United States General Accounting Office 135811

GAO

Testimony

For Release
on Delivery
Expected at
10:00 a.m. EST
Tuesday
May 17, 1988

Renewal of Authorities for U.S. Participation in the International Energy Program

Statement of
Allan I. Mendelowitz
Senior Associate Director
National Security and International Affairs Division

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

SUMMARY OF TESTIMONY BY ALLAN I. MENDELOWITZ
U.S. GENERAL ACCOUNTING OFFICE

ON

RENEWAL OF AUTHORITIES FOR U.S. PARTICIPATION IN THE INTERNATIONAL ENERGY PROGRAM

BEFORE THE

SUBCOMMITTEE ON ENERGY AND POWER
COMMITTEE ON ENERGY AND COMMERCE
HOUSE OF REPRESENTATIVES
MAY 17, 1988

Past experience with oil supply disruptions has demonstrated that price increases can be very large and significantly overshoot long-run equilibrium price levels. This can impose very high costs on oil importing nations in terms of lower gross national product and increased inflation and unemployment.

The International Energy Agency's (IEA) emergency sharing system is designed to deal with short-term oil supply disruptions by limiting excessive price increases and thereby minimizing the economic costs. Of greatest importance is the ability to compensate for reduced supplies by drawing down emergency oil stocks and restraining demand. In addition, the system allocates available supplies so that members share the burden of a shortfall. The system helps keep a country or countries that are disproportionately shorted by a particular disruption from panic actions to find supplies on world oil spot markets, which, in turn, could further aggravate world oil price increases.

The emergency sharing system is designed to help member nations cope with severe, short-term disruptions to the world oil market, not to deal with a fundamental change in the availability of world oil supplies for the medium and long-run. However, it could play an important role in easing the transition, should such a change occur.

The authorities contained in the Energy Policy and Conservation Act are necessary for effective U.S. participation in the IEA, including the authority for international oil allocation. Current authorities expire on June 30, 1988.

In our work on the IEA, we have not identified any circumstances that would invalidate the original and continuing justification for U.S. participation in the IEA. Therefore, we believe that Congress should extend these authorities.

Mr. Chairman and Members of the Committee:

We appreciate the opportunity to be here today to discuss legislation to extend for 5 years, to June 30, 1993, legal authorities in the Energy Policy and Conservation Act (EPCA) which enable the United States to participate in the International Energy Program (IEP) and the International Energy Agency (IEA) as provided for by the IEP Agreement. At your request, our testimony focuses on those IEA programs concerning how the United States and the 20 other member nations could respond to a severe oil supply disruption.

In the current environment, the world oil market is somewhat less vulnerable to a disruption than it was in the 1970s. OPEC's share of world oil production is lower, there are new less hazardous transportation routes, and there is more excess production capacity. Nevertheless, there is still the risk for oil importing countries of an oil supply interruption associated with war and civil unrest in producer countries. Furthermore, it is forecast that current oil market conditions that give us some protection from a severe disruption will change in the 1990s as the oil market tightens again. Hence the IEA continues to have an important role to play.

Invariably when an oil interruption occurs and causes a shortage, oil prices will rise. Past experience with interruptions,

particularly the 1973-74 Arab oil embargo and the 1978-79 Iranian oil supply disruption, has demonstrated that price increases can be very large and significantly overshoot long-run equilibrium price levels. This, in turn, can impose very high costs on oil importing nations in terms of lower gross national product and increased inflation and unemployment.[1]

The IEA has a number of short-term and long-term programs designed to promote energy security. An objective of its programs for dealing with short-term oil supply disruptions is to limit excessive price increases, thereby minimizing the costs of disruptions to oil importing nations. Of greatest importance in an oil supply interruption is the ability of IEA countries to offset reduced supplies through drawing down emergency oil stocks and reducing oil consumption through demand restraint measures. This can narrow the disequilibrium between supply and demand and thus reduce upward pressure on world oil prices. If the supply interruption is not too large, the IEA response can consist primarily of the coordinated drawdown of emergency reserves and the implementation of demand restraint measures.

