets.

It was tempting then, in the midst of what seemed a multitude of crises, to believe that a careful and well-intentioned government could correct a multitude of ills within energy markets. The Federal government was not shy to respond -- it intervened with a heavy hand into energy markets -- controlling prices, allocating supplies, and developing synthetic fuels. Ironically, that very planning and government market management, including billions of dollars poured into various energy programs, are now widely regarded as having aggravated the very problems they set out to correct.

As a result, these efforts to directly manipulate supply and demand are now widely recognized as policy blunders. Our growing interdependence with the global economy did indeed present us with new dangers in 1973, but it was also presenting us with opportunities. Rather than rising to the challenge of seizing these opportunities by managing the risks, our first reaction was to do neither, by turning inward

and attempting to isolate and insulate ourselves from the intrusion. It was a costly error, which hopefully we will never repeat.

In fact, the evidence is strong that we have learned from our errors. Since decontrol of energy markets by Presidents Carter and Reagan in the late 70s and early 80s, both Republican and Democratic administrations have understood the key realities of the global marketplace in which this industry operates, and have developed appropriate strategic measures to manage the risks associated with that marketplace. First, they have recognized that global oil markets are heavily influenced by a small contingent of low cost producing nations in the Persian Gulf. Second, they have recognized that the supply behavior of those countries is the outcome of market, political and military circumstances which often give rise to unpredictable supply swings and price volatility, and that explicit energy policy measures are required to manage the economic vulnerability associated with this volatility. Third, they have recognized that the appropriate strategic energy policy is to rely principally on market forces to promote the development and security of alternative supplies. Generally, this policy of primary reliance on markets has been extremely effective in managing what 25 years ago was seen as growing vulnerability to supply disruption and to the use of oil as a political weapon by suppliers intent on subverting U.S. foreign policy goals. Massive new supplies have been developed outside of OPEC, OPEC's market share has been reduced, and new technology has greatly expanded the frontiers of non-OPEC supply. This supply growth has facilitated economic expansion and enhanced the security associated with world oil.

Current policy embodies an appropriate strategic commitment

The status of current policy toward imports is described clearly in the Comprehensive National Energy Strategy [CNES] adopted by the Department of Energy last year. First, the CNES properly articulates the key features of the market realities faced by this industry.

- Energy is the economy's lifeblood. The CNES begins with recognition of energy's role in the economy. It states that "Energy is the lifeblood of modern economies...The lifestyle U.S. citizens enjoy, the envy of much of the world, was built in large measure on reliable, affordable energy supplies."
- Markets are global, and participation is not optional. The CNES also explicitly acknowledges the reality that the U.S. is inextricably bound to reliance on a global marketplace. It states that "Energy is a global commodity. The price and availability of energy resources in one region can have global implications. Complacency about energy availability was shaken during the economic recessions that followed the two oil shocks experienced in the 1970s."
- Markets as the keystone of energy policy. Finally, and perhaps most importantly, the CNES recognizes the limits of governments and the primacy of markets. "During the 1970's, it became apparent that the decades-old regulation of many energy prices was counterproductive and that the nation should pursue market-oriented policies toward energy supply and use wherever possible .. This approach allows markets to be the key determinants of supply and demand, while government supplements market forces through policies that bolster energy security and provide for a cleaner environment."

Second, the CNES outlines key elements of the strategic commitment to promoting security of energy supply and use.

- Improving the security of energy is a key strategic goal. Recognizing security as one of the government's key strategic goals, the CNES states that "Enhancing the security of global and domestic energy markets is one of the best bulwarks against threats to our nation's continued economic prosperity."
- Oil supply stabilization at home. The first measure proposed by the CNES to promote this goal was to stop the decline in domestic oil production by 2005. A separate document, the Fossil Energy Strategic Plan, is even more explicit, calling for policies to increase the supply of secure domestic oil by 0.5 million barrels a day by the year 2010. Toward these ends, the CNES specifically commits the

Department of Energy to "support environmentally responsible development of leased federal lands," and repeatedly cites the need to "...avoid duplicative and unnecessary regulations" to promote development of oil and gas resources on federal lands.

- Maintain SPR readiness. A second measure proposed by the CNES to promote this goal was that of maintaining the readiness of the SPR to provide the government with the capability to supplement supply early in the case of an emergency generated by a temporary supply disruption.
- Diversification of global supply. The security of the global petroleum market has been significantly enhanced by the emergence of numerous new sources of supply worldwide. The Strategy document recognizes the key importance of maintaining this diversification, and recognizes the role played by U.S. firms in continuing this trend. The administration has been very helpful in promoting diversification into areas such as the Caspian Sea, Russia, and Latin America.
- Aggressive gas development. Another key element of the CNES is the active promotion of expansion of domestic natural gas supply. Retirement of nuclear facilities, new technical advances in gas turbine technology, the strong environmental advantages of natural gas, and the magnitude of the remaining resource base have given rise to expectations of major increases in gas demand in the U.S. over the next several decades. Most forecasts now call for an increase of 30% to 50% in natural gas consumption over the next 15 years, with about 80% of this increase coming from domestic sources. Meeting this challenge will require an aggressive acceleration of drilling activity nationwide, combined with sustained growth in the development and application of new technology.

This general strategic approach is not new to the CNES adopted last year. Rather, the CNES simply articulates an approach to energy policy which has been evolving for nearly two decades, namely that of facilitating the free flow of trade and investment to allow industry to compete in this market. This approach has already accumulated an impressive record of success.

- Technological progress. Industry has developed and applied ever more advanced technology, reducing the cost advantage enjoyed by the Persian Gulf, and greatly expanding the frontiers of non-OPEC supply worldwide.
- Domestic oil supply growth. By the end of 1997, industry had already successfully reversed the decline in domestic oil supply in the Lower 48 states, and had plans in place to arrest the decline in Alaskan oil after 1999.
- Natural gas expansion. Domestic natural gas supply had risen by nearly 3 TCF between 1986 and 1997, a nearly 19% expansion.
- SPR capability. The SPR was deployed to limit the impact of the major disruption in Persian Gulf supply during the war with Iraq in 1990 and 1991.
- Global supply diversification. Since the late 70s, concentration in the global oil market has generally been declining. OPEC's market share fell from nearly 60% of the global market in the mid-70s to just over 40% in 1997.

As a result of these successes, the global economy now enjoys a far higher level of energy security than in the 70s, despite a nearly 20% higher level of oil consumption. The U.S. is a principal beneficiary of this enhanced security, which has occurred despite an increase in import dependence to historic highs by 1998.

Recent experience has exposed new sources of vulnerability

However, these successes to date should not lull us into a false complacency that the security problems associated with growing import dependence are permanently "solved." In fact, the experience of 1998 exposed a number of serious gaps in the defenses afforded by current policy.

Generally, the central concerns of energy security policy since the 70s have been those of reducing vulnerability to short run supply interruptions and limiting the long-term concentration of supplies from OPEC and the Persian Gulf. There is little if any protection in current policy from any risks associated with temporary collapses in prices such as that which might be associated with a short-term decline in demand. This is understandable, for several reasons. First, it was supply interruptions that triggered the

sharp price spikes in 1973 and 1979 that led to two major U.S. recessions. Second, it was OPEC's exercise of market power which kept prices high from 1973 through the early 80s, contributing to a sharp slowdown in worldwide economic growth during those years. Third, because the U.S. is a net oil importing country, it would generally be expected that a decline in price, temporary or otherwise, would on balance represent an economic gain to the U.S.

However, this third point contains a subtle flaw. That is, while a permanent decline in price is unambiguously beneficial to a net importing country such as the U.S., a temporary decline is problematic, for several reasons. First, while the temporary decline confers unambiguous short-term benefits to consumers, it also increases the market share of the low cost OPEC producers, setting the stage for potentially higher future prices. Second, the asymmetric response to prices of supply from marginal petroleum producing properties may cause such losses of market to OPEC to be permanent and cumulative even if the price decline is short lived. That is, marginal oil and gas wells are often not easily restarted once the abandonment decision is made. Consequently, a short term price decline may result in a permanent loss of production capacity, and a fluctuating price may lead to progressive deterioration of marginal production capacity.

In 1998, many of the strategic accomplishments of the recent past became jeopardized, as the industry faced precisely such a temporary collapse in prices due principally to an unanticipated drop in demand and two poorly timed supply increases from OPEC countries.

- Drop in Asian demand. Recession in the Asia/Pacific region began in the second half of 1997, but was not generally recognized until early 1998. Between 1990 and 1997, the region accounted for nearly 80% of the growth in global oil demand. While demand growth appeared to continue in 1997, much of the increase is now recognized to have been stock building, as consumption was actually falling by late 1997. The impact of the collapse became pronounced in 1998, as Asian growth shifted abruptly to a sharp and unexpected decline.
- Miscalculation by OPEC. The second significant factor in the emerging crisis occurred in November of 1997. OPEC, facing a largely stagnant market share due to continued growth in non-OPEC supply, decided to increase its production quotas in an attempt to regain market share.
- Abnormally warm winters. A third factor at work was the abnormal warmth of the winters of both 1997/98 and 1998/99. In the first quarter of 1998 heating degree days were 17% below normal in the principal U.S. heating oil markets, leading to a sharp decline in U.S. oil consumption in the first quarter of 1998 and an excessive build of middle distillate inventory.
- Return of Iraq. The fourth factor contributing to the crisis was the U.N. decision to permit increased Iraqi exports for humanitarian reasons. As a result, a million barrels a day of new Iraqi crude reentered the market in 1998, in a year when the total increase in world demand was less than half that level.

The extreme financial vulnerability of the domestic industry quickly became apparent. Oil prices fell 40% between November of 1997 and December 1998. Earnings for the major oil companies fell 62% between third quarter 1997 and third quarter 1998. A sample of independent oil companies had, overall, negative third quarter earnings in 1998. The consequences mounted quickly.

- Decline in drilling. The first victim of the crisis was investment by the industry in new wells. The number of active drilling rigs declined by almost half between November 1997 and February 1999, hitting a new all time low in early 1999.
- Declines in employment. A second consequence of the crisis was a sharp acceleration in the decline in industry employment. U.S. employment in exploration and production fell by over 47,800 jobs between January 1998 and February 1999, a 14% drop.
- Shut in of marginal wells. Since November of 1997, 136 thousand oil wells and 58 thousand gas wells have been shut in as uneconomic. Many of these wells will be permanently abandoned.
- Production declines. Crude oil production in 1998 resumed the decline that had been largely halted in the previous two years. Oil production fell 7.8% from January 1998 to January 1999. Natural gas supply growth came nearly to a halt in 1998.

Price collapse was temporary, but it had real long term consequences for strategic goals

The factors giving rise to the recent oil price weakness were transitory. Eventually the combined forces of demographics and income growth, particularly in the developing world, will result in a resumption in growth of world demand for oil. Even a modest resumption of sustained growth will require massive new supply additions, much of which will continue to come from the Persian Gulf. With demand growth of only 2 percent annually, an additional 36 million barrels per day of new crude oil production capacity will need to be added worldwide within the next two decades, posing as formidable a supply problem as the industry has ever faced in the past. Similarly, supplying the natural gas volumes expected by recent forecasts will require aggressive expansion of industry activity beyond current levels.

These future prospects for the global market continue to pose critical strategic challenges that this particular industry has demonstrated a unique capacity to meet. The strategic danger is not that the recent weakness in oil prices will continue indefinitely. It will not. In fact, the worst of the most recent price weakness may already be past. Rather the danger is that the industry emerges from these temporary declines permanently diminished in its capacity to perform this role in the future. There are a number of losses that the recent price weakness has precipitated that are viewed as wholly or partially irreversible, including:

- Permanent loss of domestic resources. Plugging of abandoned wells generally renders the resources behind such wells as permanently unrecoverable.
- Lost human capital. Rapid industry-wide job losses in petroleum severely depress enrollments in geology, petroleum engineering, and related sciences that are difficult to recover, as the fields acquire a reputation as risky. This reduces the capability of industry to respond to a recovery. For example, in 1983 there were 11,000 undergraduates in petroleum engineering in the U.S. By 1996, that number was down to 1,300, and serious personnel shortages reduced the industry's capacity to increase drilling in 1996 and 1997. Likewise, today's cutbacks will generate future personnel shortages when markets begin to recover.
- Jeopardized feasibility of stabilizing or reversing the decline in domestic oil production. The decline in domestic oil supply in 1998 alone offset two thirds of the increase set as a strategic goal of the Fossil Energy Strategy for 2010. Further declines in supply are likely in 1999, particularly if capital spending continues to fall as indicated by surveys of company spending plans made early in 1999.
- Jeopardized feasibility of domestic gas expansion goals. A major increase in domestic gas supply would require an acceleration of drilling effort relative even to the activity that was occurring prior to the crisis. But now, drilling has fallen far short of those levels. This shortfall has already nearly halted the growth of gas supply in 1998, and threatens to reduce supply in 1999. The sensitivity of the outlook to drilling is illustrated for offshore gas production in a study released recently by the Department of Energy (DOE). In a high drilling case, DOE estimates that Gulf of Mexico gas production could expand over 40% by 2002, but under a low drilling scenario, production could fall by more than 30% over the same horizon. By early 1999, actual drilling was already falling below the levels assumed in DOE's low case.
- Reduced global supply diversification. Cuts in capital spending and drilling have occurred globally, not just in the U.S, and a recent survey by Salomon Smith Barney indicates that such investment will continue to decline through 1999. Lowered levels of investment in non-OPEC regions will eventually lead to some recovery of OPEC's market share, potentially reversing the trend toward diversification of global supplies that has so enhanced energy security in the past.

Unintended policy effects erode security framework

But it is not only the recent oil market weakness that is eroding the foundations of the security framework that has been established over the past several decades. Equally important is the progressive erosion of that framework by the unintentional side effects of other federal policies, particularly in the areas of domestic land use, taxation, regulation, and foreign policy. Unintended restrictions on the ability

to supply energy, both domestic and international, are increasingly imposed with casual regard to their implications for compromising industry's ability to ensure future availability of oil supply.

- Federal land access. Domestically, access to federal land has become an acute problem. Since 1983, access to federal land in eight Western states has declined by more than 60 percent. In Alaska, the industry is being denied access to some of the most prospective areas of the domestic resource base, in portions of the National Petroleum Reserve and in the entire Arctic National Wildlife Refuge. Offshore, continued government moratoria on key acreage impedes development, and restricts the application of some of our most promising new technologies. These restrictions flourish despite the exemplary environmental record that the industry has compiled in its development offshore and in sensitive onshore areas.
- Foreign frontier supply. The U.S. petroleum industry has much to offer in terms of sustaining this supply diversity via the contributions of U.S. energy companies to supply growth outside of the United States. Numerous new opportunities have opened up worldwide over the past decade, in Russia, the Caspian Sea Region, Asia, West Africa and Latin America. Generally, U.S. firms in recent years have been welcomed by these new frontier countries for their experience, capital and technical prowess. Increasingly, however, these activities are being threatened by the unintended consequences of two sets of U.S. policies, namely the increasingly adverse tax treatment of foreign source income by the U.S. government, and the growing tendency for the U.S. to utilize economic sanctions against oil producing countries as an instrument of foreign policy. Both have had the effect of putting U.S. firms at a competitive disadvantage in international activity. Since 1986, the largest U.S. firms have lagged far behind their principal global competitors, comprised of both OPEC and non-OPEC companies. Over the decade from 1986 to 1996, non-U.S. companies expanded their liquids supply by nearly 60%, while global supply by U.S. companies actually declined over the same period. Our companies did increase their foreign production over the period, but at less than half the rate of foreign companies of similar size, and not by an amount sufficient to offset decreases in domestic production. Economic sanctions threaten to further aggravate these trends. Existing sanctions exclude U.S. firms from countries comprising 10% of world oil production and 16% of estimated remaining oil resources, while new sanctions threaten to expand this coverage to countries accounting for two thirds of current oil production and over 80% of remaining oil resources.
- Alternative Minimum Tax. The asymmetric response of marginal production to price changes puts such production at risk in a volatile market. However, rather than trying to remedy such vulnerability, the current structure of the Alternative Minimum Tax serves to aggravate it, by increasing the tax burden on producers in weak markets.
- Regulatory policies. A number of federal regulatory programs currently threaten to marginalize portions of the domestic resource base that are otherwise viable supply sources.
- Reduced downstream flexibility. In recent years, a number of differing fuel standards have developed in response to regional air quality concerns. In some instances, such differences may serve to reduce the substitutability of fuels to such a degree as to make regions of the U.S. more vulnerable to regional price shocks following refinery accidents or sudden demand or supply shifts.

Policy remedies: Some do's and don'ts

A number of remedies are readily available to address these concerns. However, some of the most frequently mentioned measures are among the least desirable, while some of the most needed remedies are typically not considered.

In the first category are measures devoted to direct limitation of imports. While tariffs or quotas on imports are the most direct approach to limiting import dependence, it is not likely that such measures represent a cost effective means to reduce the risks associated with such dependence, and some likelihood that they might even increase them. Such controls would support U.S. domestic prices and protect domestic production, at least temporarily. However, they would also raise energy costs to all consumers and industries in the U.S., while depressing global energy demand and reducing world oil prices, reducing

non-OPEC supplies outside of the United States. This differential impact on U.S. costs would disadvantage all U.S. industry, and any gain in global supply diversity from increased domestic supply would be at least partially offset by the loss of non-OPEC supply elsewhere. A 1996 DOE study of a hypothetical \$20 per barrel import fee, for instance, indicates it could lower imports by about 3 million barrels daily by 2015, through a combination of increased domestic production and decreased domestic consumption, but at a cost to the domestic economy of as much as \$120 billion annually. Previous DoE studies of import tariffs have estimated costs on the order of 10 times any estimated benefits. Moreover, such tariffs typically invite retaliation, eroding the fabric of free trade and investment that has been developing for several decades, and which has been a key factor driving the diversification of global supply. In a rapidly globalizing economy, the institution of tariffs on such a key commodity as oil would impose a major burden on the competitiveness of U.S. industry.

On the other hand, we have identified above a number of key concerns with the adequacy of current policy. Most of the remedies to these concerns, however, are not explicitly in the realm of trade policy. A few would require new legislation; most could be implemented within the scope of existing legislative authority. Such remedies would be designed to supplement existing policies. The strategic framework developed to date has recognized the vulnerability posed by the upward price movements associated with temporary crude supply interruptions, and has developed effective remedies for such risk. Current strategy does not recognize that there is also a risk associated with temporary price collapses, namely that of permanent damage to the petroleum industry and reductions in its capacity to respond in the future. Because of this current gap in the security framework, short-term crisis conditions seriously threaten the achievement of the government's own explicit policy goals. Although no explicit contingencies have been established to handle such a crisis, a number of options are available to the government to significantly alleviate this threat.

At a minimum, government policies affecting the industry should be designed to "do no harm." Policies which compromise industry's ability to supply energy should be reassessed. Such policies include:

- No new taxes. Avoid new taxes harmful to industry, such as reinstatement of the Superfund tax, the oil spill excise tax, or increased taxes on foreign source income.
- Changes in the Alternative Minimum Tax (AMT). The AMT raises industry taxes in weak markets. It should be repealed or reformed.
- Unneeded regulation. Avoid costly new regulations with questionable benefit. Royalty valuation rules proposed by MMS put new burdens on industry with little prospect for enhancing government revenue. New requirements for reducing sulfur in fuels threaten major new burdens on the refining industry with little commensurate environmental benefit. Likewise, there is little reason for new EPA regulations for hydraulic fracturing of coalbed methane wells, or for inclusion of the oil and gas E&P industry in EPA's Toxic Release Inventory (TRI).

Beyond this minimum, it is within the scope of existing government policy precedents to provide temporary assistance to limit the damage associated with an extraordinary market event. Such "lifeboat" policies are as important an instrument to managing vulnerability to abnormal price collapses as stockpiles are to managing vulnerability to abnormal upward price shocks. They implicitly recognize that the assets permanently lost to a short-term crisis may have more long term value than the cost of the rescue. Such options might include:

- Emergency loans. Provide low cost emergency loans to smaller independent producers.
- Temporary royalty relief. Provide royalty relief on properties made marginal by temporary collapses in prices.
- Lease extensions. BLM/MMS should issue blanket extensions of term on leases where an exploration well has been drilled, or where there is a suspension of exploration or production.
- Marginal well tax credit. Provide temporary tax credits to prevent abandonment of marginal wells during a temporary price collapse.

