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STATEMENT OF
F. KEVIN BOLAND
SENIOR ASSOCIATE DIRECTOR
RESOURCES, COMMUNITY AND ECONOMIC
DEVELOPMENT DIVISION
BEFORE THE
SENATE COMMITTEE ON ENERGY AND
NATURAL RESOURCES

Mr. Chairman and Members of the Committee:

We appreciate the opportunity to be here today to discuss the proposed Energy Emergency Preparedness Act Amendments of 1983 (S. 1678) and the nation's ability to coordinate an energy emergency response with its allies. Over the past several years, we have addressed many aspects of this important issue in numerous reports and testimonies. In our appearance before this committee on March 7, 1983, we expressed reservations about the administration's fragmented legal authorities to respond to an oil shortage, and the inadequate level of advance planning to deal with such an emergency.

The bill before this committee, S. 1678, deals with many of the problems we cited, including incomplete emergency response procedures, the prospects of conflicting federal and state laws and policies, and the legal impediments regarding Executive Manpower Reserves. S. 1678 also appears to deal effectively with the problem of the administration's fragmented authority to act in petroleum shortage emergencies by combining such authority into one statute.

We also have suggestions that we believe will further assist in accomplishing the objectives of the proposed legislation. My testimony will briefly discuss the following subjects:

--The Strategic Petroleum Reserve's (SPR's) fill rate and size.

--Readiness to use the SPR.

--The lack of national economic response measures.

--Energy emergency preparedness organizations and procedures.

--U.S. participation in the International Energy Agency (IEA), including lessons learned from the recent test of the IEA system.

Mr. Chairman, let me start by discussing the provisions of S. 1678 as they relate to the SPR.

SPR FILL RATE AND SIZE

Last June we analyzed the impacts of various SPR fill-rate options which are available over the next few years to achieve a 500-million-barrel level.[1] All of these options fill the SPR at a faster rate than the administration's proposed programs, although at different expenditure levels. In the final analysis, the choice involves a value judgement of whether the economic and national security benefits which could result from filling the SPR earlier justifies greater Government expenditures. For example,

[1]Letters dated June 13, 1983, to the Chairman, Subcommittee on Fossil and Synthetic Fuels, House Committee on Energy and Commerce; and the Chairman, Subcommittee on Energy and Mineral Resources, Senate Committee on Energy and Natural Resources.

the analysis showed that a 500-million-barrel level could be reached in fiscal year 1985 if commercial interim storage is used. Restricting the fill rates to amounts that can be stored in permanent storage capacity, or permanent capacity plus onsite interim storage, will delay reaching the 500-million-barrel level until fiscal year 1986. The administration's reduced fill-rate schedule would not achieve 500 million barrels until fiscal year 1987. The cost to the Government varies with the oil price assumptions used. Assuming declining oil prices, filling the SPR at the administration's proposed schedule minimizes total expenditures. If rising oil prices are assumed, however, the administration's proposed schedule results in the highest total expenditures of all oil fill-rate options included in our analysis.

Based on this work, we think that a reasonable objective would be to match the fill rate with the availability of new permanent storage capacity. This objective may not only help minimize total government expenditures if oil prices rise in the future but would (1) provide the added protection of a larger reserve more quickly then the 145,000 barrels per day proposed by the administration and included in S. 1678, (2) avoid reliance on expensive interim storage, and (3) minimize the inefficiency of unused permanent storage capacity. Such an objective would allow a fill rate of about 185,000 to 190,000 barrels per day in fiscal year 1984.

With regard to the SPR's ultimate size, a 750-million-barrel inventory appears to be a generally accepted objective. While we have no current analytical information to support a different level, the question remains whether alternative sizes should be open to consideration in view of changing economic and oil market conditions. We note that in the past, several studies have indicated that an optimum inventory level could be higher than 750 million barrels. Nevertheless, in recent years there have been reduced expectations of future import levels and the expected sources of the imports have changed somewhat.

READINESS TO USE THE SPR

Several provisions regarding our readiness to use the SPR are included in S. 1678. One requires the Secretary of Energy to report annually on how he intends to use the reserve--specifically, on actions taken to assure that (1) the SPR will be used to meet domestic needs, (2) it can be applied to meet our international obligations, and (3) it can be protected from speculation and hoarding.