---

[1]The Arab oil embargo was estimated to have decreased the U.S. gross national product by over $300 billion (1983 dollars) during 1974-76. Even small disruptions like the 1978-79 Iranian interruption can have severe consequences; for example, between September 1978 and September 1980, crude oil prices increased 2-1/2 fold--from $13 to $32 a barrel. In internal analyses, the Organization for Economic Cooperation and Development estimated that by the end of 1981 the higher oil prices since the start of the disruption had resulted in a total loss in real income to its member countries of nearly $1 trillion, or $1,300 for every person (based on 1979-1980 dollars).

For larger disruptions, IEA has an emergency system for allocating oil supplies available to the group of countries more or less evenly[2] so that members share the burden of a shortfall. The system helps to keep a country or countries that are disproportionately shorted by a particular disruption from panic actions to find supplies on world oil spot markets, which, in turn, could further aggravate world oil price increases.

The sharing system is designed to go into operation for supply disruptions when one or more member countries, or the group as a whole, is experiencing or can be expected to experience a 7 percent or more supply shortfall. The emergency sharing system is intended to help member nations cope with severe, short-term disruptions to the world oil market, not to deal with a fundamental change in the availability of world oil supplies for the medium and long run. However, it could play an important role in easing the transition, should such a change occur.

---

[2]For example, when the group of IEA countries experiences a shortage of oil supplies of between 7 and less than 12 percent relative to a pre-disruption base period, each member is responsible for implementing demand restraint measures sufficient to reduce its final oil consumption by an amount equal to 7 percent of its final consumption during the base period. If the group oil supply shortfall is greater than the amount of oil offset by members' demand restraint obligations, the difference is to be offset by members' drawdown of emergency reserves. A country's share of the emergency reserve drawdown obligation is essentially determined by its level of net oil imports relative to the total net oil imports of all members during the previous calender year multiplied by the group supply shortfall.

The authorities contained in the Energy Policy and Conservation Act are necessary for effective U.S. participation in the IEA. Among other things, they provide authority for international oil allocation, for U.S. provision of energy industry information and data to the IEA, and for limited antitrust and breach of contract defenses for actions that oil companies take to implement both the IEA information and allocation programs. Current authorities expire on June 30, 1988.

In our work on the IEA we have not identified any circumstances that would invalidate the original and continuing justification for U.S. participation in the IEA. Therefore, we believe that Congress should extend these authorities.

I will now discuss more specific questions and subjects that you asked us to address concerning the emergency oil sharing system, drawdown of emergency oil stocks, and Presidential authority to allocate oil to meet a possible U.S. oil allocation obligation.[3]

---

[3]Related to these issues, we issued a report in February 1988 on U.S. antitrust authorities which affect U.S. oil companies that participate directly in the IEA, International Energy Agency: Plan to Provide Legal Defenses to Participating U.S. Oil Companies (GAO/NSIAD-88-89BR).

WOULD OIL ALLOCATED AMONG IEA NATIONS BE EXCHANGED AT OR BELOW THE THEN PREVAILING MARKET PRICE?

There is more than one market price for oil. During an oil supply interruption, the oil market will continue to exchange oil at a variety of prices, even after adjustments are made for quality, transportation costs, payment terms, and so forth. Many oil supply contracts provide for prices to change in response to changing market conditions, so as a disruption unfolds, the price will rise. Reportedly, much of the oil under contract today contains such clauses. Spot market prices, for individual cargoes of oil normally purchased to balance out short-term supply needs, will fluctuate and probably be higher than contract prices. At the same time, if OPEC countries cannot agree on how high to raise official prices, some may charge different prices than others, and both contract and spot prices will be affected.

Under the IEP Agreement, the price for oil allocated by an oil company in one IEA country to a company in another member country for the purpose of helping to balance out members' allocation rights and obligations is to be based on conditions prevailing for "comparable commercial transactions." The term comparable commercial transactions, as defined by the IEA, does not exclude any type of market transaction. In theory, then, a company selling/allocating oil to another company could price its oil in a

variety of ways.[4] Buying companies, of course, will try to negotiate the lowest possible price.

We believe that most, if not all, companies selling allocated oil will seek prevailing market prices for their oil, which will likely mean spot prices.[5] However, even though the allocated oil may sell at spot prices, we believe that the prevailing spot market prices may be lower than they otherwise would be because of the emergency sharing system, as discussed in our response to the next question.