Beyond this agenda of items intended to address short-term crises, industry now views a number of current federal policies as inconsistent with its expressed long-term strategic energy objectives. These include:

- Access restrictions. Current access restrictions to federal onshore and offshore properties preclude exploration in areas containing some of the most highly competitive remaining world-class domestic exploration targets.
- Permitting. The cost, complexity and time required in the permitting processes for oil and gas exploration and development should be reduced.
- Expensing. Current items such as geological and geophysical (G&G) and lease delay rentals should properly be expensed rather than capitalized for federal income tax purposes.
- Royalty valuation. Work with industry to implement a fair and equitable royalty valuation system in place of the current one, which all parties agree is unworkable the way it is currently being managed.
- Unilateral sanctions. Limit the use of unilateral economic sanctions as an instrument of foreign policy.
- Treatment of foreign source income. Current limitations on use of the foreign tax credit and other aspects of current tax law reduce the competitiveness of U.S. firms operating abroad. Easing these would reduce the potential for double taxation of foreign source income.
- Support for alternative funding of Superfund. Past funding of Superfund came predominantly from the petroleum industry, despite the fact that it was responsible for less than 10% of the problem. More equitable, broader-based funding mechanisms should be devised for future Superfund revenues.
- Fuel standards. The effects of regulation on the flexibility of the refining system should be considered in designing standards aimed at improving environmental performance.

Conclusion

While the API believes that the U.S. has generally adapted successfully to the challenges of growing dependence, we also recognize that world markets continue to pose continuing security challenges, some old and others somewhat new. Vulnerability to short run supply interruptions is appropriately managed by the maintenance of a Strategic Petroleum Reserve. Vulnerability to long run market concentration is appropriately handled by policies that encourage global supply diversification. It is this diversification that has been the key strategic accomplishment of energy markets over the past quarter century, and it is a commitment to free trade and investment that has been the keystone of policies promoting such diversification.

However, the experience of 1998 and early 1999 has revealed a new source of vulnerability not covered well by existing energy security policy. It has also highlighted the elements of other federal policies that are unintentionally eroding the foundations of the successful framework which has been developed over the past several decades. Unfortunately, this erosion is occurring at precisely a time when the challenges imposed on that framework are increasing. API strongly hopes that this investigation serves to focus attention on remedies appropriate to enable the industry to continue to effectively meet these challenges.

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EMBAJADA DE MÉXICO

June 3, 1999

Mr. Bernard Kritzer
Manager, Special Projects,
Office of Chemical and Biological
Controls and Treaty Compliance,
Bureau of Export Administration, U.S.
Department of Commerce, Room 2093,
Washington, D.C., 20230

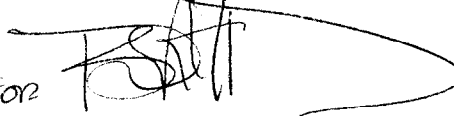
Re: Investigation of Imports of Crude Oil and Petroleum Products under section 232 of the Trade Expansion Act of 1962, as amended.

Dear Mr Kritzer:

Attach you will find the comments of the Government of Mexico in the above reference investigation.

Please feel free to call me if you have any questions or comments.

Sincerely,

FOR 

Javier Mancera
Minister

**Comments of the Government of Mexico on the Investigation
initiated May 4, 1999 under section 232 of the Trade Expansion
Act of 1962, as Amended.**

The Government of Mexico presents its comments to assist the Department of Commerce in its investigations of United States' imports of crude oil and petroleum products under section 232 of the Trade Expansion Act of 1962, as amended. The Government of Mexico is extremely concerned about the possibility of the unjustified creation of an obstacle to bilateral trade in this product. Mexico believes such an action, under section 232 of the Trade Expansion Act of 1962, would be not only unfounded and unnecessary, but would also harm the economic well-being of both countries, with unpredictable and long-lasting consequences on the energy sector on North America.

The nature of trade between our two countries is highly complementary. Mexico has been supplying the United States with 1.25 million b/d average of oil in the first quarter of 1999, representing 14.1% of total U.S. imports, and 8.4% of total supply of this product in the United States, which is today the single most important refining country of Mexico's heavy crude oil, Maya. On the other hand, 60.4% of Mexican refined oil products imports come from the United States, which represented 12.1% of Mexican domestic consumption. The United States is the single natural and LPG gas supplier of Mexico to complement its domestic production. The reliability of the United States supply of petroleum products to Mexico enhances the already high degree of integration of both countries in crude oil and petroleum trade. In addition, the United States is an important capital goods supplier of Mexico's energy sector, thereby confirming the importance of trade.

Mexico believes that no justification exists for the use of measures that constitute exceptions to the multilateral rules of trade, furthermore in a manner which would constitute a means of arbitrary restriction to commercial flows and would inevitably open the door for other Members of the WTO to apply similar exceptions in other cases.

Safeguarding trade in petroleum between Mexico and the United States will help promote economic growth in the North American region. A sound, healthy economy on both sides of the border, based on unhampered trade, is the most appropriate way to address any possible commercial or industrial concerns now or in the future.

For the reasons stated above, the Government of Mexico urges the Department of Commerce to reject any action that could threaten to distort the trade of crude oil and petroleum products between Mexico and the United States.

OIL-011

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June 3, 1999



NEW ENGLAND FUEL INSTITUTE

Phone: (617) 924-1000 • Fax: (617) 924-1022

June 3, 1999

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Washington, D.C. 20230

Dear Mr. Kritzer:

The New England Fuel Institute hereby submits 3 copies of its comments to the Department of Commerce regarding the Department's investigation on oil imports. NEFI would be pleased to respond to any questions that the Department may have.

Respectfully submitted

John F. Sullivan
Executive Vice President
and CEO

Enclosures



NEW ENGLAND FUEL INSTITUTE

Phone: (617) 924-1000 • Fax: (617) 924-1022

COMMENTS

of the

NEW ENGLAND FUEL INSTITUTE

on the

"INITIATION OF
NATIONAL SECURITY INVESTIGATION OF
IMPORTS OF CRUDE OIL AND PETROLEUM PRODUCTS"

BUREAU OF EXPORT ADMINISTRATION
DEPARTMENT OF COMMERCE

Docket No. 990427107-9107-01

Washington, D.C.

June 3, 1999

The New England Fuel Institute ("NEFI") hereby submits comments to the Department of Commerce on the Section 232 investigation involving oil imports. As importers and marketers of refined petroleum products throughout the six New England states, our members are deeply concerned that the U.S. Government could impose restrictions on these imports in the form of quotas or increased tariffs. NEFI members believe that imports do not threaten national security, and no import adjustments are necessary.

I. Description

NEFI represents 1100 home heating oil marketers in the six New England states. These members also market other refined petroleum products; many operate small bulk plants and a few operate barge and deepwater terminals. The vast majority of refined petroleum products consumed in New England are either imported directly or derived from foreign crude oil.

II. No Threat to National Security

Based on current circumstances, NEFI believes that oil imports do not pose a threat for the following reasons:

First, the U.S. Government has examined whether oil imports threaten to impair national security on a number of occasions. In the 1970s, the U.S. was not only dependent on foreign supply but about 40 percent of those imports came from the Middle East. These imports made the U.S. vulnerable to a supply disruption. However, beginning in the 1980s non-OPEC sources of supply began coming on the world market. As this supply increased and diversified, the U.S. and the world became less dependent on Persian Gulf supplies and accordingly less vulnerable to a supply disruption. In recent years, this diversity has continued and supplies from North and South America have increased substantially. In fact, Canada has become the second largest supplier to the United States. Because of these changes, it is difficult to conclude that the majority of imports now come from insecure sources, thereby posing a threat.

Second, since the late 1970s the United States and many of its allies have stockpiled crude oil to hedge against another supply disruption. Such stocks -- the Strategic Petroleum Reserve ("SPR") in the United States -- have a calming effect on the markets. These reserves add another layer of protection to the U.S. and its economy. Thus, the existence of the SPR also argues against a finding that oil imports pose a threat.

Third, NEFI members believe that the Department's examination of the oil import question should focus on whether such imports impact (1) military requirements, and/or (2) the U.S. economy;

(1) As the Department is well aware, U.S. and NATO forces in Yugoslavia have had no difficulty obtaining supplies of petroleum for their operations. Moreover, there is ample statutory authority for the President to require that military supplies be given priority if any circumstances changed during the next several months should the war escalate.

(2) The U.S. economy is thriving as a direct result of lower petroleum prices. Consumers have more money to spend on other goods and services, and industry, particularly those that are energy-intensive such as agriculture and petrochemical, have enjoyed lower costs of production. All of these factors help boost the economy.

During the past 18 months, oil prices dropped about \$6 per barrel and the Consumer Price Index ("CPI") was correspondingly reduced by .7 percent. An adjustment to imports (quotas or tariffs) would raise prices. It is clear that an increase in oil prices would result in a corresponding increase in the CPI. Such increases would be bad for the economy; they would slow growth and reduce employment. Accordingly, oil imports do not currently threaten national security under either the narrow definition of "meeting military requirements" or the broader definition of "impacting the U.S. economy." In fact, a case could be made that adjustments to imports would threaten the national security.

III. Regional and Sectoral Impact of Adjustments

A. New England

NEFI is concerned that adjustments to imports under Section 232 could disproportionately damage New England's economy. New England has a higher than average use of oil for heating and operating its homes, commercial businesses and industries. Accordingly, any restrictions on imports would be felt more severely in New England than other parts of the nation. The Department should recognize that this injury would be widespread across the region and have long-term consequences. In addition, it would injure the home heating oil marketers of New England and raise the price of this essential fuel to the consumers whom they serve.

B. Injury to Independent Producers/Targeted Relief Outside of Section 232

While the U.S. economy has benefitted from lower oil prices, domestic producers, particularly independents, have suffered financially, and some have closed in wells with marginal production. NEFI recognizes these problems, and its members believe that the Government should take action to provide relief to this segment of the petroleum industry. However, the form of relief should not include any adjustments to oil imports. It would be imprudent and inequitable for the Government to provide relief for independent producers by damaging the overall economy, injuring energy-intensive industries such as agriculture and petrochemicals, and disproportionately harming certain regions of the country such as New England and other segments of the petroleum industry, such as home heating oil marketers. Surely, the Government can help producers more directly with measures outside the scope of Section 232 relief.

IV. Conclusion

The New England Fuel Institute respectfully urges the Department of Commerce to find that oil imports do not threaten to impair the national security of the United States. Such a finding is not supported by the current state of events:

1. Oil imports come from diverse and far more stable sources than imports during earlier Section 232 investigations;
2. The Strategic Petroleum Reserve provides protection to the economy from a supply disruption;
3. U.S. military requirements in Yugoslavia and elsewhere in the world are being adequately met; and
4. The U.S. economy is doing exceptionally well.

However, if the Department were to make such a determination, it should not recommend any adjustment to oil imports. Such adjustments (tariffs and quotas) would:

1. Harm the U.S. economy, by slowing growth and reducing employment;
2. Make energy-intensive industries less competitive at home and abroad; and

3. Damage the independent home heating oil segment of the petroleum industry and disproportionately damage the New England economy.

NEFI supports targeted assistance to independent domestic producers who have experienced financial difficulties as a result of lower petroleum prices. However, relief for these companies should not come at the expense of the U.S. economy and other segments of the industry.

Thank you.



IRVING OIL CORPORATION

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June 3, 1999

June 3, 1999

Mr. Bernard Kritzer
Bureau of Export Administration
U.S. Department of Commerce
Room 2093
14th and Pennsylvania Avenue, N.W.
Washington, D.C. 20230

Dear Mr. Kritzer:

Irving Oil Corporation and Irving Oil Terminals, Inc. of New England hereby submit three copies of comments to the Bureau of Export Administration, Department of Commerce, in response to the Section 232 investigation on oil imports.

Sincerely,


Brian Monkhouse

Enclosures



IRVING OIL CORPORATION

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BANGOR, MAINE 04402-0401

June 3, 1999

COMMENTS

Subject: Section 232 Investigation of Oil Imports

Irving Oil Corporation and Irving Oil Terminals, Inc., both U.S. companies headquartered in New England (referred to collectively as "Irving") hereby submit comments to the Department of Commerce pursuant to Section 232 of the Trade Expansion Act, as amended, 19 U.S.C. Section 1862. Irving is an independent company that engages in the importation and distribution of refined petroleum products. Irving is supplied primarily by its affiliate, Irving Oil Limited, a refiner located in New Brunswick, Canada.¹ The Company is concerned that the Department's investigation and the possibility of adjustments to oil imports could have adverse consequences for its operations, the trading relationship between the U.S. and Canada, and the U.S. economy.

¹ Irving Oil Limited owns and operates a 250,000 barrel per day refinery in Saint John, New Brunswick, Canada. It refines and ships to the United States gasoline, jet fuel, kerosene, diesel fuel, home heating oil, and residual fuel oil. The Saint John refinery is a state-of-the-art facility producing refined petroleum products with specifications that exceed U.S. environmental standards.

I. Secure Source of Supply

Based on the authority of Section 232, the U.S. is trying to determine if oil imports threaten to impair the national security. However, to make such a determination, the Department of Commerce should not simply look to the volume of imports entering the country. Such an approach does not lead to a qualitative analysis of the import situation. Rather, the Department should focus on the security of the sources of supply provided to the U.S. By gauging the security of these sources, the Department can better determine the vulnerability of the U.S. to potential supply disruptions.

II. Vulnerability

A. Diversity of Supply

One of the most significant measures of assessing vulnerability is whether oil production is concentrated in a few countries. Since the 1970's, the sources of U.S. petroleum imports have become extremely diverse. Currently, more than twenty different countries from various different regions of the world supply petroleum products to the United States. The

diversity of sources represents a significant change from the past reliance of the United States on Persian Gulf suppliers.

Today, more than half of the petroleum imported into the United States comes from a wide variety of sources in the Western Hemisphere. From 1994 through 1997, imports from Canada and Mexico increased 23 percent and 41 percent respectively; in comparison, imports from all other countries increased only 10 percent. In addition to Western Hemisphere sources, Europe and Africa are also significant sources of supply. So long as this diversity of supply is maintained, the United States will not be vulnerable to political turmoil or production problems in any one region.

B. Canadian Imports

In addition to diversity, the stability and proximity of foreign sources are also important factors. Since 1996, Canada has been the second largest supplier of imported petroleum products to the United States, surpassing any Persian Gulf supplier.¹ A number of qualities contribute to making Canada an extremely secure source of petroleum for the United States.

¹ Energy Information Administration, Dept. of Energy, Petroleum Supply Monthly, Pub. No. DOE/EIA-0109 (99/04) at 8-12 (Apr. 1999).

First, the United States and Canada have enjoyed a special trade relationship since the implementation of the U.S.-Canada Free Trade Agreement (CFTA) in 1988. This agreement, which grants special treatment for trade between the two countries, was continued and strengthened in the North American Free Trade Agreement (NAFTA) in 1994.

Second, the United States and Canada have a close and stable diplomatic relationship that is free from the types of political issues that plagued U.S. petroleum supply from the volatile Persian Gulf in past years.

Third, the United States and Canada share a common, secure land border that permits delivery of petroleum products by truck, rail car and barges on inland waterways. This shared border ensures that (1) delivery would continue even if ocean transportation were interrupted by a crisis, and (2) supplies would reach the United States rapidly if supply from another source were interrupted. Moreover, the proximity of substitute supply from Canada to the United States would also help to reduce vulnerability if a supply disruption were to occur in another part of the world.

III. Harm to U.S. Economy and Trading Partner

U.S. consumers pay substantially lower prices for their gasoline as a direct result of imports, including those from Canada. In addition, the U.S. economy as a whole derives substantial benefits from such lower petroleum prices. In the recent past, the United States experienced an overall reduction in energy prices of approximately \$40 billion. Consumers spent this amount on other goods and services, and the U.S. economy flourished.

Conversely, higher petroleum prices tend to have a detrimental effect on the economy. Thus, restrictions on petroleum imports pursuant to Section 232 would raise the price of fuel in the United States and would harm the U.S. economy; long-term economic analyses conclude that economic growth would be slowed, while unemployment, inflation and interest rates would increase. A weak economy would not foster national security.

In addition, such restrictions would injure the closest ally of the United States. Due to the significance of the U.S. market to Canadian petroleum suppliers, restrictions could have a detrimental impact on them and the Canadian economy.

IV. Import Adjustments Inconsistent with NAFTA

The potential adjustment of imports from Canada appears to conflict with the provisions of the North American Free Trade Agreement (NAFTA) and its predecessor, the U.S. Canada Free Trade Agreement. Specifically, Article 607 of NAFTA excepts restrictions on trade in energy between the United States and Canada only if necessary to protect military supply or in response to armed conflict. The President's statement that accompanied the submission of the NAFTA to Congress actually states that this exception "does not apply to energy trade between the United States and Canada."² Accordingly, the ability of the United States to adjust imports from Canada is questionable and inconsistent with the underlying principles of NAFTA.

V. Conclusion

Irving urges the Department to determine that petroleum imports do not threaten to impair the national security of the United States. Diverse, secure sources of supply, particularly those from Canada, minimize U.S. vulnerability. However, if the

² North American Free Trade Agreement Implementation Act Statement of Administrative Action, reprinted in House Doc. 159, 103rd Cong., 1st Sess., Vol. 1 (1993).

Department finds such a threat, certainly no restrictions on imports, particularly those from Canada, should be imposed. Such restrictions would not serve national security objectives, would injure U.S. independent marketers supplied by Canada, and, in turn, their customers, and would potentially violate NAFTA.

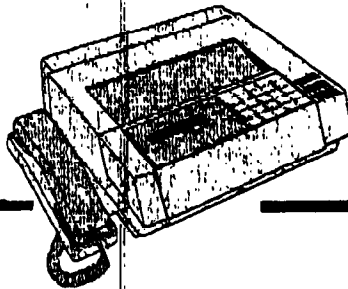
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CITGO Petroleum Corporation

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MESSAGE

Enclosed are CITGO Petroleum Corporation comments for Docket No. 990427107-9107-01, dealing with the investigation of imports of crude oil and petroleum products on U.S. national security. I will also send the original and two copies by mail. Thank you for your consideration.



CITGO Petroleum Corporation

DAVID J. TIPPECONNIC
President
Chief Executive Officer

P.O. Box 3758
Tulsa OK 74102-3758

June 3, 1999

Bernard Kritzer
Manager Special Projects
Office of Chemical and Biological Controls and Treaty Compliance
Bureau of Export Administration
U.S. Department of Commerce, Room 2093
Washington D.C., 20230

Ref: Investigation of Imports of Crude Oil and Petroleum Products on U.S. National Security (Docket No. 990427107-9107-01)

CITGO Petroleum Corporation, is a refiner, transporter and marketer of transportation fuels, lubricants, petrochemicals, refined waxes, asphalt and other industrial products. CITGO has 5000 employees, 6 major manufacturing facilities, ownership of 60 marketing terminals and a product supplier to more than 15,000 branded gasoline stations. CITGO is owned by PDV America, Inc., an indirect wholly owned subsidiary of Petr leos de Venezuela, S.A., the national oil company of Venezuela. Since CITGO imports a great deal of oil for our manufacturing processes, we believe we are uniquely qualified to present our views on the subject notice.

It is widely acknowledged that the United States will never be self-sufficient in crude oil production, and therefor must import oil and some quantity of petroleum products to maintain a strong economy. Policies that continue to encourage global supply diversification will serve to protect U.S. national security. It is this diversification that has been the key strategic accomplishment of energy markets over the past quarter century, and it is a commitment to free trade and investment that has been the keystone of policies promoting such diversification. Thus the long term U.S. strategy of reliance on diversified and secure sources of crude supplies is working to the benefit of the U.S. economy.

Oil imports outside the Middle East currently account for over 80 percent of total U.S. imports. Reliable suppliers, particularly those in the Western Hemisphere such as Venezuela, do not represent a threat to national security. Venezuela has become one of the largest exporters of oil to the United States, currently supplying over 18 percent of total US oil imports. Venezuela is located very close to the U.S. Gulf Coast and for over 80 years has played a key role in ensuring the energy security of the United States. Through global crises and calm, Venezuela has served as a reliable and dependable

Letter to Bernard Kritzer

June 3, 1999

Page 2

source of oil for the U.S. Venezuela is also the longest continuous democracy in Latin America, and highly values an excellent long-standing relationship with the U.S.

The increasing globalization of the world economy is transcending traditional political and geographical boundaries. Venezuela for one has accepted the challenge of fully integrating its economy into the global environment. Since Venezuelan crude oil production was opened to private investment U.S. energy companies have made substantial investments. Venezuela's international vertical integration strategy has made its national oil and gas company the world's second oil company and third largest refiner, and one of the largest investors in the United States. In the U.S. alone, CITGO holds 7 percent of total refining capacity with a 10 percent share of the gasoline market. This economic interdependence works to the advantage of U.S. and Venezuelan energy security.

Any actions by the President to impose artificial restraints on imports are not warranted by current or foreseeable conditions. Insulation from world markets will fail, and would entail costs that are not sustainable in a competitive and interdependent global marketplace.

CITGO encourages the Department's investigation to focus attention on the benefits of reforming U.S. energy, tax and regulatory policies to enable the petroleum industry to continue to effectively meet the nation's energy needs.

Sincerely,



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RECEIVED
June 7, 1999

EMBAJADA DE VENEZUELA
WASHINGTON, DC 20007

**THE EFFECT OF IMPORTS OF CRUDE OIL AND PETROLEUM
PRODUCTS ON U.S. NATIONAL SECURITY: THE VIEW OF
VENEZUELA**

Submitted to the Department of Commerce

by the

Embassy of Venezuela, Washington, D.C.

