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GAO AND ENERGY

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Speech by

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at

The International Energy Conference

of

The International Research Center for Energy and
Economic Development

March 23, 1983

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The U.S. General Accounting Office may not be a "household word" to all of you. For this reason, I thought I would start by explaining briefly who we are and what we do. Then, I will discuss some of our recent and ongoing work with emphasis on natural gas pricing, western leasing, and emergency preparedness. I will conclude by mentioning two areas of our work which look to the future.

GAO was established as an independent, nonpartisan legislative agency by the Budget and Accounting Act of 1921 to help Congress insure economy and efficiency in the Federal Government. Today, it is headed by Comptroller General Charles A. Bowsher. Our major responsibility is to assist the Congress by auditing and evaluating Federal programs, activities and financial operations. We also provide legal opinions and frequently comment on proposed legislation.

We employ 5,000 people. Half of them work in Washington, D.C. The other half are located across the United States and at three locations abroad, where they can review Government operations. In fiscal year 1982, we issued 949 reports to the Congress and Federal agency officials, testified 177 times before congressional committees, and assisted Congress in many other ways.

This work comes to us in several ways. Our fundamental mandate is to evaluate Government programs. We also have responsibilities assigned to us by specific legislation, such as the Nuclear Waste Policy Act of 1982. This law requires that we monitor Federal efforts to develop underground facilities for permanent nuclear waste disposal. In addition, we frequently respond to congressional requests to look into specific problems and to evaluate legislative options.

Energy is one of our major areas of activity. Our energy work is organized along certain broad lines reflecting the Federal role in energy. These are Federal resources and power, energy technology and nuclear issues, regulation and management, and energy policy and national security. We are specifically responsible for the audit and evaluation of programs at the Department of Energy, the Nuclear Regulatory Commission, the Tennessee Valley Authority, the energy-related portions of the Department of the Interior, and the Synthetic Fuels Corporation.

GAO PLANNING AND PRIORITIES

I do not need to emphasize to this audience that this area is complex and far-reaching. Energy provides all aspects of modern life. Our work in this area represents a major effort in terms of time and human resources. We make every effort to prioritize the use of our efforts to meet the pressing needs of our audience. For this reason, we have initiated a strategic plan for energy. We look ahead for the next 24 to 30 months and try to identify important and emerging issues and those programs where our evaluations will have the most impact.

We realize that energy is a "real world" issue, not simply one dominated by Government programs, that supply and demand operating in the marketplace is the most important determining factor. Furthermore, the market does not stop at the border of the United States. It is probably no exaggeration to say that the international price of oil is the most important single driving force shaping energy decisions here in the United States. Recent events, such as the slackening of world oil demand, reduction of OPEC prices and lessening of U.S. imports from the Middle East, have tended to diminish the visibility of energy. Nevertheless, all of you remember the 1970s. Acute shortages were followed by periods of abundance only to be once again replaced by short supply and rising prices. Energy put the U.S. economy on a roller coaster, and the problems of the 1970s have not gone away. The United States continues to import 14 percent of all its energy and to consume about 25 percent of the world's energy supply.

Within this context we have identified six strategic target areas for our work:

--the Strategic Petroleum Reserve,

--Emergency Preparedness,

--Electricity Supply and Demand,

--Nuclear Power Regulation in the post Three Mile Island Era,

--the Synthetic Fuels Corporation, and

--the Pacific Northwest Power Act.

All of these include issues in which we anticipate high congressional interest and areas for which a broad summary report within the next two years would be timely. Other major areas, for which we expect to commit substantial resources, include energy research and development, Federal regulation of natural gas and nuclear power, including nuclear waste. Congressional interest in energy remains high, and we must continue to respond to growing numbers of specific congressional inquiries. I might mention that between 65 and 70 percent of our work in energy responds to congressional requests. To the extent that our planning is successful, we will have anticipated much of Congress' interests, and our replies will flow from our ongoing work.

