

The original documents are located in Box 4, folder: “Testimony, June 8, 1976, Joint Economic Committee - Subcommittee on Energy” of the Frank Zarb Papers at the Gerald R. Ford Presidential Library.

Copyright Notice

The copyright law of the United States (Title 17, United States Code) governs the making of photocopies or other reproductions of copyrighted material. Frank Zarb donated to the United States of America his copyrights in all of his unpublished writings in National Archives collections. Works prepared by U.S. Government employees as part of their official duties are in the public domain. The copyrights to materials written by other individuals or organizations are presumed to remain with them. If you think any of the information displayed in the PDF is subject to a valid copyright claim, please contact the Gerald R. Ford Presidential Library.

TESTIMONY
OF
FRANK G. ZARB
ADMINISTRATOR
FEDERAL ENERGY ADMINISTRATION

BEFORE THE
JOINT ECONOMIC COMMITTEE
SUBCOMMITTEE ON ENERGY
JUNE 8, 1976

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE,

IT IS A PLEASURE TO BE HERE TODAY TO DISCUSS THE IMPLI-
CATIONS FOR U.S. ENERGY POLICY OF THE EVOLVING RELATIONSHIPS
AMONG OPEC GOVERNMENTS, THE INTERNATIONAL OIL COMPANIES AND
THE GOVERNMENTS OF MAJOR OIL CONSUMING COUNTRIES. THE QUESTIONS
YOU HAVE RAISED DESERVE A GOOD DEAL OF ATTENTION, DISCUSSION
AND DEBATE BECAUSE THEY ARE IMPORTANT FOR THE UNITED STATES
AND FOR THE INTERNATIONAL COMMUNITY AS A WHOLE.



LET ME BEGIN BY SETTING THE CONTEXT: THE PRESENT WORLD ENERGY SITUATION, THE INTERRELATIONSHIPS AMONG OPEC, THE COMPANIES AND THE CONSUMER NATIONS, AND THE OUTLOOK FOR THE FUTURE. IN SHORT, WHAT IS THE SITUATION NOW, WHAT ARE OUR GOALS AND EXPECTATIONS, WHAT CHANGES MIGHT BE CONTEMPLATED TO HELP US ACHIEVE OUR GOALS, AND, CONVERSELY, WHAT MIGHT BE THE IMPACT OF VARIOUS OTHER PROPOSALS FOR CHANGE?

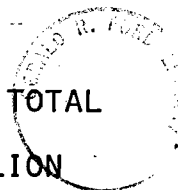
LET'S LOOK AT SOME OF THESE QUESTIONS.

THE FREE WORLD NOW USES ABOUT 50 MILLION BARRELS OF OIL PER DAY, SOME 60 PERCENT OF WHICH IS PRODUCED IN OPEC NATIONS. THE INTERNATIONAL OIL INDUSTRY KEEPS 800 MILLION BARRELS OF OIL MOVING AT ALL TIMES, AND LIFTS, TRANSPORTS, REFINES, AND MARKETS NEARLY 80 PERCENT OR 9 BILLION BARRELS PER YEAR OF OPEC OIL FOR END-USE CONSUMPTION. THE U.S. ALONE CONSUMES ABOUT ONE-THIRD OF THE WORLD'S DAILY OIL PRODUCTION, ABOUT 16 MM B/D. OUR TOTAL OIL IMPORTS (CRUDE AND PRODUCT) AMOUNT TO 6.5 MM B/D CURRENTLY, LARGELY FROM OPEC SOURCES. FURTHER, U.S. CRUDE IMPORTS FROM ARAB NATIONS HAVE GONE FROM ABOUT 22 PERCENT BEFORE THE 1973-1974 EMBARGO TO ABOUT 45 PERCENT NOW. SAUDI ARABIA HAS BEEN THE NUMBER 1 SUPPLIER OF U.S. CRUDE OIL IMPORTS SINCE NOVEMBER 1975 AND WAS SECOND FOR THE WHOLE OF 1975.

THE RECENT, WIDELY PUBLICIZED FIGURES SHOWING IMPORTS EXCEEDING DOMESTIC PRODUCTION MAY BE CONSIDERED A FLUKE BUT THEY ARE INDICATIVE OF AN OVERALL TREND. THE TREND SHOULD BE OF CONCERN. AND IT LOOKS AS IF IT IS NOT GOING TO BE REVERSED QUICKLY.