June 7, 1999

These comments are submitted on behalf of the Government of Venezuela by its Embassy in Washington, D.C. in response to the Bureau of Export Administration's notice of initiation of a national security investigation under section 232 of the Trade Expansion Act of 1962, as amended (19 U.S.C. § 1862) and request for public comments regarding the effects on national security of imports of crude oil and petroleum products (64 Fed. Reg. 23820 - 23821). These comments are submitted to the Department of Commerce to ensure that Venezuela's energy and trade relationships with the United States and its contributions to U.S. national security are considered in the formulation of U.S. policy.

INTRODUCTION

For over eighty years, Venezuela has been a constant, stable, and reliable supplier of oil to the United States. Through global crises and calm, Venezuela has been, and remains, a consistent and dependable source of crude oil and petroleum products for the United States. As one of the world's largest exporters of oil, and the largest foreign supplier of crude oil and petroleum products to the United States, Venezuela has never stopped its flow of oil, for political or any other reasons, to the United States, or any other market.

Venezuela and the United States have developed a strong energy relationship that has engendered increasingly broader economic development and investment opportunities in both countries. Recognizing the potential in energy cooperation with the United States, Venezuela has taken numerous steps to realize that potential, including opening its energy industry to U.S. involvement and making substantial investments in the U.S. refining industry. Venezuela, in turn, serves as a trusted oil supplier and as a major export market to the United States.

The energy trade relationship between the United States and Venezuela has been, and will continue to be, a key component in the diversification of foreign energy sources that underpins much of U.S. international energy policy. The development of the U.S./Venezuelan energy relationship has fostered, and continues to foster, the broader growth and linkage of energy infrastructures, and the development of cooperative energy policies, throughout the Western Hemisphere as a whole. Therefore, due in large part to the U.S./Venezuela energy relationship, the Western Hemisphere continues to evolve as a geographically and politically cohesive energy market, strongly supporting the energy security of the United States, and all countries in the Americas.

I. Venezuela and the United States: Natural and Historic Partners in Energy

Venezuela assigns great value to its long-standing, excellent relationship with the United States and the long history of oil trade between our two countries that has benefitted both countries so much. The supply of oil and energy products to the United States from Venezuela has been particularly crucial to U.S. energy security during global crises such as World War II, the Korean conflict, the Suez Canal crisis, the Six-Day Arab-Israeli War, the Yom Kippur War, the Iran-Iraq War, and, most recently, the Persian Gulf War. In addition, Venezuela has never participated in politically-motivated interruptions of oil supplies to world markets.

The geographic proximity between Venezuela and the United States makes trade between the two countries both economically advantageous and logistically feasible. Major port cities along both the eastern seaboard and the Gulf Coast can be reached from Venezuelan ports by tanker much faster and more economically than from California, Alaska, or Middle East points of embarkation. Shipping time between Venezuela and the United States is 4-5 days, as opposed to 35-45 days from the Persian Gulf. In addition to its geographic location, Venezuela's natural resources set it apart

from other Western Hemisphere suppliers of oil to the United States. The Venezuelan national oil company, Petróleos de Venezuela, S.A. (PDVSA), is the second-largest oil company in the world. Venezuela's proven reserves of crude oil and condensates amount to over 76 billion barrels, the largest outside the Persian Gulf. Venezuela's total oil resources are, in fact, much greater by virtue of one of the largest hydrocarbons reserves in the world – the Orinoco Belt, which contains 1.2 trillion barrels of conventional and unconventional crude oil *in situ*, of which 270-320 billion barrels are recoverable under today's technology. At current rates of consumption, 396 billion barrels of crude oil could satisfy U.S. consumption completely for over 60 years. Venezuela also maintains a vast distribution system and has access to most of the Caribbean Basin oil storage capacity. Crude oil production in Venezuela is currently approximately 2.7 million barrels per day. Venezuela's refineries produce approximately 1.3 million barrels per day of petroleum products, and Venezuela's long-term plans include increased production of refined petroleum products. Venezuela is also orienting itself towards increasing production of its vast non-associated natural gas reserves, which amount to over 146 trillion cubic feet.

II. U.S. Energy Security

It is an undisputed reality that the United States will have to rely on foreign sources for a substantial portion of its oil consumption. Throughout this decade, U.S. officials from significant domestic U.S. oil producing states and with considerable expertise on energy issues have understood that U.S. reliance on imported oil from nearby and reliable foreign sources is part of the solution to the question of U.S. energy security, not part of the problem. In 1991, Representative Mike Synar of Oklahoma, former member of the Energy and Power Subcommittee of the House Commerce Committee, stressed the importance of Western Hemisphere oil suppliers, saying "the goal is not to

displace U.S. oil with oil from other Western Hemisphere countries. To the contrary . . . increased reliance on more stable supplies of oil from the Western Hemisphere – particularly Venezuela and Mexico – will displace those supplies we currently import from less stable regions."^{1/} This sentiment was echoed as recently as last year by Senator Frank Murkowski of Alaska, Chairman of the Senate Committee on Energy and Power who, upon returning from a visit to Venezuela, delivered remarks to the Senate emphasizing the importance of Venezuela to U.S. energy security given the reality that "the U.S. will import greater and greater amounts of oil to meet its domestic energy needs in the coming decades notwithstanding our efforts to maintain a viable domestic oil and gas industry."^{2/}

The long-term energy policy goals of the United States, as set forth in the National Energy Strategy (NES) issued in 1992 by the Department of Energy (DOE), and reiterated in the recent Clinton Administration's Comprehensive National Energy Strategy last year, emphasize the importance of diversifying U.S. oil supply, particularly by decreasing reliance on oil from the Persian Gulf and by expanding the development of the "vast potential" of non-Persian Gulf oil producing countries. The major mechanism whereby this goal would be achieved is Western Hemisphere energy integration. The NES in 1992 stated that "Western Hemisphere cooperation on energy issues will be an important focus of the National Energy Strategy,"^{3/} and suggested policies designed to reduce government controls on energy production and barriers to trade and investment in energy, and to promote hemispheric cooperation on energy production and use.

^{1/} 137 Cong. Rec. E3633.

^{2/} 143 Cong. Rec. S2777.

^{3/} U.S. Department of Energy, National Energy Policy Plan (1992), 83.

This goal set forth in 1992 is no longer simply a theory. By 1998, the Department of Energy's Comprehensive National Energy Strategy touted increased Western Hemisphere energy cooperation that has occurred, and singled out for special mention the collaboration between Venezuela and the United States in this regard.^{4/} The first Summit of the Americas, which took place in Miami in December, 1994, provided the framework for increased Hemispheric cooperation. As a result, three Energy Ministerial Meetings have taken place and a fourth is scheduled for New Orleans, Louisiana in July of this year. The most recent Energy Ministerial Meeting, which took place in Caracas in January 1998, coincided with the first Energy Business Forum of the Americas, at which energy industry representatives from various countries in the Hemisphere discussed the role of industry and the private sector in promoting Hemispheric cooperation. The confluence of the Hemispheric Energy Ministers' Meeting and the Energy Business Forum demonstrated not only the resolve of Western Hemisphere governments to coordinate their policies, but also the willingness of Western Hemisphere companies to forge business and commercial relationships across borders that will increasingly be the *sine qua non* of meaningful Western Hemisphere energy cooperation.

As the Hemisphere's largest energy exporter and largest energy importer, respectively, Venezuela and the United States have propelled the process of integration and energy cooperation throughout the Western Hemisphere. In addition, the investments by Venezuela in the U.S. oil industry and the participation of many of the U.S. companies in exploration and production activities in Venezuela have been instrumental in this process.

Venezuela's oil trade relationship with the United States has helped forward U.S. energy policy and U.S. national security interests, while at the same time serving the economic interests of

^{4/} U.S. Department of Energy, National Energy Policy Plan (1998), 16-17.

both countries. In recent years, Venezuela has dramatically reformed its energy and fiscal policies to provide the U.S. energy industry with access to its enormous hydrocarbons reserves, thereby benefitting the U.S. oil industry and ensuring even further the secure flow of energy products to the United States.

III. Integration of the U.S. and Venezuelan Oil Industries

Venezuela has integrated its economy into the Western Hemisphere and the global environment. The process of integration began in 1989 with the implementation of a comprehensive program of macroeconomic adjustment and structural reforms at both the political and economic levels. Venezuela has liberalized its economy, lifting restrictions on foreign investment, lowering tariffs, undertaking fiscal and monetary reforms, and, this spring, ratifying a bilateral tax treaty with the United States. Bilateral trade between Venezuela and the United States exceeded \$20 billion in 1997, and Venezuela is currently the third-largest U.S. trading partner in Latin America as well as the third-largest market for U.S. exports in the region.

The opening of the Venezuelan oil industry to foreign companies is a key component of Venezuela's economic strategy. Foreign companies, many of which are U.S. companies, are now actively participating in upstream activities of the Venezuelan oil industry. First, PDVSA has successfully completed three rounds of international bidding for the operation of inactive or marginal oil fields. Under agreements to develop these areas, foreign companies or consortia contribute financial resources, infrastructure, operational skills, and technology, towards crude oil production from these fields. Second, through eight profit-sharing agreements in areas along the northern coast of Venezuela that are expected to contain several billion barrels of crude oil, foreign companies or consortia are the owners of crude oil they produce in collaboration with PDVSA, which is entitled

to up to a 35 percent share in each venture. U.S. companies participate in seven of these agreements. Finally, four strategic associations, three of which have U.S. participation, have been initiated for the upgrading of the extra-heavy hydrocarbons reserves in the Orinoco Belt. These associations will upgrade Orinoco Belt reserves from 7°-9° API, producing 16°-30° API synthetic crude oil which can then be refined in refineries in Venezuela and throughout the world, including in the United States.

Among the U.S. companies that are or have been involved in these activities are: BP Amoco, Benton Oil and Gas Company, Conoco, Enron Oil and Gas Company, Burlington Resources, Maxus Energy Corp., Mobil Corp, Arco, Chevron, Mosbacher Energy Company, Occidental, and Pennzoil.

Venezuela is also extensively involved in the U.S. oil industry. Having invested over \$2 billion to date, PDVSA ranks among the top ten foreign investors in the United States. PDV America, a U.S. subsidiary of PDVSA, owns Citgo Petroleum Corporation (Citgo), headquartered in Tulsa, Oklahoma, and PDV Midwest Refining L.L.C., (PDV Midwest), headquartered in Lemont, Illinois. These companies refine and market petroleum products, including gasoline, diesel fuel, jet turbine fuel, petrochemicals, lubricants, asphalt, and refined waxes, throughout the continental United States east of the Rocky Mountains. Citgo has significant refining operations in Lake Charles, Louisiana and Corpus Christi, Texas. Additional Citgo refineries are located in Savannah, Georgia and Paulsboro, New Jersey, and Lyondell-Citgo, a Texas limited liability company formed by subsidiaries of Citgo and Lyondell, operates a substantial refinery in Houston, Texas. Citgo has the largest retail gasoline distribution network in the United States, marketing gasoline through more than 15,000 independent Citgo-branded retail outlets in 48 states. The assets of PDV Midwest include a 160,000 barrels-per-day refinery and 13 products terminals. Together, Citgo and PDV

Midwest account for approximately seven percent of total U.S. refining capacity. PDVSA's U.S. investments also include refining joint ventures with Amerada-Hess, in the U.S. Virgin Islands; with Phillips, in Texas; and with Mobil, in Louisiana.

IV. Oil and the Venezuelan Economy

The Venezuelan economy is reliant, to an extraordinary degree, on the petroleum industry, which accounts for 27 percent of Gross Domestic Product (GDP), 78 percent of export earnings, and more than half of government operating revenues. Venezuela understands the economic hardship that faces domestic U.S. producers as a result of low oil prices. No country, however, has suffered more from the recent temporary oil prices than Venezuela. Venezuela's Central Bank foresees a decline of 5 to 7 percent of our GDP largely because of the severe drop in oil prices. In addition, the Venezuelan government has already made several national budget adjustments, Venezuela's budget deficit has been as large as 9 percent of GDP, and Venezuela's food consumption in the first quarter of this year decreased by more than 10 percent.

The recent drop in U.S. oil prices (which have since increased significantly) were reflective of the steep reduction in oil prices worldwide and, of course, were not caused by oil imports into the United States. Oil is a commodity traded on the world market, and the low oil prices were the result of a combination of unexpected global factors that gave rise to world-wide overproduction relative to demand. These factors include the steep reduction in demand for oil in Asia stemming from the economic crisis in that region, unusually warm winter weather, and the return of significant volumes of crude oil production from Iraq onto the world market. The existence of such factors cannot be the basis for any action by the United States that would jeopardize the oil relationship between Venezuela and the United States that is vital to both countries.

Venezuela is not an adversary of domestic U.S. producers, large or small. Rather, Venezuela has a community of interests with U.S. producers in defending oil prices. Our common goal is to maintain world oil prices at reasonable levels to permit adequate returns for producers in the United States as well as in Venezuela, and to make possible the significant investments that will be needed in order to satisfy the growing world-wide demand for oil that will characterize world markets well into the 21st century. Historically, reasonably-priced oil has contributed greatly to economic development throughout the world, including the United States, and it has been a significant factor in the unprecedented growth of the U.S. economy of the past seven years.

V. Conclusion

The thrust of Venezuela's energy policies, now and for the future, and the essence of the international reintegration of the Venezuelan oil industry, is perhaps most profoundly evident in the nature and extent of Venezuelan /U.S. energy relations, whereby Venezuela exports oil to the United States, U.S. companies are actively engaging in upstream activities in Venezuela, and the Venezuelan oil industry is actively engaging in downstream activities in the United States. Venezuela is not simply an exporter of oil to the United States; it is much more. As a commercial matter and as a matter of joint national interests, Venezuelan and U.S. energy interests are inextricably bound together, as is the energy security of both countries. Venezuela has made significant commitments to be a dependable supplier of oil to the United States to meet U.S. energy needs. Venezuela and the United States have continued — and have strengthened — a cooperation by which Venezuelan oil serves U.S. energy needs reliably and securely and complements the United States' own sources of oil.

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June 3, 1999

Mr. Bernard Kritzer
Manager, Special Projects
Office of Chemical and Biological
Controls and Treaty Compliance
Bureau of Export Administration
U.S. Department of Commerce
Room 2093
14th and Pennsylvania Avenue, N.W.
Washington, D.C. 20230

Dear Mr. Kritzer:

The Independent Fuel Terminal Operators Association ("IFTOA") hereby submits, in triplicate, comments to the Department of Commerce in response to the May 4 Federal Register on "Initiation of National Security Investigation of Imports of Crude Oil and Petroleum Products," 64 F.R. 23820 (May 4, 1999).

As indicated, IFTOA is an association of deepwater terminal operators who import substantial volumes of refined petroleum products. Association members believe that current imports do not threaten to impair the national security of the United States, and accordingly, no adjustment to imports is necessary.

We would be happy to provide any additional information or response to any questions the Department may have.

Thank you for your consideration of our comments.

Respectfully submitted,



Andrea Grant
Counsel

Enclosures

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COMMENTS

**"INITIATION OF NATIONAL SECURITY INVESTIGATION
OF IMPORTS OF CRUDE OIL AND PETROLEUM PRODUCTS"**

submitted to the

BUREAU OF EXPORT ADMINISTRATION
DEPARTMENT OF COMMERCE
[DOCKET NO. 990427107-9107-01]

June 3, 1999

The Independent Fuel Terminal Operators Association ("IFTOA") hereby submits comments to the Bureau of Export Administration of the Department of Commerce in response to the Request for Comments on "Initiation of National Security Investigation of Imports of Crude Oil and Petroleum Products."¹ The investigation was initiated pursuant to Section 232 of the Trade Expansion Act of 1962, as amended.²

I. Introduction

IFTOA is an association of owners or operators of deepwater terminals along the East Coast from Maine to Florida. The members are independent petroleum companies; none is affiliated with a major integrated oil company. They import and export products including gasoline, diesel fuel, home heating oil, kerosene and jet fuel; and market such products at the wholesale and retail levels. Thus, the members have a direct interest in U.S. policies affecting imports of petroleum.

The purpose of the current Section 232 investigation is to determine whether the U.S. national security is impaired by the importation of petroleum. The term "national security" for

^{1/} 64 Fed. Reg. 23820 (May 4, 1999). See also, 15 CFR Parts 700 to 709.

^{2/} 19 U.S.C. § 1862.

purposes of a Section 232 investigation has never been defined. IFTOA submits that the "national security" is a complex matter; it must be evaluated in terms of the vulnerability of the United States to an interruption in the supply of an essential commodity, the long term interests of the national economy and each of its sectors, and the diplomatic and trade effects of various policies designed to reduce imports or increase domestic production. U.S. national security is not simply a function of the level of petroleum imports as a percentage of U.S. petroleum consumption or the volume of oil that the military consumes.

IFTOA believes that a diverse global supply of petroleum from secure sources, together with the ready availability of the Strategic Petroleum Reserve, are the most effective means of protecting the national security.

As members of the U.S. petroleum industry, we recognize the plight of domestic producers caused by the drop in the price of petroleum over the past year. Even with the recent incremental increase, the long-term effects on domestic producers will be severe. However, as discussed below, IFTOA believes that imports of petroleum do not adversely affect the national security. At the same time, IFTOA would support measures to assist domestic producers without restricting imports.

II. Current and Projected Levels of Imports
Do Not Threaten National Security

A. Diverse Supply and Secure Sources

Since the 1970's, the sources of U.S. petroleum imports have become diverse, and secure. In fact, more than half of the petroleum imported into the United States comes from sources in the Western Hemisphere.³ In 1997, Canada and Venezuela each supplied more imports than Saudi Arabia.⁴ In 1996, Venezuela modified its refineries to produce additional reformulated gasoline to meet Clean Air Act standards; as a result, its exports of petroleum to the United States have undergone substantial growth.⁵ Imports of petroleum from the North American Free Trade Agreement partners, Canada and Mexico, grew 23% and 41% respectively between 1994 and 1997. In comparison, all other imports grew at a rate of 10% during that period.

Significant change in U.S. supply has occurred outside of the Western Hemisphere as well. Currently, more than twenty

^{3/} U.S. Dept. of Energy, Comprehensive National Energy Strategy, Pub. No. DOE/S-0124, at 16 (Apr. 1998).

^{4/} U.S. International Trade Commission, "Industry & Trade Summary - Refined Petroleum Products," USITC Pub. 3147 at 12 (Dec. 1998).

^{5/} Id. at 11.

different countries export petroleum to the United States. Of these, a substantial number are not members of the Organization of Oil Producing and Exporting Countries ("OPEC"), and imports from non-OPEC countries exceed imports from OPEC countries. Individual non-OPEC countries, such as Colombia, Norway and the United Kingdom, now rival Kuwait as a source of petroleum for the United States.⁶ Thus, the foreign sources of supply to the United States are no longer concentrated in one country or a small group of countries in a politically volatile area such as the Middle East.

World-wide supply patterns can also have an impact on U.S. national security because disruptions in other parts of the world affect the available supply to the United States. In the rest of the world, as in the United States, reliance on OPEC - particularly Persian Gulf - suppliers has decreased since the 1970s, while supply from new sources has increased. Thus, the potential of a severe impact to the United States of disruptions elsewhere in the world has also decreased.

^{6/} Energy Information Administration, Dept. of Energy, Petroleum Supply Monthly, Pub. No. DOE/EIA-0109 (99/04), at 8-15 (Apr. 1999).

B. Dependence, Not Vulnerability

Dependence on foreign sources of petroleum is inescapable and has certain beneficial economic effects; the lower prices that result from imported sources have been a major contributing factor in the economic boom of the past few years. However, dependence is not equivalent to vulnerability. A paper published by the Energy Information Administration last year made this very distinction, which has long been maintained by the Department of Energy and the Petroleum Industry Research Foundation. The Agency found that the measure of net imports as a percentage of total petroleum could only describe the dependence on foreign petroleum; however, it determined that it is the vulnerability to changes in foreign supply that should determine whether measures to protect security should be taken.

In choosing oil security measures, one of the most important distinctions is between oil import dependence and oil import vulnerability. Knowing that the Nation imports 2 percent or 50 percent of its oil tells how dependent it is, but not how vulnerable it is to oil price shocks and to oil disruption.⁷

Thus, the current investigation should focus on the vulnerability of the United States to disruptions in foreign supply, not on

^{7/} James M. Kendell, "Measures of Oil Import Dependence," U.S. Department of Energy, Office of Integrated Analysis and Forecasting, Oil & Gas Division at 1 (July 20, 1998).

import dependence. Vulnerability should be analyzed from two perspectives: (1) physical, i.e., vulnerability to a physical petroleum disruption; and (2) economic, i.e., vulnerability to substantial price increases.