You may be interested in the analytical basis or rationale by which we prioritize our work. Even in an atmosphere which emphasizes the free market, the Federal Government retains a major role in energy. We at GAO follow the Government. Let me cite a few examples. Electricity supply and demand, as I have mentioned, is one of our strategic target areas. The Nation's utility industry is faced with a unique situation. Historically, high levels of demand growth have given way to static and, in some cases, declining demand. Several of our reports dating from 1978 have highlighted the imbalance between supply and demand. In our future work, we will address this issue in several stages. First, we plan to develop an inventory of the Nation's power generating capacity by subregion. Second, we will look at ways regional imbalances can be matched and at impediments to this provement. Third, we will examine the need for future resource development, including the role of nuclear power. At this point we expect to be able to analyze the utility industry, public and private, and comment on the traditional roles of Federal, State and local government.

In the case of the Synthetic Fuels Corporation, we know that Congress will have to make a decision in the 1984 timeframe on future funding. Market forces and energy prices have delayed if not killed many synfuels projects. We plan to examine SFC's process for selecting and funding projects. The Corporation's overall effect on the development of the synthetic fuels industry in the light of the very real question of whether Government subsidy is needed or appropriate.

The Pacific Northwest Power Act, which has been in place for about four years, is another piece of legislation that we have targeted specifically for evaluation. We intend to put together a report card on how the act has worked to meet electricity needs and use within the region. We will evaluate each major component of the act in terms of regional supply and demand planning and of the effectiveness with which conservation and renewable energy resources are being applied. We will also look at how the act has worked to meet its other objectives of maintaining fisheries and ecological systems.

RECENT AND ONGOING GAO WORK

Natural Gas Pricing

Let me turn to some examples of recent reports which may be of particular interest to you. Natural gas has been in the headlines lately. The President has just submitted a complex and controversial proposal for decontrol. Earlier this year we released two reports, "An Analysis of Natural Gas Pricing Alternatives" and "Information on Contracts Between Natural Gas Producers and Pipeline Companies." We analyzed the energy and economic impacts of the continued operation of the Natural

Gas Policy Act and other alternatives. Not surprisingly we found "there is no free lunch." All the options involved trade-offs.

Two possibilities stood out: immediate price decontrol and continuation of NGPA. They were not only the most likely alternatives, but also, on balance, seemed most favorable for industry and consumers than the other options we analyzed. Both, however, have pluses and minuses. Price decontrol in 1983 promises to alleviate many of the disadvantages caused by intrastate pipelines' inability to compete with interstate pipelines. It also promotes economic efficiency. However, provisions of existing contracts create the potential for a huge price fly-up. We estimate that such price increases could range anywhere from 18 percent to over 100 percent--with about 90 percent being "most likely." This contrasts with increases of about 20 percent per year over the past few years. Most of the increase would be attributable to the contract terms in contracts negotiated when natural gas was scarce in the 1970s. In fact, in our "most likely" case we estimated that under total decontrol, these contract terms could raise prices about 60 percent above present market clearing prices.

NGPA, on the other hand, offers a smoother transition to price decontrol and lower consumer costs overall. Moreover, the contract problem appears less severe under NGPA than under decontrol. Under NGPA, however, price control will remain on a portion of old interstate gas after 1985. This low cost gas will enable interstate pipelines to bid above market prices for new decontrolled supplies, average the two prices and still maintain a competitive market price. Intrastate pipelines fear they will lose access to these new supplies after 1985. We found that this problem, though real, was likely to be short-lived. Our reports concluded that there isn't a clearly "correct" choice. Both have their own advantages and disadvantages, but if total decontrol is chosen, the contract problem will have to be dealt with.

Our reports were released before the President made his recent proposals. As you know, he called for the total decontrol of prices accompanied by complex provisions for abrogating contracts, while holding price increases at or near the rate of inflation. Recently, both the Senate and House have requested that we review the Administration's plan. Senator McClure and Representative Markey have asked us to assess its energy and economic impacts on both a national and regional basis. Representative Sharp has requested that we look at its effect on FERC's resource requirements to fulfil its regulatory responsibilities.

