



Testimony

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Alternative Financing Methods for  
the Strategic Petroleum Reserve

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Before the  
Subcommittee on Energy and Power  
Committee on Energy and Commerce  
House of Representatives



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Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to discuss our analysis of alternative, nontraditional methods of financing the Strategic Petroleum Reserve (SPR). My testimony today reflects the information contained in our recent report to you, Strategic Petroleum Reserves: Analysis of Alternative Financing Methods (GAO/RCED-89-103, Mar. 16, 1989).

The SPR represents a U.S. investment of close to \$17-18 billion and may require future expenditures of between \$5 and \$6 billion to bring its inventory to 750 million barrels of crude oil and to enhance drawdown capability and improve distribution capacity. Particularly during this period of budget austerity, these expenditures are significant. As the Comptroller General has pointed out, the budget deficit is among the most urgent issues facing the administration and the Congress. Unless this problem is solved, it will hamstring the nation's ability to achieve vital policy goals, such as filling the SPR.

#### RESULTS IN BRIEF

While most of the alternative financing proposals we examined have some advantages, all of them also have economic costs or other disadvantages which do not allow us to recommend one as superior to the current method of financing the SPR. For example, some proposals, such as new taxes or user fees, would reduce the budget deficit by increasing government revenues, but would raise prices to the consumer. Other proposals, such as leasing oil or indexed bonds, could reduce short-term expenditures, but might increase long-term expenditures by more than the initial reduction in outlays.

Some proposals, such as selling equity in the SPR, involve exchanging future government profits on the value of oil already in the SPR (should oil prices rise in the future) for lower current

expenditures. Other proposals would establish a separate SPR entity. If the SPR entity is off-budget, its expenditures would not be reported in the budget. However, if the government provides funding to the entity, that funding would count against the deficit.

Before I discuss in greater detail our analysis of various types of alternative financing, I will provide a brief background on the SPR's role and importance, its current status, and the current method of financing it.

#### THE SPR PLAYS A KEY ROLE IN U.S. ENERGY SECURITY

The SPR, authorized by the Energy Policy and Conservation Act (Public Law 94-163, Dec. 22, 1975), as amended, is the nation's first line of defense in an oil supply disruption. By law it may not be drawn down and the oil distributed unless the President determines that a severe energy supply interruption has occurred or that drawdown is necessary to fulfill U.S. obligations under the international energy program.

The Department of Energy (DOE) is responsible for the SPR's management, maintenance, operation, and construction, including buying and storing the oil. In the event of a drawdown, DOE would administer the withdrawal and sale of the oil from the SPR. DOE currently plans to auction the oil to the highest bidders at drawdown.

Current trends point to increased importance of the SPR over the next decade. In our recent report, Energy Security: An Overview of Changes in the World Oil Market (GAO/RCED-88-170, Aug. 31, 1988), we found that while the United States, like other major oil-importing countries, is less vulnerable to an oil crisis today than it was a decade ago, certain developments may over time

increase our vulnerability. For example, U.S. domestic production is decreasing, and imports are increasing. In the 1990s the world oil market may again become tight and production may become increasingly concentrated in the Middle East. We believe that the United States can reduce its vulnerability to a potential oil supply disruption by, among other measures, continuing to build the Strategic Petroleum Reserve.

#### THE SPR'S CURRENT STATUS

As of April 1989, over 560 million barrels of the currently planned 750 million barrels of oil were stored in the SPR. In fiscal year 1988, DOE disbursed \$338 million from the SPR petroleum account for the acquisition and transportation of 20.8 million barrels of oil. On the basis of the amounts appropriated and the market price of oil, DOE currently expects a fill rate of 60,000 to 65,000 barrels per day during fiscal year 1989.