The relevant measures of assessing physical vulnerability include (1) concentration of world oil production in a few countries; (2) maintenance of an emergency supply; (3) surge capacity and excess world production; and (4) demand and alternative fuels.⁸ Based on these measures, the United States is not as vulnerable to a physical disruption as it was in the past. As discussed above, world oil production is no longer concentrated in a few countries. The United States and many other countries have created emergency stockpiles to be drawn on in case of a disruption. As demonstrated by the current low price situation, there is excess world production. In addition, the General Accounting Office forecasts a decline in reliance on oil as a transportation fuel over the next twenty years, which would decrease overall demand for petroleum.⁹

On the economic side, the most relevant factor in determining vulnerability is "oil intensity", i.e., oil

^{8/} Id. at 4-5.

^{9/} Id. at 5.

consumption per dollar of gross domestic product ("GDP"). Since the 1970's, oil intensity has decreased because GDP has increased at an even higher rate than oil consumption. Oil consumption in 1998 was about the same as in 1978 (18.8 versus 18.7 million barrels a day), while the GDP had increased dramatically since 1978. Consequently, while payments for imported oil approached 3 percent of GDP in 1980, they now account for less than 1 percent of GDP¹⁰; at such a level, the price of imported oil does not have the same impact on the national security that it once had. In addition, the switch to other fuels for home heating and electricity generation also caused a decrease in oil intensity in the United States.¹¹ Consequently, the vulnerability of the United States to oil price volatility -- now and for the foreseeable future -- is decreasing.

C. Maintenance of a Strategic Petroleum Reserve

The existence and maintenance of the Strategic Petroleum Reserve is a primary defense against any actual or threatened cut-off of imports to the United States. The amount currently in reserve, about 562 million barrels, is sufficient to withstand

^{10/} Id. at 7 (describing total energy expenditures as a percentage of GDP).

^{11/} Id. at 7.

approximately 56 days of a total import interruption.¹² More importantly, strategic reserves are now commonplace in many countries. The member countries of the International Economic Agency have agreed that strategic reserves should be drawn upon early in an emergency. In total, the member countries "could inject 4 million to 5 million barrels per day of oil from their reserves into the market."¹³ The existence of reserves around the world helps to lessen the potential impact of disruptions in other countries, which ultimately lessens the effect of those disruptions in the United States.

D. The U.S. Economy Benefits from Imports

The continued health of the U.S. economy is a critical element in the national security analysis. The security of the U.S. derives fundamentally from the strength of the economy. Policies that limit growth or impair U.S. economic performance relative to our competitors ultimately will harm national security by depriving the U.S. of its leadership position in the world economy.

^{12/} Id. at 5.

^{13/} Comprehensive National Security Strategy at 16.

As demonstrated by the experience of the past two years, the low prices that accompany imports are beneficial to the U.S. economy as a whole. The 1998 decline in oil prices held down consumer price inflation by 0.6 percentage points; economists believe that the drop in oil prices may have accounted for 0.5% in the increase in economic growth. The price of energy in the United States drives every sector of the U.S. economy. The low prices afforded by an unimpeded supply of foreign petroleum contributes significantly to U.S. economic security.¹⁴

E. Adverse Impact of Restrictions on Imports

1. Sectoral Impact

Restrictions on petroleum imports pursuant to Section 232 would be contrary to national security interests because they would necessarily increase the price of petroleum in the U.S. relative to the world price. This price increase is the primary effect of a flat import fee, a variable import fee, a "floor" price for domestic oil, or a quota on imports. Each of these

^{14/} Conversely, increased petroleum prices can harm the economy. For example, in April 1999, a 0.7% increase in the consumer price index "was driven by a 6.1% spike in energy prices;" this increase also caused some businesses "to raise prices to make up for the extra bit they are spending on energy costs." Wall Street Journal, Consumer Prices Jumped 0.7% in April, A2, May 17, 1999.

forms of restriction forces domestic petroleum prices higher, thereby injuring all domestic consumers of energy in direct proportion to their use of energy. Industries particularly vulnerable because of high levels of energy input include, but are not limited to petrochemicals, agriculture, transportation, mining and manufacturing.

2. Regional Impact

Moreover, import restrictions would have a disparate impact on the various regions of the country. Those regions with a higher than average use of petroleum would be injured relative to regions with less than average petroleum use. The Northeast, with its high proportion of homes, businesses, and industries that use oil for heat and power, would be most severely harmed by oil import restrictions.

3. Macroeconomic Impact

The macroeconomic effects of oil import restrictions are also detrimental. Virtually every economic analysis of the effect of oil import restrictions concludes that growth would be slowed, unemployment, inflation and interest rates would

increase.¹⁵ In addition, as prices for goods manufactured in the United States would rise due to increased energy costs, they would become less marketable on the export market. A loss in export sales would decrease U.S. industrial production, GDP and employment.

III. Targeted Solutions to Assist U.S. Petroleum Producers

IFTOA recognizes the seriousness of the situation faced by domestic producers, which have been hurt by the extended period of low prices. However, it would be contrary to U.S. national security interests to take broad action to assist the domestic producers in a manner that would have a devastating impact on other sectors of the industry and the U.S. economy in general.

Therefore, IFTOA strongly supports the adoption of alternative measures that would provide effective, targeted assistance to U.S. producers. Such assistance was proposed in Congress this session in S. 325 and S. 595 introduced by Senator Pete Domenici (R-NM) and Senator Kay Bailey Hutchison (R-TX), respectively. Such measures should include:

^{15/} Id. (describing economic concerns generated by the April 1999 jump in CIP).

- tax credits for marginal well production;
- special tax treatment for income derived from recovered inactive wells;
- modification of royalty policies;
- expansion of oil recovery credit to cover additional recovery techniques;
- modification of Alternative Minimum Tax to allow carry-back for unused credits and to apply regular tax depreciation schedules; and
- credit for exploration and development.

In addition to such immediate remedies, the Government can play a significant role in improving the situation of domestic producers in the long term. The National Energy Policy Plan has committed the government to working with industry in developing new technologies to increase recovery from mature wells and decrease the cost of the regulatory environment.¹⁶ IFTOA urges the consideration of the wide range of relief options that can be employed to assist the domestic producers without harming other industry sectors.

IV. Timeframe

Although the Department has announced an abbreviated time frame for the investigation, the Association urges the Department to spend more time on its review. The nation's economy is at a

^{16/} Comprehensive National Energy Strategy, at 15.

historically high level that has been sustained for a long period of time. No oil crisis, such as those of the 1970s, currently threatens the national security, supplies of petroleum are more than abundant and military fuel requirements are being met for U.S. and NATO forces engaged in combat in Yugoslavia. Thus, while IFTOA appreciates the desire of the Department to expedite the investigation, in terms of the national security, circumstances do not warrant such an expedited determination.

V. Conclusion

U.S. dependence on foreign sources, under current situations and for the foreseeable future, does not translate into vulnerability of the United States to disruptions in supply and price volatility. Diverse, secure sources, coupled with the availability of the Strategic Petroleum Reserves and a high gross domestic product, protect the national security.

The U.S. economy - hence our national security - benefits from low-cost fuel imports; conversely, the economy would languish if restrictions were imposed on these imports. Therefore, the Commerce Department should find that current and projected levels of petroleum imports do not threaten national

security, and that restrictions on such imports would not serve national security objectives.

OIL-016

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June 1, 1999

Bernard Kritzer, Manager, Special Projects
Office of Chemical and Biological Controls and Treaty Compliance
Bureau of Export Administration
U.S. Department of Commerce, Room 2093
Washington, D.C., 20230

Re: Comments in Response to May 4, 1999 Federal Register Notice on the National Security Impacts of Petroleum Imports

Dear Mr. Kritzer:

I enclose 3 copies of "Comments On The Advisability Of Oil Import Restrictions Under Sec. 232 Of The Trade Expansion Act" and ask that these remarks be entered into the record of your Sec. 232 investigation.

Please feel free to call if you have questions.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Bryan C. M. Chastel de Boenville".

Bryan C. M. Chastel de Boenville

Enclosure

COMMENTS ON THE ADVISABILITY OF OIL IMPORT RESTRICTIONS UNDER SEC. 232 OF THE TRADE EXPANSION ACT

Introduction

Twenty-five years ago I was beginning my career as an analyst in the policy office of the Federal Energy Administration. My office did the staff work for the interagency Energy Resources Council, which set Administration energy policy in those days. It was a heady time when energy policy was the central question of the day. Most people believed that how the country responded to the key energy issues would have important consequences for later generations. Today I have no involvement with petroleum policy, but I have spent most of the intervening years as a consultant involved with energy forecasting. I have also had experience with the aspects of the global warming problem that touch upon what can be done by utilities and how effective various strategies will be.

I might start by confessing that what I thought was going to happen 25 years ago never happened. The idea that the real price of oil in early 1999 could possibly be less than it had been in 1974 remains difficult to imagine, and is not something I would have even thought possible at the time. The reason why it seemed impossible was not that oil was running out – I knew there was plenty in the rest of the world – but I didn't believe the US would ever allow its dependence on imports to grow unchecked. I supposed in those days that basic strategic thinking by what I took to be a very powerful military-industrial complex would rule out the possibility of complete reliance on imports. If nothing else, I supposed that market forces would operate to keep imports down if the cartel controlled supply.

Why didn't this happen? The real answer is simple: we took the easy way out during a period when oil producing nations were unable to get their act together. In my early experience as an energy analyst, this was illustrated by a 1975 letter on energy policy sent by the then president of Ford Motor Company to President Ford. That letter filtered its way down, and it fell to one of my friends to draft a reply. In essence, the president of Ford wanted to know, what's the point of all this Project Independence stuff? Independence would require major changes and wasn't possible anyway. It would be expensive and difficult, and it would certainly hurt the Ford Motor Company. Given that the oil reserves of the Middle East are plentiful, why don't we just rely on the free market to bring it to us? No doubt a response was prepared on the merits of the administration's policy positions, but the point is, Congress and the American political system chose the Ford Motor Corporation approach rather than the Nixon / Ford / Carter dirigiste approach to energy policy.

Granted, the easy-way-out philosophy bought a quarter century more cheap oil and the attendant economic benefits, but was it worth it when we look at the next quarter century? We postponed doing something serious about petroleum dependence and global warming, two pressing problems that are intertwined and complex, that grow more threatening with each passing year, and that require a policy response that will be unpopular and more expensive than it should have been. The problems didn't go away; we just put off having to face them. The proper response to Ford Motor then, and to those who blocked all attempts to at least point our policy in the right direction since, is that there really are national security issues at the heart of the both questions, and we cannot allow other countries to set critical parameters that will govern our future.

Those 25 years are gone, there's no longer a possibility of independence from petroleum imports -- there may never have been, even in the early 70s -- but our dependence can be managed much better than at present. The possible outcomes of a Sec. 232 proceeding -- including either quantitative petroleum import restrictions or oil import duties -- are an important first step. I urge the Department of Commerce to affirmatively find that the current levels of crude oil imports has an

adverse impact on national security, and to take immediate steps to limit the consequences of reliance on petroleum imports.

Impact of Foreign Competition on the Economic Health of the Domestic Petroleum Industry

Figure 1 shows the companies that imported large amounts of crude in 1998 and how much they brought in. The list accounts for about 88% of crude imports.

- In 1974 the Seven Sisters, all but two US-based, owned and controlled almost all of the oil moving in world trade. Today, the surviving companies no longer own equity in the oil they import and have themselves dwindled in number, in part because of the truly competitive nature of the business. The US majors are remarkably efficient and for the most part are managed superbly. And yet they haven't done very well as a group. The losers who were assimilated, or are in the process of being assimilated, include Gulf, Amoco, and Mobil. Recent market reports suggest that Texaco may soon join these ranks.

Notice the role of foreign companies. The Venezuelan state oil company (PDV America) is the second largest importer. The Middle Eastern joint venture, Star Enterprise, is a major player, and the European multinationals control BP, Amoco and Shell.

None of this is sinister by itself, but it does show the large and growing extent of foreign ownership of key components of the US oil market. The US can no longer by fiat command that the companies carve up available supplies in the event of a sustained interruption, as the companies did in 1974. Today, a large share of imports is brought in by firms beyond the US government's jurisdiction. While the US still conducts tests of the emergency sharing system set up after 1974, neither of the OPEC-controlled firms participates. And yet the supplies they could contribute would be sorely missed in the event of an embargo, and the Strategic Petroleum Reserve would be drawn down all the more rapidly if they failed to cooperate.

- The United States is a particularly mature oil province, meaning that the easy-to-find, cheap-to-produce reserves are gone. The domestic oil production industry is hurt, and hurt badly, when import prices hit historically low levels, since domestic producers can no longer compete effectively. Domestic production cost is not only markedly higher here than abroad, the average US well produces little more than about 13 barrels a day, meaning that it is economically marginal and particularly sensitive to the effect of downward prices swings. The US industry

Figure 1. 1998 Crude Oil Importers

| | |
|---------------------------|------------------|
| MOBIL OIL CORP | 221,971 |
| PDV AMERICA INC | 212,745 |
| AMOCO CORP USA | 197,203 |
| EXXON CORP | 192,431 |
| SUN CO INC | 190,966 |
| STAR ENTRPSE | 189,642 |
| USX CORP | 187,472 |
| CHEVRON CORP | 178,504 |
| SHELL OIL CO | 176,627 |
| KOCH INDUS INC | 169,696 |
| TOSCO CORP | 165,265 |
| CLARK REFG & MKTG INC | 117,072 |
| VALERO ENERGY CORP | 112,787 |
| LYONDELL PETROCHEM CO | 90,725 |
| E I DUPONT DE NEMOURS | 84,716 |
| BP AMER INC | 76,198 |
| COASTAL CORP THE | 75,244 |
| PHILLIPS PETRO CO | 69,397 |
| ULTRAMAR DIAMOND SHAMROCK | 47,051 |
| Total | 2,755,712 |
| Total US | 3,120,790 |

badly needs price stability and predictability to keep production from dropping even faster. In recent months we've watched Mr. Ali Ibrahim Naimi, the Saudi oil minister, ratchet prices up and down as he seeks to enforce OPEC production discipline. Our small producers and stripper well owners have paid heavily during the period of low prices and instability.

- The administration should not be under any illusions that action under Sec. 232 will produce a revival in the domestic industry. Assuming domestic prices rise in response to a Trade Expansion Act remedy, the ensuing higher prices will produce a flurry of activity in all of the indicia of industry responsiveness – more wells will be drilled, more seismic line miles will be logged, employment will go up – but there is no reason to expect that a sustained increase in domestic crude oil production will result. The decline in US production will continue without regard to any likely Sec. 232 action. While one could argue about rates of decline under various policy regimes, the restrictions would have to be major indeed to produce any noticeable, sustained increase in domestic production.

It is very likely that either quantitative restrictions or oil import duties will result in market distortions that produce harmful inefficiencies. What happened to the domestic refining industry in the wake of the Entitlements program of the 1970s should be carefully avoided. There probably will be a few refiners who will suffer real harm by a Sec. 232 action, but it is better to avoid many of the even more harmful programs that were put in place in the mid-1970s to protect refiners/consumers. Specifically, there is no need for a windfall profits tax, nor any measure to guarantee refiners access to cheaper supplies of domestic oil, if any exist. Windfall profit issues, if any, can be determined using the Petroleum Industry Financial Reporting System. Case-by-case relief for supply disruptions can be given where a compelling showing of hardship can be made.

Quantity, Quality and Availability of Imports

Many Americans might suppose that 20 years of freedom from oil regulations would have produced a surge in domestic oil reserves, as the Reagan and Bush administrations promised. The surge never developed and today reserves are far below where they were. While there have been a few years when additions to reserves at least matched draw down for production, there haven't been nearly enough such years to prevent proved reserves from falling very significantly. The international situation does show expansion in proved reserves, but the increase to world reserves was much greater between 1975 and 1991 than in the last seven years. The data are summarized in Figure 2.

- While there is some question whether international reserves will peak in 10 years or in 25 years, there is reason to doubt it will be much longer than that. *After that time, all industrial countries will be competing for remaining supplies worldwide.* In addition, the newly industrialized countries, particularly the most populous, will also be attempting to secure adequate supplies to provide the types of transportation services we take for granted. In many instances, the new market entrant will have

Figure 2. Change in US and World Petroleum Reserves

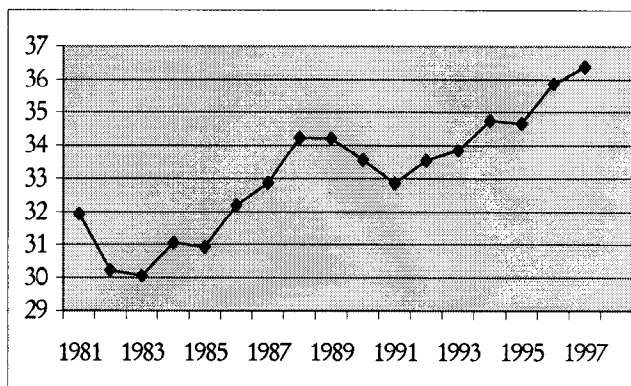
| Year | Area | Oil | Gas |
|------|-------|---------|---------|
| 1975 | US | 34.2 | 237.1* |
| | World | 712.4 | 2546.0 |
| 1991 | World | 999.2 | 4,211.5 |
| 1998 | US | 22.5 | 167.2 |
| | World | 1,020.1 | 5,087.2 |

*including Prudoe Bay gas. Units are billions of barrels for oil and trillions of cubic feet for natural gas. Source: Oil and Gas Journal, as quoted by secondary sources.

added far more value than his or her US counterpart, and will be seeking to run a motorbike capable of hundreds of miles per gallon instead of a second SUV capable of 15 mpg.

- There has been no repeat of the politically motivated embargo of 1974. But we learned in 1980 and again in 1990 how closely our economic fate remains linked to events in the Middle East. We seem destined to learn the same lesson for events in Central Asia, where the planned pipelines transit a thousand miles of geopolitical territory one could politely describe as being difficult to defend. Crude oil is both absolutely essential to our economy, and marginal developments abroad can have both direct and indirect macroeconomic consequences.
- A major difference between the situation today and that prevailing when oil imports hit their earlier peaks in 1980 is the relative effect on the merchandise trade balance. Because real oil prices have been so low, the US has been able to run consistent deficits on current account without letting the imbalance get out of hand. And yet the recent run-ups in world crude prices have caused the deficit to grow considerably. So while the dollar outflows haven't been a problem in recent years, there is no reason to think that they won't become a problem if oil prices continue to rise.

Figure 3. US Petroleum Consumption (Quads)



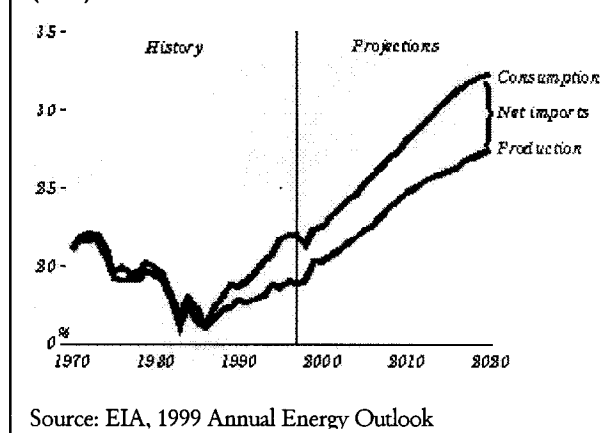
Defense and Essential Civilian Sector Requirements

Most people assume that 25 years of talking about the importance of energy conservation has had the desired effect. It hasn't. *Per capita energy consumption in 1997 was as high as at any time in the past.* All the conservation practiced when prices were high has disappeared, despite more stringent standards for the construction of homes, cars, furnaces, and hot water heaters. Significantly higher petroleum prices are the only market force that will produce a conservation response.

It hasn't. *Per capita energy consumption in 1997 was as high as at any time in the past.* All the conservation practiced when prices were high has disappeared, despite more stringent standards for the construction of homes, cars, furnaces, and hot water heaters. Significantly higher petroleum prices are the only market force that will produce a conservation response.