THE PRESIDENT HAS PROPOSED A PROGRAM OF CONSERVATION AND RESOURCE DEVELOPMENT, WHICH, IF IMPLEMENTED, COULD GIVE THIS COUNTRY SUFFICIENT ENERGY SECURITY INITIALLY BY 1980 AND MORE BY 1985 TO SUSTAIN A SUPPLY INTERRUPTION WITH MINIMUM ECONOMIC DISRUPTION. UNLESS MAJOR PORTIONS OF THIS PROGRAM ARE ADOPTED, HOWEVER, FEA PROJECTIONS OF FUTURE DEMAND FOR OPEC OIL INDICATE THAT THE UNITED STATES COULD BE IMPORTING MORE THAN 10 MM B/D BY 1985 IF OUR POLICIES TO STIMULATE PRODUCTION AND CURTAIL DEMAND ARE NOT ENACTED. IT IS ALSO PROJECTED THAT AS MUCH AS 55 PERCENT OF THAT PROJECTED TOTAL U.S. IMPORT DEMAND COME FROM ARAB SOURCES.

PEOPLE MIGHT POINT OUT THAT THIS IS THE REASON WE NOW HAVE A STRATEGIC STORAGE SYSTEM MANDATED. AND IT IS. BUT IF THESE TRENDS BECOME REALITY IN 1985, THEN THE STORAGE PROGRAM WE ARE SETTING UP MAY NOT BE ENTIRELY SUFFICIENT. U.S. STRATEGIC RESERVES ARE SCHEDULED TO TOTAL APPROXIMATELY 325 MILLION BARRELS BY 1980 AND 500 MILLION



BARRELS BY 1985. AT THE PROJECTED IMPORT RATES, THE RESERVES WOULD COVER AN IMPORT INTERRUPTION OF LESS THAN 2 MMB/D FOR 6 MONTHS IN 1980, AND ABOUT 5 MMB/D FOR 3 MONTHS FOR AN IMPORT INTERRUPTION IN 1985. WHILE THIS RESERVE WOULD PUT US INTO MUCH BETTER SHAPE THAN WE WERE IN 1973-74, AND WHILE THE INTERNATIONAL EMERGENCY PROGRAM WOULD HELP CONSIDERABLY, WE CANNOT CONTINUE TO FOLLOW THESE TRENDS--UNLESS WE WANT TO SEE OUR SUCCESSORS IN THESE SAME SEATS IN 1985 ASKING THE SAME QUESTIONS AND GIVING MORE GRIM ANSWERS.

I MENTION THESE POINTS BECAUSE IT IS IMPORTANT TO APPRECIATE THE SIGNIFICANCE OF THE EXTENT TO WHICH THE U.S. MAY HAVE TO DEPEND ON INTERNATIONAL SUPPLIES OF OIL IN THE FUTURE--IF WE ARE UNWILLING TO COMMIT THIS NATION TO EXPAND ENERGY PRODUCTION, TO REDUCE ENERGY CONSUMPTION, AND TO STRIVE FOR A SIGNIFICANT REDUCTION IN OUR LEVEL OF IMPORTS. UNDER ALMOST ANY CIRCUMSTANCES, THE ROLE OF THE INTERNATIONAL OIL COMPANIES MAY BE CRUCIAL TO THE SECURITY OF OUR IMPORT SUPPLIES AND THOSE OF OUR ALLIES.

UNTIL RECENTLY, THE WORLD OIL MARKET WAS DOMINATED BY INTERNATIONAL OIL COMPANIES HEADQUARTERED IN THE U.S. AND ONE OR TWO OTHER MAJOR CONSUMER COUNTRIES. THOSE

CONDITIONS GENERALLY ASSURED A SECURE SUPPLY OF OIL AT PREDICTABLE, LOW AND STABLE PRICES, BECAUSE UNDER THE CONCESSIONS, THE COMPANIES DETERMINED THE RATE OF DEVELOPMENT AND PRODUCTION AS WELL AS THE PRICE OF CRUDE MARKETED INTERNATIONALLY. MOREOVER, INTERNATIONAL OIL INDUSTRY ASSURED ACCESS TO, AND CONTROL OVER, EXCESS PRODUCTION CAPACITY IN VARIOUS OIL PRODUCING COUNTRIES, PROVIDED THE SUPPLY SECURITY FOR THE ADEQUATE, STABLE, UNINTERRUPTED VOLUMES OF PETROLEUM SO VITAL TO THE ECONOMIC DEVELOPMENT OF BOTH THE OIL PRODUCERS AND CONSUMERS OF THE FREE WORLD.