An annual reporting requirement on SPR use can undoubtedly serve a useful purpose if it provides more information than past reports on this subject. Despite the clear advantages of effective SPR use planning, we have noted in past testimony and reports that the administration's SPR Drawdown Plan and SPR Drawdown and Distribution Report--which we evaluated in a January

1983 report to this committee[2]--provided little specific information about the amount, rate, and timing of SPR use in an emergency. In addition, the administration did not deal with other important policy questions such as the possibility that some SPR oil might be retained in private inventories after it is sold.

DOE has indicated that actions are being taken to resolve these issues. For example, the Secretary of Energy has stated that DOE was developing measures that would appear to meet the requirements of the SPR use provision in S. 1678, including an assurance that SPR oil entering the market during an emergency would be protected against speculation and hoarding.

While we commend DOE's efforts to address these concerns related to using the SPR, we urge that measures taken be as specific as possible. Otherwise, it is doubtful that they would be of much value to the Congress or be effective if and when needed.

SPR drawdown testing

Another provision of S. 1678 concerning the SPR's readiness authorizes the Secretary of Energy to sell SPR oil as part of a drawdown and distribution test. We concur in the merits of testing DOE's ability to physically draw down the SPR. We recognize, however, that there may be practical difficulties in actually selling and distributing large quantities of SPR oil without causing disruptions in oil markets or in DOE's on-going oil fill program.

[2]Analysis of the Strategic Petroleum Reserve Drawdown Plan and the Strategic Petroleum Reserve Drawdown and Distribution Report (GAO/RCED-83-85, Jan. 3, 1983).

If these difficulties can be overcome, we urge that DOE consider testing the SPR drawdown capability at significant levels over a reasonably sustained period of time to ensure system reliability during an emergency. Such testing is important because the Department's ability to substantially draw down the SPR over a sustained period of time has yet to be demonstrated. During testimony on May 24, 1983, before the Subcommittee on Environment, Energy and Natural Resources, House Committee on Government Operations, we discussed problems and delays in installing automated central control systems at two of the major SPR storage sites. We concluded that these, and other obstacles, "raise concerns about DOE's ability to successfully sustain a major drawdown of the oil reserves in the volumes that could be needed...."

Subsequent to our testimony, a DOE Inspector General report[3] on a 1-day drawdown test at the Bayou Choctaw storage site, in July 1983, stated that the design specifications of the drawdown equipment for a Phase I drawdown were adequate but that problems could be encountered in meeting the higher Phase II drawdown rate. While generally giving high marks for the site operations, the report documented problems at the site, including a lack of standarized systems and components--which makes repairs more difficult--and problems with a new inventory control system which is designed to ensure that adequate spare parts for critical drawdown equipment will be available when needed.

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[3]Drawdown Reliability of the Bayou Choctaw Site of the Strategic Petroleum Reserve, September 28, 1983, U.S. Department of Energy, Office of Inspector General.

DOE has conducted other drawdown tests which have also been of limited duration and quantity. Although one test conducted on April 22-23, 1980, involved a simultaneous drawdown at 3 sites of 1.4 million barrels of oil, no tests have lasted more than 1-2 days and no oil has been physically moved from the SPR into normal distribution channels.

Timing of SPR use

One final aspect of SPR use I would like to discuss concerns the timing of an SPR drawdown. DOE has stated that it intends to use the SPR only as a last resort in the event of a severe oil shortage. Another use of the SPR that may merit further consideration, however, is the use of at least a partial drawdown early during a disruption to help mitigate rapid price increases.

Sudden price increases have proven to be among the most damaging effects of oil supply disruptions. Current research indicates that early drawdown could help to minimize price increases from disruptions. Therefore, early SPR drawdown, particularly if coordinated with similar stock drawdown by our allies, should be considered a viable option in our SPR use plans.