IF MARKET PRICES ARE USED TO TRADE THE ALLOCATED OIL, WHY IS AN IEA PROGRAM NEEDED TO ALLOCATE THEM?

It is important that the allocation system not be evaluated in isolation. It is an integral part of an international agreement that includes demand restraint and emergency oil reserves as well as equitable sharing of oil. In addition, there is an information program for collecting current data on world oil supply and

---

[4]Prior to 1984 there was some confusion about how IEA allocated oil should be priced. While the IEP Agreement said at "comparable commercial terms," the IEA's Emergency Management Manual said term (i.e., contract) and not spot prices should be used. In December 1983 the manual was amended to be consistent with the agreement.

[5]In a survey we conducted in 1984 of U.S. oil companies that directly participate in the IEA's emergency sharing system, most said that price should be based on the prevailing market price at the time of the disruption. See Survey of Oil Company Views on Fair Sharing in an International Oil Supply Disruption (GAO/NSIAD-85-45) Feb. 5, 1985.

distribution that can be useful in assessing the size and other important aspects of a disruption, deciding on appropriate ways to respond, and implementing oil allocation. Information sharing also provides an important element of transparency, which can help alleviate possible suspicions and concerns that major oil companies may be favoring some oil importing nations over others. Countries that have assumed IEA obligations have done so based on their assessment of the entire IEA system. Some members might not have found the emergency programs sufficiently attractive if allocation were not a component. Consequently, the benefits of the whole system should be assessed rather than individual components.

Although the drawdown of reserves and the implementation of demand restraints are likely to be the most effective responses to an oil disruption, the allocation program may also contribute by reducing the rise in oil prices. Less oil may be taken out of consumption for speculative stockbuilding and hoarding, and panic buying may be reduced. Both of these effects would limit disruption-induced price increases. In addition, the allocation program may help to deter politically inspired embargoes against one or more IEA countries, which happened during the 1973-74 Arab oil embargo of the United States and the Netherlands, and it provides a mechanism for coping with an embargo should deterrence fail.

In normal markets, oil companies keep sufficient stocks on hand to ensure smooth operation of the oil supply and distribution system. To this end, companies hold some stocks to compensate for unexpected shutdowns in various operating systems. However, they generally do not keep large stocks on hand to protect against major world oil supply disruptions, because it is expensive to hold stocks and severe disruptions are infrequent and not predictable.

In a severely disrupted world oil market, with a substantial shortfall of supply, much uncertainty about current and future supply levels, and rapidly rising oil prices, many companies may build stocks beyond normal levels, further compounding the supply shortfall relative to consumption. Prices will be driven higher than they otherwise would. This is worrisome because, as the 1978-79 experience shows, high prices may not quickly revert to longer term equilibrium levels when the supply disturbance is over because OPEC countries can reduce production to keep prices at artificially high levels.

The allocation program is designed to provide all IEA countries access to a given share of the oil supplies that are available to the group of countries as a whole. In an emergency the spot market may not function efficiently. It is worth remembering that during the 1978-79 Iranian oil supply interruption, there were periods when oil available on the spot market was significantly reduced or virtually dried up. With the allocation program, each IEA country

is entitled to a certain supply of oil and, therefore, may expect that if the country cannot obtain all of that oil on world markets, it will be able to secure the remainder through IEA re-allocation. Consequently, the program may reduce a panicky search for oil by those countries and companies which are especially shorted by a disruption and thus lessen upward pressure on prices.

The demand restraint and emergency reserve elements of the system, in combination with allocation, should also reduce a speculative search for oil for excess stockbuilding, which would reduce available supplies for consumption and exert upward pressure on world oil prices. When the IEA allocation program is activated, member countries are responsible for reducing their demand by 7 or 10 percent (depending on the size of the shortfall) and for drawing down emergency reserves to offset that part of the shortfall not covered by demand restraint requirements.[6] These actions can significantly reduce upward pressure on world oil prices and thus mitigate the adverse economic impacts of disruptions.