THAT CONTROL, TOGETHER WITH THE FACT THAT THE UNITED STATES HAD AN EXPORT CAPABILITY, RENDERED THE OIL SUPPLY DISRUPTIONS OF THE 1950'S AND 1960'S INEFFECTIVE AND SHORT-LIVED.

BUT SOME OF THESE CONDITIONS HAVE CHANGED VERY SIGNIFICANTLY: THE PRICE, THE TERMS OF ACCESS TO OIL AND THE PRODUCTION LEVELS FOR THE INTERNATIONAL OIL MARKET ARE SET BY THE OPEC MEMBER STATES. THEIR OWN NATIONAL OIL COMPANIES ARE MOVING TO ESTABLISH REFINERIES AND RELATED FACILITIES IN THEIR OWN COUNTRIES TO MARKET PETROLEUM PRODUCTS INTERNATIONALLY. AND A FEW HAVE SOUGHT TO INVEST IN SUCH OPERATIONS, VIA JOINT VENTURES, IN CONSUMING COUNTRIES. THE UNITED STATES IS NOW A NET OIL IMPORTER;

AND WHILE THERE IS A SUBSTANTIAL AMOUNT OF EXCESS PRODUCTION CAPACITY IN OIL EXPORTING COUNTRIES, IT IS NO LONGER UNDER THE CONTROL OF THE INTERNATIONAL COMPANIES. MOREOVER, THE PRINCIPAL REASON SUCH EXCESS PRODUCTION CAPACITY EXISTS IS BECAUSE THE OIL EXPORTING COUNTRIES HAVE SHUT IN ONE-FOURTH OF THEIR PRODUCTION TO SUSTAIN A WORLD PRICE MORE THAN FIVE TIMES THE 1973 LEVEL. THESE CHANGES, AS WELL AS THE RELATIVE DEARTH OF ALTERNATIVE SOURCES OF SUPPLY MEAN THAT WE CAN PROBABLY EXPECT CONTINUED UPWARD PRICE PRESSURE FROM OPEC AND POSSIBLY EVEN SOME PRODUCTION CUTBACKS--WHETHER DELIBERATE AND SELECTIVE OR UNAVOIDABLE AND GENERAL.

BUT THESE CHANGES NOTWITHSTANDING, THE INTERNATIONAL COMPANIES ARE STILL IMPORTANT TO THE COMMERCIAL MARKETING OF OPEC OIL--AND TO THAT EXTENT THEY CONTINUE TO EXERCISE SOME INFLUENCE IN THAT MARKET. THE EMBARGO AND PRODUCTION CUTBACKS 1973-1974 DEMONSTRATED THE EXTENT OF OPEC CONTROL OVER WORLD PRICES AND OVER SUPPLY TO THE ENTIRE SYSTEM; BUT THAT CUTBACK IN SUPPLY ALSO DEMONSTRATED THE INABILITY OF OPEC TO CONTROL WHETHER OR NOT A SPECIFIC NATIONAL RECEIVED OIL. THIS IS AN IMPORTANT WEAKNESS IN THE THE CAPABILITY OF OPEC TO SELECTIVELY TARGET PRODUCTION CUTBACKS ON PARTICULAR COUNTRIES.

THE ROLE OF THE INTERNATIONAL COMPANIES IS CRUCIAL TO AN UNDERSTANDING OF THE REASON FOR THAT WEAKNESS; AND

THEIR CONTINUED CONTROL AND MANAGEMENT OF THE INTERNATIONAL DISTRIBUTION AND LOGISTICS SYSTEM, AS WELL AS THEIR EQUITY INTERESTS IN THE REFINING AND MARKETING OF INTERNATIONAL OIL, ARE THE PRINCIPAL COMPONENTS OF THEIR ROLE.