LACK OF NATIONAL ECONOMIC RESPONSE MEASURES

A major gap in DOE's energy emergency preparedness program is the lack of national economic response measures to mitigate the effects of a severe energy supply disruption. Past experience has demonstrated that these effects can be serious, even in a relatively minor shortfall such as the Iranian oil cutoff of

1979. During that disruption, crude oil prices increased two and one-half fold--from $13 to $32 a barrel--between September 1978 and September 1980. The disruption is believed to be a significant factor in the fall of the annual rate of growth of the GNP from a positive 1.2 percent in the first quarter of 1980 to a negative 9.6 percent in the second quarter. It also was a factor in adding about 2 percentage points to inflation in 1979 alone. Furthermore, a recent GAO report concluded that even under today's slack market conditions, large oil supply disruptions could double or even triple oil prices and have serious effects on inflation, economic growth, and employment.[4]

DOE has studied several alternatives to deal with the impacts of a disruption, including standby temporary withholding tax reductions and block grants to the states to recycle revenue from the windfall profits tax or emergency tariffs back into the economy. However, DOE has taken little action to make such measures available in an emergency, relying instead on the free market to handle the economic impacts.

The need for such economic response measures was emphasized by several states during the recent International Energy Agency's test of its emergency sharing system (AST-4). The 10 states participating in the U.S. domestic energy emergency response part of the test were virtually unanimous in their call for federal economic response measures to mitigate the economic impacts of the

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[4]Oil Supply Disruptions: Their Price and Economic Effects (GAO/RCED-83-135, May 20, 1983).

disruption. The states concluded that the federal government was best situated to deal with the economic consequences (such as unemployment, declining state revenues, and the social costs of high energy prices) associated with rapidly rising oil prices, since federal revenues from the crude oil windfall profits tax would increase significantly due to higher oil prices. Despite the states' concern about the impact of high prices, DOE took no action, citing as reasons the administration's incomplete analysis of the impact of allocation and pricing on the domestic economy and the lack of participation in the test by high level economic policy makers in other federal agencies.

The states' pointed call for federal action during the AST-4 test underscores the likely intense pressure for national economic response measures which would follow an actual crisis. In our view, if such response measures are not designed now and placed in standby status, we may find ourselves formulating such measures in the turmoil of an actual disruption. A standby national emergency economic response plan may also lessen the likelihood of either the federal government or individual states instituting oil price and allocation controls. Experience from the 1979 Iranian shortfall indicates that such controls have the potential to actually exacerbate the effects of the shortage.

In view of the AST-4 test results and a considerable amount of research by DOE and private organizations examining various aspects of economic response measures, we urge the committee to review this matter during its consideration of S. 1678.

EXTENSION OF ANTITRUST DEFENSE

Subsection 4(a) of the bill would amend subsection 252(j) of the Energy Policy and Conservation Act (EPCA) to extend limited antitrust protection for U.S. oil company participation in IEA activities until June 30, 1985, the date on which EPCA as a whole expires. Existing law provides this protection only until December 31 of this year.

Since IEA was formed, the U.S. government recognized that the International Energy Program (IEP) agreement could not be successfully implemented without the assistance of at least the major U.S. international oil companies; yet the actions required could have anticompetitive consequences and result in antitrust suits against the companies. To obtain and authorize company assistance in carrying out the U.S. obligations under the IEP, EPCA authorized the development and implementation of a voluntary agreement and plan of action. The agreement, administered by DOE but approved and monitored by both Justice and the FTC, sets forth the circumstances under which industry can participate in IEA activities. The plan of action, also to be administered by DOE but approved and monitored by both Justice and the FTC, is to set forth the kinds of specific actions that are authorized for companies to take during an actual emergency. An invited U.S. company that signs the voluntary agreement and plan of action has available to it the statutory defense against any civil or criminal suit brought under Federal or State antitrust laws for actions taken to carry out the agreement or plan, provided the actions were not taken for the purpose of injuring competition.

Many U.S. oil companies maintain that they will not participate in the IEA without the benefit of an antitrust defense. The IEA Secretariat, the U.S. government, and many foreign governments and oil companies maintain that without U.S. oil company participation the viability of the IEA is threatened. However, during AST-4, U.S. antitrust monitoring and recordkeeping requirements covering U.S. oil company involvement in such an exercise were criticized by U.S. and foreign oil companies and the IEA Secretariat as being excessive and burdensome. U.S. antitrust authorities have tried to be responsive within the framework of existing U.S. law.