- The situation is even worse with petroleum consumption. The only usage declines have followed periods of sharply higher prices, lagged by two years. Overall petroleum consumption has grown rapidly since 1984. See Figure 3.
- Another particularly significant trend concerns natural gas. Despite the common perception that the US has all of the gas it could ever need, and the fact that we have been producing more natural gas, we have basically been importing a large proportion of our marginal supplies from Canada. EIA's assessment of the future of this trend also presents reasons for concern (Figure 4). While Canada is a particularly loyal friend of the United States, it should not be

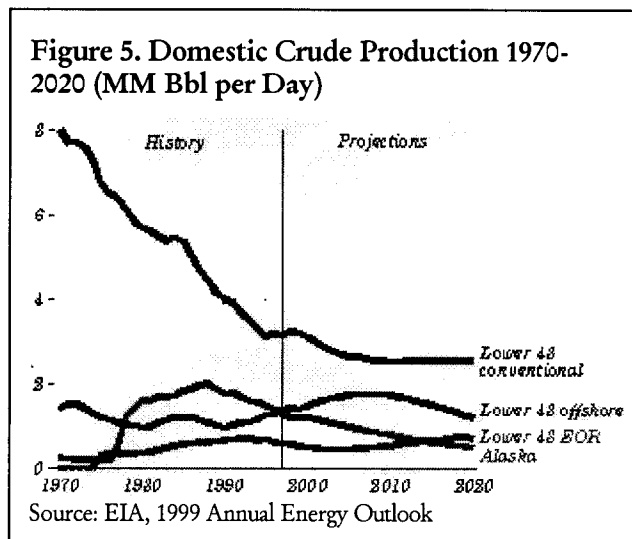
Figure 4. Natural Gas Supply and Demand (Tcf)



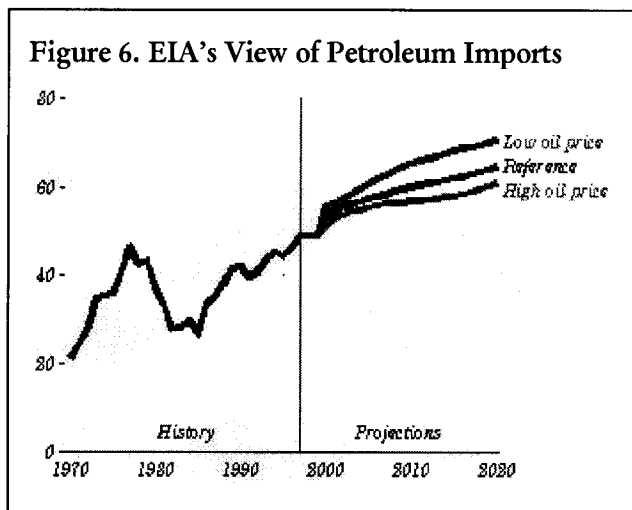
Source: EIA, 1999 Annual Energy Outlook

forgotten that the National Energy Board took steps to restrict gas exports to the US in the mid-1970s, and caused the gas that did cross the border into the northern tier to be sold for more than \$4/Mcf. We must expect Canada to protect her own economic interest. Again, there's no reason to think controls are imminent, but the situation deserves careful attention.

- To the extent that either quantitative restrictions or large import duties are imposed on oil, demand for gas will increase proportionately. According to recent studies, the US is already going to fire nearly all planned additions to electricity production by using natural gas for the foreseeable future, which a major reason why the projected growth in consumption is so great. If oil duties are increased, consideration will have to be given to ways to prevent natural gas demand, and hence gas imports, from getting out of hand. Stricter due diligence rules for institutions providing long-term finance for gas-fired electricity production is one possible measure.



- Figure 5 presents the Energy Information Administration's view of what's going to happen to oil production. One can't help but wonder what could make it possible for the US to produce so much future natural gas (Figure 4) and not so much future oil (Figure 5). I suspect that EIA may be a little optimistic about future domestic gas production.



- By the same token, no one should be confused about the magnitude of the salutary effect that either oil import duties or quantitative restrictions will have. At best, they will slightly reduce oil imports from the expected reference case shown in Figure 6 to the high oil case. While the amount of the effect would vary with the size of the duty or quantitative restriction, it would have to be very large to have even a relatively modest impact for nearly a decade. This doesn't mean that the idea should be abandoned, but proponents of the idea should be realistic about how long it will take to bring the situation back to manageable proportions.

Other Factors Relevant to the Damage to National Security Caused by Oil Imports

Just as the government has had no policy toward oil imports, it has no serious policy toward global warming. Global warming has less pressing national security implications than oil imports, but the long-term implications of neutrality toward greenhouse gas emissions could produce climatic changes that disrupt key national security variables.


- Only two policy initiatives in recent years are even worth mentioning. The Clinton Administration began its tenure with what started out as a carbon tax. Unfortunately, it soon became a general energy tax when, for illogical political reasons, electricity produced by nuclear energy was included in the tax, while the usual ineffective technologies favored by the democratic left were subsidized. Shortly thereafter, it died the usual death Congress reserves for energy tax legislation.
- The second initiative, the Kyoto Treaty, at first appears to be a serious attempt to do something. But consider: In 1990 according to EIA, total fuel combustion greenhouse gas emissions were 1,346 million metric tons. By 1997, this total had risen to 1,480 million metric tons. EIA now projects that energy-related carbon emissions will reach 1,790 million metric tons in 2010, conspicuously way beyond the promised 1990 level. This farce will have grown to 1,975 million metric tons in 2020.
- Unfortunately, the Administration failed to really understand how very costly it would be to actually hold down the use of carbon-based fuels to 1990 levels. However, Congress understood, and continues to ignore Kyoto. The Administration itself has yet to understand that the most promising technology for reducing greenhouse gases, by an order of magnitude, is an emphasis on nuclear electrification using the most recent innovations in safe reactor design and allowing the current generation of reactors to be re-licensed in the post-2005 timeframe. It is important to understand that while Sec. 232 restrictions on oil imports may have a minor impact on CO₂ emissions, it will not have anything like the effect that a coordinated strategy emphasizing nuclear power would have.

Conclusion

The question of whether national security has been harmed by crude oil imports has been investigated by the Secretary of Commerce again and again.¹ The answer has been made in the affirmative again and again. The situation today is every bit as threatening as at any time in the past, even more so. And yet Sec. 232 has yet to be used to provide an effective remedy. Sometimes administrations fooled themselves into thinking that their energy policies were working; at other times overt politics intervened to prevent remediation.

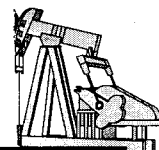
It is time to use the statute as Congress intended and protect our nation from even greater danger by directly managing our dependence on oil imports. Sec. 232 restrictions will not be enough to solve the underlying problems, but they are a necessary first step. However, this step should only be taken if the Administration is willing to accept the consequences of this extraordinary remedy, many of which are harmful, and shows it has the political will to withstand the storm of criticism that action under Sec. 232 will inevitably produce.

Respectfully submitted,



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¹ Affirmative findings of harm were made for the Sec. 232 proceedings of 1975, 1979, 1982, 1987, and 1994. However, there has never been an effective restructuring of crude oil imports resulting from a Sec. 232 initiative.



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June 3, 1999

Re: Comments On National Security Investigation of Imports of Crude Oil and
Petroleum Products [Docket No: 990427107-9107-01]

The following comments are submitted on behalf of the Independent Petroleum Association of America (IPAA) and the National Stripper Well Association (NSWA). IPAA represents the 7000 independent oil and gas producers of America. NSWA represents the small business operators in the oil and natural gas industry, producers with low volume, high cost stripper or marginal wells.

If you have any questions regarding these comments, please contact either Gil Thurm, President of IPAA, or Lee Fuller, Vice President of Government Relations of IPAA, at 202-857-4722.

Sincerely,

George Yates
Chairman, IPAA

Danny Biggs
President, NSWA

Comments
On
National Security Investigation of Imports of Crude Oil and Petroleum Products
[Docket No: 990427107-9107-01]
On Behalf Of The
Independent Petroleum Association of America
And The
National Stripper Well Association

This document presents comments by the Independent Petroleum Association of America (IPAA) and the National Stripper Well Association (NSWA) regarding the national security investigation of imports of crude oil and petroleum products by the Bureau of Export Administration. IPAA represents the 7000 independent oil and gas producers of America. NSWA represents the small business operators in the oil and natural gas industry, producers with low volume, high cost stripper or marginal wells. IPAA submitted the Section 232 petition that resulted in the 1994 investigation of the impact of crude oil and petroleum products. IPAA and NSWA strongly believe that this prior investigation failed to significantly address the problems posed by increased reliance on imported crude oil. Consequently, IPAA and NSWA believe that the focus of this investigation should not be *whether* imports pose a risk to national security but *what* actions should be taken. These comments will review past efforts, present the reasons for action to support domestic oil production, and present a number of actions that should be taken by the President in response to the determination of national security risks posed by imported crude oil.

Past Actions

The two most recent Section 232 investigations into the national security implications of increased crude oil imports have agreed on one key point – increased imports pose a national security risk. In 1987, the investigation conducted under the Reagan Administration reported:

The Secretary of Commerce has concluded that there has been a substantial improvement in U.S. energy security since the last Section 232 petroleum finding in 1979. However, declining domestic oil production, rising oil imports, and growing Free World dependence on potentially insecure sources of supply raise a number of concerns, including vulnerability to a major supply disruption. The investigation found that the maintenance of U.S. access to sufficient supplies of petroleum is essential to our economic security, foreign policy flexibility, and defense preparedness. Given these factors, the Secretary of Commerce found that petroleum imports threaten to impair the national security.

Similarly, the investigation in 1994 by the Clinton Administration produced the following statement by President Clinton:

I am today concurring with the Department of Commerce's finding that the nation's growing reliance on imports of crude oil and refined petroleum products threaten the nation's security because they increase U.S. vulnerability to oil supply interruptions.

In 1987 imports of crude oil and refined products constituted 40.1 percent of U.S. demand. In 1994 imports were 50.8 percent of demand. In 1998, imports had increased to over 55 percent of

demand. Clearly, there can be no other conclusion – imports represent a continuing and growing threat to the nation’s security. At issue will be what actions should be taken to respond.

In 1995, President Clinton listed the following measures that his Administration intended to take to address the threat:

- Increased investment in energy efficiency.
- Increased investment in alternative fuels.
- Increased government investment in technology, to lower costs and improve production of gas and oil and other energy sources.
- Expanded utilization of natural gas.
- Increased government investment in renewable energy sources.
- Increased government regulatory efficiency.
- Increased emphasis on free trade and U.S. exports.
- Maintenance of the Strategic Petroleum Reserve.
- Coordination of emergency cooperation measures.

Unfortunately, this was a flawed program – a program that has failed to effectively address increasing imports or the national security threat. It is flawed because it places too little emphasis on elements that enhance domestic oil production.

The following items detail some of these flaws.

- Increased investment in alternative fuels.

This item was primarily directed toward the extensive development and utilization of vehicles using alternative fuels by the year 2000. While it has been a laudable goal, it has produced little change in overall fuel demand, and even less in the context of reducing imports.

- Increased government investment in renewable energy sources.

Renewable energy sources accounted for about 8 percent of U.S. energy consumption in 1997 – a decline of 3 percent from 1996. Of this amount, 55 percent was contributed by hydroelectric power, a source of energy that has little Administration support and limited likelihood of future expansion. Another 38 percent came from “biomass”. Most of this was from waste incineration – another source with little Administration support. The remaining renewable energy contributions were geothermal (5 percent), solar (1 percent), and wind (< 0.5 percent). Clearly, none of these would make any significant reduction in imported oil use.

- Increased emphasis on free trade and U.S. exports.

This component was primarily directed at improving the reliability of imported oil sources. However, the U.S. is now twice as dependent – on a percentage basis – on the foreign oil sources that participated in the 1973 oil embargo as it was then. This diversification strategy has failed. America remains largely dependent on the volatile Middle East for its imported oil. Protecting against the potential instability of Middle Eastern oil supplies consumes significant amounts of the U.S. budget. CNN reported last year that “military buildups that have kept U.S. ships, planes, and troops within striking distance of Iraq since the 1991 Persian Gulf war have cost U.S. taxpayers about \$6.8 billion....” This \$6.8 billion figure is in addition to annual expenditures of about \$50 billion to maintain a strong military contingent in the Gulf and it does not reflect the most recent actions in Iraq.

- Maintenance of the Strategic Petroleum Reserve.

After the determination of the 1994 Section 232 analysis, the Administration supported efforts to sell 28 million barrels of Strategic Petroleum Reserve oil for budget purposes. It was not until 1998 that the Administration reversed its support for sales and not until the end of 1998 that the Administration initiated an effort to reacquire the oil it had sold. Moreover, even if it were full, the Strategic Petroleum Reserve provides at most a 90 day supply of crude oil.

- Increased government regulatory efficiency.

While the concept of this element is to improve the regulation interaction between the government and the industry, it has fallen far short and in many respects the regulatory relationship has deteriorated. The most noteworthy example is the proposal by the Department of Interior to increase the royalties taken from the production of crude oil on federal lands by changing the valuation method. This proposed method ignores contracts producers signed with the federal government by collecting royalties on values downstream of the well. This proposal has been a serious barrier to developing a sound regulatory reform agenda between independents and the Administration. The issue has been characterized by a contentious relationship that has included name-calling by the Secretary of the Interior. Its outcome remains a key issue.

Additionally, the Bureau of Land Management has proposed a major rewrite of all of its oil and gas operating rules that have created serious unrest within the industry rather than a sense of a better regulatory agenda. This so-called plain English exercise has created additional uncertainty, costs, and barriers for developing federal lands. And, other elements of the Administration, such as the Forest Service have banned drilling for a potentially world class gas reserves in certain federal lands in Montana.

Recent efforts by the Administration have showed the potential for a better working relationship such as the use of “royalty in kind” to acquire oil for the Strategic Petroleum Reserve.

- Expanded utilization of natural gas.

This element of the program would be a valuable element if it were approached appropriately. Unfortunately, it has not been. Although the Comprehensive National Energy Strategy (CNES) includes a goal to expand the nation's natural gas supply to meet a national use of 30 trillion cubic feet per year, the Administration's actions have not moved toward the essential steps that are necessary to meet this net 40 percent increase over current natural gas use. There are three key elements to the expanded utilization of natural gas: access to natural gas bearing resources, a regulatory structure that provides gas producers with adequate incentives to develop new gas, and an industry with the capital to develop the resource. Rather than assist in developing new resources, the Administration has limited access to likely potential resources. Producers are faced with a FERC proposal on pipeline rates that could further diminish the share of the natural gas price going to producers and therefore reduce their return on investment. Finally, as the past eighteen months have shown, there can be no healthy domestic natural gas industry without a healthy domestic oil industry.

The current approach adopted after the 1994 Section 232 analysis must be revised to include a specific and aggressive focus on what was described in the last paragraph of President Clinton's announcement:

Finally, led by the Department of Energy and the National Economic Council, the Administration will continue its efforts to develop additional cost-effective policies to enhance domestic energy production and to revitalize the U.S. petroleum industry.

More importantly, this aspect must be developed with a full recognition of the fundamental changes that have taken place in the domestic oil industry over the past 15 years – a factor that changes the type of actions that the federal government must take.

A Changing Industry and The Implications

Changes to the Domestic Oil Industry

Inherent in evaluating options to respond to the national security threat posed by ever-increasing imports of foreign oil is a clear understanding of the evolving nature of the domestic oil industry. Today's domestic industry has changed dramatically since the 1986 oil price crisis. The principal factor in this change is the shift in the role "major" oil companies are playing in the development of domestic oil resources. The 1986 price crisis changed the way majors viewed U.S. oil production. It began a clear shift in investment by majors in domestic oil production.

In rough terms, U.S. oil production comes from three areas – Alaska, the Gulf of Mexico offshore, and the onshore lower 48 states. Currently, about 20 percent of domestic production comes from Alaska; about 20 percent comes from the offshore Gulf of Mexico; and, about 60 percent comes from the lower 48 onshore – one-third of this from "marginal wells" producing less than 15 barrels per day. Since 1986, investment by major oil companies has shifted to exploration and development targets outside the United States. Within the U.S. majors are now primarily interested in developing Alaska and the deep water offshore. As a result the lower 48 onshore has increasingly become the province of the independents. The independents' share of this production has increased from about 45 percent in the mid-1980s to over 60 percent in 1997. It is an irrevocable shift in the structure of domestic oil production. It is a shift that must now be reflected in public policy decisions.

Clearly, independents are a different element of the oil and gas production industry than majors. They do not have the resources of majors such as refineries and chemical operations to buffer them during periods of low oil prices such as those in 1986 and again over the past eighteen months. Independents finance their operations differently than majors as a result. Recent assessments by IPAA to summarize sources of financing show that capital formation was generated primarily from the following four sources: end-users of the energy (29 percent), internally generated sources (26 percent), outside investors – oil and gas partners (20 percent), and banks (15 percent). During price crises three of these sources are impaired. Internally generated funds are limited. Banks are reluctant to increase their exposure. And, other oil and gas partners are suffering the same limitations. Thus, the end-users' role has increased substantially as other capital dries up and the end-users recognize their dire need for resources and are interested in developing reserves.

This reality must be a part of public policy considerations in fulfilling the objectives of the CNES. The CNES includes an objective to stop the decline in domestic oil production as a means to improving national energy security. This objective is more clearly stated in the Fossil Energy Strategic Plan as follows:

Improve the capability of the U.S. petroleum industry to increase the supply of secure, domestic oil by an average of 0.5 million barrels/day in the 2001-2010 period while significantly reducing the environmental impact of oil production.

To put this objective in a clearer context, it was developed at a time when domestic oil production was on the order of 6.5 million barrels/day. It, therefore, translates into a national goal to increase domestic production to about 7 million barrels/day. That target starts from a production level that has now dropped below 6 million barrels/day. Clearly, it cannot be achieved without substantial reliance on the independent producer and substantial changes in national energy policy.

Yet, at the same time the independent producer has suffered the most significantly from the current price crisis. The statistics on damage to the industry are mind-numbing.

- Domestic production has dropped below 6 million barrels per day – the lowest since 1951
- Operating rig counts have hit historic lows
- Over 56,000 jobs have been lost in the industry since November of 1997
- More than 136,000 oil wells (25 percent of total U.S. oil wells) and 57,000 gas wells have been shut down
- \$2.21 billion in lost federal royalties and state severance and production taxes
- Capital budgets for oil and natural gas development have been savaged – down 25 – 30% with the biggest cuts in the US
- Indirectly – or perhaps directly – the price crisis has driven mega-mergers within the industry.

Taken together these factors define the devastation in the industry. Equally important, they lead to the realization that their consequences are not immediate or necessarily foreseeable. As the Energy Information Administration stated in its analysis “*Oil and Gas Development in the United States in the Early 1990's: An Expanded Role for Independent Producers*”:

Although the majors' primary upstream (exploration, development, and production) investment targets shifted abroad, the reduced role for the majors in U.S. oil and gas production did not become strongly apparent until the 1990's.... Reductions in spending and production by other U.S. producers responding to the oil price collapse of 1986 and its aftermath, together with lags inherent between exploration and development activity and production accounted for this delay. Also, the majors did not become net sellers of U.S. oil and gas reserves until the 1990's.

In 1986, domestic crude oil production was 8.68 million barrels/day. Once the price crisis was past, little was done to develop responses. The changes to the industry were not understood. By 1997, domestic crude oil production had dropped to 6.45 million barrels/day – a loss of over 2 million barrels/day. This time, this crisis, action must be taken to avoid a similar loss of domestic production, of an important domestic resource.

Implications on the Nation's Natural Gas Objectives

Moreover, the implications are broader than crude oil. They are equally critical to domestic natural gas production. The CNES includes an objective to increase domestic natural gas use by a net 6 trillion cubic feet/year by 2010. This would require annual production level of about 30 trillion cubic feet/year. It is critically important to recognize that oil and gas are found together, produced together, draw from the same capital pool, and rely on the same infrastructure – both human and material. Over the past 18 months low oil prices have not only shut in 136,000 oil wells but 57,000 gas wells also. Capital budget cuts for new upstream development hit both oil and gas. The exploration and production (E&P) personnel necessary to accelerate and maintain a more active resource base development program have been devastated with employment in this sector shrinking by 56,400 – about 15% of its total – since November 1997. The requisite upstream service vendor segment to facilitate growth (drilling contractors, well service contractors, cement and stimulation vendors, well logging, oil country tubular goods) have also suffered dramatically. For example, from November 1997 through April 1999, the domestic drilling rig count dropped 50 percent. The rig count is a quick measure of the level of activity in the industry. While most of this drop has been in the oil side of the business – approximately a 60 percent drop – the natural gas side of the industry has seen about a 40 percent decline. Faced with these stark problems, capital will not easily flow to the upstream (E&P) segment of the business; it will require clear indications that adequate returns can be achieved on new E & P capital investment. Both elements of the industry must be considered. Without a strong domestic oil industry, we cannot have a strong domestic natural gas industry and the national goal of a 30 trillion cubic feet per year natural gas market will not be achievable.

The Consequences for National Security

Similarly, it is essential to recognize that domestic oil production is the nation's true strategic petroleum reserve. Far more than the hundreds of millions of barrels in the Strategic Petroleum Reserve, the ability to produce 6.5 to 7 million barrels/day of domestic oil is essential to America's national security. Oil is this nation's economic lifeblood. Without a stable oil supply the U.S. economy and the world's economic health are at risk.

The most recent price crisis has shown how much more vulnerable the crude oil market is to instability. This crisis showed how different the oil market has become in the past twelve years. In 1986, the market price was largely defined by the decisions of the Oil Producing Exporting

Countries (OPEC). But, since then oil pricing has changed to be largely dependent on commodity futures markets – principally the New York Mercantile Exchange (NYMEX), the International Petroleum Exchange (IPE), and the Singapore Mercantile Exchange (SIMEX). These exchanges, like all markets, are subject to volatility and the potential to set prices based on factors that do not reflect the fundamentals of the industry.

