

The Effect of Crude Oil and Refined Petroleum Product Imports On The National Security



Prepared by

**U.S. Department of Commerce
Bureau of Export Administration
Office of Strategic Industries and Economic Security
Strategic Analysis Division**

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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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because they contain classified information.
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are denoted by {Deleted to Protect Classified Information}.

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.

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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 lead 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.)

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- 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 lead 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.

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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)

Year	Total OPEC	Total Arab OPEC	Non-OPEC Sources	Gross Imports	U.S. Exports Apparent of Crude & Net		Petroleum Consumption* (MMB/D)	Net Imports as a Percentage of Apparent Consumption	
					Products	Imports		Total Imports	OPEC Imports
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

Year	1978	1979	1980	1985	1986	1987
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: 1988, 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.

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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.

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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>	<u>Motor Gasoline</u>	<u>Distillate</u>	<u>Residual Fuel Oil</u>	<u>Liquified Petroleum Gas</u>	<u>Products Imports as a Percent of:</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.

TABLE III - 6

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>						
Crude Oil**	6.4	6.6	5.3	3.2	4.2	4.7
Products	2.0	1.9	1.6	1.9	2.0	2.1
	8.4	8.5	6.9	5.1	6.2	6.8

*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 Explorer & 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/Dcline	
			<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

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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>
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World Oil Price,
CIF (1982\$)
Total Free World
Production (MMB/D)

U.S. Production
(MMB/D)
U.S. Net Imports
(MMB/D)

DISRUPTION SIMULATION

World Oil Price,
CIF (1982\$)
Total Free World
Production (MMB/D)

U.S. Production
(MMB/D) (Deleted to Protect Classified Information)
U.S. Net Imports
(MMB/D)

Consumption (MMB/D)

United States and
Territories

Production (MMB/D)

United States

Net United States Imports (MMB/D)

50 State Area
U.S. Territories
Total United States

Net Stock Additions (MMB/D)

U.S. Strategic
U.S. Commercial
Foreign
Total Net Additions

Source: NSC Stockpile Study

IV-6

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 coasts 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.

James W. Hoya,
Administrative Law Judge.

FR Doc. 87-29763 Filed 12-28-87; 8:45 am
BILLING CODE 3510-07-M

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

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

SUBJECT: 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.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); 475.34
(naphthas 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); 517.5120 (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 NW, 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. Marin,
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.

Gilbert B. Kaplan,

Acting Assistant Secretary for Import
Administration.

(FR Doc. 87-29807 Filed 12-28-87; 8:45 am)

BILLING CODE 3510-07-M

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 action is
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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Watkins, Mr. H. Vaughn, Jr.	56	B-37

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
Dharam, 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."

SFR 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 SFR, 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."

B-11

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.

B-13

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."

EETI "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."

DECLASSIFIED

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."

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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 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 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 DOE 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 Auth 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."

"The rise in the level of petroleum product imports to the east coast reduces the need for intercoastal transportation of refined petroleum products between the gulf coast and the east coast."

"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).

Comments:

"...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.

Valero provides data and charts on supply, demand, and refining capacity that indicates the U.S. had only 84% of the refining capacity to be self-sufficient at the end of 1986. The ratio may decline to 76% by 1995.

Valero provides substantial data indicating the higher costs of U.S. refiners compared to foreign competitors.

Mack Wallace
(Co-Chairman of Council for a Secure America)
Hughes & Luce
1500 United Bank Tower
Austin, Texas 78701

Letter of December 28, 1987 with an application in intervention in support of the NESC petition, also dated December 28, 1987 (COPP 1).

Comments:

Urges public hearings, of which at least one should be held in an oil-producing state.

Include representatives of the Department of Defense as part of the investigation and in the conduct of the public hearings.

Urges that crude oil be declared a strategic mineral.

Recommends that a temporary variable import tariff be imposed on imported oil.

Mr. H. Vaughn Watkins, Jr.
201 Heritage Building
Jackson, Mississippi 39201

Letter dated January 20, 1988 (COPP 56).

Comments:

As a member of the Society of Independent Professional Earth Scientists (SIPES), reiterates SIPES' call for public hearings.

Late Addition:

Royal Norwegian Embassy
Washington, D.C.

Letter dated January 28, 1988, and received from the Department of State during April 1988 (COPP 65)

Comments:

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 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 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....PMAA does not believe that Commerce is bound by these classified scenarios. If they are, PMAA 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 (COPF 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 Auth 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."

"The rise in the level of petroleum product imports to the east coast reduces the need for intercoastal transportation of refined petroleum products between the gulf coast and the east coast."

"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).

Comments:

"...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.

Valero provides data and charts on supply, demand, and refining capacity that indicates the U.S. had only 84% of the refining capacity to be self-sufficient at the end of 1986. The ratio may decline to 76% by 1995.

Valero provides substantial data indicating the higher costs of U.S. refiners compared to foreign competitors.

Mack Wallace
(Co-Chairman of Council for a Secure America)
Hughes & Luce
1500 United Bank Tower
Austin, Texas 78701

Letter of December 28, 1987 with an application in intervention in support of the NESC petition, also dated December 28, 1987 (COPP 1).

Comments:

Urges public hearings, of which at least one should be held in an oil-producing state.

Include representatives of the Department of Defense as part of the investigation and in the conduct of the public hearings.

Urges that crude oil be declared a strategic mineral.

Recommends that a temporary variable import tariff be imposed on imported oil.

Mr. H. Vaughn Watkins, Jr.
201 Heritage Building
Jackson, Mississippi 39201

Letter dated January 20, 1988 (COPP 56).

Comments:

As a member of the Society of Independent Professional Earth Scientists (SIPES), reiterates SIPES' call for public hearings.

Late Addition:

Royal Norwegian Embassy
Washington, D.C.

Letter dated January 28, 1988, and received from the Department of State during April 1988 (COPP 65)

Comments:

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.