We do not oppose some extension of the Section 252 antitrust defense, but we believe (1) the Committee should discuss the specific extent of any extension with the FTC and the Justice Department and (2) the Secretary of Energy may want to use existing authority under EPCA to establish an Advisory Committee on IEA matters which could, among other things, serve to assure broad and balanced participation by both large and small oil companies. Concerning the latter, although no oil company has expressed concern, major U.S. oil companies tend to dominate industry participation in IEA activities. They devote more staff and financial resources to IEA activities than other companies. The Advisory Committee would provide a communication vehicle for smaller oil companies, consumers, and other interested parties.

Despite the importance of advance approval of anticipated participating company actions before a crisis occurs, a revised

plan of action tailored to the IEA's Emergency Sharing System has not been finalized. Although DOE has made recent progress in developing the plan, it has been in preparation for more than 5 years. To enable companies to know what actions they could take in emergency situations, finalization of this plan should be stressed, particularly in light of the uneasy situation in the Middle East.

ENERGY EMERGENCY PREPAREDNESS ORGANIZATIONS

Section 3 of S. 1678 appears intended to (1) broaden the use of voluntary agreements and plans of action to include a wider range of participants and to be available for domestic as well as international emergencies and (2) resolve legal constraints impeding use of the Emergency Executive Manpower Reserves. We agree with the concept of making effective use of industry expertise and the expertise of other organizations during an energy emergency. However, antitrust and conflict-of-interest waivers in the bill as proposed are very broad. While our work to date has not evaluated the alternatives, we would urge the committee to explore whether the objective could be achieved with more limited exemptions.

Voluntary agreements

The Energy Policy and Conservation Act provides authority for a voluntary agreement to obtain industry assistance for one defined purpose, to carry out U.S. obligations under the International Energy Program. Industry actions and associated anticompetitive risks can be evaluated by reference to the

particulars of the provisions of the IEA and its implementing documents, and protections designed to minimize these risks.

S. 1678, on the other hand, would substantially increase the President's authority to enter into voluntary agreements with industry, in exchange for antitrust protection, to facilitate preparation for, or respond to, a domestic or international energy emergency. The particular purposes for which a voluntary agreement might be developed and used are unspecified. Consequently, the associated anticompetitive and other risks cannot be effectively evaluated.

We suggest that the committee consider asking DOE to more precisely define the purposes for which voluntary agreements would be used in an emergency and specify them in the bill. For example, authority might be provided for a voluntary agreement with industry, coupled with antitrust protection, to allow companies to participate in meeting U.S. obligations to provide oil to NATO. Congress would then be in a better position to (1) determine who the anticipated participants in a voluntary agreement would be, (2) evaluate the potential anticompetitive consequences of the agreement, and (3) determine whether the benefits to be gained from the voluntary agreement outweigh the risks of anticompetitive consequences.

Executive manpower reserves

The objective of the manpower reserves is to develop and maintain the capability to quickly augment DOE staff during an energy emergency with experienced industry professionals who can

help identify and assess supply and demand problems and assist in coordinating energy production and distribution. As we have frequently noted in the past, major legal problems that have precluded use of the Reserves include the following:

--Reservists who serve or advise federal officials during an emergency are subject to general conflict-of-interest laws and to additional civil provisions of the Department of Energy Organization Act.

--Participation of industry officials in the program may expose the officials and their companies to antitrust risks.

The bill provides comprehensive exemptions, to be used at the discretion of the President, to eliminate these barriers. Reservists may be (1) exempted from antitrust and conflict-of-interest and financial reporting laws prior to as well as during an emergency, (2) able to make policy decisions, and (3) used during domestic as well as international energy emergencies.

There are substantial risks associated with these exemptions. For example, reservists would be protected by the exemptions even where they, on behalf of the Government, negotiated contracts with their private employer; provided Government relief or assistance to their private employer; received multiple salary payments from companies other than their own employer while they are working for the Government; used their temporary emergency Government jobs to facilitate price-fixing agreements; or provided favoritism to their private employers during the energy emergency. While providing some waivers for conflict-of-interest restrictions, the Defense Production Act,

which presently authorizes the Manpower Reserves, contains explicit provisions to preclude these types of situations. No such protections are included in S. 1687 as drafted. While we support the judicious use of conflict-of-interest and antitrust waivers in emergency situations, care should be taken to establish some parameters.

