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STATEMENT OF

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BEFORE THE

SENATE COMMITTEE ON ENERGY AND
NATURAL RESOURCES



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ON

U.S. PARTICIPATION IN THE INTERNATIONAL ENERGY AGENCY

Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss with you our observations on U.S. participation in the International Energy Agency (IEA). In response to the Chairman's request, I will outline the current activities of the IEA, the benefits as well as the risks and uncertainties of U.S. participation, and the importance of antitrust protection for U.S. oil companies that participate in IEA activities. I will also discuss the recent executive branch reassessment of U.S. international emergency preparedness following the 1983 IEA Emergency Sharing System Test (AST-4).

Our testimony is based on our ongoing and past work on the IEA, which encompasses a wide range of issues concerning U.S. involvement. A list of unclassified GAO reports on IEA-related issues is attached. Our ongoing work is in response to a request by Senator Howard Metzenbaum.

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CURRENT IEA ACTIVITIES

The IEA, established in 1974, is the principal multilateral energy forum for 21 major oil consuming countries of the industrialized world.¹ It maintains a Secretariat in Paris consisting of 124 people and has an operating budget for fiscal year 1984 of \$9.2 million. IEA also has a number of industry advisory groups.

The United States was the moving force in establishing the IEA and funds 25 percent of its budget. As the world's largest consumer of petroleum and the primary target of the 1973-74 Arab oil embargo, the United States believed it could derive substantial benefits from an organization like the IEA. U.S. participation is pursuant to an executive agreement.

A primary concern of the oil consuming countries who joined together to form the IEA was to reduce their vulnerability to politically or economically inspired oil supply interruptions. IEA, with the voluntary assistance of 46 international oil companies, would accomplish this through an emergency oil sharing system that would insure that serious oil shortfalls, that is, those in excess of 7 percent, would be shared proportionately. No single country or group of countries would be subjected to the

¹Australia, Austria, Belgium, Canada, Denmark, Greece, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States, and West Germany.

disruption of a narrowly targeted oil embargo because all IEA members would share available oil supplies and dissipate the impact of the embargo. When oil is to be shared, individual country allocation rights and obligations are calculated based on past consumption patterns and how the disruption affects individual countries.

Before the oil sharing system is triggered, each member country is initially expected to employ measures to restrain demand and/or rely on its own emergency reserves to offset a shortfall. The IEA program calls for member countries to maintain a reserve equal to 90 days of the previous year's net oil imports.

The oil supply situation has changed since the IEA was established:

- There is now a world glut of oil, making an embargo less likely.
- The U.S. level of imports has decreased and in 1983 Arab oil exporting countries provided less than 15 percent of U.S. total net imports. No Middle East country was among the top five U.S. suppliers.
- The United States has spent a great deal of public funds to build up the Strategic Petroleum Reserve (SPR), whose present level is over 380 million barrels.

Despite these changes, other IEA members remain significantly dependent on imported oil, particularly from the Middle East, and the possibility of an oil supply interruption remains.

However, the probable cause of disruption has changed; it is not an Arab oil embargo that is considered most likely but rather the disruption of Persian Gulf oil caused by civil unrest or war, such as the current Iran-Iraq conflict.

IEA monitors the changing world oil market and supports efforts to reduce industrial countries' vulnerability to oil supply interruptions. To help achieve these goals, the IEA:

- Reviews the member countries' energy policies and programs, based on annual submissions from each country. Each IEA country is periodically reviewed in depth and recommendations are made where policies can be improved.
- Regularly makes current oil market assessments based on monthly country submissions compiled from company and government data and provides a forum for discussing oil market developments.
- Serves as an energy policy coordinating forum through regular multilateral energy conferences.
- Encourages and facilitates research on new technologies to develop alternative sources of energy and more efficient energy use through cooperative multinational projects.
- Participates in long-term cooperative efforts to reduce oil import dependence through conservation and increased reliance on other fuels, such as coal, gas, and nuclear.
- Strives to establish a dialogue between oil consuming and producing countries.
- Performs special ad hoc energy security assessments, such as the one completed in 1983 on alternatives to European imports of Soviet natural gas.

BENEFITS OF U.S. PARTICIPATION

In response to the Arab Oil Embargo of 1973-74, consuming countries scrambled frantically in an attempt to gain assured access to oil supplies, which resulted in a tripling of oil prices, leading to economic disruption in the form of inflation, decreased economic growth, and increased unemployment. The scramble for oil also challenged, and to some extent strained, the overall political, security, and economic ties that bound together many of the industrialized countries. The IEA was established to enhance the ability of the developed world to respond to such an energy emergency.

