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STATEMENT OF
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BEFORE THE
SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
SENATE COMMITTEE ON ENERGY AND
NATURAL RESOURCES
ON THE STRATEGIC PETROLEUM RESERVE

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to be here today to discuss issues relating to the Strategic Petroleum Reserve (SPR). We have followed the SPR program since its inception and have issued numerous reports on matters affecting the Reserve. At the request of the full Committee, we report quarterly on SPR activities. Also, we recently completed a series of reports that evaluated administration documents submitted to the Congress under the Energy Emergency Preparedness Act of 1982.

My testimony today is based primarily on this work and focuses on the SPR's fiscal year 1983 fill rate and the administration's budget request for fiscal year 1984. In addition, I will comment on the concerns we have about the adequacy of the administration's plan for using the SPR and other aspects of the administration's energy emergency preparedness program.

First, however, I would like to emphasize the importance of the SPR to the Nation's ability to respond to energy emergencies. The SPR is the cornerstone of the administration's energy emergency preparedness program; and, in fact, is virtually the only major mechanism presently available to deal with an energy supply disruption.

STATUS OF SPR AND FILL RATES PLANNED

The administration has made good progress in filling the SPR. Of the 318 million barrels of oil in the SPR as of April 30, 1983, about 70 percent was added during the past 2 years. As of April 30, the fiscal year 1983 fill rate has averaged 188 thousand barrels per day (MBD) and the Department of Energy (DOE) plans to average 220 MBD for the entire fiscal year. This will require increasing the average daily fill rate to about 265 MBD during the remaining five months of the fiscal year.

DOE currently has funds available which could enable it to reach an even higher average fill rate for the fiscal year--about 288 MBD. However, because of budgetary concerns and the improved energy supply situation, the administration would prefer to keep the average fill rate at 220 MBD for fiscal year 1983 with even lower levels in subsequent years. The 1984 budget submission calls for fill rates of 145 MBD in fiscal year 1984 and 100 MBD in subsequent years.

There are several issues concerning the fill rate plans that I would like to discuss in more detail. First, we have reported a deferral under the Impoundment Control Act. Second, I will discuss the effects of the administration's proposal to lower the fill rates in fiscal year 1984 and subsequent years.

DEFERRAL OF OIL ACQUISITION FUNDS

The Energy Emergency Preparedness Act requires a minimum average annual fill rate of at least 300 MBD until there are 500 million barrels in the Reserve. However, the act allows a lower fill rate if the President finds that the 300 MBD rate would not be in the national interest for a particular fiscal year. On

December 1, 1982, the President made such a finding for fiscal year 1983. With the finding, the act requires a minimum fill rate of at least 220 MBD, or the highest practicable fill rate achievable with available funds.

The act's clause "* * *the highest practicable fill rate achievable, subject to the availability of appropriated funds" has caused some confusion over the minimum fill rate required by the act for fiscal year 1983. DOE and the Office of Management and Budget (OMB) have interpreted the act's requirements differently. DOE views the act to require that all funds available--the $2.1 billion appropriated for fiscal year 1983 and $2.4 billion carried over from prior years--be used to determine what is available for achieving the highest practicable fill rate. In DOE's view, the term "practicable" gives DOE discretion to decide not to buy oil at prices which needlessly increase the cost of SPR oil. At prices DOE is currently paying, the $4.5 billion could support a fiscal year 1983 fill rate of about 288 MBD and cover advance purchases for the first 6 months of fiscal year 1984. However, DOE believes that the highest practicable fill rate may be lower than 288 MBD.

OMB, on the other hand, believes that funds carried over from prior fiscal years should not be counted in determining the fiscal year 1983 fill rate requirement. OMB believes that the planned 220 MBD fill rate is in compliance with the act.

We agree with DOE's position that all unexpended current and prior year balances should be considered as available funds for purposes of calculating the highest practicable fill rate. We recognize, however, that factors relating to prudent

management may be taken into account when determining what fill rate is practicable.