The administration's Comprehensive Energy Emergency Response Procedures Report noted difficulties involved in defining the extent to which these exemptions should be given. The administration acknowledged the need to balance competing objectives served by the conflict-of-interest and antitrust laws on one hand with the use of industry assistance in energy emergencies on the other. It concluded that "just where this balance should be struck is not yet clear."

We would suggest that DOE could go a long way toward developing more specific waivers of conflict-of-interest and antitrust laws by carefully defining how it intends to use the executive reserves. With these uses in mind, it would be easier to tailor the waivers to meet the need and avoid the use of blanket exemptions.

UPGRADING COMPREHENSIVE PROCEDURES

As proposed, S. 1678 would require the Secretary of Energy to report annually on actions taken to upgrade the administration's emergency response procedures.

We agree with this provision. The usefulness of the report, however, will depend on the completeness and overall quality of

the report provided by the executive branch. In our recent analysis of the administration's Comprehensive Energy Emergency Response Procedures Report, we reported that the administration's response lacked required specificity and demonstrated that key parts of the energy emergency preparedness programs were still not ready.

IMPLICATIONS OF AST-4

Although the IEA Emergency Sharing System has never been activated, periodic and limited tests of the system in 1976, and more comprehensive tests in 1978, 1980, and 1983, have been conducted. The recently completed fourth test of the system (AST-4) was designed to determine how well prepared participating countries, including the United States, are to meet their oil sharing obligations under the IEA agreement and what potential problems can be anticipated if the system were activated in a real crisis.[5]

This test provided useful training and other benefits to government, industry, and IEA Secretariat personnel, many of whom had not participated in the previous IEA tests.

However, we have identified several concerns regarding U.S. participation in the test which we would like to bring to your attention. The test revealed a number of key problems which should be addressed if the IEA Emergency Sharing System is to make

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[5]For further elaboration of this test, see Assessment of U.S. Participation in the International Energy Agency's Fourth Test of Its Emergency Sharing Allocation System, (GAO/NSIAD-84-4, Oct. 13, 1983).

a significant contribution to reducing the costs and dislocations of an oil supply interruption. In particular, it focused attention on some of the difficulties the United States might face in relying exclusively on market forces to fulfill U.S. international obligations under the IEA Emergency Sharing System and to cope with the economic impacts of a major oil shortage. On the operational level, the management of U.S. participation in AST-4 was marked by inadequate preparation, lack of coordination, and failure to resolve disagreements within the executive branch on important test-related issues. In addition, DOE made several assumptions and decisions which may have unduly reduced the U.S. allocation obligation and inclined companies to make much larger voluntary offers for testing purposes than they would in a real emergency situation, raising questions as to how seriously the U.S. views the sharing system.

Economic response policy

The test demonstrated the substantial economic consequences of relying solely on price to restrain demand. DOE forecast oil prices rising to $98 per barrel, gasoline selling at $2.83 per gallon, substantial reductions in U.S. manufacturing activities and Gross National Product, and significant increases in unemployment and consumer prices. As previously discussed, AST-4 participants from the states strongly felt that the federal government would have to establish and be ready to implement some revenue recycling measures to address the problem.

Fair sharing, oil company participation, and SPR use

DOE assumed certain behavior for the U.S. oil market that was critical to meeting the U.S. oil sharing responsibility under the test. However, the ability of the market to adjust as quickly and smoothly as DOE assumed does not reflect the realities experienced in prior emergencies.

Most U.S. oil companies that actively participate in IEA activities have said that they would not volunteer oil supplies to the IEA Emergency Sharing System unless a program existed to assure that the burden would be shared equitably with their domestic competitors. About 90 percent of voluntary offers made by major oil companies during the test were predicated on the existence of a "fair sharing" program. Therefore, AST-4 clearly showed that some form of a fair sharing program is probably necessary.

Besides major oil companies that have been working directly with the IEA, other U.S. companies may be willing to voluntarily share oil with other IEA member nations. However, the test did not convincingly demonstrate that these companies can make a significant contribution because there were serious doubts about the realism of most offers of oil made by these companies. For example, significant information was missing in three-fourths of the offers made by these companies, so DOE made up or guessed at the missing data. Officials at the IEA quickly recognized these as improbable or erroneous.