The nature of oil markets is such that a temporary shortfall in oil supplies can lead to the price of oil quickly overshooting the long-run equilibrium price, exacerbating the impact of any shortage. U.S. officials have concluded that the existence of the IEA system can dampen the rise of oil prices in an emergency, thus providing an economic as well as a political benefit. They believe the IEA also helps the member countries improve their understanding of the changing oil market, providing insights into how to enhance energy policies and programs both unilaterally and collectively.

U.S. officials also believe that the United States gains collective security through the IEA Emergency Sharing System, which is more desirable than a potentially destructive "go-it-alone" approach to solving oil shortages. As such, it can yield

economic, foreign policy, and national security benefits to the United States.

Lastly, if there were an embargo targeted at the United States or an interruption seriously affecting U.S. oil supplies, the United States could stand to receive oil under the IEA Emergency Sharing System.

RISKS AND UNCERTAINTIES

The Emergency Sharing System is the key element of the IEA and the aspect about which important questions are asked. Will it work in an emergency? Each participating country's willingness to subject its domestic oil production and supplies to international allocation during an emergency is crucial to the effectiveness of IEA. Will countries have the political will to actually divert some of their oil to help other countries?

The Emergency Sharing System's allocation process has been tested four times, but the role that price will play in the voluntary sharing of oil during an emergency has never been tested. A consensus among member countries on the principles of oil pricing during an emergency is critical to a voluntary functioning of the IEA allocation system. However, IEA members have differed over the pricing principle to be used for the oil being shared in an emergency. Recent efforts have been made to address these differences. The IEA guidelines now indicate that such a price can be anywhere between the long-term contract price and

the spot market price. Nevertheless, this compromise may not resolve the underlying price concerns to insure effective operation of the system in an actual emergency.

There is also uncertainty over when the IEA Emergency Sharing System should be used. U.S. officials have held that it should be activated only during a sudden and severe oil crisis, when each IEA member country would readily accept its obligations under the International Energy Program (IEP), the charter of the IEA. They contended that the system is onerous and costly to operate and somewhat heavy-handed for dealing with temporary market disruptions or gradual supply reductions.

However, the Iranian oil supply interruption of 1978-1979 demonstrated that relatively small imbalances in supply and demand can cause significant price increases and have serious economic consequences. It also showed that the IEA, which had originally been established to respond to large supply interruptions, was unprepared to respond effectively to a shortfall of less than 7 percent.

At the onset of the Iran-Iraq war in 1980, however, the IEA did provide the forum for developing and implementing an ad hoc coordinated response by member countries. Although these efforts apparently were constructive in moderating the effects of the crisis, it should also be pointed out that the improved world availability of oil was the major factor in re-establishing market equilibrium.

A question remains whether, for a subcrisis situation, member countries should seek to develop a more coordinated response, which might include stock drawdowns or demand restraint measures. In this regard, the U.S. government is currently discussing the possibility of drawing down the SPR in a subcrisis. However, the United States could be disadvantaged if it unilaterally drew down its stocks, and other IEA countries did not take comparable action or, worse yet, built stocks.

The 1983 test of the Emergency Sharing System (AST-4) revealed a number of additional problems which should be addressed if the system is to make a significant contribution to reducing the costs and dislocations of an oil supply interruption.² In particular, the test focused attention on some of the difficulties the United States might face in relying exclusively on market forces to fulfill its international obligations under the Emergency Sharing System. It also raised some questions as to how seriously the United States viewed the sharing program. AST-4 showed, for example, that:

--The United States relied on a sharp increase in the price of oil to restrain demand. However,

²For 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).

the IEA Secretariat, its expert's group, and other IEA countries questioned whether this was consistent with IEA commitments. They pointed out that if the price in the United States, which will likely have an oil allocation obligation under the IEA system, rose significantly above the level that countries with allocation rights were willing to pay, the whole system would be frustrated.

--The Department of Energy (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 major U.S. companies said that they would not volunteer oil supplies to the IEA Emergency Sharing System unless some form of fair sharing program existed to assure that the burden would be shared equitably with their domestic competitors. DOE assumed that its market-based approach for coping with emergencies might preclude any need to employ a fair sharing program or that other options, i.e., drawdown of the SPR and a system of direct supply orders to various companies, might be relied on should that assumption prove false.

--The United States in the test relied heavily on companies, other than the major oil companies that have been working directly with IEA, to supply oil to meet U.S. obligations. The companies may be willing to share oil with other IEA member nations, but the test did not convincingly demonstrate that these companies can make a significant contribution in an actual emergency.

Another test of the IEA system is now tentatively scheduled for the fall of 1985.

RECENT EXECUTIVE BRANCH REASSESSMENT
OF U.S. PREPAREDNESS

In the aftermath of AST-4, the executive branch began to restudy U.S. international emergency preparedness. In recent months there has been considerable activity, including (1) the creation of interagency task forces; (2) an organizational change at the Department of Energy in which the Offices of Energy Emergencies and International Affairs were merged; and (3) an IEA evaluation of the U.S. response programs. U.S. officials recently advised us that their reassessment was still on-going.

