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THE U.S./EUROPEAN ENERGY SITUATION:
A REVIEW OF THE STRATEGIC SETTING

by

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Introduction

Although almost nine years have passed since the industrialized world was staggered by the dramatic OPEC oil price rises, to date the United States and Western Europe have been unable to reach a consensus on what should constitute an effective alliance energy relationship. While the political rancor emanating from both sides of the Atlantic is perhaps more muted than it was in the past, the reality of the situation is that political parochialism in Western Europe, Japan and the United States continues to make it impossible to effect a comprehensive energy program among the major OECD nations. It is this author's contention that unless we soon cast aside our partisan differences and begin to implement common strategies on such issues as conventional and non-conventional energy production, accelerated conservation, joint stock management and drawdown strategies, and common approaches on energy and security policy towards the U.S.S.R., the Middle East and the Third World, we will soon witness the collapse of the international economic order established by the Bretton Woods Agreement in the immediate aftermath of World War II. The time for action is now and I hope that this paper will serve as a useful backdrop for our discussion during the remainder of this conference.

I. The Evolution of U.S. Energy Policy In The Post Embargo Period.

In the aftermath of the 1973-74 OAPEC oil embargo, and the associated, if belated, recognition of the consequences of the U.S. dependence on imported oil, President Nixon proclaimed on November 7, 1973, that the national goal by the end of the decade should be to meet energy needs without any dependency on foreign oil. By the time President Ford released the Project Independence Report in November 1974, U.S. energy policymakers were aware that under no political circumstances could the United States become totally self-sufficient in energy at reasonable economic costs. President Ford's motto, "reasonable self-sufficiency," was increasingly heard more and more and was a harbinger of the fact that the dream of energy independence would remain a dream.

Nevertheless, President Ford advocated bold initiatives, designed for the most part to encourage the development of domestic energy supplies: creation of a 300 million barrel strategic petroleum reserve (SPR), a tariff on imported crude oil, attempts to decontrol domestic oil and natural gas prices, the authority to order major power plants to convert from oil and gas to coal, and support for the vigorous expansion of nuclear power. Although President Carter warned the nation early in his term that resolving the energy crisis was "the moral

exports, (4) conflicting special interest groups such as farming and ranching, versus energy resource development companies in the West, (5) differences between those regional refiners utilizing domestic price-controlled crude and those using high-priced imported crude and (6) conflicts between states dependent on price-controlled inter-state gas and those dependent on price-decontrolled inter-state gas.

In addition, there were and are serious regional and political differences on a whole range of environmental issues (offshore oil and gas development, nuclear waste storage, the opening of federal lands, the dangers of acid rain, etc.) that once they are lodged in the state and federal court system can delay the implementation of new energy projects for years. Moreover, the country remains politically polarized on the trade-offs between the need for higher energy prices to encourage conservation and the need to avoid renewed inflationary pressures and place further constraints on an already precarious economic recovery.

Overarching all these competing claims is a complex amalgam of state, federal, and congressional regulatory agencies and oversight committees, often working at cross purposes or duplicative in function, which in the best of circumstances require cumbersome procedures which can delay the timely implementation of a comprehensive national energy program.

These same generic problems beclouded the National Energy Plan of the Carter Administration whose basic objective was to reduce reliance on oil imports from projected levels of 16 mmbd to 6 mmbd. This was to be accomplished by greater use of coal and accelerated conservation until renewable energy sources could be developed. Nuclear power was seen as an energy source of last resort. The SPR was to be expanded to 1 billion barrels.

While the Carter Administration was attacked by its critics for unduly focusing on reducing energy demand and improving energy efficiency rather than on providing market incentives to increase energy supply, the chief problems that President Carter's National Energy Plans 1 and 2 encountered in Congress was that although legislators agreed that higher domestic oil and national gas prices were needed to encourage conservation, they could not agree on how high oil prices should go or who should benefit from the increases. They debated: should oil be priced at the world price as determined by OPEC? Would the appropriate price be the replacement cost of a depletable resource? What is a valid measure of replacement cost? Is price based on production cost plus a fair rate of return more appropriate than price based on replacement costs? These questions formed the cornerstone of the domestic policy debate.

nuclear licensing and to resolve the problems of nuclear waste storage.

The December 1978 passage of the National Energy Act, which included the National Gas Policy Act, the Powerplant and Industrial Fuel Use Act, and the Energy Conservation Policy Act, was heralded as a major step toward reducing U.S. dependence on imported oil. In reality, most of the provisions had only a marginal impact on the way Americans produced and consumed energy, while others, particularly the Powerplant and Industrial Fuel Use Act (PIFUA), actually served to increase oil imports by limiting the use of natural gas by electric utilities.