Because member countries agree to restrain demand and share available supplies according to a pre-determined formula, opportunities to build stocks beyond normal levels are limited. Countries which secure more supply than they are entitled to are

---

[6]If members have emergency reserves in excess of 90 days of net oil imports, they can substitute stock drawdown for demand restraint. Members can also substitute demand restraint, fuel switching, or surge domestic oil production for drawdown of emergency reserves.

required to allocate the excess to members who are short of their supply right. Thus, there is a disincentive for a country to seek more oil supply than it is entitled to. In addition, most IEA countries have domestic fair sharing systems that can be put into effect when allocation is activated. These systems are designed to ensure an equitable sharing of supplies among all companies within a country. Thus, there is a disincentive in these countries for companies to accumulate excess supplies.[7]

DOES IEA ALLOCATION GIVE THE SAME ALLOCATION AS WOULD RESULT FROM USE OF THE MARKET MECHANISM?

There will be two forces at play when the IEA oil sharing system is in operation, both market forces and allocation. If the two do not dovetail, the allocation formula will override the way the market is distributing oil. Under the IEA system, oil supplies are to be shared largely relative to the way the members used supplies in the year or so preceding the disruption. If the oil market eventually stabilizes at a higher equilibrium price, new consumption patterns will emerge. In this case, some countries will not want to purchase all of their rights to oil allocation at prevailing market prices. This would be an indication that it was time for members

---

[7]If an IEA country does not have a fair sharing system, as is the case with the United States, it is still responsible for assuring that the aggregate supply of oil available to its companies during a given time period does not exceed the country's supply right. If the supply is in excess, the country's government must persuade or, if necessary, order specific companies to divert an amount of oil which, in aggregate, will bring the country within its supply right.

to consider de-activating the allocation program. Consequently, we believe the system is essentially useful as a short-term response mechanism.

The large majority of oil trades among IEA countries are expected to occur apart from the IEA's allocation sharing system. These trades will essentially be a continuation of normal commercial transactions by the oil industry. Companies will be free to send oil where they choose at market prices.[8] It is not possible to tell in advance of a disruption exactly how much or what proportion of the IEA's total oil trade will occur apart from the IEA's allocation of oil. However, according to one analyst, based on past tests of the allocation system, not more than 5 percent of the undisrupted oil trade would be likely to involve reallocations.[9]

At the same time, companies will be receiving guidance directly from the IEA Secretariat in Paris and/or the governments of the IEA countries in which they operate, encouraging them to move oil voluntarily in directions that help facilitate the balancing of the system. It seems reasonable to assume, particularly for the

---

[8]The IEA's determination of which countries have an obligation to allocate oil to others and which have an allocation right to receive oil will be based on the extent to which normal commercial transactions have not balanced out available supplies among the members.

[9]Daniel Badger, "International Cooperation During Oil Supply Disruptions: The Role of the International Energy Agency," Responding to International Oil Crises, edited by George Horwich and David Leo Weimer (Washington, D.C.: American Enterprise Institute for Public Policy Research, 1988), p. 9.

early stages of a disruption, that countries especially shorted would be willing to pay higher prices to secure supplies than nations not affected as severely. To the extent this is the case, market forces will reinforce the intended IEA allocation.

Once a month, the IEA Secretariat will formally calculate member countries' allocation rights and obligations. Companies and countries will then be asked to submit voluntary offers to the IEA Secretariat, offering to either provide or receive oil to correct the imbalances that still remain in the system for that month. The Secretariat, with assistance from oil industry experts, will analyze the offers and match and approve those that seem to best promote balancing of the system.

The matching process will take into account the quality and quantity of the oil offered versus that sought, where the oil is needed and when, and so forth. The matching will not consider oil prices. Companies will be responsible for negotiating price terms, so they will still be free to charge the prevailing market price for their oil.

As oil prices rise and the period of time during which the sharing system is in operation increases, it is likely that the IEA formula for allocating oil will diverge from the market's allocation of oil because (1) the formula is based on past consumption patterns associated with different oil prices and (2)

demand elasticities for oil vary across countries. In other words, at higher prices, consumers in some countries will value oil less and thus reduce their demand more.[10] How quickly the two will diverge and to what extent is difficult to say. In any event, when a number of countries with allocation rights no longer want to pay prevailing market prices for allocation oil, we believe this will indicate a new equilibrium price is evolving and the time is approaching to de-activate the allocation system.