The current price crisis is illustrative. Prices have reached historic lows in real terms. Yet, the fundamentals of the industry do not suggest that should be the outcome. Worldwide demand for oil slowed in 1998 as a result of the Asian economic problems, but it did not decrease. Most projections suggest that oil demand will continue increase at a 1.5 to 2.0 percent per year growth rate. Similarly, most analysts suggest that the current worldwide productive capacity for oil is only 3 to 4 percent above current demand. Thus, without additional production coming on line, demand would exceed supply in the next two to three years. Moreover, this simple assessment does not address the natural depletion in oil production that occurs – and has been exacerbated from new drilling technologies and the lack of new investment as the price crisis drove investment down. These conditions in most industries – and historically in the oil industry – argue for upward pressure on prices not the catastrophic collapse that occurred.

Nevertheless, a price collapse occurred and it is important to recognize the factors that contributed to it. Generally, the triggering factors are attributed to three events – the collapse of Asian economies, warmer than normal winters in the Northern Hemisphere, and a market share competition between Venezuela and Saudi Arabia. These occurred in late 1997 and early 1998. This first phase was worsened by projections of vast oversupplies of oil by such institutions as the International Energy Agency (IEA). Reports by the IEA and others (many of which used IEA's data) projected excess supply while at the same time being unable to find the physical barrels that they projected. The markets continued to react and suppress prices – putting extreme pressure on domestic oil production.

As most OPEC and non-OPEC countries took action to reduce production to stabilize oil prices, the market was unresponsive. It then became evident that quietly Iraq was using the UN sanctions process to continue to destabilize the oil market. At the beginning of the oil price crisis Iraq was a minor factor – exporting 600,000 to 700,000 barrels/day of oil. But early in 1998 the UN sanctions process expanding the sales volume that Iraq could sell to \$5.25 billion every six months and allowing the expenditure of \$300 million every six months to refurbish its oil production capacity. Even though less than \$25 million of this allocation has been used, Iraq still increased its oil exports to as much as 2.5 million barrels/day. As other nations cut production, Iraq's increased – offsetting the effect on inventories, becoming the swing producer¹ in setting

¹ The term “swing producer” can have two meanings – one related to the volume of production and one related to its effect on the commodity market trading in crude oil.

The most common use of the term relates to the volume of production. Most experts would consider Saudi Arabia as the world's swing producer. Over the past several decades, this has been correct. Because Saudi Arabia has had the ability to produce 8 to 10 million barrels per day of crude oil, it can alter its production to respond to swings in the supply side of the crude oil market. In general, this has been a response that has been taken from a positive perspective – that is, Saudi Arabia has been viewed as a responsible nation acting to respond to supply shortfalls by increasing production.

However, the current world market is facing a different balance. Most analysts agree that excess worldwide productive capacity is shrinking – a problem worsened by low oil prices. As excess productive capacity diminishes, any nation that produces more oil than the increment between demand and productive capacity becomes a swing

price in the world market, and continuing to suppress world oil prices. Ultimately, this role was limited by Iraq's current productive capacity and by the decision by OPEC and non-OPEC countries to further reduce production. Yet, the potential implications are both insidious and profound.

If Iraq was able to exert this much influence on world oil prices under these circumstances, what are the implications to national security when the gap between demand and productive capacity close? As the gap closes, any producer nation that produces more than the gap can become the world's swing producer². That is, by reducing its production, it can create a supply shortage and drive prices upward. Or, it can increase production and drive prices downward.

Both options threaten U.S. national security. Shortages and high prices affect the economy adversely and the consequences are higher as the country becomes more dependent on foreign oil. Low prices directly impair the health of the domestic oil industry as they have in the current price crisis, leading to lost production and making the nation more susceptible to supply disruption. The current world oil market is heading in this direction and the Administration needs to take actions to respond to it and to value the nation's domestic oil production as an element of this response.

Action Steps

This Section 232 analysis needs to produce recommendations that fully value domestic oil production and to enhance its development. It needs to put a defined set of objectives on the broad framework suggested in 1994. These need to address a number of known areas of public policy and put in place ongoing commitments to address future emerging issues as the implications of the current price crisis are identified. It is also important to recognize that while the federal government needs to participate in the support of the domestic oil industry, there are a limited number of actions it can take.

Following are a specific set of recommendations.

Tax Policy

producer. So, while Saudi Arabia has been the only volumetric swing producer in the past, many other countries will be able to fill that position in the not too distant future. One of these will be Iraq. However, in Iraq's case it will give Saddam Hussein the ability to manipulate oil supply by cutting production and creating economic chaos.

The concept of a swing producer in the commodity market is different and relatively new. A decade ago, oil prices were not determined primarily by the commodity market. Rather, refineries used a system of "posted" prices. However, since then the role of the commodity markets, such as the New York Mercantile Exchange (NYMEX), have dramatically changed the pricing of crude oil. Now, traders buy and sell paper barrel futures on the exchange floor. But, in doing so, the "liquid" barrel market is also defined. The factors that drive traders reflect the same volatile dynamics of stock and commodity markets. Among these are assessments of the current and future supply and demand for crude oil. During the past year these perceptions were critical to the pricing of crude oil, particularly the perception of excess supply. In this trading world, producers that are willing to sell the last barrel at the market price are effectively able to set every barrel's value. During the latter part of 1998, Iraq showed its willingness to continue increasing production while all other producing nations reduced theirs. In taking this action, Iraq became the "swing producer" for the commodity market.

In this case, the term "swing producer" is used in this latter context.

² In this case, the term refers to the volumetric swing producer.

A pivotal option available to the federal government is reform of the tax code. Over the past several decades treatment of the oil and gas industry in the tax code has constrained the use of deductions and credits as opposed to the time when the national policy objective was to encourage domestic oil and natural gas development. Some of these constraints have been modified – many to the benefit of independents. However, as price fluctuations become more threatening, more must be done. For example, the National Petroleum Council's 1994 *Marginal Wells* report made the following statement:

Preserving marginal wells is central to our energy security. Neither government nor the industry can set the global market price of crude oil. Therefore, the nation's internal cost structure must be relied upon for preserving marginal well contributions.

The *Marginal Wells* report then went on to recommend a series of modifications to the tax code including a marginal wells tax credit and expensing key capital expenditures.

The proposed marginal wells tax credit is a good example of a well-reasoned countercyclical approach to the problem. It phases in when oil prices drop and phases out when they rise. It serves as a safety net in times price crises. It protects what was 20 percent of domestic oil production at the start of 1998 and what will always be a pivotal element of the nation's true strategic petroleum reserve – as long as it is preserved.

During periods of low oil or natural gas prices that threaten the future of domestic resources, it is essential to develop options to enable producers to retain a greater portion of their income. At the federal governmental level, adjustments to the tax code can provide a mechanism to allow producers to retain cash from existing operations or to recover it from prior years' operations. The oil and gas producing industry endorses changes to the tax code that would address these objectives.

- Tax Credits

A countercyclical marginal well tax credit – a concept recommended by the National Petroleum Council's 1994 *Marginal Wells* report – that would be available during low oil and gas price fluctuations, including a ten year carryback and applicability against both regular and alternative minimum taxes. This provision would serve as a safety net to small producers by providing additional revenue at a time when prices are low to keep wells operating.

The Marginal Well Production Tax Credit amendment to the Internal Revenue code will establish a tax credit for *existing* marginal wells. Marginal oil wells are those producing less than 15 barrels per day or producing heavy oil and for high water cut wells producing less than 25 barrels per day. Marginal gas wells are those producing less than 90 thousand cubic feet (Mcf) a day. The amendment will allow a \$3 a barrel tax credit for the first 3 barrels of daily production from an existing marginal oil well and a \$0.50 per Mcf tax credit for the first 18 Mcf of daily natural gas production from a marginal well.

The tax credit would be phased in and out in equal increments as prices for oil and natural gas fall and rise. The phase in/out prices are as follows:

OIL – phase in/out between \$14 and \$17

GAS – phase in/out between \$1.56 and \$1.89

The amendment would allow the tax credit to be offset against regular and the alternative minimum tax (AMT). In addition, for producers without taxable income for the current tax year, the amendment would provide a 10-year carryback provision allowing producers to claim the credit on taxes paid in those years. The carryback credit may be used to offset regular tax and AMT.

- Modification of Alternative Minimum Tax (AMT)

A countercyclical restructuring of the calculation of Alternative Minimum Taxable Income (AMTI) to eliminate from the calculation certain preference items and adjustments. During low oil prices, this would reduce the income against which the AMT is calculated thereby leaving more income to maintain and develop production.

- Modification of Percentage Depletion

Current law limits the use of percentage depletion in several ways thereby limiting the availability of capital to maintain and develop production. These provisions would: eliminate limitations on the use of percentage depletion across all properties; eliminate the current limitation on using percentage depletion in excess of 65 percent of net taxable income; and, allow excess percentage depletion to be carried back against past taxes. These steps will free capital for small producers to maintain and develop production.

- Expensing Expenditures

The ability to recover expenditures as quickly as possible allows capital to be reinvested more rapidly. These provisions would assure that geological and geophysical costs and delay rental payments can be expensed in the year that they are incurred.

These fundamentally essential reforms to the federal tax code have been introduced in both the House of Representatives (H.R. 1971) and the Senate (S. 1042).

Financial Instruments

A second and new area for federal public policy related to domestic oil production is the creation of financial instruments to aid the industry in troubled times and improve capital development generally.

- SBA Loans

The Administration has opened this idea by working with the Small Business Administration to use existing authority to provide small business loans to oil producers and related industry. However, it is a limited program.

- Loan Guarantees

The Senate passed a broader loan guarantee program offered by Senator Pete Domenici during consideration of the 1999 Emergency Supplemental Appropriations Act (H.R. 1141). While not completed on that legislation, the provision has now been incorporated into H.R. 1664. The oil and gas loan guarantee program provides a two-year GATT-legal, \$500 million guaranteed loan program to back loans provided by private financial institutions to qualified oil and gas producers and the associated oil and gas service industry. The minimum loan to be guaranteed for a single company at any one time would be \$250,000 (subject to waiver); the maximum would be \$10 million. The board

established to administer this would have the authority to determine the specific requirements in awarding loan guarantees, including the percentage of the guarantee, appropriate collateral, loan amounts, and interest rates. Repayment of the loans would be required within six years.

Loan guarantees are an approach that has been used by the federal government to facilitate the recovery of key domestic industries or municipalities in times of severe crisis. They have been used for Chrysler Corporation and New York City. The Department of Agriculture operates an ongoing loan guarantee program for farmers that addresses their problems during low commodity prices. In this case the concept would provide bridge financing to allow independent producers and the oil industry supply business to recover from the current price crisis.

- PADDIE MAC

Another concept that deserves evaluation is called the “Petroleum Development Investment Management Corporation” – PADDIE MAC for short. This concept is pattern after other government sponsored enterprises (GSE) like Fannie Mae and Sallie Mac.

Under the Paddie Mac concept, loans would be made and serviced by banks and other oil and gas lenders in conformity with Paddie Mac guidelines. Paddie Mac would guarantee the non-recourse loans (volumetric production payments) secured by producing oil and gas properties. Independent engineering of reserves confirming sufficient future production to repay the loans would be required, standardized documentation used and future prices would be hedged through Paddie Mac. Paddie Mac would also make a secondary market for the guaranteed loans, assuring lenders of liquidity. Loans purchased would be bundled for sale in the capital markets as investment grade debt. Based on its GSE status, the cost of funds to borrowers are projected to be two or more percent less than most producers now pay, and hedging of future prices would be more favorable than most producers get today. Efficient hedging would be available, separate from loans, to enable producers to insulate themselves from price volatility and disastrously low prices.

The Department of Energy has considered this concept in the past and the Administration should revisit it now.

Addressing possible financial instruments where the federal government can assist the domestic oil industry are a needed part of a total package.

Public Lands and Royalties

The U.S. is a mature oil producing area but there are still substantial oil reserves that can be developed. Additionally, world class gas reserves lay beneath federal lands and need to be developed to reach the national 30 trillion cubic feet per year goal. Many of these are on federal lands where federal policy defines both their access and their desirability. Both need attention in any policy option. The Administration needs to revisit its positions on access to public lands for production. The Department of Energy has shown how new production techniques reduce the environmental risks to public lands. Similarly, the federal government needs to recognize that the U.S. is competing for worldwide capital. Other governments have been responsive to the flight of capital. The federal government needs to recognize that just as the recent price crisis

has force change on the industry, it is time to determine how the federal government needs to change to draw its resources into the worldwide competition. There are options in all areas.

- Federal policymakers to find ways through existing federal laws and regulations to provide regulatory relief to small independent oil producers. For example, the Bureau of Land Management is allowing marginal oil well operators producing on public lands to suspend operations for up to two years without losing their leases. This suspension would waive the requirement that operators promptly plug wells that are not producing paying quantities until oil prices return to normal prices.
- With oil prices now at record lows, wells producing 50 barrels of oil per day or 120 Mcf/d are uneconomic. Royalties need to be reduced for these wells; otherwise they will be shut-in or abandoned, further reducing the benefits of domestic production. Better still would be a two-year royalty reinvestment policy for these uneconomic wells. If every royalty dollar for an uneconomic well is reinvested into keeping the well on line, the greater the return to the American public. Both the royalty investment account and reduced royalty approach would terminate when oil prices recover to economic levels.
- Other options include:
 - Temporarily suspend mandatory on-site maintenance tasks that do not pose a threat to public health, safety, and the environment, but which are costly for producers to carry out.
 - Delay any portion of the "Plain English" rule that creates additional regulatory burdens or costs.
 - Reduce to \$1.00 an acre those lease rental charges which are currently over \$1 an acre. If a lease bonus is \$2.00 an acre or more, then waive first year rental.
 - Eliminate rights of way and rental charges for pipelines, roads and other surface facilities.
 - Speed up the processing of permits and applications to operate on public lands. Independents can't afford to have investment capital sitting idle while they wait for overdue approvals.
 - Streamline processes related to the National Environment Policy Act (NEPA). Also, provide credits for costly environmental documentation work. These cost savings measures were developed from Interior Secretary Babbitt's Green River Advisory Committee recommendations.
 - Transfer Bureau of Land Management oil and gas regulatory authority to state agencies to eliminate costs associated with complying with duplicative federal and state regulations.

These reforms to the federal regulatory structure have been introduced in both the House of Representatives (H.R. 1985) and the Senate (S. 1049).

Federal Royalty Regulations

Unfortunately, one federal regulatory initiative needs to be addressed directly – the Minerals Management Service (MMS) proposal to revise the current crude oil valuation process. The MMS's proposed oil royalty valuation rule making essentially raises royalties by implementing policies not consistent with the lease contract and increases uncertainty. IPAA does not oppose changes in the present oil royalty valuation system. But, independents need a fair and equitable oil royalty rule. Congress acted to delay implementation of this rule until October 1999 with the assumption that MMS would negotiate in good faith on this rule. Workshops have occurred, but independents have no way of determining if MMS plans to make changes to the rulemaking that will be beneficial. MMS needs to repropose the rulemaking for comment. Alternatively, the issue needs to be addressed through enacting legislation (S. 924) that would clarify the underlying issues in contention between the federal government and producers.

However, as discussed above, the broader issue here is creating a royalty policy that draws a fair balance between the revenue that can be raised and the value to national security to develop the resource to maintain a healthy domestic oil and natural gas industry. A comprehensive, but flexible royalty in-kind program can achieve this balance.

The United States Needs to Develop A Strong Role in World Oil Policies

As the second largest producing nation in the world and the largest consuming nation, U.S. policymakers must send a message that we value our domestic resources and that we will not allow the economically and strategically valuable domestic oil industry to be destroyed. Policymakers also have an obligation to step to the international table and participate in decisions that preserve excess producing capacity and thus avoid the inevitable short supply that low prices guarantee. America must make clear that it intends to support America's struggling oil and natural gas producers.

Iraq presents an instant case. No one questions the need to provide humanitarian aid to the people of Iraq. It is equally clear that few believe that the current humanitarian aid program is effective. It needs to be reformed. At the same time the UN sanctions program handed Iraq an oil weapon that Saddam Hussein used effectively in 1998 and early 1999. The U.S. needs to recognize that Saddam Hussein will take advantage of every oil option he can to punish his enemies. In the past he was prepared to develop as much production as possible to keep prices low – punishing Saudi Arabia, Kuwait, and other OPEC countries as well as the domestic U.S. oil industry. If he is allowed unfettered access to capital to develop his oil industry, he will try to expand to a level where he can easily be a swing producer whether that is exporting 2.5 or 3.0 or 4.0 million barrel/day. Once there, he can decide whether prices are high or low. This is a fatal strategy for the U.S. economy and national security. The United States needs to be an active player in restricting the options provided to Iraq by the UN.

Commitment to the Future

Finally, the recommendations to the President must reflect a commitment to continue to address emerging issues as the consequent threats to domestic oil production appear from the current price crisis and future ones. No one can gauge the nature of these threats now. Some may come as OPEC countries grapple with their own interests as oil producing countries such as the current Iraqi threat. Others may arise as the current price crisis recedes. For example, over the past

decade refinery investment – particularly along the Gulf Coast – has included equipment to better process heavy, sour crudes. This investment may weaken the natural demand for lighter, sweeter crudes from the mid-continent, depressing their relative price. Similarly, pipeline investments in the Gulf Coast have reversed historic crude pipelines carrying mid-continent crudes to Gulf Coast refineries. Now, these pipelines carry product to compete with mid-continent refineries that typically use domestic crudes. Pipeline investment in the north can allow Canadian crudes or crudes imported into Canada to compete in natural markets for domestic crude in the Midwest and mountain states. New fuel regulations will pressure smaller refiners that are normal customers of domestic oil producers, perhaps putting them out of business. Each of these examples poses an as yet undefined threat to domestic oil production. Each could require a different solution.

Conclusion

As this Section 232 analysis defines its recommendations, it needs to recognize that the underlying national security risk posed by imports must rely on sustained domestic oil production as a counter. Sustained domestic oil production requires a strong domestic oil industry, one that will be largely comprised of independent oil producers. Consequently, unlike the 1994 analysis, this Section 232 analysis must include a significant and substantial set of recommendations to value domestic oil production. Failure to include such a clear domestic oil component will produce a failed program, a program unworthy of national support, a program doomed to watch oil imports grow and to put America's national security at greater risk.

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JUN 8, 1991

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Comments of the
NORTH TEXAS OIL & GAS ASSOCIATION
to the
U.S. DEPARTMENT OF COMMERCE
BUREAU OF EXPORT ADMINISTRATION
under
SECTION 232 of the
TRADE EXPANSION ACT of 1962

The Department of Commerce investigated in December 1994 the effects of crude oil imports on the national security of the United States. It found that “. . . the reduction in exploration, dwindling reserves, falling production, and the relatively high cost of U.S. production all point toward a contraction of the U.S. petroleum industry and increasing imports from OPEC sources. Growing import dependence, in turn, increases U.S. vulnerability to a supply disruption because non-OPEC sources lack surge production capacity; and there are at present no substitutes for oil-based transportation fuels. Given the above factors, the Department finds that petroleum imports threaten to impair the national security.”

Petroleum imports in 1994 were 8.996 million barrels per day, according to the Energy Information Agency (EIA). Since 1994, petroleum imports have escalated to 9.907 million barrels per day in 1997, the most current figures available from EIA.

Meanwhile, every major indicator from the domestic oil and gas industry has declined since Commerce’s finding in 1994. Jay Hakes, EIA, testified before the House Subcommittee on Oversight of the House Ways & Means Committee on Feb. 25, 1999 that, “By December 1998, production had fallen about 500,000 barrels per day from a year ago levels, despite an increase in production in the Gulf of Mexico. If prices recover only slowly, as shown in our current base case forecast, the cumulative loss in production between 1997 and 2001 would be another three-quarter to 1 million barrels per day, on top of the 2.5 million barrels decline we have seen between 1985 and 1997. Under these circumstances, imports would increase at least another 1 million barrels per day over the 5 million barrels per day increase that occurred between 1985 and 1997.”

U.S. crude oil production fell to the lowest level in more than 50 years in January 1999 when only 5.8 million barrels per day were produced. Oil production in the U.S. has declined 13 percent since 1994 (6.7 million barrels per day).

The drilling rig count, which is probably the most watched barometer of oil and gas industry activity, hit all-time lows on April 30, 1999, when only 494 rigs were working. When Commerce made its finding in December 1994 there were 791 rigs operating.

More than 137,000 oil wells and 57,000 natural gas wells have shutdown since November 1997.

The most painful aspect of the recent oil price crash is the estimated 41,000 lost jobs in

the oil industry. A continuous decline in domestic oil-patch jobs will mean exporting more paychecks, technical drilling and production expertise, and investments in technology and equipment. This will have a severe impact not only on the U.S. petroleum industry, but on the many industries that service and supply it.

As oil imports grow, so will the trade gap. During the past 20-plus years, the United States has imported more oil than the net difference between our purchases and sales of automobiles, electronics equipment, and other finished goods. From 1970 to 1992, petroleum imports have totaled \$924 billion, which is more than 73 percent of the cumulative trade gap of \$1.26 trillion. Imported oil sucks billions of dollars out of U.S. economy, and it doesn't provide U.S. jobs, nor does it pay U.S. taxes.