Development of energy resources on Federal lands and on the Outer Continental Shelf

The accelerated leasing of Federal lands for energy exploration and development was, and remains today, one of the Reagan Administration's key energy initiatives. Rapid inventorying of Federal lands for energy resources, the development of any new-found resources to reduce U.S. dependence on foreign sources of energy and, although not specifically highlighted, the additional revenues to the Treasury from an accelerated leasing program were strong motivating factors.

We have followed the Administration's program closely. For example, we have issued three reports on the accelerated 5-year Outer Continental Shelf (OCS) leasing program. In our initial report, we doubted the Interior Department's ability to accommodate an accelerated program--particularly in Alaska where sales were to be increased by 60 percent during the 5-year period. We also noted that the success of the new program would hinge on (1) industry's ability and willingness to increase its development activities, and (2) public acceptance of the program. I have in mind the absence of litigation which, in the past, has slowed offshore activities. In follow-on reports we have questioned the Administration's estimated budgetary receipts for the offshore leasing program and also suggested that increased royalty rates be used to protect the public's financial interest.

We have also looked at the Administration's plans for leasing of on-shore Federal lands--both for oil and gas and coal. In a February 1982 report we noted that while some progress had been made in opening up Alaska lands, administrative and procedural problems had to be overcome before accelerated leasing could come about.

A related issue in the development of Federal resources--particularly coal--is the "checkerboard" problem common in the west. Federal and railroad holdings are so small and intermingled that economic development of resources contained on those lands is precluded. On March 7 of this year, we issued a report to Representative Williams of Montana on a Department of Interior proposal. The Government and a railroad--in this case Burlington Northern--would realign some of their holdings in Montana to give each a tract of land large enough for economic leasing and/or development. Although railroads are generally not permitted to participate in Federal coal leasing, they can acquire Federal coal by exchange. We took the position that Interior should proceed with its consideration of the exchange, but offered some recommendations to Interior for consideration in future exchanges.

Currently, we are reviewing the Powder River Basin coal lease sale held last April--the first large sale in over a decade and the largest sale in America's history. As you are aware, a great deal of controversy surfaced after the sale. Representative Markey and Senator Baucus have asked us to review the sale. Some of the issues they asked us to review include

--the basis for the Interior Department's late decision to change bidding systems,

--Interior's use of lease valuation methods, and

--whether or not the public received fair market value for its coal in the April and October sales.

We support the Administration's attempts to increase the leasing of Federal lands for energy development, but we are also concerned that it be done in such a way that the public's overall interest is protected. As you are aware, legislation governing the leasing of Federal lands provides that a number of factors be considered in leasing decisions and that a balance be struck to assure that no one consideration is given short-shrift.

We can all recall examples of differences that arise reflecting different observers points of view. I once asked my father, "how much is coal?" He replied, "That depends upon whether you are buying it or shovelling it." One of our major concerns at this time is the question of a fair and equitable return to Government for leased lands. Under this Administration the Government's bid acceptance processes are being revised--in the OCS program and in the case of the Powder River sale. This approach relies more on company competition and other marketplace factors--rather than on Interior's independently developed evaluations which are based on their economic, geologic, and engineering analyses. It has led to lower royalty rates. Reliance on the marketplace is fine, but this reliance must be tempered by marketplace trends. For example, today the economy is weak and the outlook and future demand for all energy resources, including coal, is uncertain. Under these conditions, we question whether the Administration's current marketplace approach to leasing--especially when it is offering far more land for lease than ever before--will ensure that the Government gets "fair market value".

The Administration is concerned, and rightly so, that the Government receive a fair return for the development of Federal mineral resources. We have issued a number of reports over the past several years pointing out management problems with Interior's oil and gas royalty collection process. The Department is making a concerted effort to correct these problems; it has established the Minerals Management Service and is working on a new royalty accounting system.

We are continuing to monitor and report periodically on Interior's progress in this regard, and are examining other financial and accounting issues as well. For example, we recently issued a report to Interior pointing out that more timely deposit of the application fees for noncompetitive oil and gas leases could result in interest savings of several hundred thousand dollars a year.

Emergency Preparedness and the SPR

Emergency preparedness for imported oil interruptions is an area where I feel GAO has made an important positive contribution.