POSSIBLE IMPACT OF PRICE DISPUTES ON THE ALLOCATION SYSTEM

We also expect that differences over price will occur in the early phases of the allocation system's operation because of the multiple prices that will prevail in markets as well as different expectations about the length and magnitude of the disruption. Under the IEA system, if two parties to a prospective voluntary offer transaction cannot agree on price, the deal is not completed. The Secretariat will then attempt to match the offer to provide oil with another interested buyer and to match the offer to receive oil with another offering seller. If the buyer believes

---

[10]Some IEA countries may employ price controls. If price controls are used to hold down price increases, demand won't be reduced as much as it otherwise would. If price controls are in effect in a country with allocation rights and if the government does not allow companies to pass through the full cost of oil imports, companies will be discouraged from importing oil and/or have an incentive to export products to countries where controls are not in effect. Historically, though, IEA governments which have employed price controls have increased prices within a short time, so domestic prices closely followed world prices.

that the seller's prices are unreasonable, it can bring the matter before the IEA. Under the IEP Agreement, questions related to the pricing of oil allocated during an emergency shall be examined by the Standing Group on Emergency Questions (SEQ), which consists of government representatives from member countries. The SEQ may ask the Secretariat to gather data concerning what might be considered a "fair" price for the oil in question. This information could be used in discussions with the concerned parties aimed at resolving the dispute.[11]

However, we think it is quite possible that most of the oil to be allocated by the IEA will be exchanged without price disputes requiring SEQ involvement. This is not to say that buyers and sellers will not vigorously argue about what is a fair price. Countries which have been cut off from major sources of normal supply may not be happy to pay high prices for replacement oil but will do so to secure the supplies. In the absence of the IEA sharing system, they might not be able to obtain as much replacement oil and they might have to pay even higher prices. Moreover, as is the case in undisrupted markets, there will be

---

[11]A number of years ago, the IEA Secretariat suggested that its Executive Director mediate price disputes, and, if that failed, the IEA's Dispute Settlement Center be used. If a country or a company persistently rejected offers because of price and if the Executive Director felt the price offers to be reasonable, he would have the option to refer the cases to the Center. According to the proposal, the Center would assess what was a fair price. Once the Center made a determination, the allocation right of the country of the prospective purchaser would terminate if the purchaser refused to pay the price. This suggestion was not adopted.

reference points for buyers and sellers to consider in judging what is a fair price for different grades of crude oil and products. For example, the trade press will cite prices for such exchanges. More to the point, oil companies engage in buying and selling oil all the time. It is their business to know what is a reasonable price for any given transaction.

Assuming that governments do not attempt to interfere with the pricing of oil, companies may do reasonably well in concluding deals. There should be incentives for both sellers and buyers to reach a deal. Sellers will presumably want to come to closure, because they will (1) need to reduce their supply to a level consistent with their country's supply right and (2) know that if they do not, their government may order them to provide a given quantity of oil to another country at a specified price, which may be lower than what the companies could have got on their own. Presumably, buyers will want to conclude transactions because they need the oil. If a buyer is too picky about price and a deal falls through, the Secretariat may successfully match the seller with another interested buyer willing to pay the price. By the time the original buyer is matched with a new prospective seller, prices may have gone up further.

If numerous price disputes occur, where buyers and sellers cannot reach agreement and the differences are brought to the SEQ, effective IEA allocation could be impeded. The IEA does not have a

mechanism, such as compulsory binding arbitration, for assuring resolution of such disputes in a timely and effective manner.

Before ending the discussion of the IEA emergency sharing system, I would like to make a few additional comments. The system has never been activated. There has not been an oil supply disruption large enough to trigger the system since it was established. Moreover, it is a complicated system that has many parts and would require the active, voluntary cooperation of many countries and oil companies to function effectively. Because of this situation the IEA, with help from international oil companies, continues to study and seek ways to improve the system, and periodically conducts tests of the allocation mechanism. To date, five tests have been held and a sixth is scheduled for this fall. Following each test, improvements have been made in the system. However, any emergency will have unique aspects, and it is not possible to realistically test all elements of the system. Therefore, one cannot know with certainty how well the system will work. Nevertheless, we believe the system makes a genuine contribution to our energy security and has considerable value as a standby emergency response mechanism.