Oil has been called the most important commodity in the world. During the 20th Century, at least three wars have been fought over oil: World War I, World War II and Desert Storm. In World War I, it was over oil to fuel the mammoth dreadnoughts built by Great Britain and Imperial Germany in a naval arms race as costly to civilian economics as the Cold War was 40 years later. In World War II, it was Japan's grasp for the rich oil fields of Southeast Asia, and Adolf Hitler's desire to control the Rumanian Fields at Ploesti and the enormous Soviet Energy deposits on the Caspian Sea.

Today, most of the world's major oil producing nations are politically unstable, politically fragile and militarily vulnerable. Saudi Arabia, the country with the most oil reserves in the world, now a friend and ally of the United States, was a driving force to implement the first embargo against the United States in 1973. Saudi Arabia was the first Arab nation to use the "oil weapon" in an attempt to influence U.S. foreign policy. While the Saudis were our allies in Desert Storm, they remain a dedicated Moslem nation, hostile to secularism, wary of Israeli influence, and suspicious of U.S. intentions. Petroleum products are the Saudis only bargaining chip in the international community, but it is a very, very powerful chip.

Although circumstances may change slightly, virtually the same is true of the other Arab oil producing countries of Iraq, Iran, Libya, and Kuwait.

We cannot count on any foreign country, even our traditional friends, such as Great Britain, Canada or Mexico, during a major disruption of oil worldwide.

Constantine Flackos, Senior Petroleum Analyst for Merrill Lynch in New York, said

recently: "We cannot forecast when and how another energy crisis will come . . . but I can tell you it will come."

"In 1980, our surplus capacity was approximately 35%," he said. "Today, the capacity is 6 percent or 7 percent. This is crucial to an industry that is susceptible to politically induced supply interruptions. And, right now, looking down the road the next five years, I don't see anything that will significantly cause positive change."

If OPEC is ever successful at managing its production, the cartel will be able to control oil prices and the purse strings of the world. OPEC will not only be able to control the flow of oil to the U.S., but also the flow of oil **in** the U.S. Sheikh Ahmed Zaki Yamani, former oil minister to Saudi Arabia, told an audience at Southern Methodist University in Dallas in December 1998, that the upstream cash squeeze is beginning to make serious inroads into drilling rates, and it will affect actual production on non-OPEC areas quickly. "After all, if OPEC is to gain market share, as it hopes to do, it must do so from the higher-cost producers elsewhere," Yamani said. By driving down prices, OPEC can drive out high-cost U.S. production and replace it with their own.

Why is U.S. oil more costly to produce? Oil wells in the U.S. produce an average of 11 barrels per day compared to Saudi Arabia's average of 5,773 barrels per day. Additionally, foreign governments do not have to pay the many taxes imposed on U.S. oil production (income, state severance, property taxes, state franchise taxes, state income taxes and sales taxes) and comply with a myriad of costly federal and state regulations. Regulation of the oil industry has turned into a maze of complexity that cost the industry \$8.2 billion in 1996, which is about one-fourth of the net income of the top 200 oil and natural gas companies and more than the Environmental Protection Agency's entire budget, according to *Petroleum Industry Environmental Performance Sixth Annual Report* by the American Petroleum Institute (API). Put another way, the cost of regulatory compliance equates to \$83 for each household in the U.S.

Another disturbing development is the increasing ownership of U.S. refining capacity by foreign investors. Many inland refineries are going out of business, while foreigners are buying the refineries on the coast.

Natural gas, the cleanest-burning fossil fuel, has become a very important fuel for the U.S. It is plentiful and environmentally superior to other fuels. But, if you lose the oil, you will

lose the natural gas, too. A recent example: Texas Railroad Commission figures for April 1999 show that oil completions were down 69 percent and natural gas wells completions were off 42 percent from a year ago.

SOLUTIONS

After Commerce's report, President Bill Clinton stated: "I am concurring with the Department of Commerce's finding that the nation's growing reliance on imports of crude oil and refined petroleum products threaten the nation's security because they increase U.S. vulnerability to oil supply interruptions. I also concur with the Department's recommendations that the Administration continue its present effort to improve U.S. energy security, rather than to adopt a specific import adjustment mechanism."

Frankly, the programs recommended in 1995 have failed miserably to reduce petroleum imports, as have the programs of the administrations of Presidents Nixon, Ford, Carter, Reagan and Bush.

The federal government has rejected taking action that would reverse the trend of ever increasing oil imports, because most policymakers have the misconception that there is a "free" market for crude oil.

Donald P. Hodel, former Secretary of Energy and Secretary of Interior under President Reagan, understood the market forces at work. He wrote in his 1993 book, *CRISIS IN THE OILPATCH*: "Although we knew it to be true, I believe we inadequately took into account the fact that, thanks to OPEC, the world oil market is *NOT* a free market. Furthermore, in retrospect, it seems that we should have foreseen that a world oil price collapse would devastate the U.S. industry, and that such a price collapse could not be caused by a truly free market because a very large segment of that market is controlled by OPEC. If we had taken that view, we might have been able to prevent the harmful impacts of predatory pricing. In fact, I did try to prevent this but was unable to obtain administration support."

A worldwide "free" market does not exist for oil. Small, independent oil companies in the U.S. must compete against foreign governments, integrated major oil companies and other independents. No other sector of the economy has to compete against foreign governments. But even more predatory is the fact that these foreign governments have formed a cartel to further

influence oil markets and attempt to drive out competition from high-cost producers. Additionally, U.S. oil producers must pay a myriad of taxes that foreign oil does not pay, and comply with thousands of complex regulations.

The manipulation of oil markets by foreign governments is bad for U.S. oil producers *and* consumers. Consumers in the Northeast, one area of the nation that should be most concerned about this increased dependence on foreign oil, rely on imported oil for about 90 percent of their petroleum consumption. The Northeastern U.S. is the most vulnerable to economic instability because of rapidly swinging prices and to environmental problems created by more and more oil coming into the U.S. by tanker. API reports that from 1980 to 1994 there were 58,159,000 gallons of petroleum products spilled from tankers, barges, freighters and other vessels compared to only 823,000 gallons from offshore drilling and production facilities. As more oil must be imported by tanker, the chances increase that more accidents will occur, damaging the environment along the coast.

President Clinton could solve many of these problems by simply implementing an environmental equalization fee of \$3 to \$4 per barrel of imported oil and/or petroleum product. U.S. oil industry must pay about \$3 to \$4 per barrel to comply with the many regulations imposed upon it. So, the environmental equalization fee would make imported oil pay its fair share and level the playing field with domestic producers.

In 1994-1995, the federal government had an excellent opportunity to reverse the slide in U.S. oil production and increase in foreign oil imports. It's failure to take appropriate action then has made the situation even more critical today. The Department of Commerce and the President must begin corrective action to this dangerous trend.

OIL-019

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BEFORE THE
BUREAU OF EXPORT ADMINISTRATION
U.S. DEPARTMENT OF COMMERCE
WASHINGTON, D.C.

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In the matter of :
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 INVESTIGATION OF IMPORTS OF : Docket 990427107-9107-01
 CRUDE OIL AND PETROLEUM PRODUCTS :
-----X

COMMENTS OF THE
AIR TRANSPORT ASSOCIATION OF AMERICA, INC.

The Air Transport Association of America, Inc. submits these comments in response to the April 28th notice of the Bureau of Export Administration concerning its investigation to determine the effect on U.S. national security of imports of crude oil and petroleum products. 64 Fed. Reg. 23820 (May 4, 1999). We offer these comments to emphasize the serious adverse effects that imposition of import quotas or fees would have on users of petroleum products in this country.

ATA is the trade and service association of the U.S. airline industry.¹ The operations of our members, and thus their ability to serve the travelling and shipping public, are dependent upon their access to economical sources of kerosene jet fuel. They consequently are vitally interested in any regulatory proceeding that could affect the availability and price of jet fuel.

¹ ATA's members are Airborne Express, Alaska Airlines, Aloha Airlines, America West Airlines, American Airlines, American Trans Air, Atlas Air, Continental Airlines, Delta Air Lines, DHL Airways, Emery Worldwide, Evergreen International, Federal Express, Hawaiian Airlines, Midwest Express, Northwest Airlines, Polar Air Cargo, Reeve Aleutian Airlines, Southwest Airlines, Trans World Airlines, United Airlines, United Parcel Service, and US Airways. ATA's associate members are Aeromexico, Air Canada, Canadian Airlines International, KLM--Royal Dutch Airlines, and Mexicana Airlines.

U.S. scheduled airlines carried 614.1 million passengers in 1998. Of those, 560.9 million were transported in domestic service. In 1998, 20.4 billion revenue ton miles of freight were carried; 8.8 billion revenue ton miles in domestic service and 11.6 billion revenue ton miles in international service. U.S. scheduled airlines operated 8.3 million flights last year, which means that they flew nearly 23,000 flights on an average day. U.S. airlines consumed almost 18.9 billion gallons of jet fuel in 1998.² Over 700 domestic airports receive airline service. More than 565,000 persons are employed in the scheduled U.S. airline industry.

American consumers have benefited enormously since the economic deregulation of the U.S. airline industry in 1978. Measured in real terms, the price per mile of air travel (what is commonly referred to as "yield") in the United States declined by more than 35 percent in the two decades since Congress deregulated the airline industry. A detailed study that the Brookings Institution published several years ago concluded that airline deregulation was producing overall benefits exceeding \$18 billion per year. Morrison and Winston, The Evolution of the Airline Industry at 10 (1995).

These impressive improvements to consumer welfare have occurred because the airline industry was unfettered from government economic regulation and its attendant costs. Government action that increased the cost of jet fuel used in the United States would wrench those benefits from consumers.

² Consumption for domestic service was 13,757,789,120. Consumption for international service was 5,131,711,966.

U.S. airlines also provide important transportation benefits to the U.S. Government, particularly the Department of Defense. U.S. airlines carry government personnel throughout the United States and to foreign locations under the General Services Administration's passenger transportation program, commonly known as the city-pair program. Many U.S. airlines—both passenger and cargo—also participate in the Department of Defense's Civil Reserve Air Fleet program. Their participation is an integral part of the Defense Department's airlift resources. The U.S. military does not have enough organic resources to provide the air transportation it needs, especially when responding to international crises. Operations Desert Shield and Desert Storm demonstrated the dependence of the U.S. military upon civilian U.S. airline resources to move troops and materiel. Twenty-seven U.S. airlines participated in those operations. They carried 310,00 troops—64 percent of the total airlifted to Saudi Arabia from the United States and Europe. Those airlines also transported nearly 150,000 tons of cargo, which represented 27 percent of the total freight that the U.S. Air Force's Military Airlift Command flew into the theater. Obviously, government intervention that increases airline industry costs and therefore harms the health of the industry promises to diminish such future participation.

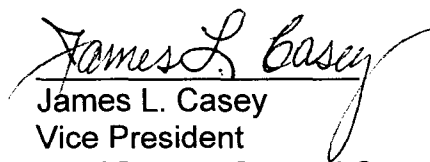
The foregoing review outlines the benefits that the U.S. public and military realize from the airline industry. They can be provided because of the ability of U.S. airlines to operate efficiently within this country.

Much of that efficiency results from the ease of access to economical supplies of jet fuel. Governmental intervention that limited or otherwise interfered

with the workings of the petroleum marketplace would jeopardize that efficiency. Important civilian and military air transportation needs would be at risk. Imposition of quotas or fees on imported crude oil or petroleum products would generate significant costs for U.S. airlines. A one-cent increase in average fuel cost would produce \$190 million in increased expenses for the U.S. airline industry.

Compared with other U.S. industries, the airline industry continues to experience below average net profit margins. This has one unmistakable implication. Costs from import quotas or fees inevitably would be reflected in higher prices to consumers of air transportation services or diminished service, or both. Low-density domestic markets—i.e., smaller communities—would be at particular risk. Such consequences would not be in the public interest and we urge the Bureau to be mindful of that as it conducts its investigation.

Respectfully submitted,



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June 4, 1999

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June 3, 1999

Mr. Bernard Kritzer
Manager, Special Projects
Office of Chemical and Biological Controls and Treaty Compliance
Bureau of Export Administration
Department of Commerce, Room 2093
Washington, DC 20230

Re: INVESTIGATION OF IMPORTS OF CRUDE OIL AND
PETROLEUM PRODUCTS

Dear Mr. Kritzer:

On behalf of the Society of Independent Gasoline Marketers of America ("SIGMA"), our firm submits these comments in response to the Department of Commerce's ("DOC" or "the Department") notice of initiation of national security investigation under Section 232 of the Trade Expansion Act of 1962, as amended (19 U.S.C. 1862), and DOC's request for public comments regarding the effects on national security of imports of crude oil and petroleum products.^{1/} SIGMA respectfully requests the Department consider these comments favorably in issuing its determination.

SIGMA is an association of over 270 independent gasoline marketers operating in all 50 states. Last year, SIGMA members sold over 30 billion gallons of motor fuel, representing over 21 percent of all motor fuels sold in the United States in 1998. SIGMA members supply over 28,000 retail outlets across the nation and employ over 200,000 workers nationwide.

The independent gasoline marketer's position in the market is dependent upon the existence of numerous sources of supply, both foreign and domestic. If any of these alternative sources of supply were eliminated by any means, then the position of independent marketers would be severely

^{1/} 64 Fed. Reg. 23,820 (May 4, 1999).

threatened. If independent gasoline marketers disappear, then competition in the wholesale and retail gasoline markets would be restricted and gasoline prices would increase significantly.

I. Introduction

SIGMA recommends that Department find that imports of crude oil and petroleum products do not threaten to impair U.S. national security. If, however, DOC should find that such a threat exists, it should recommend against any presidential action that would place artificial limits on import levels. The attempts of the U.S. federal government to regulate the oil industry in the past has demonstrated that measures designed to prop up prices for domestically produced crude oil and petroleum products create far more problems than they solve and impose costs that far exceed the benefits they supposedly provide.

A decade ago, the Department of Energy ("DOE") issued a report concluding that the imposition of an oil import fee or other measures limiting crude oil and petroleum product imports would increase U.S. prices for these commodities and would create problems that far outweigh any benefits.^{2/} The U.S. should not repeat the mistakes of the past – most notably, the 1970s – when government-created distortions in the oil industry led to gross inefficiencies and unnecessary costs for American industries and consumers. The imposition of an import fee would lead us down that risky path. If stimulation of U.S. crude oil production is the desired goal, there are alternative policies that could achieve that goal which would result in lower costs for U.S. industries and consumers.

Section 232 of the Trade Expansion Act of 1962, as amended, and the pursuant DOC regulations, provide specific guidance as to those factors which should be considered in determining whether imports may be causing a national security threat. In this regard, the statute and regulations also make clear that the "strength of our national economy"^{3/} is a key concern in assessing the effect on national security of the imports under investigation. With respect to economic security, the statute and regulations specify several additional factors that the Department of Commerce must examine in reaching its determination. These factors include: (1) the impact of foreign competition on the economic welfare of any domestic industry essential to our national security; (2) the displacement of any domestic products causing substantial unemployment, decrease in government revenues, loss of investment or specialized skills and productive capacity, or other serious effects; and (3) any other relevant factors that will cause a weakening of our national economy.^{4/}

^{2/} U.S. Department of Energy, *Energy Security, A Report to the President* (March 1987).

^{3/} 15 C.F.R. § 705.4(b) (1998).

^{4/} 19 U.S.C. § 1862(d) (1999); 15 C.F.R. § 705.4(b) (1998).

In addition to these guidelines, the Department appears to consider each of the above factors in the context of a classified scenario approved by the National Security Council. This scenario apparently posits a one-year mobilization of the U.S. armed forces, beginning immediately, followed by a three-year conventional war.

In its report on U.S. energy security, DOE examined in detail the question of whether a national security threat might result from U.S. imports of crude oil and petroleum products. DOE concluded that the U.S. has both limited crude oil reserves and the highest energy consumption of any nation.^{5/} This finding makes clear that the United States will be in a position of having to import much of its energy needs for the foreseeable future. DOE also concluded that dependence on energy imports does not necessarily equate with national security vulnerability.^{6/} Indeed, undue reliance upon U.S.-produced oil will further drain the remaining U.S. reserves and will, in the long run, pose a greater security threat than maintaining a secure supply of imports from reliable sources. The key factors in DOE's determination of U.S. vulnerability are: (1) our dependence on imports that are potentially subject to disruption; (2) the risk that significant disruptions in our oil supply will actually occur; and (3) our capability to respond to such disruptions.^{7/} Finally, DOE determined that a key national security concern is to ensure the continued health and growth of the U.S. economy as a whole.^{8/} Price declines for crude oil this decade have greatly benefitted the U.S. economy and have contributed to its growth. Lower prices for crude oil and refined petroleum products, therefore, have actually enhanced the U.S. national security.

It is clear today, as it was when DOE wrote its report, that imports of crude oil and petroleum products do not pose a threat to our national security. Because of America's limited reserves and high rate of consumption, the nation will – for the foreseeable future – have to rely on oil imports to meet its energy needs.

II. Imports of Crude Oil Do Not Threaten to Impair National Security

A. Dependency Does Not Equate to Vulnerability

As indicated above, Section 232 requires DOC to consider many factors in determining whether imports threaten our national security. An assessment of the national security impact of oil imports, therefore, can only be made by examining the various factors that bear on the economic well-being of the United States. Thus, while the level of oil imports is unquestionably relevant to

^{5/} DOE, *supra* note 2 at 50.

^{6/} *Id.*

^{7/} *Id.* at 25.

^{8/} *Id.* at 9.

this determination, the overall effect of oil imports on the American economy and the consequent ability of the U.S. to confront a national emergency must also be closely considered.

There is no question that the U.S. will continue to be dependent on oil imports for the foreseeable future. Reliance on imports, however, does not – and will not – translate into vulnerability in the event of a national emergency. While the decline in oil prices has reduced the exploration and production of oil from remote or low-yield reserves, a decline in U.S. production in the short term may enhance the security of the U.S. in the long term by preventing premature depletion of remaining accessible reserves.

Moreover, there is no reason to believe that the U.S. will become vulnerable to a disruption in crude oil imports. In recent years, the nation has diversified its source of supplies, turning increasingly to secure, reliable channels in the Western Hemisphere to satisfy its energy needs. In 1998, for example, 46 percent of U.S. imports of crude oil were from Canada, Mexico, and Venezuela.^{9/} The considerable reserves of these suppliers – as well as North Sea suppliers such as Norway and the United Kingdom – and the substantial excess production capacity available, strongly suggests that this mutually advantageous oil trade relationship will continue. Indeed, during the Persian Gulf War, Western Hemisphere suppliers increased the amount of crude oil and petroleum product available to the U.S. market to offset the shortfall resulting from the removal of Iraqi oil from the U.S. market. Further, with the demise of the Soviet Union and the opening of its oil industry to foreign investment, yet another reliable source of oil for the U.S. may be emerging.

It is important, when assessing the effect of oil imports on U.S. security, to consider both the effect of imports on the economy as a whole and our capacity to respond to potential supply disruptions. In this regard, the U.S. has developed a workable and effective mechanism for responding to any supply disruptions that may occur. Since the 1970s, the United States has developed the Strategic Petroleum Reserve and other national and international programs designed to offset sudden declines in imported supply. As a result, the U.S. oil industry today is far better equipped to respond to a national crisis than at any time in the past 25 years.

B. Import Restraints Would Harm the U.S. Economy and Undermine National Security

The national security of the United States depends, to a considerable degree, on the well-being of the entire economy. Energy price declines this decade have contributed in large part to our economic growth and continued wealth. Import restraints would have a serious adverse effect on the economy in general and American consumers in particular. Indeed, the enormous costs that would result from such restraints would far outweigh the benefits that would accrue to the domestic oil industry.

^{9/} "Petroleum Supply Monthly," Energy Information Administration (Feb. 1999). Table 40.

As the Cabinet Task Force on Oil Import Control observed in its report to President Nixon in 1970, "... the availability of low-cost energy to the nation is key to economic growth and a rising standard of living.... An abundant supply of low-cost energy and related raw materials is essential to the competitiveness and vitality of U.S. industry...."^{10/} Much about our society has changed since 1970, but the importance of low-cost energy supplies remains the same. Indeed, this need for low-cost energy is exacerbated by the need to compete in the rapidly expanding global economy.

C. Import Restraints Would Force the U.S. to Deplete its Remaining Resources Prematurely

It is well accepted that the U.S. does not have sufficient reserves of crude oil to satisfy its needs in the long term. Regardless of how much exploration and advanced recovery is undertaken, domestic demand will always exceed domestic supply. From the Eisenhower to the Carter Administrations, government measures limiting oil imports encouraged U.S. producers to exploit and sell off most or all of the nation's low-cost oil. What remains is oil that has a higher cost of production. Restricting oil imports of crude oil at this time would only serve to "drain America first" of our remaining viable reserves. Import restrictions would cause artificial market distortions which would, in turn, encourage premature exploitation of these reserves. Such a policy would compromise its long-term security for the short-term benefit of a limited number of crude oil producers. At the same time, the economy as a whole would suffer the effects of higher energy prices. From a security standpoint, depleting the low-cost reserves of other nations makes more sense than reducing the nation's domestic supplies.