The SPR is currently funded through annual appropriations by the Congress. The sources of these funds are general government revenues from, for example, taxes, duties, or borrowing. Most government expenditures are funded in this way, and SPR expenditures, for most of the SPR's history, were included in the annual budget. The Omnibus Budget Reconciliation Act of 1981 established the SPR Petroleum Account, the account that pays for SPR oil acquisition and transportation, as an off-budget account. However, in 1985, as part of the effort to control government expenditures, the Gramm-Rudman-Hollings Act brought this account back on the budget.

#### GAO'S ANALYSIS OF SPR FUNDING PROPOSALS

We examined approximately 40 alternative financing proposals for the SPR. We compared the alternatives that we identified to the current method of acquiring and financing SPR oil through

congressional appropriations that are reported in the budget. Our comparison covered (1) short- and long-term acquisition and financing costs to the government, (2) the effect on the budget and national debt, and (3) other key considerations, such as who would control the SPR oil.

We did not, however, quantify the costs or benefits of specific proposals. Instead we focused on the likely impact of the proposals from a broader perspective--for example, whether a proposal would tend to increase or decrease annual expenditures or the national debt. We also did not attempt to analyze all possible combinations of the proposals.

For clarity we grouped our analysis of the proposals into three broad categories, those that

- increase government revenues by selling financial instruments such as bonds, increasing taxes or user fees, selling government assets or using receipts from revenue-producing assets, or selling futures or option contracts and dedicating these revenues to the acquisition of oil for the SPR;<sup>1</sup>
- acquire oil by means other than outright purchase, such as renting or leasing, mandating that firms contribute oil to the SPR, or providing inducements to encourage private SPR contributions; and
- set up a separate SPR entity to handle financing or acquire oil and manage the SPR.

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<sup>1</sup>GAO is currently reviewing dedicated funding and will be issuing a report on this subject in the near future.

## Revenue-raising Alternatives

Revenue-raising alternatives include special bonds and taxes, asset sales and receipts, and futures and options contracts. These proposals generally address the means by which the government could raise money for funding the SPR, but they do not directly affect the purchase price of oil or other SPR costs. In practice, revenue raised in these ways could be used to finance any government expenditure--not just to purchase SPR oil. However, these proposals dedicate the revenues to funding the SPR.

The proceeds obtained from issuing special bonds to purchase SPR oil would substitute for conventional debt (i.e., the issuance of Treasury securities), which is normally used, when necessary, to finance government expenditures. If these bonds can be sold at a lower interest rate than comparable Treasury offerings by, for example, indexing the face value of the bonds to the price of oil, then the government's interest cost might be reduced. However, if the price of oil rises, the government will have to repay a greater amount when the bonds come due. This additional amount may or may not be more than the interest saved over the life of the bond on a discounted present value basis.<sup>2</sup>

Additional revenues received from new or increased taxes or asset sales, such as the sale of government land, would lower the current budget deficit to the extent that they result in additional income and budget expenditures are not increased. However, new taxes, such as a dedicated gasoline tax or a tax on petroleum

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<sup>2</sup>The discounted present value, also known as the net present value, is a concept that allows meaningful comparison of dollar flows, either money received or money spent, that occur at different times. In general, revenues to be received in the future are worth less than equal revenues on hand today because money on hand can be invested to yield a higher amount in the future or, in the case of the federal government, it can reduce the amount borrowed. The farther into the future the expected revenues or costs are, the less value they have in today's dollars.

products, would increase the price consumers pay for these products. Furthermore, the sale of a revenue-producing asset, such as the Naval Petroleum Reserve (NPR), would result in the loss of future revenue. The sale price of a revenue-producing asset would need to reflect the discounted present value of future revenues for the government to avoid a loss. In our view, asset sales should be evaluated on their own merits. We have consistently recommended against asset sales and other proposals that would reduce outlays and the deficit in the short term, but lead to higher deficits in the long run. Furthermore, the proceeds of most asset sales are excluded from the calculation of the budget deficit for purposes of the Gramm-Rudman-Hollings procedure.