Accordingly, we are reporting to the Congress a deferral under the Impoundment Control Act of $800 million of funds in the SPR Petroleum Account. Our estimate of the amount deferred is based on our calculation of the amount that will not be used if DOE limits the average fill rate for fiscal year 1983 to 220 MBD and carries out current plans to enter into contracts for oil delivery in the first 6 months of fiscal year 1984. If the deferral is disapproved by one House of Congress, DOE would be required to use all the available funds to fill the SPR. As I indicated earlier, we estimate that, at current prices, available SPR funds would support a fiscal year 1983 fill rate of about 288 MBD.

In deciding whether to take action on the deferral, Congress needs to consider several important questions. First could DOE increase the fill rate to 288 MBD in this fiscal year? Second, do the benefits outweigh the costs associated with the higher rate?

Our discussions with DOE and the Defense Fuel Supply Center (DFSC), DOE's purchasing agent for much of the SPR oil, indicate that it may be possible to achieve the 288 MBD fill rate for the fiscal year. However, to do so, DOE would have to overcome several significant constraints involving oil purchases and storage requirements.

Constraints to meeting the 288 MBD fill rate

The most significant constraint stems from the need to acquire private interim storage capacity. By the end of fiscal

year 1983, DOE expects to have about 362.1 million barrels of storage capacity available at the SPR sites. This would be about 21 million barrels less than needed to accomodate a 288 MBD average fill rate. Consequently, DOE would have to acquire private interim storage capacity. DOE has estimated that it would cost up to $90 million per year to store this oil and that the oil may have to be stored for 2 years. Also, DOE program officials believe that the contracting process to acquire such storage could take at least 90 days and it would have to begin almost immediately to allow time for oil deliveries to these facilities in the last quarter of fiscal year 1983. DOE has prepared but has not issued the Invitation for Bids for the additional storage capacity.

Another potential constraint is that DOE would need to substantially accelerate the last quarter fill rate--to about 497 MBD--to reach 288 MBD year-end average. Filling at this rate would require purchases of an additional 25 million barrels of oil during the last quarter of the year and would increase the chance that logistical problems might occur. According to DFSC, its ability to purchase this quantity of oil depends on the amount of advance notice provided by DOE and on the amount of oil offered by suppliers in the solicitation process. DFSC said it needs about 30 days to arrange oil deliveries. In addition, unless oil companies or traders offer to sell the required quantities of oil at prices that DFSC considers to be reasonable, DFSC may not be able to buy the oil. DFSC is constrained to some extent in purchasing oil by provisions of the Energy Policy and Conservation Act that call for SPR oil to be acquired in a

manner that minimizes the cost of the SPR and the impact on the oil market.

In summary, in order to meet the 288 MBD fill rate actions need to be taken very soon. Also, an early decision by the Congress on this deferral is needed so that sufficient time will be available to acquire the additional oil. As I mentioned earlier, DOE believes it will take about 90 days to acquire interim storage and DFSC says it needs at least 30 days to arrange for oil deliveries. If the additional oil is to be delivered in the fourth quarter, DFSC would need to begin ordering in early June.

Factors to Consider Regarding the Deferral

In making the decision on whether to overturn the deferral a number of factors should be considered. These factors include the impact on SPR inventory, the time saved in increasing the SPR inventory, the costs associated with the higher rate, and the potential impact on the fiscal year 1984 appropriation level.

Filling at 288 MBD in fiscal year 1983 would add about 25 million barrels to the Reserve by year end. This would provide an additional 15 days of oil at the SPR's current 1.7-million-barrel per day drawdown capability.

The effects of this higher fill rate on the SPR completion schedule depends on future fill rates. For example, a 288 MBD fill rate in fiscal year 1983 will achieve a 383 million barrel inventory 4 months earlier than filling the reserve at a constant rate of 220 MBD. The higher fill rate will also reach the 383 million barrel level 6 months earlier than if the fiscal

year 1983 fill rate is held to 220 MBD and the fiscal year 1984 fill rate is limited to the administration's 145 MBD rate.

Another factor to be considered is the costs asociated with the 288 MBD fill rate. This rate could require DOE to spend about $75 million to $90 million during the next year for private interim storage capacity. In addition, if the fiscal year 1984 fill rate is 220 MBD or higher, it would be necessary to keep the oil in the interim storage facilities for an additional year since the available storage capacity at the SPR sites planned for fiscal year 1984 could accomodate only up to a 220 MBD fill rate. An additional factor to consider, which could be either an advantage or disadvantage, is the cost of the additional oil purchased at the 288 MBD rate. If oil prices rise, then the amount paid for this oil would be less than what it would cost in the future. Alternatively if prices drop, the price paid for the additional oil would be higher.