The test also raised questions about if and how the U.S. would use the SPR in such an emergency. DOE's decision not to

draw down the SPR, and in fact to continue filling it during a considerable part of a simulated major disruption, may reflect the difficulty the U.S. government might experience in deciding when and how to use the reserve in a real crisis.

Reactions by allies and handling of price

Finally, U.S. primary reliance on market forces to cope with the disruption, as well as certain actions taken by the U.S. government during the test, have raised concerns within the IEA and with other IEA countries, about the U.S. commitment to the Emergency Sharing System.

Following the AST-4 test, major IEA participants, including the Secretariat, industry and government groups, and oil market experts, completed individual assessments of the test. Overall, these groups raised several concerns about the viability of the system in a real crisis and U.S. participation in the test. Areas of principal concern cited included the lack of pricing in the test of the voluntary offer process, the impact of the U.S. relying exclusively on oil price increases to achieve demand restraint objectives, the absence of a U.S. fair sharing program, and the problems that arose with the U.S. nonreporting company offers.

The international assessments indicated a need for participating countries to have appropriate demand restraint and fair sharing programs in place if the IEA voluntary offer system is to work effectively in a real emergency. These assessments focused attention on the importance of compatible national

emergency systems to the successful operation of the entire international Emergency Sharing System. IEA assessment groups concluded that reliance on unrestrained price escalation would not be in keeping with each nation's commitment to the IEA. They indicated that a U.S. approach that relies on price increases as its principal, if not exclusive, response to a major oil supply disruption presents serious problems for the IEA sharing system.

Price was not included in the simulated international allocation of oil under the IEA sharing system because member country governments and participating oil companies failed to reach agreement on a method for determining the price at which oil would be exchanged in AST-4. However, the price of oil in an international emergency is important to the effective distribution of oil supplies among consuming countries. If the IEA's 21 member countries that are to share oil in a severe disruption cannot agree on a pricing approach, serious questions could be raised about the viability of the Emergency Sharing System.

Before I summarize my statement, Mr. Chairman, I would like to bring one more item to your attention. In our March 7, 1983, testimony, we expressed a concern that the different energy statutes do not use common terms or language to trigger their respective authorities. For example, a "severe energy supply interruption" is the key to utilization of certain provisions of the Energy Policy and Conservation Act (EPCA), the Emergency Energy Conservation Act (EECA), and the Powerplant and Industrial Fuel Use Act. On the other hand, authorities under the Defense

Production Act are generally only available in connection with national defense and defense preparedness activities. The structure of S. 1678 making its new authorities specific to energy emergencies is an improvement. However, it introduces yet two more terms, "domestic energy emergency" and "international energy emergency." Both terms seem very broad and neither term is defined in the bill, unlike "severe energy supply interruption" which is carefully defined in EPCA and EECA. Consequently, it is not clear in what circumstances these new authorities might be used nor do there appear to be constraints on their use.

SUMMARY

I would like to summarize my testimony by re-emphasizing some of our observations. We note that S. 1678 deals with many of the emergency preparedness problems we have cited in past reports and testimony. It also combines emergency preparedness laws into one statute, although the circumstances in which some of its authorities may be used are not entirely clear. In particular, we agree with

--its objective to make effective use of industry expertise,

--the provisions to facilitate SPR drawdown testing, and

--the requirements that the Secretary of Energy report on improvements in DOE's comprehensive procedures.

In some areas, we have made suggestions which we believe would further assist in accomplishing the bill's objectives. Among them:

--A reasonable objective for a SPR fill rate could be to match it with the availability of permanent storage capacity.

--While 750 million barrels is a reasonable objective for the size of the SPR at this point, the question should remain open for further consideration in view of changing economic and oil market conditions.

--The committee should consider whether the objective to effectively use industry expertise could be accomplished with less wide-ranging exemptions from existing antitrust and conflict-of-interest laws.

Finally, we would like to point out a few related matters that we believe warrant the attention of this committee:

--The results of AST-4 surfaced fundamental problems relating to U.S. participation in the IEA and our ability to meet oil sharing obligations. DOE actions in response to this test should be carefully monitored.

--The potential benefits of using the SPR early in a disruption to dampen sharp price increases should be considered.

--DOE should be encouraged to develop national economic response measures to deal with economic dislocations caused by rising oil prices and fuel shortages.

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That concludes my prepared statement. We would be happy to respond to any questions.