The sale of options contracts on currently stored SPR oil could also raise some revenue for the purchase of additional oil for the reserve. An options contract would give the purchaser the right (but not the obligation) to buy SPR oil at an agreed-to price on an agreed-to date. Such contracts might be attractive to firms that wish to ensure that they have access to oil should a disruption occur. To retain control of SPR oil until a disruption occurs, DOE could sell options contracts at a price that reflects the expected price of oil during a disruption. However, the per barrel selling price of such an options contract is likely to be low, reflecting that under current market conditions the risk of a disruption is also low. Therefore, this proposal is not likely to raise enough revenue for the government to purchase meaningful quantities of oil for the SPR. Selling options contracts at a disruption price, however, may be desirable as an energy policy alternative to facilitate early distribution of SPR oil.

## Alternative Ways of Acquiring Oil

Alternative ways of acquiring oil (other than the current method of government purchases) include renting and leasing, and compulsory or induced private contributions. The government could rent or lease oil at an initial cost less than outright purchase; but over several years, this alternative is likely to prove more costly since the "rent" is likely to reflect both the private sector's higher cost to borrow money and its desired profit. In addition, lease proposals might complicate drawdown unless the question of whose oil (the government's or the lessor's) is withdrawn first in an emergency is settled during negotiation of the lease.

The government, under existing provisions of SPR legislation, could require the private sector to store oil, to which the private sector retained title, in the SPR. On the other hand, the private sector might be induced to store oil in the SPR in return for some form of compensation, such as the receipt of government-owned SPR oil at less than disruption prices at drawdown. Such an agreement would allow the government to reduce its current costs in exchange for reduced expected future profit resulting from the sale of SPR oil. Like leasing proposals, these alternatives might complicate drawdown.

## Establishing a Separate SPR Entity

Some proposals suggest establishing a separate SPR entity--a government corporation, such as the Tennessee Valley Authority, or a trust.<sup>3</sup> Separate government entities have sometimes been

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<sup>3</sup>A trust, as used here, means an entity with the power to undertake financial transactions on behalf of another person or institution, in this case, the SPR. The Treasury also maintains separate receipt and expenditure accounts, usually called Trust Fund Accounts; these are not referred to here.



established for business-type activities that generate receipts from selling products or services and finance their costs primarily by such receipts. However, the SPR, an integral part of DOE, normally generates no revenues.

A separate SPR entity could obtain oil by using some of the alternatives I have just discussed. For example, it could use funds from the sale of assets or debt to buy oil, or be the beneficiary of dedicated revenue. If the entity is off budget, its expenditures would not be reported in the budget. However, if the government provides funding to the entity, that funding would count against the deficit.

We are concerned about the growing number of proposals to establish off-budget entities to carry out governmental functions. Such entities avoid the discipline required by budget resources. They are a serious threat to the integrity of the government's budget and financial management systems. If the proliferation of such entities continues, it will raise grave doubts about the credibility of the government's reports on its financial operations and condition. This will make it even more difficult for decisionmakers and the public to understand and deal meaningfully with the overriding problem of the budget deficit.

#### CONCLUSION

In conclusion, Mr. Chairman, we believe that during the next decade the SPR will continue to play a vital role in U.S. energy security. Accordingly the United States should continue to develop the SPR as quickly as is fiscally responsible.

Most of the alternative financing proposals we examined have some advantages. However, all of them also have disadvantages that must be carefully weighed. On the basis of our analyses, we are not prepared to recommend any of proposals we reviewed as being

clearly superior to the current process of financing SPR oil purchases through annual appropriations. Further, as I mentioned earlier, we are concerned about the growing number of proposals to establish off-budget entities to carry out governmental functions.

I hope that our analysis will be useful to the Congress in identifying trade-offs relating to alternative financing proposals. We would welcome the opportunity to work with you further as you explore these proposals in greater detail.

We would be pleased to answer any questions that you or members of the Subcommittee may have.