NOW, HAVING SET THE OVERALL CONTEXT, LET'S FOCUS ON SOME OF THE QUESTIONS AND IMPLICATIONS RAISED BY VARIOUS PROPOSALS THAT HAVE BEEN SET FORTH IN YOUR QUESTIONS.

AS FAR AS THE GENERAL QUESTION ON PRICE AND SUPPLY, WE MUST RECOGNIZE THAT POTENTIAL PURCHASERS CAN ENJOY LOWER OPEC PRICES ONLY IF OPEC NATIONS COMPETE WITH EACH OTHER, OR WITH OTHER ALTERNATIVE SUPPLIERS, TO SELL MORE AND MORE FOR LESS AND LESS. CONTROL OVER SUPPLY IS THE KEY, RATHER THAN THE NUMBER OF BIDDERS IN THE MARKET. OPEC MEMBERS HAVE NOT SHOWN A GREAT WILLINGNESS TO CUT PRICES TO COMPETE WITH EACH OTHER. IF ALTERNATIVE NON-OPEC SOURCES OF SUPPLY COULD BE DEVELOPED, THEN OPEC NATIONS WOULD FACE SOME GREATER DEGREE OF SELLING COMPETITION.

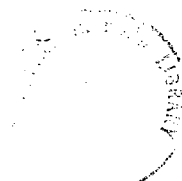
ON THE OTHER HAND, PROPOSALS FOR DIVESTITURE, FOR INCREASED REGULATION, OR IMPORT QUOTAS (SELF-IMPOSED EMBARGOES) WOULD NOT HAVE THE EFFECT OF INCREASING SUPPLY. AND EACH OF THOSE COULD ACTUALLY SERVE TO REDUCE TOTAL

WORLD SUPPLY OVER THE NEXT FEW YEARS BECAUSE OF FINANCIAL OR LEGAL DISRUPTION TO INVESTMENT IN EXPLORATION AND DEVELOPMENT AROUND THE WORLD AND IN THIS COUNTRY. THE ISSUE OF A U.S. IMPORT TARIFF, WHICH YOU HAVE ALSO RAISED, WAS DEBATED DURING MUCH OF 1975, AND PARTS OF THAT QUESTION REMAIN TO BE DECIDED BY THE SUPREME COURT. I DO NOT THINK WE NEED TO GO THROUGH THE HISTORY OF THAT DEBATE FOR THE RECORD HERE.

I WOULD LIKE TO MAKE A FEW POINTS ABOUT THE CONCEPT OF SHORE-LINE DIVESTITURE THAT YOU INTRODUCED IN YOUR LIST OF QUESTIONS AND ISSUES. FIRST, THOUGH THIS MAY SEEM TO BE AN ALTERNATIVE TO VERTICAL DIVESTITURE, WE FEEL THAT IT MIGHT ALSO BE A RESULT OF IT. IN OTHER WORDS, SHORE-LINE DIVESTITURE (OF INTERNATIONAL AFFILIATES FROM U.S. PARENT CORPORATIONS) COULD CONCEIVABLY BE CARRIED OUT BY SOME OF THE COMPANIES THEMSELVES IF THEIR CALCULATIONS OF THE IMPACT OF VERTICAL DIVESTITURE INDICATED THAT WOULD BE THE LESSER OF TWO EVILS.

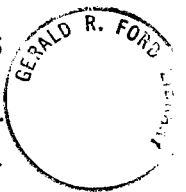
TO SKETCH THE CASE QUICKLY, OF THE 7 LARGEST OIL COMPANIES IN THE WORLD:

- 5 ARE U.S. BASED, BUT



- ONLY 15 PERCENT (3.5 MMB/D) OF THEIR WORLD TOTAL "CONTROLLED" PRODUCTION (22.6 MMB/D) IS IN THE UNITED STATES
- ONLY 23 PERCENT (6 MMB/D) OF THEIR WORLD TOTAL REFINING (25 MMB/D) IS IN THE UNITED STATES
- ALL DEPEND HEAVILY ON OPEC CRUDE EVEN TO SUPPLY THE U.S. MARKET
- ONLY A SMALL PART OF THE WORLD TANKER FLEET IS OFFICIALLY U.S. FLAG OR U.S. OWNED, BUT A LARGE PART OF THE TOTAL FLEET IS EFFECTIVELY CONTROLLED (OWNED OR LONG-TERM LEASED) BY U.S. COMPANIES.