By the time of the Iranian crisis in late 1978-79, it was apparent that most government leaders did not really understand (1) how the energy industry is structured, that it is not monolithic and that segments of it are major adversaries and competitors; (2) the degree to which deep seated regional, economic, political and social issues are affected in the process of energy policy implementation; and (3) that enactment of an energy program requires serious trade-offs in terms of other social goals, such as protection of the environment and equitable distribution of income regionally.

Although oil imports fell from 8.8 mmbd in 1977 to 8.2 mmbd in 1978, the U.S. energy situation had improved very

- Japan and members of the European Economic Community (EEC), notably France, sought bilateral deals with the Arab oil producers to ensure access to oil supplies - possibly to the detriment of other consuming states.
- A European-Arab dialogue began in June 1975 without the participation of Japan and the United States.
- Participants in the 1975-77 Conference on International Economic Cooperation disagreed about policies that would ensure access to oil supplies at reasonable prices.
- Europe and Japan became suspicious of U.S. motives in seeking a special relationship with Saudi Arabia at the very time (June 1974) the United States was urging allied cohesion and formation of the International Energy Agency (IEA); Europe and Japan feared the United States was moving to protect its own interest at their expense.
- Europe, Japan, and the United States differed about international nuclear policy, especially the development and export of enrichment and reprocessing facilities that could be utilized to manufacture nuclear weapons.
- Europe, Japan, and the United States disagreed about what policies to adopt in the Arab-Israeli dispute.

the time needed to exploit them, new developments in enhanced oil and gas recovery technology, and the enormous potential for energy savings that could be made available through the more efficient use of energy. The events of 1979 completely shattered this complacency.

The removal of 5 mmbd of Iranian oil from the international market between December 27, 1978 and March 1979 generated shock waves in the industrialized world. Overnight 3 mmbd of surplus oil production was eliminated and world oil reserves were drawn down at the rate of 2 mmbd. The fall in Iranian production set off panic in the spot market as large independents, small refiners and other new market entrants rushed to buy oil, sending prices soaring. In a portent of the future, producers abrogated existing contracts, diverting more oil into the spot market. OPEC financial reserves began to escalate again. The oil bazaar was upon us.

Geopolitically, the fall of the Shah sent political convulsions throughout the Persian Gulf, especially in Saudi Arabia. Riyadh queried whether the United States could be counted upon to support the Kingdom, if Washington failed to support the Shah, whom only a year earlier President Carter had toasted as "an island of stability" in a sea of chaos. The Saudis were incredulous that Washington could watch the demise of a regime which formed the cornerstone of its Middle Eastern

bill of the OECD nations from \$140 billion in 1978 to \$290 billion in 1980. As a direct result of these events GDP in the OECD fell by 2 percent, an amount roughly equal to the price effects of the 1973-74 crisis. Unlike the earlier crisis, however, the overall macroeconomic effects were exacerbated by a deflationary impact occurring as a result of delayed OPEC expenditures and tightening monetary and fiscal policies by most OECD members. Whereas the IEA countries had averaged about 3.6% per annum GDP growth between 1976-1979, in 1980 and 1981, GDP growth fell to about 1%, 1.2 percent respectively.

V. The Oil Glut: The European and U.S. Responses

Although it is always easy to be prescient with hindsight, on balance, a review of the U.S./European response to the energy situation during 1978-80 leaves one with the conclusion that the alliance was in disarray. By 1981, the results of the Bonn, Tokyo and Venice Summits demonstrated little except that Western Europe, Japan and the United States continued to an extraordinary degree to pursue their own parochial interests to the detriment of the larger interests of the industrialized world. Oratory notwithstanding, the 1980 Venice Summit's goal of reducing oil's share in total energy use from

53 to 40 percent and developing non-oil energy supplies equivalent to 15-20 mmbd by 1990 could not be taken seriously in the absence of concrete programs designed to achieve this goal. The fact that the best the Summit participants had to offer was a clarion call for a "large" increase in coal and "enhanced" use of nuclear power in the medium term, and, in the longer term, synthetic fuels, solar, and other forms of renewable energy left one feeling that one had entered into Alice's Wonderland.

Coming in the aftermath of the seizure of the Grand Mosque in Mecca, the Soviet intervention in Afghanistan, growing signs of a major political destabilization in the Middle East and rising concerns over the stability of the international financial system, the leadership of the industrialized world both in the public and private sectors has been paralyzed into inaction.

While the change in political leadership in the United States and in much of Western Europe during the last several years has brought some positive energy policy developments, alliance energy relations remain contentious. Tragically, I must note that key issues (continued U.S. price controls on U.S. natural gas, U.S. coal export policy, U.S. nuclear policy, alliance energy trade with the U.S.S.R., U.S. and European differences over U.S. Middle Eastern policy, U.S. monetary and

fiscal policy, OECD policy towards the Third World) have been on the agenda since at least 1973. The fact that they are now at as high a fever pitch as at any time since 1973 demonstrates the degree to which we have failed to address some of the most serious political, social and economic problems confronting the global community.