D. The U.S. Has Developed Programs that Have Improved Our Ability to Respond to National Emergencies

A final factor affecting national security is America's ability to respond quickly and effectively to national emergencies. Even an ample supply of domestically produced oil would not guarantee national security if it could not be effectively utilized in an emergency. In this regard, the U.S. is in the strongest position in years, further evidence of the absence of any security threat today or in the future. The U.S. response to critical, temporary, supply shortages in the past demonstrates that it has always been able to respond to oil supply disruptions as they occur.

In World War II, the U.S. developed alternative arrangements as German submarines threatened our supply lines and sustained a war effort on two widely separated fronts. In 1974, 1979, and most recently in 1991, during the Persian Gulf War, the United States found alternative sources to disrupted Middle Eastern supplies in relatively short order. The U.S. now has in place a system of internal programs that allow us to more effectively respond to oil supply emergencies.

^{10/} *The Oil Import Question: A Report on the Relationship of Oil Imports to National Security*, Cabinet Task Force on Oil Import Control, February 1970.

Since the abolition of price and allocation controls in 1981, the ability of the U.S. to alleviate regional shortages has been greatly improved. It was these government controls that were the principal cause of the gasoline lines of the 1970s.^{11/} Preventing a reoccurrence of government controls will help ensure against such regional shortfall crises in the future.

Similarly, the development of such programs as the Strategic Petroleum Reserve ("SPR") and the International Energy Agency energy sharing program has greatly improved the United States' ability to respond quickly to supply disruptions and other crises. SPR, originally authorized by the Energy Policy and Conservation Act in 1975 as the nation's insurance policy, currently holds 561 million barrels in reserve for the U.S., with an overall capacity of approximately 680 million barrels. It has been tested and can be made available immediately to a substantial portion of U.S. refiners. These developments are further evidence of this country's improved security position.

III. Petroleum Product Imports Do Not Pose a National Security Threat

Along with investigating the impact of crude oil imports on national security, DOC is also looking into the effects of petroleum product imports. However, the case for restraints of petroleum products is untenable. There simply is no evidence of any national security threat from petroleum product imports.

A. Petroleum Product Imports Do Not Negatively Affect Domestic Refiners

When one examines the current state of domestic refining industry, it becomes clear that domestic refiners are in no way disadvantaged by imports of refined petroleum products. If domestic refiners were disadvantaged by such imports, the capacity-utilization of domestic refineries would be low and falling as imports of refined products increased. But a low and falling rate of capacity-utilization is not observed in the U.S. refining industry.

Refinery production in the U.S. rose 5 percent between 1995 and 1998.^{12/} The capacity-utilization rate for U.S. refineries for all petroleum products was nearly 95.6 percent in 1998, among the highest levels in two decades.^{13/} Further, capacity for additional processing beyond the initial distillation phase – "high conversion" capacity for the production of products, such as finished motor gasoline – continues to increase. Feeds to catalytic crackers have risen to 5.1 million barrels per day, feeds to catalytic hydrocrackers have risen to 1.1 million barrels per day, and feeds to delayed and

^{11/} See, e.g., Robert L. Bradley, Jr., *Oil, Gas and Government: The U.S. Experience* (Rowman & Littlefield: 1996).

^{12/} EIA, *supra* note 9 at Table 3; "Petroleum Supply Annual," 1995 at Table 2.

^{13/} EIA, "Petroleum Supply Annual," 1997 and 1998 at Table 16.

fluid coking units have risen to 1.75 million barrels per day.^{14/} These increases are the result of efforts by the domestic refining industry to increase its yield of gasoline components and other light, "high conversion" products. Such expansion would not be undertaken if refiners were injured significantly by imports of refined petroleum products.

In addition, average monthly imports of refined products decreased by approximately 13 percent, or 247,000 barrels per day, between their 1985-1990 levels and their 1991-1998 levels.^{15/} Moreover, average monthly gasoline imports, which account for only about 4 percent of total U.S. supply, fell by 22 percent from their 1985-1990 levels of 368,000 barrels per day to their 1991-1998 levels of 300,000 barrels per day.^{16/}

B. The U.S. is Not Vulnerable to Supply Interruptions in the Event of a National Emergency

The United States enjoys considerable energy security due to the fact that those petroleum products that are imported come primarily from secure and reliable sources. In 1998, 36 percent of refined gasoline came from Venezuela and Canada alone.^{17/} Indeed, in 1998 non-Persian Gulf nations accounted for 95 percent of U.S. petroleum product imports. The three leading Western Hemisphere suppliers were (1) Venezuela, 18 percent; (2) Canada, 17 percent; and (2) the Virgin Island, 16 percent.^{18/} Western Hemisphere sources such as Canada and Venezuela have proven reliable during past emergencies and crises and are secure from the turmoil that threatens the Middle East. Also, transportation from Western Hemisphere sources is quick and not subject to long delays.

IV. In the Event DOC Finds a National Security Threat, It Should Not Recommend Import Restraints as a Remedy

All evidence indicates that crude oil and petroleum product imports do not impair U.S. national security. However, in the event that the Department were to find that oil imports do threaten the national security of the U.S., it should not recommend import restraints as a remedy.

Far from enhancing our position, the net effect of an oil import fee or other import restraint would be to impair U.S. national security. In the short term, imposition of a fee would lead to some

^{14/} *Id.*

^{15/} EIA, *supra* note 9 at Table S1.

^{16/} *Id.* at Table S4.

^{17/} *Id.* at Table 40.

^{18/} *Id.*

reduction in the level of imports because increased prices will lead to decreased consumption. In the mid-term, an oil import fee could contribute to increased domestic production, albeit at high cost. An oil import fee will not, however, resolve the long-term energy dependence of the U.S. It would exacerbate the problem by "draining America first" of its oil reserves and would impair the national security of the U.S. by discouraging future production by our reliable and secure foreign suppliers.^{19/} Or, just as serious to our future energy needs, it would force these suppliers to pursue markets elsewhere, thus displacing the American market permanently – to our detriment, if we were to need these friendly foreign supplies in an emergency.

In 1994, the Environmental Protection Agency ("EPA") promulgated a rule regarding reformulated gasoline ("RFG") that held foreign refiners to a more stringent standard for the production of both conventional and RFG gasoline during the period 1995-1997. In 1997, EPA revised the rule to alleviate, in large part, this discrimination. It is important to note, however, that even with the new rule, foreign refiners are only be able to use their own individual baselines for the production of RFG up to the volume of gasoline they exported to the United States in 1990. New import restraints would place further controls on the total national supply, to the detriment of consumers and the overall U.S. economy. A weakened economy is a significant national security threat. Measures that would cause a weakening of the economy, therefore, should be avoided.

In addition, as DOE has concluded time and time again, an oil import fee would impose excessive costs on the U.S. economy that could actually serve to undermine our economic and national security, rather than enhance it. As previously noted, Section 232 and DOC's own regulations expressly recognize the importance of assessing conditions overall in the U.S. economy in determining whether to recommend an adjustment to imports.

Imposition of an oil import fee undoubtedly would provide some benefits to U.S. oil producers. It would increase U.S. crude oil production, would reduce U.S. payments for oil imports, and increase employment in the U.S. oil industry. DOE has concluded, however, that "[u]nder any reasonable assumptions, *this benefit is very small*"^{20/} (emphasis added). DOE has concluded that the macroeconomic losses from an oil import fee would greatly outweigh the limited benefits, and concludes that oil import fees, "... though often well intentioned, have usually cost the Nation a great deal, without much perceptible improvement to national security."^{21/}

An oil import fee would increase the cost to consumers not only of crude oil and petroleum product imports, but also of other energy sources. In this regard, DOE has estimated that "[f]or each

^{19/} DOE, *supra* note 2 at 73.

^{20/} *Id.* at D-3.

^{21/} *Id.* at 72.

\$1 per barrel fee imposed, oil consumers would pay more than \$4 billion per year for their purchases of energy."^{22/} In contrast to the increase in energy costs, imposition of a \$10 per barrel oil import fee would likely generate less than \$18 billion in the first year."^{23/}

An oil import fee would have substantial negative effects on the U.S. Gross National Product ("GNP") and rate of inflation. DOE has estimated that annual GNP losses would range from \$15-25 billion for a \$5 per barrel fee and from \$30-45 billion for a \$10 fee.^{24/} The increase in energy prices would, at the same time, necessarily raise the costs of U.S. producers, particularly in energy-intensive industries, such as agriculture, steel, the petrochemical industry, and others. An oil import fee would lead to a decline in outputs, causing worker layoffs and decreased capital utilization. The negative effects would spread to other sectors of the economy, since energy-intensive industries and consumers affected by energy price increases would spend less for other commodities. The relationship between energy price increases and economic recessions has been demonstrated – each of the oil price increases since World War II has been followed by a recession.

An oil import fee also would have a negative effect on the U.S. balance of trade. Energy-intensive industries are vulnerable to increases in the price of crude oil and refined products. An oil import fee would burden these industries with significantly increased energy costs that would not be borne by their foreign competitors. An oil import fee would seriously erode the competitive position of U.S. firms in the world market and would further increase the present trade imbalance. This debate was fully aired during congressional consideration of the 1993 proposed energy tax on British thermal units ("Btu"), with an additional surcharge on oil. A Democratic Congress rejected President Clinton's Btu tax because of its probable negative effects on the economy. An oil import fee would have substantially the same effects and should be similarly rejected.

V. If DOC Determines that Some Form of Import Restraint is Advisable, It Should Not Recommend a Differential Fee on Crude Oil and Petroleum Products

In the past, proposals have been made that would impose a higher levy on petroleum products than on crude oil imports (or a "differentiated fee"). Such proposals have been consistently rejected by the Congress. If the federal government imposes a fee on imported crude oil, a fee of like size must, of necessity, be imposed on imported products to avoid disadvantaging domestic refiners. Some, however, have urged the imposition of greater import fees on refined products than on crude oil. Such an action is simply not justified based on the facts. Adoption of a higher import fee on refined products than that imposed on crude oil would be contrary to the national interest because

^{22/} *Id.* at D-4.

^{23/} *Id.* at D-4.

^{24/} *Id.* at D-5.

it would impose even greater costs than a flat fee, while benefitting the sector of the oil industry that is least in need of assistance.

A differentiated fee would cause the price of refined products in the U.S. to rise even higher than under a straight fee. Petroleum product imports have a disciplining effect on prices. While their volume is relatively low, their availability has kept the market competitive and petroleum product prices stable. The imposition of a higher fee on imported products would reduce import competition, and enable U.S. refiners to increase the price of all petroleum products by an amount up to the level of the fee. If there were a differential between the fee on crude oil and that on products, refiners would raise their prices to the higher level. The result would be even higher costs to the U.S. economy, compounding the problems that would be caused by the imposition of the fee. Further, imposition of a differentiated fee on imported products would unfairly burden regions of the country, particularly the Northeast and Midwest, that are more heavily dependent on imported petroleum products.

Independent gasoline marketers and chain retailers would be particularly disadvantaged by a differentiated fee. Such a fee would render it nearly impossible for independent marketers and chain retailers to compete. Without imported product available, domestic refiners would have little incentive to seek motor fuels to independent marketers and chain retailers at competitive prices. If independent marketers and chain retailers were to disappear, competition would decrease, resulting in higher prices, to the detriment of the American consumer. U.S. refiners, of course, would be the beneficiaries of a differentiated fee. They also benefit from today's low crude oil prices, and are least in need of such a windfall. A differentiated import fee, therefore, would benefit that sector of the domestic oil industry least in need of assistance, at the expense of independent marketers, chain retailers, and U.S. consumers.

Some proponents of an import fee have argued that it is necessary to help the domestic refining industry meet the costs of complying with U.S. environmental regulations to which foreign refiners are not subject. But if the federal government wants to help the domestic refining industry offset such costs, there are other means of accomplishing this goal that would have far less of a negative impact on the U.S. economy. Indeed, at a time when EPA is proposing costly Tier 2 sulfur rules, it is ironic that any U.S. refiner would consider an import fee – rather than less expensive environmental regulations – as a solution. Moreover, imposing a fee on petroleum products would be the most costly potential means by which to solve the refiners' problem. If the government desires to help the industry with the regulatory costs imposed, any remedy should address the root cause of the increased costs. In this regard, if the government cannot find more efficient, less expensive methods to attain its goals, it could offer beneficial tax treatment for investments incurred by domestic refiners to comply with environmental regulations. Also, it could improve the industry's access to capital through elimination of the "lender liability" requirements contained in the Resource Conservation and Recovery Act of 1984 ("RCRA") and the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA"), and perhaps through the institution of federal loan guarantees for domestic refiners.

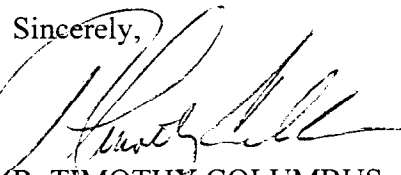
Mr. Bernard Kritzer
Page 11

Further, it is ludicrous for the domestic refining industry to claim that it is alone in meeting these costs. Foreign refiners who wish to sell their products in the U.S. market also must bear the costs of compliance with U.S. environmental regulations as well as the costs of complying with the environmental regulations of their own countries.

VI. Conclusion

In conclusion, imports of crude oil do not pose a threat to the national security of the U.S. There is a significant distinction between reliance and vulnerability with respect to crude oil imports. In addition, there simply is no credible evidence that imported petroleum products threaten to impair U.S. national security. This lack of evidence is made clear upon examination of the state of the domestic refining industry today.

The U.S. enjoys an extraordinarily secure position, both because of its continued domestic production and its secure sources of supply of crude oil and petroleum product imports.

Sincerely,


R. TIMOTHY COLUMBUS

Counsel

Society of Independent Gasoline Marketers of
America



OIL-021
UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for Export Administration
Washington, D.C. 20230

June 3, 1999



Honorable Dave Hancock
Minister of Intergovernmental and Aboriginal Affairs
Province of Alberta
10800 - 97th Avenue N.W.
Edmonton, Alberta
Canada T5K 2B6

Dear Minister Hancock:

Thank you for your letter concerning the Department of Commerce's investigation of the effects on the national security of oil imports pursuant to Section 232 of the Trade Expansion Act of 1962, as amended.

The Department has established an interagency working group to draw upon the expertise available throughout the U.S. Government to ensure a comprehensive review of the multi-faceted issues at hand. We are using the 1994 investigation as the starting point for our analysis. On May 4, the Department published a notice in the *Federal Register* announcing the investigation, outlining the procedures we are using, and requesting public comments.

I appreciate your reminder of Alberta's longstanding role as a trade partner and energy supplier to the United States. We are including your letter as part of the public comments file and will take it into account in our review of U.S. oil imports.

Please contact me or have your staff contact Roger Majak, Assistant Secretary for Export Administration, at (202) 482-5491, if you have any questions.

Sincerely,

William A. Reinsch





ALBERTA
MINISTER OF INTERGOVERNMENTAL AND ABORIGINAL AFFAIRS

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May 25, 1999

The Honourable William M. Daley
Secretary of Commerce
Herbert C. Hoover Building, Room 5854
14th Street and Constitution Avenue, N.W.
Washington, D.C. 20230

Dear Secretary Daley:

On behalf of the Government of the Province of Alberta, Canada, I am writing with regard to the investigation initiated by your department under Section 232 of the Trade Expansion Act of 1962, as amended, to determine the effects on United States national security of imports of crude oil and petroleum products.


As you know, our two countries share the world's largest and most comprehensive trading relationship, including a strong and growing energy trade with many common areas of interest. Canadian crude oil holds approximately 11% share of the U.S. market, most of it from Alberta. Alberta has had a long and productive energy relationship with the United States and has always advocated an open trade and investment environment. The province was the most vocal supporter of the Canada - U.S. Free Trade Agreement and was active in contributing to a comprehensive Energy Chapter. The Energy Chapter provides the basis of our energy relationship as it addresses all aspects of two-way trade and even national security considerations.

The United States has benefited from the reliable contracts of supplies of oil from Alberta and Alberta has benefited from secure access to the U.S. market. This relationship offers major economic benefits to both our countries. Many U.S. companies have invested in Canadian energy developments, and Canadian companies have also been active investors in the U.S. Furthermore, as producers from relatively mature oil basins, Alberta and the United States have been similarly affected by the recent downturn in oil prices.

Canada has long been properly regarded as the most secure source of imported energy supplies for the United States, and the energy provisions of the Canada-U.S. Free Trade Agreement and NAFTA further enhance the mutual sense of security with respect to ensuring a reliable two-way flow of energy between our countries. We believe Alberta's role as a dependable energy supplier to the United States will continue to grow in the years ahead.

I believe that the maintenance of a strong energy industry in both Canada and the U.S. is a priority objective we share. Both our countries recognize concerns related to national energy security. Clearly we have enhanced our mutual security through the Energy Chapter of the Canada-U.S. Free Trade Agreement (FTA) and NAFTA. Indeed, our exports to the U.S. are an integral contribution to that national security equation. In view of our strong and mutually beneficial relationship, I would urge that this investigation focus on national security related to offshore imports only, and that Canada be excluded from this investigation.

Yours truly,



Dave Hancock, Q.C.
Minister

cc: The Honourable Sergio Marchi
Minister of International Trade

Mr. Raymond A.J. Chretien
Ambassador of Canada to the United States of America

His Excellency Gordon D. Giffin
Ambassador of the United States of America

Honourable Steve West
Alberta Minister of Energy

OIL-022



THE SECRETARY OF COMMERCE
Washington, D.C. 20230

JUN 22 1999

RECEIVED
June 24, 1999

His Excellency
Raymond Chrétien
Ambassador of Canada
Washington, D.C. 20001

Dear Mr. Ambassador:

Thank you for your letter concerning the Department of Commerce's investigation of the effects on the national security of oil imports pursuant to Section 232 of the Trade Expansion Act of 1962, as amended.

The Department has established an interagency working group to draw upon the expertise available throughout the Government to ensure a comprehensive review of the multi-faceted issues at hand. We are using our 1994 Section 232 investigation of oil imports as the starting point for our analysis. On May 4, the Department published a notice in the *Federal Register* announcing the investigation, outlining the procedures we are using, and requesting public comments.

I appreciate your reminder of Canada's longstanding role as a trade partner and energy supplier to the United States. We are including your letter as part of the public comments file and we will take it into account in our review of U.S. oil imports.

Please contact me or have your staff contact Roger Majak, Assistant Secretary for Export Administration, at (202) 482-5491, if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "William M. Daley".

William M. Daley

Canadian Embassy



OS EXECUTIVE SECRETARIAT
Ambassade du Canada
1999 MAY 24 AM 11: 21

501 Pennsylvania Avenue, N.W.
Washington, D.C. 20001

May 20, 1999

The Honourable William M. Daley
Secretary of Commerce
Herbert C. Hoover Building, Room 5854
14th Street and Constitution Avenue, N.W.
Washington, D.C. 20230

Dear Secretary Daley,

I am writing with regard to the investigation initiated by your Department under Section 232 of the Trade Expansion Act of 1962, as amended, to determine the effects on the national security of imports of crude oil and petroleum products.

As you know, our two countries share the world's largest and most comprehensive trading relationship, including a strong and growing energy trade offering major economic benefits to both our countries. If U.S. exports to Canada are deducted, Canadian exports of crude oil and petroleum products to the United States amounted to a net 7.6% share of the U.S. market in 1998. The total value of this bilateral trade was \$9.5 billion in 1998, of which Canadian exports to the U.S. were \$8 billion and U.S. exports to Canada were \$1.5 billion. Even though higher volumes were traded in 1998, low oil prices had an impact on this \$9.5 billion trade over 1997 results, when total value equalled \$11.2 billion. The industries in Canada and the United States have been similarly affected by low prices in the oil sector over the past year.

Canada has long been properly regarded as the most secure source of imported energy supplies for the United States. The energy provisions of the Canada-U.S. Free Trade Agreement and the NAFTA further enhance the reliability and security of the two-way trade in this sector. Canada is supportive of a strong U.S. energy industry and recognizes U.S. concerns regarding national energy security. Indeed, Canadian exports to the U.S. are an integral contribution to that national security equation.

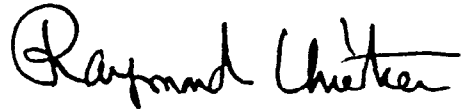
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In this context, I would like to recall that your Department's 1994 report on the effects of petroleum imports on national security recommended, inter alia, that the President not use his Section 232 authority to adjust imports, and that the President address oil import concerns through a variety of initiatives, including increased emphasis on free trade and the development of new energy supplies in this hemisphere and other areas friendly to the United States.

Without prejudging the current Section 232 investigation and its eventual conclusions, I am convinced that the investigation will confirm Canada's role as a secure supplier of crude oil and petroleum products in the U.S. market.

Best Regards!

Yours sincerely,



Raymond Chrétien
Ambassador

P.C. Excellent event in
Chicago. Some speech
now will thought out -