THUS THE GREAT BULK OF THE HOLDINGS OF THESE COMPANIES (OFTEN THOUGHT TO BE "AMERICAN" RATHER THAN INTERNATIONAL) IS OUTSIDE OF THE UNITED STATES. WE, THE U.S. GOVERNMENT DOES EXERT CONSIDERABLE INFLUENCE OVER THOSE COMPANIES BECAUSE THEY ARE HEADQUARTERED HERE. WE TAX THEM, TELL THEM HOW TO ALLOCATE SUPPLIES, FIX PROFIT MARGINS AND TRANSFER PRICES, TELL THEM WHERE AND WHEN THEY CAN LOOK FOR OIL, BUILD REFINERIES, MERGE WITH OR EXCHANGE ASSETS WITH OTHER COMPANIES. AND WE CAN, AND DO, CHANGE MANY OF THE RULES WHEN WE FEEL THE GOVERNMENT AND THE AMERICAN PEOPLE WILL BENEFIT. BUT IF WE FORCE THOSE SAME COMPANIES TO DIVEST THE BULK OF THEIR ASSETS, DON'T WE ALSO DIVEST OURSELVES OF THE BULK OF OUR REAL AND POTENTIAL CONTROL? IT IS WORTH ASKING WHETHER OR NOT U.S. INTERESTS WOULD BE SERVED AS THE COMPANIES WERE WEAKENED.



WHERE WOULD THE COMPANIES MOVE? CANADA? BRITAIN? NORWAY? JAPAN? THE BAHAMAS? IRAN? WHO IS TO SAY? THE POINT IS THAT THOSE COMPANIES WOULD HAVE INTERNATIONAL MARKETS IN MANY OTHER PARTS OF THE WORLD, AND WOULD ALMOST CERTAINLY HAVE TO RELY HEAVILY UPON OPEC FOR PRODUCTION. COULD THEY BE PERSUADED TO CONCENTRATE NEW RESOURCE DEVELOPMENT THERE? THAT WOULD DEPEND UPON WHERE THE PROFITS AND LONG-TERM OUTLOOK WOULD BE BEST. BUT SURELY THEY WOULD BE LOST TO THE CONTROL OF THE UNITED STATES AND PERHAPS THAT OF OTHER CONSUMING COUNTRIES. AND SURELY THE DECISIONS OF THESE "FORMERLY AMERICAN" COMPANIES WOULD NOT BE OVERLY CIRCUMSCRIBED BY A FEELING OF GREAT INDEBTEDNESS TO THEIR FORMER HOST COUNTRY.


FURTHER, SINCE THE LAST EMBARGO, AN INTERNATIONAL ENERGY AGENCY HAS BEEN ESTABLISHED AND HAS PUT INTO PLACE AN INTERNATIONAL EMERGENCY PROGRAM. THIS IS A STEP OF MAJOR NATIONAL AND INTERNATIONAL IMPORTANCE AND ONE OF THE REAL ACCOMPLISHMENTS OF THE INTERNATIONAL ENERGY AGENCY. THE EMERGENCY PROGRAM DEPENDS UPON THE ABILITY OF THE OIL COMPANIES TO MANAGE SUPPLY AND DISTRIBUTION, PRESENTLY THE MAIN LINES OF DEFENSE IN THE EVENT OF ANOTHER EMBARGO OR SUPPLY DISRUPTION. IS IT THE CASE THAT IN FUTURE EMERGENCIES THE LIMITED SUPPLIES COULD STILL BE DIRECTED AS EASILY AMONG

SEPARATE INTERNATIONAL AND U.S. COMPANIES AS WITHIN SINGLE INTEGRATED FIRMS? WOULD VOLUNTARY ALLOCATIONS BY AND WITHIN EACH COMPANY NETWORK BE EFFECTIVE? OR WOULD CONSUMER NATIONS BE FORCED TO RELY ON INTERMEDIATE MEASURES, OR EVEN PERHAPS OR RATIONING AND THE OTHER STRINGENT MANDATORY ACTIONS CALLED FOR IN THE EMERGENCY PROGRAM? WOULD ANY OF THE MEASURES BE EFFECTIVE IF THE U.S. HAD GIVEN UP ITS POWER AND CONTROL OVER THE COMPANIES. WOULD U.S. DIVESTITURE THUS IMPACT DIRECTLY ON THE SECURITY AND POLITICAL/ECONOMIC INTERESTS OF OUR IEA PARTNERS? THERE ARE QUESTIONS THAT SHOULD BE OF CONCERN TO US AND TO OUR FELLOW MEMBERS OF THE IEA.