WOULD COORDINATED STOCKDRAW BY ALL IEA NATIONS BE NECESSARILY SUPERIOR TO AN UNCOORDINATED STRATEGY?

You raised the question of what would happen if a coordinated stockdraw strategy based on a shared consensus among IEA nations

turns out to be wrong. For example, the strategy might require a large drawdown based on the consensus assumption that the disruption will be short, but the disruption turns out to be long-lasting. And, you ask whether a diversified, decentralized stock drawdown strategy which "hedges bets" and incorporates different forecasts of the unfolding disruption might be a safer bet.

We have the following observations and comments.

-- Emergency oil reserves cannot solve a long-term supply shortfall. Their major contribution is to dampen panic buying and excessive price increases during the early phases of a supply disruption. If a disruption is long term, early stockdraw will permit a transition period during which the world can adjust to a long-run reduction in available oil supplies. Early drawdown also buys time for decisionmakers to assess more fully the size and causes of a disruption and to develop, if appropriate, political or other responses for coping with it.

-- One danger is that, after having gone to the substantial expense of building and holding emergency stocks, countries will not use them or not use them quickly enough because governments are overly cautious, particularly in the early stages of a disruption.

-- One benefit of trying to hammer out a coordinated response among IEA countries is that it may reduce the possibility of some members trying to "free ride" on the response measures which other members employ. If there is not a coordinated response, the benefits from any one country's actions will be dissipated. Therefore, it is reasonable for the United States to want and expect other countries to take effective action if it is to drawdown the Strategic Petroleum Reserve in a substantial way.

-- The IEA does not have pre-set coordinated stock drawdown strategies. Rather, it has a process and set of procedures for quickly assembling data and information on the likely size and duration of a disruption and on members' various capabilities for responding. Depending on the nature of a disruption, the IEA Secretariat may forecast more than one likely outcome. Member countries will meet to discuss how to coordinate their responses. However, each member country will be responsible for determining what it thinks is the most likely outcome and deciding how it wants to respond. Whether the disruption is big enough to trigger the oil sharing system or is smaller but serious enough to warrant a different coordinated response, members will be free to choose among various stock drawdown, demand restraint, and fuel switching measures as methods for responding.

Consequently, the end result is more likely than not to be a coordinated response using different measures.

-- The danger of drawing down too much stocks early in a disruption, on the assumption the shortfall will not last that long, is reduced if members have substantial reserves to start with. Similarly, if a country has large reserves to begin with, it will have more flexibility for engaging in a substantial drawdown at the start, when there may be much uncertainty about how long the disruption will last. As the disruption continues to unfold, the country can re-evaluate whether it should reduce the rate of drawdown to make stocks last longer.

SHOULD THE UNITED STATES WAIT FOR A CONSENSUS STRATEGY ON STOCKDRAW OR ACT ON ITS OWN?

Some studies and analyses have concluded that, if necessary, the United States would be better off to unilaterally draw down its emergency oil reserves if other nations are not willing to do so. The reason is because substantial economic benefits would result from replacing lost oil imports and moderating oil price increases. Other countries would, in effect, become "free riders," benefiting from U.S. actions. Similarly, the United States could be a free rider if another IEA country drew down its emergency

reserves and we did not. However, to maximize benefits for everyone, a coordinated response is necessary.

While it can be demonstrated that the United States would be better off to unilaterally draw down its stocks than not to draw at all, the IEP Agreement and other IEA agreements commit all members to take joint actions in certain situations. The United States should encourage other members to live up to their commitments. If they do, the benefits for all will be greater. Other IEA countries are well aware that the United States has a very large Strategic Petroleum Reserve and that substantial U.S. drawdown of these reserves will have large benefits for them. Thus, there is an added incentive for them to take effective actions if they believe such actions are necessary for the United States to draw down its reserves.

In discussing this point, it is important to recognize that other emergency response measures, such as demand restraint and fuel switching, can also restrain oil price increases for all users. Consequently, if the United States draws down the Strategic Petroleum Reserve, it does not follow that other countries also have to draw down emergency oil stocks to make a fair contribution. What is critical, though, is that the other measures must work effectively.