The final factor to be considered that I would like to discuss, Mr. Chairman, is the fact that if available funds are used this year to achieve the 288 MBD rate, the Congress would need to appropriate additional funds for fiscal year 1984 oil purchases.

As can be seen, a decision on overturning the deferral will involve some difficult tradeoffs. The SPR inventory can be increased in less time, but additional cost may be incurred to store the oil in interim storage facilities. These costs may be increased or decreased depending on future oil prices. As mentioned earlier, the timing of a decision on the deferral also

impacts on the likelihood of the higher rate actually being achieved.

Let me now turn to the administration's fiscal year 1984 budget proposal.

ADMINISTRATION'S PROPOSAL TO REDUCE THE SPR FILL RATE FOR FISCAL YEAR 1984 AND BEYOND

The administration's fiscal year 1984 SPR budget proposes reducing the fill rate to 145 MBD in fiscal year 1984 and to 100 MBD in fiscal years 1985 and 1986. The justifications the administration cited for the reduced oil fill rates are that it is necessary to restrain Federal spending to the maximum extent possible because of the economic problems that face the Nation and, considering the status of the SPR and the world oil market, the Nation is not as vulnerable to supply interruptions. In deciding on this proposal, in addition to considering the administration's justification, it may be useful to consider some of the other effects of the proposal. The proposed fill rates would (1) be considerably lower than the fill rates set forth in the Energy Emergency Preparedness Act, (2) further delay reaching the 500-million-barrel goal of the act, (3) impact on the withdrawal capability of the SPR, and (4) result in not using all available permanent storage capacity.

The fill rates proposed by the administration are significantly lower than those envisioned by the Congress in passing the Energy Emergency Preparedness Act. As discussed previously, the act requires a minimum average annual fill rate of at least

300 MBD unless the President finds that this rate is not in the national interest. In such cases, the minimum fill rate becomes 220 MBD or the highest practicable rate achievable with available funds. The proposed 145 MBD fill rate for fiscal year 1984 is less than half of the 300 MBD rate and the proposed 100 MBD rate in fiscal year 1985 and 1986 is about one-third of the 300 MBD rate.

The fill rates proposed by the administration would extend the time needed to achieve a 500-million-barrel reserve by about 2 years. In establishing the minimum fill rate requirements of the Energy Emergency Preparedness Act, the Congress demonstrated the importance it attached to filling the SPR to a minimum 500-million-barrel level. Increasing the fill rate to 300 MBD after fiscal year 1983 would allow this goal to be reached by January 1985. Maintaining the post-fiscal year 1983 fill rate at 220 MBD would delay reaching this target by about 6 months, until July 1985. The administration's proposed fill rates of 145 MBD in fiscal year 1984 and 100 MBD thereafter would delay reaching this goal by more than 2 years until March 1987.

The fill rates proposed by the administration also delay DOE's ability to increase the withdrawal capability for the SPR. Currently, the SPR can be withdrawn at a rate of 1.7 million barrels per day for about 4 months when the drawdown rate would gradually decrease before being exhausted about 5 months later. A 500-million-barrel Reserve could be drawdown at a rate of 3.5 million barrels per day for 3 months and at a declining rate for another 3 months. Although the larger

Reserve would be exhausted sooner at the maximum drawdown rate, it allows more flexibility to match the drawdown rate to the Nation's needs in the event of a supply disruption. This underscores the value of a larger Reserve size.

Finally, the lower fill rates proposed by the administration would not fill all of the permanent storage capacity available. Unused permanent storage capacity could grow from over 16 million barrels in fiscal year 1984 to about 54 million barrels in fiscal year 1986. In addition to permanent storage capacity, DOE recently determined that it may be able to temporarily store an additional 17.9 million barrels at the SPR sites by the end of fiscal year 1984. This additional temporary storage capacity also would be unused at the proposed fill rates.