BUT BEYOND THAT, WOULD THE ABILITY OF PRODUCERS TO TARGET AND EMBARGO BE REDUCED OR ENHANCED BY U.S. DIVESTITURE LEGISLATION? WOULD DIVESTED U.S. DOMESTIC COMPANIES, AND THE NON-U.S. INTERNATIONALS WITH WHOM THEY DEAL THROUGH SALES BE EASIER TO POLICE? WOULD THAT ABILITY, ALMOST TOTALLY LACKING IN 1973, BE MUCH MORE REAL IF THERE WERE NO U.S. BASED COMPANIES WITH WORLDWIDE NETWORKS, IF A MUCH SMALLER PART OF THE WORLD TANKER FLEET WERE UNDER EFFECTIVE U.S. CONTROL, AND IF THERE WERE NO INTERNATIONAL OIL COMPANIES WITH DOWNSTREAM MARKET INTERESTS TO PROTECT IN THIS COUNTRY? UNDER THE BEST CONDITIONS, AT THE VERY LEAST THE NEW INTERNATIONAL COMPANIES WOULD HAVE TO BE BROUGHT INTO THE IEA -- THAT IS IF THEY REMAINED BASED WITHIN IEA COUNTRIES RATHER THAN MOVING TO OPEC NATIONS.

FURTHER, AND ON A DIFFERENT SCALE, IT SHOULD BE REMEMBERED THAT THE NEW U.S. COMPANIES, THOUGH FORCED BY DIVESTITURE TO FIND NEW SUPPLY SOURCES, WOULD STILL SEEK ASSURED ACCESS TO SUPPLY. STATE OIL COMPANIES OF THE PRODUCING COUNTRIES AND THE INTEGRATED FOREIGN OIL COMPANIES COULD PROBABLY FULFILL THIS ROLE WITHOUT BEING IN ILLEGAL "CONTROL" OF THESE REFINERS, BUT WITHOUT NECESSARILY SHARING THEIR INTERESTS IN CASE OF EMBARGOES OR POLICY CONFLICTS. THE PRODUCTION/SERVICE COMPANIES IN THE OPEC COUNTRIES MIGHT NOT BE ABLE TO FULFILL THE ENVISIONED LONG-TERM SUPPLY OFFTAKE ROLE THROUGH DIVESTED U.S. COMPANIES.

THIS WOULD BE IMPORTANT TO NATIONS AS WELL AS COMPANIES BECAUSE, AS I HAVE SAID, THE COMPANIES ACT AS THE VITAL LINKAGE MECHANISM BETWEEN OPEC AND THE CONSUMERS. BUT FURTHER, THE IMPACT ON FUTURE MARKETS COULD BE CONSIDERABLE. ARAMCO, FOR INSTANCE, WILL BE INVOLVED IN BETWEEN 20 AND 25 PERCENT OF ALL OPEC OIL EXPORTS. SAUDI ARABIA WILL HAVE MOST OF THE EXCESS PRODUCTION CAPACITY IN THE WORLD. THE MERE SIZE OF THE RESERVES, THE EXCESS CAPACITY, THE SIZE OF THE U.S. MARKET, AND THE POTENTIAL AND PROVEN ABILITY OF INTERNATIONAL INTEGRATED COMPANIES TO ALLOCATE AROUND "TARGETED" COUNTRIES IN AN EMBARGO MAKE THIS A SUPPLY SECURITY CONSIDERATION THAT COULD DETERIORATE IF THE COMPANIES WERE BROKEN UP.