PRESIDENTIAL AUTHORITY TO ORDER INTERNATIONAL OIL ALLOCATION

Under section 251 of EPCA, the President, by rule, may authorize and, if necessary, order international allocation of petroleum products by companies engaged in producing, transporting, refining, distributing, or storing petroleum products and subject to the jurisdiction of the United States, in such amounts and at such prices as may be necessary to fulfill U.S. obligations under the IEP. Use of this authority is limited to international energy supply emergencies and may be invoked only after activation of the emergency sharing system.

The Departments of Justice and Energy contend that section 251 also provides authority for limited domestic allocation of petroleum to facilitate voluntary industry participation in the international allocation system by assuring a "fair sharing" of the allocation burden among participating U.S. companies. However, we previously reported considerable opposition within the petroleum industry and among some major petroleum users to use of section 251 as authority for any domestic allocation. Litigation could result if section 251 were used for this purpose.

Fair sharing refers to the distribution of available oil among petroleum companies operating within one participating country so that no one petroleum company is disproportionately penalized or benefited due to its authorized actions taken to implement the

IEA's emergency sharing system. Fair sharing is a principle of sharing oil domestically among companies which removes a major disincentive to full company participation in the international allocation of oil. The disincentive is that if some companies provide oil for international allocation and others do not, the domestic market share of the former may be adversely affected.

Fair sharing is not a legal requirement of the IEP, but its significance to the effective implementation of IEA allocation is recognized in the IEA's Emergency Management Manual. The manual places responsibility for fair sharing or correction of imbalances between companies on the individual member governments, recognizing differences among member governments with respect to competition policy and antitrust laws.

At the time of the enactment of EPCA and the development of the IEA sharing system, petroleum in the United States was, in large part, subject to the domestic allocation and price restraint provisions of the Emergency Petroleum Allocation Act (EPAA). Thus a U.S. domestic fair sharing system was integrated into the EPAA domestic allocation program, and it was not a matter of discussion when EPCA was enacted. EPAA, however, expired in 1981, along with its implementing domestic allocation program.

The issue is whether EPCA can legally authorize the development of

a fair sharing or limited allocation system, although it may not have been intended to do so. Section 251 of EPCA states that

> "The President may, by rule, require that persons engaged in producing, transporting, refining, distributing, or storing petroleum products, take such action as he determines to be necessary for implementation of the obligations of the United States under Chapters III and IV of the international energy program insofar as such obligations relate to the international allocation of petroleum products ...." (Emphasis added.)

Thus, section 251 relates specifically to the "international allocation of petroleum," and chapters III and IV involve only allocation among countries and not companies.

If section 251 were relied on during a serious oil supply disruption and litigation resulted, the litigation could impede fulfillment of U.S. obligations under the IEP. We have previously testified that clarifying the legislation, before an international energy emergency occurs which would require implementation of section 251, merits consideration.

Relevant to whether litigation might arise and, if so, to what extent are the different roles of the U.S. Reporting Companies and Non-Reporting Companies. Reporting Companies are major oil

companies invited by the IEA and approved by their respective governments to actively participate in IEA activities. During tests of the emergency sharing system and implementation of the system, Reporting Companies provide data on their supply situations directly to the IEA in Paris. In addition, a subset of these companies provides representatives to serve on the IEA's Industry Advisory Board, which regularly provides advice to the IEA on emergency oil sharing and related questions. By voluntarily consenting to be Reporting Companies, such firms evidence an interest in the IEP and a commitment to making the international sharing system work during an emergency.

Non-Reporting Companies are firms that produce, import, or export oil or hold inventories but that have not been asked or consented to serve as Reporting Companies. In the United States, Non-Reporting Companies are responsible for about 50 percent of domestic oil production and net oil imports and 33 percent of refinery throughput. Thus, their willingness and ability to volunteer oil in an emergency for international allocation could determine whether a possible U.S. obligation to supply oil is met. U.S. Reporting Companies have said that their willingness depends on U.S. oil companies proportionately sharing the burden.

Mr. Chairman, that concludes my prepared statement. We would be happy to respond to any questions.