Since taking office in January 1981, the Reagan Administration has taken a firm stand in demonstrating its commitment to a domestic energy policy which minimizes the federal role and leaves to the marketplace the future of U.S. energy supply and demand. In this regard, the President's decision to accelerate the decontrol of oil was a positive step. Nonetheless, there are many issues that remain unresolved. Among these the Administration must give priority attention to the accelerated decontrol of natural gas prices at the wellhead, a removal of demand restrictions on natural gas in the industrial and electric utility sectors, a reexamination of the Alaska Natural Gas Transportation system, the establishment of a comprehensive policy on electric power, including the extension of federal statutory and adjudicative authority to establish time limits for rate reviews by local or state Public Utility Commissions.

In addition, the U.S. government must move as rapidly as possible to propose legislation to modify the Clean Air Act to

allow the greater utilization of coal both domestically and internationally. The U.S. government should formulate strong legislation to combat the pollution of Canadian and European natural resources by acid rain and move to end the regulatory bottlenecks at the state and federal level that block enhanced coal exports to Western Europe and Japan. Only when such obstacles are removed, will the United States have the capability to offer a partial viable alternative to still greater European dependence on Soviet natural gas in the 1990's.

In the nuclear arena, policy areas demanding immediate attention are, (1) the establishment of generic design and licensing procedures, (2) a streamlining of the regulatory process, (3) the enactment of a comprehensive nuclear export policy, (4) the establishment by the U.S. private sector of a nuclear reprocessing and breeder reactor capability, (5) the enactment, with federal preemption of states' rights if necessary, of an away from reactor long-term nuclear waste storage facility, (6) a reassessment of U.S. non-proliferation policy emphasizing new approaches, such as enhanced diplomatic and financial support for the IAEA inspection system, the creation of more nuclear free zones and the establishment of an international plutonium regime.

Finally, a major task for U.S. energy policy in the 1980's will be to establish national conservation goals which are both

cost effective and environmentally sound. Some of the major policy areas demanding attention are: (1) Federal government support of fuel economy standards for all major home appliances, especially for gas consuming equipment; (2) the extension of tax incentives to consumers for insulation and the installation of very efficient gas boilers and furnaces, (3) the extension of tax credits to include alternative heating systems (biomass, wood, heat pumps, electric furnaces, etc.); (4) more liberal depreciation of industry investments in high-efficiency heating and power equipment; (5) the repeal of the Fuel Use Act; (6) the lifting of all bans on oil and gas use by industry in any of its processes; (7) the expansion of the statutory authority of the Synthetic Fuels Corporation to promote conservation programs and to provide loans for upgrading U.S. refinery capacity; (8) the U.S. government should assess the role that cost effective accelerated conservation can play in reducing demand for new electric power plants; (9) the extension of fuel economy standards, the development of more fuel efficient vehicles and the rapid expansion of mass transit systems; (10) the expansion of conservation programs by state and local governments.

In Western Europe, there is no less need for vigorous action in the energy programs of individual governments, in the European Economic Community, and in the IEA. While time does not allow a detailed discussion, some of the key policy issues

demanding immediate attention are (1) a reconciliation of structural differences in the IEA and EEC emergency oil sharing mechanisms which may create problems in a crisis; (2) the establishment of common IEA stock build and drawdown policies; (3) the enactment of bold and mandatory demand restraint programs to be enacted by the IEA membership at the onset of a crisis (both trigger and pre-trigger); (4) the removal throughout Europe (and the United States) of electricity tariffs that decline as the amount bought by the consumer increases. Policy in this area should be shifted to increase tariffs as electricity consumption increase; (5) the enactment of a comprehensive European program on coal and oil refining which fully takes cognizance of the unique structural problems plaguing Italy's oil refineries and yet still encourages the production and consumption of EEC-produced coal; (6) the enactment of a comprehensive Community policy towards nuclear energy, which can be accepted by all European states; (7) a move towards greater energy policy coordination between the North Sea oil and gas producers and the rest of Western Europe; (8) the removal of tax and regulatory barriers hindering accelerated development of European energy resources and (9) the enactment of a common European/U.S. policy on East-West trade.

While many of the delegates to this conference from both sides of the Atlantic may take strong exception to some of my

policy recommendations or argue that political realities prohibit their enactment, I challenge you to cast aside your negativism and at least consider the possibility that a bold new alliance commitment in these and many other areas is possible.

The time to act is now. With the possibility of renewed hostilities in the Middle East, the prospect of further shocks to the international financial system, growing divisions in the Western alliance and the prospect of new political and economic convulsions in the major oil producing nations all looming before us, it is essential that we on both sides of the Atlantic drop our parochialism, tone down our rhetoric on those issues that divide us, and embark on pragmatic directions that address these problems. Let us hope we will do so and demonstrate the forceful united leadership that will insure our joint global energy security for the remainder of the century.

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