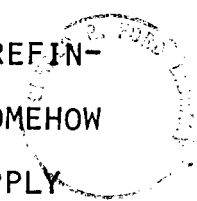


AT THE PRESENT STAGE OF THE NEGOTIATIONS, THE OWNER-COMPANIES OF ARAMCO ARE TRYING TO GET A SUPPLY COMMITMENT FROM SAUDI ARABIA. THEY ARE TALKING ABOUT 7 MMB/D OR SO.

IF THOSE COMPANIES ARE THEN CUT OFF FROM OR GIVEN SHARPLY REDUCED ACCESS TO U.S. MARKETS, WHAT WILL BE THE IMPACT FOR U.S. SUPPLY SECURITY? EVEN IF THE ARAMCO PARTNERS DON'T BUY SO MUCH, OTHER COMPANIES MAY, OF COURSE--BUT WILL THE PRICE TO THEM BE HIGHER OR LOWER? WHAT WOULD A CHANGED TRADE FLOW MEAN TO OUR ALLIES?

NONE OF THESE QUESTIONS CAN BE ANSWERED WITH TOTAL CERTAINTY, AND NONE OF THE POTENTIAL OUTCOMES CAN BE PREDICTED ABSOLUTELY, BUT ALL MUST BE WEIGHED BEFORE ANY INTELLIGENT DECISION CAN BE REACHED ON THE OVERALL ISSUES THIS COMMITTEE HAS RAISED.

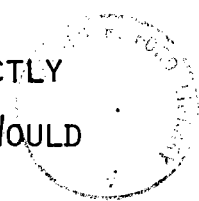
ON THESE POINTS, SOME MIGHT ARGUE THAT THE PRICE IS WORTH PAYING--THAT A GREATER U.S. GOVERNMENT ROLE AS A REGULATOR OR A PURCHASER FOR IMPORT, OR CONVERSELY, THAT FORCING ARMS-LENGTH DEALINGS BETWEEN U.S. REFINERS AND OPEC MAY BE ADVANTAGEOUS. THIS IS A CRITICAL JUDGMENT. IT ASSUMES EITHER THAT: 1) A GOVERNMENT BODY WITH NO DIRECT INTERNATIONAL OIL EXPERIENCE IN EXPLORATION, PRODUCTION, REFINING, NEGOTIATION OR LOGISTICS COULD PERFORM BETTER SOMEHOW THAN THE COMPANIES, AND THUS ENHANCE OUR PRICE OR SUPPLY



SECURITY POSITION; OR 2) THAT 18 OR 22 OR SOME OTHER NUMBER OF U.S. COMPANIES WITHOUT INVOLVEMENT IN PRODUCING COUNTRIES COULD MAINTAIN OR INCREASE THE DEGREE OF NATIONAL AND INTERNATIONAL SUPPLY SECURITY AND, AT THE SAME TIME DRIVE A HARDER BARGAIN ON PRICE WITH THOSE GOVERNMENTS THAN THE PRESENTLY INTEGRATED FIRMS.

PROBABLY BOTH OF THOSE ASSUMPTIONS ACTUALLY RESTS ON ANOTHER, MORE BASIC ASSUMPTION--THAT SOMEHOW, FOR SOME REASON, THE COMPANIES AND OPEC REALLY ARE IN EVIL PARTNERSHIP TO DO HARM TO CONSUMING GOVERNMENTS AND CITIZENS. ANTHONY SAMPSON MAKES THIS CLAIM IN HIS BOOK, THE SEVEN SISTERS. I AM AFRAID THAT, AS WELL AS HE WRITES AND AS SMART AS HE MAY BE, MR. SAMPSON MISUNDERSTANDS THE OIL INDUSTRY AND COMMERCE AND BUSINESS IN GENERAL.

WITH OR WITHOUT FORMAL AGREEMENT, SUCCESSFUL PRORATIONING OF OPEC PRODUCTION RESTS UPON THE CONTINUED WILLINGNESS OF ARABIAN PENINSULA PRODUCERS -- ESPECIALLY SAUDI ARABIA -- TO HOLD BACK PRODUCTION DISPROPORTIONATELY FOR THE SAKE OF THE CARTEL. THE SMALLER THE MARKET FOR OPEC OIL -- WHETHER DUE TO REDUCED DEMAND OR ADDITIONAL SUPPLIES FROM ALTERNATE SOURCES -- THE MORE COSTLY AND DIFFICULT BECOMES A PRORATIONING SCHEME. WOULD DIVESTITURE INDIRECTLY OR DIRECTLY ALTER TOTAL DEMAND FOR, OR TOTAL SUPPLY OF, OPEC OIL? WOULD