We are well aware, as you are, that at the present time there is a glut of oil and prices have come down. Nevertheless, the United States and other industrialized nations remain dependent on imported oil, including substantial amounts from the Persian Gulf area.

We have been following two main tracks in this area. First, since mid-1980, at the request of the Senate Energy Committee we have monitoried the Strategic Petroleum Reserve. We are required to file quarterly reports on SPR activities through fiscal year 1985. Our other effort is more wide ranging. In 1981 we published a report, "The United States Remains Unprepared for Oil Import Disruptions." It reviewed then current emergency programs as well as alternative approaches. We concluded that the Federal Government was unprepared to cope with emergencies. Since then we have released many reports and testified before several congressional committees.

The Administration has announced that in an emergency it intends to rely on the free market and the SPR. It has abandoned price controls, demand restraint and other measures. As a result of these policy changes the SPR is virtually all we have. We recently reported to the Senate Energy Committee on the Administration's SPR drawdown plans and overall emergency preparedness program. Like the old testament prophet Daniel, "we weighted them in the balance and found them wanting."

A current controversy swirls around the SPR fill rate. Two problems that plagued its early development were delays in construction and oil acquisition. Over the past 2 years, the Administration made good progress in filling and expanding the SPR. Today it contains about 300 million barrels of crude. The Administration, however, intends to reduce its fill effort on the grounds of the need to reduce Government spending and the improved energy supply situation. Of course, from a contrasting point of view, the time to buy oil is when it is cheap and available.

The situation today is this. The Energy Emergency Preparedness Act requires a minimum average annual fill rate of 300,000 barrels per day until the total reaches 500 million barrels. The President has an escape clause from the 300,000 barrel a day rate. If for any fiscal year he finds that this rate is not in the national interest, the minimum becomes 220,000 barrels per day or the highest practicable rate subject to the availability of funds.

During the first quarter of this fiscal year, the Administration filled the SPR at an average rate of 173,000 barrels per day. The Administration has stated that over the entire year, however, it intends to revise the rate to 220,000 per day. The problem arises for fiscal years 1984 through 1986. The proposed fill rate will fall to 100,000 to 145,000 barels per day and delay the achievement of a 500 million barrel reserve by at least 2 years.

What goes in, must come out. Let me turn to the problem of SPR draw down. Protection from the adverse affects of supply disruptions is, in large part, determined by how and when the Government can distribute SPR oil. Advance planning is critical to effective use in an emergency. It can also contribute to public confidence and deter panic buying at home and facilitate cooperation other major oil importing nations abroad.

I have already hinted at our reaction to the Administration's SPR draw down plans. In our view more analysis and policy decisions are needed on such questions as timing of drawdowns, strategies in various types of disruptions, and coordination with our allies.

A LOOK AT SOME FUTURE GAO WORK

Before I conclude my remarks, let me look ahead a bit. Nuclear power once seemed to be the wave of the future. A number of factors, including escalating costs, shrinking demand, Three Mile Island, and others have led to a virtual nuclear moritorium. Nevertheless, nuclear power is the object of intense public and congressional interest. The Administration has emphasized it. We regard the current hiatus as a window of opportunity, a time to learn from what has happened to the industry and make whatever changes or mid-term corrections are necessary to "do it right next time." We plan to address several issues:

--nuclear interface with the electric utility industry,

--nuclear power infrastructure,

--regulation, and

--international implications.

Research and development is another area which looks to the future. The Administration has adopted a policy of limiting Federal support to "long-term, high-risk projects" with potentially high energy or efficiency payoffs. This approach will rely on industry to manage and finance demonstration and commercialization projects.

The Administration's policy not only reverses those of its predecessors, but is a variance with much of congressional sentiment. We, therefore, expect a heavy load of congressional requests. We plan to address this issue in a number of reviews on specific energy technologies. We plan to build toward a comprehensive report on the Nation's ability to develop and deploy appropriate energy technology.

CONCLUSIONS

It has been a pleasure for me to address a group such as this. I have with me a list of recent and forthcoming GAO reports on energy. I hope they will be of interest to some of you. At GAO, we welcome inquiries at any time. I would be glad to answer your questions.