Fiscal Year 1984 Funding Decisions Needed on Big Hill Development

In addition to a decision on the SPR fiscal year 1983 fill rate, the Congress needs to address the future development schedule and the fiscal year 1984 appropriations level for the new Big Hill storage site. DOE previously planned to begin storing oil at the Big Hill site in fiscal year 1986 and to complete filling the 140-million-barrel site in fiscal year 1989. This would complete the 750-million-barrel SPR. If this schedule is to be met, construction needs to begin in fiscal year 1984. However, the administration has proposed delaying development of the Big Hill site. It reported a deferral of fiscal year 1983 funds and did not request construction funds for fiscal year 1984. In March 1983, Congress indicated its commitment to completing the 750-million-barrel SPR by overturning the administration's deferral.

The future development schedule of the Big Hill site and the timing of the completion of the 750-million-barrel SPR will be impacted by the congressional decision on the fiscal year 1984 budget. DOE has estimated that about $360 million in additional appropriations would be needed in fiscal year 1984 to get the Big Hill site back on schedule.

I would now like to turn your attention to our concerns about the adequacy of the administration's plans to use the SPR and other aspects of its energy emergency preparedness program.

SPR DRAWDOWN PLANNING

In the final analysis of course, the entire SPR program will be only as effective as our ability to drawdown the stocks in a timely and effective way. The Energy Emergency Preparedness Act required the administration to submit its plans for the use of SPR stocks to the Congress to December 1982. The act stipulated that the Drawdown Plan should provide information about alternative SPR use strategies under different disruption scenarios. In a January 1983 report to the full Committee, in which we evaluated the drawdown plan, we noted that it provided little specific information about the conditions under which the SPR could be used. This includes the amount, rate, and timing of its use.

The degree to which the SPR could be effective during a disruption depends on a number of variables. For example, it could be more or less effective depending on the status of factors such as: oil inventory levels at the time of the disruption, production/consumption patterns, price movements during

a disruption, and other nations' stock levels and stock use policies. There is little evidence that the administration is incorporating these important factors in its SPR use policy.

More thorough advance planning could be very important to the Government's ability to act quickly during a disruption. It could also help reduce panic buying by assuring the oil industry and consumers that the reserve is available for use if necessary. Panic buying has been shown to be a principal cause of price increases in past disruptions. Better planning could also allow the Government to more easily coordinate stock drawdown with our allies, and it could help to deter oil embargoes against the United States by demonstrating our ability to counteract them.

Overall Preparedness for Oil Emergencies

Finally, Mr. Chairman, the status of the SPR program should be viewed in the context of our overall preparedness for oil emergencies. While the SPR is the cornerstone, the administration has indicated its intention to act on other fronts during a disruption. Our latest evaluation of the status of all emergency preparedness programs was made in a report to the full committee in February of this year. While I won't go into these findings in this testimony unless the Subcommittee has specific questions, I will note that we found numerous implementation problems and a general lack of preparedness in many areas. This included areas such as the Executive Manpower Reserve, the role of private oil stocks, and potential conflicts between Federal and State regulations for dealing with disruptions.

In closing, I would like to summarize the major points I raised today:

--The deferral of funds which we reported gives Congress the opportunity to require a fill rate of 288 MBD in fiscal year 1983.

--In making a decision on the deferral, Congress should consider the impact of the 288 MBD fill rate, which disapproval of the deferral could allow, on the SPR inventory, the time saved in reaching the 500-million-barrel level, the associated costs and the need for fiscal year 1984 appropriations.

--The administration's fiscal year 1984 budget proposal recommends reducing the fill rate for fiscal year 1984 and beyond.

--Decisions on fiscal year 1984 appropriations should consider the administration's justifications for the reduced fill rates as well as their effects on the time needed to reach the 500-million-barrel level, the impact on the drawdown capability, the amount of unused permanent storage capacity, and the implications of not meeting the fill rates contemplated by Congress in passing the Energy Emergency Preparedness Act.

--A decision is also needed on the levels of fiscal year 1984 appropriations for the new Big Hill site. This will provide an indication of the intent of the Congress on the future development and fill schedule for the SPR.

--The status of the SPR program should be viewed in the context of the Nation's overall preparedness for oil emergencies. However, we have found numerous implementation problems and a general lack of preparedness in many areas.

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