INCREASED U.S. GOVERNMENT INVOLVEMENT? THE KEY QUESTION FOR THE SWING PRODUCERS WOULD REMAIN UNCHANGED: WHAT IS THE ECONOMIC AND POLITICAL VALUE OF THE CARTEL TO THEM IN MAXIMIZING THE ADVANTAGE OF THEIR SINGLE RESOURCE? THAT VALUE SEEMS TO BE HIGH.

THE KEY QUESTION FOR THE UNITED STATES IS: WHAT WOULD HAPPEN TO OUR EFFORTS TO REDUCE OUR DEPENDENCE ON IMPORTED ENERGY OR EVEN EFFORTS TO DIVERSIFY SOURCES OF SUPPLY? FOR ANY OF THE ALTERNATIVES TO BE DISCUSSED -- DIVESTITURE, ADDITIONAL REGULATION, ACTIVE U.S. GOVERNMENT PARTICIPATION IN BILATERAL OR MULTILATERAL NEGOTIATIONS, OR OTHERS -- WE MUST IDENTIFY AND EVALUATE BOTH THE DOMESTIC AND INTERNATIONAL COSTS AND BENEFITS. WE MUST CONSIDER THE EFFECTS: ON THE U.S. AND THE IEA COUNTRIES AND OUR RELATIONSHIP WITH OPEC; ON NATIONAL AND INTERNATIONAL SUPPLY SECURITY; AND UPON THE PRICE OF OIL IN THE WORLD AND IN THIS COUNTRY. AND ALL OF THESE QUESTIONS MUST BE ANSWERED IN THE CONTEXT OF THE WORLD SUPPLY/DEMAND OUTLOOK FOR THE NEXT DECADE OR BEYOND. THIS IS WHAT WE TRIED TO DO WHEN WE WORKED TO PUT TOGETHER THE ADMINISTRATION'S ENERGY PROGRAM. WE FEEL THAT ALTERNATIVE PROGRAMS MUST BE EXPANDED AS RIGOROUSLY AND MUST PASS THAT SAME TESTS.



OUR ASSESSMENT OF A NUMBER OF ALTERNATIVE GOVERNMENT-INDUSTRY RELATIONSHIPS INDICATES THAT THE BENEFITS ARE OFTEN DIFFICULT TO FIND, THOUGH THE COSTS ARE POTENTIALLY VERY GREAT. MOST OF THE ALTERNATIVES WOULD DO NOTHING TO INCREASE DOMESTIC PRODUCTION OR EVEN TO DIVERSIFY OUR SOURCES OF IMPORTED OIL. MOST WOULD PROBABLY INDUCE CONSERVATION ONLY TO THE DEGREE THAT THEIR HIGHER COSTS WOULD DO SO. AND AT THE SAME TIME, OUR DOMESTIC PRODUCTION WOULD CONTINUE TO DECLINE.

THIS ASSESSMENT IS NOT MEANT TO INDICATE THAT THERE ARE NO CONDITIONS UNDER WHICH I WOULD FAVOR LEGISLATIVE OR ORGANIZATIONAL CHANGES IN THE RELATIONSHIP BETWEEN THE U.S. GOVERNMENT AND THE INTERNATIONAL OIL COMPANIES. AS I HAVE TRIED TO POINT OUT, MY MAJOR CONCERN IS THAT ANY PROPOSAL BE EVALUATED SO THAT ANY CHANGE CAN BE CLEARLY DEMONSTRATED TO BE A CHANGE FOR THE BETTER. I AM AFRAID THAT THE PROPONENTS OF THE VARIOUS ALTERNATIVES HAVE YET TO MAKE THAT CASE. I FEEL THAT THE ADMINISTRATION'S ENERGY PROGRAM HAS HAD THAT CASE MADE. NOW WE MUST MOVE TO IMPLEMENT IT BY TAKING THE NEXT SERIES OF STEPS BEYOND THE EPCA.

I WOULD BE HAPPY TO ANSWER ANY QUESTIONS YOU MAY HAVE.