Nevertheless, some things about the latest U.S. policy are known. The United States will continue to rely principally on market forces in a severe energy emergency. However, the role of the SPR appears to be changing. A few months ago, the U.S. position was perceived to be that the SPR would be held in reserve to be used as a last resort. More recently, U.S. officials advised the other IEA members that the United States ordinarily intends to draw down the SPR in large amounts at an early stage of a major supply interruption.

The specific conditions which will trigger the use of the SPR have not been clearly defined. However, U.S. officials have indicated that they will consider using the SPR in an international crisis as (1) a partial substitute for demand restraint required under Article 16 of the IEP, (2) a possible means to

meet U.S. overseas supply obligations under the IEA, (3) a vehicle reducing the need for a fair sharing program, (4) a means of dampening price escalation in an emergency, and (5) a source from which sales may be diverted to priority domestic customers.

Several questions follow from the currently stated policy: (1) Can the SPR realistically be expected to simultaneously perform all these functions in a crisis, particularly under the existing drawdown plan? (2) Will the SPR be drawn down in coordination with the drawdown of stocks by other countries? (3) Will the expected use of the SPR be sufficient to bridge the apparent gaps in compatibility between relying principally on the free market approach and contributing to an effective international emergency oil sharing program?

U.S. OIL COMPANY PARTICIPATION³

U.S. oil company participation in the IEA was requested by the U.S. government shortly after the agency was established. Although companies were initially reluctant to participate, they have participated regularly as long as they had antitrust protection. They now generally perceive their participation as beneficial to their own interests and to the interests of oil-consuming countries. The companies say the IEA also presents them with a

³In our October 1983 testimony before this Committee we provided for the record detailed information on the extent of oil company participation in the IEA.

more acceptable form of government intervention than the more direct forms, such as various nationalization schemes and/or emergency mobilization boards. Although the IEA and member governments are involved, the IEA system works within the basic distribution system used by the oil companies.

There is general agreement between the United States and other member nations that oil company participation is essential to the effective operation of the IEA Emergency Sharing System. The companies provide crucial data on the availability of oil and the mechanism for actually sharing and transporting oil. The U.S. oil companies that we have visited stated that their voluntary participation in IEA emergency activities is contingent on the existence of the antitrust defense for such activities.

The antitrust defense, which enables U.S. oil companies to meet as a group, advise the IEA Secretariat, provide disaggregated company data in an emergency and participate in an IEA allocation of supplies, was authorized by Section 252 of the Energy Policy and Conservation Act of 1975. When the antitrust defense lapsed on December 31, 1983, U.S. oil company representatives to the IEA Industry Advisory Board were advised by their lawyers not to meet. With the recent extension of the Section 252 provision to June 30, 1985, oil companies are again able to participate in the IEA with the benefit of the antitrust defense.

Mr. Chairman, this concludes my statement. We will try to answer any questions you may have.

LIST OF UNCLASSIFIED GAO REPORTS DEALING WITH THE
INTERNATIONAL ENERGY AGENCY

- Assessment of U.S. Participation In The International Energy Agency's Fourth Test of Its Emergency Sharing Allocation System (GAO/NSIAD-84-4) October 13, 1983.
- Oil Supply Disruptions: Their Price And Economic Effects (GAO/RCED-83-135) May 20, 1983.
- Operation of The International Energy Agency's Coal Industry Advisory Board (GAO/ID-83-44) April 21, 1983.
- Analysis of Department of Justice Memorandum Concerning President's Statutory Authorities In An Oil Crisis (GAO/OGC-83-6) March 4, 1983.
- Analysis of The Comprehensive Energy Emergency Response Procedures Report (GAO/RCED-83-106) February 17, 1983.
- Determination of Oil Price In The International Emergency Sharing System--An Unresolved Issue (GAO/ID-83-15) November 12, 1982.
- The Changing Structure of The International Oil Market (GAO/ID-82-11) August 11, 1982.
- Demand Restraint And Fair-Sharing Under The International Energy Program (B-206525) April 6, 1982.
- The United States Remains Unprepared For Oil Import Disruptions (EMD-81-177) September 29, 1981.
- Unresolved Issues Remain Concerning U.S. Participation In The International Energy Agency (ID-81-38), September 8, 1981.
- Analysis of the Energy And Economic Effects Of The Iranian Oil Shortfall (EMD-79-38), March 5, 1979.
- U.S. Energy Conservation Could Benefit From Experiences of Other Countries (ID-78-4), January 10, 1978.
- U.S. Oil Companies' Involvement In The International Energy Program (HRD-77-154), October 21, 1977.
- Issues Related To Foreign Sources of Oil For The United States (B-179411) January 23, 1974.

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