

DOENNEWS:

ENERGY RISKS AND ENERGY FUTURES:

SOME FAREWELL OBSERVATIONS

BY

JAMES R. SCHLESINGER

THE NATION'S FIRST SECRETARY OF ENERGY

ADDRESS BEFORE

THE NATIONAL PRESS CLUB

Washington, D.C.

August 16, 1979

stability in the region. After 1945, American pressure could persuade Stalin himself to remove Soviet forces from Northern Iran. Today, the pressures from Mr. Brezhnev flow in the opposite direction. The geostrategic landscape has been dramatically altered. The crumbling of the Northern Tier, the political disturbances in the Yemens, and in the Horn of Africa, and the vulnerability of the other states of the Gulf -- all point to the need for a new and effective response.

Even in terms of the military balance, the trends are disturbing. The Soviet Union lies near at hand -- hovering over a region to which Russia has aspired since the days of Peter the Great. Its military power continues to grow -- most ominously in the form of increasing strategic mobility and the strength of its airborne divisions. Within the region itself, there is no counterweight. The Shah's forces might have put up a scrappy defense, but today security rests upon the protection of Allah. The forces of the West in the region are small and are at the distant end of lengthy supply lines. The great military reserves of the West lie far away -- with all that that implies for rapid response. There is no significant and continuing military presence of the United States -- a fact that the inhabitants in the region must ponder as they contemplate that brooding presence to the North.

For the many Americans who since Vietnam have come to believe that military weakness is a form of virtue and of moral strength, these conditions cause little alarm. Quiet accommodation is the only such defense -- and clear indications of the reasonableness of this view are always to be found. Of late, Mr. Georgi Arbatov, whose links to the KGB are perhaps not so well known as his ability to influence and pacify American elites, has opined in an interview that the Soviet Union "would certainly not interfere with Western oil supplies" for these "would be very hostile acts, close to a declaration of hostilities." Some will, no doubt, find such offhand verbal guarantees wholly reassuring. I merely note that the episode provides a clue to those options about which the Soviets have been ruminating -- and which, we may hope, they have rejected, at least for the moment.

For those less complacent, the underlying implications are stark. Soviet control of the oil tap in the Middle East would mean the end of the world as we have known it since 1945 and of the association of free nations.

That quite clearly implies that we cannot for long acquiesce in a regional preponderance of Soviet military power. A minimum requirement is the establishment within the region of a rough balance of military power. Without such a balance there will be no deterrent force capable of resisting long-term Soviet pressure

the near-term energy future depends upon a politically stable Saudi Arabia, we must also recognize that the Kingdom is today a nation exposed to the ferment of social change. It is one in which the sensitivity to corruption is rising -- dramatically so in the wake of last year's events in Iran. And, if we do not acknowledge the possible relevance of Iranian developments, we have only to turn back to de Tocqueville as to the impact of massive economic change on traditional social structures. The subject is one so delicate that it is rarely even alluded to, yet reticence hardly should suggest that the subject is not one of the utmost gravity.

The comments to this point only underscore that the flow of OPEC oil is precarious -- and potentially subject to severe and unpredictable shocks. Yet, even if we are lucky and there are no intermittent supply interruptions, the overall flow of such oil is unlikely to increase.

Productive capacity in the OPEC nations is unlikely to grow. That forecast reflects the likely political decisions regarding the attractiveness of additional investment in capacity -- as well as resource limitations. OPEC production will not increase by even as much as ten percent from current levels -- and indeed is just as likely to recede over the years ahead. Non-OPEC production may increase significantly in

percentage terms -- but from a relatively low base. In absolute terms, such non-OPEC increases will be less significant -- perhaps ten percent of present Free World consumption -- and this in large degree will be absorbed by the less developed countries and by other industrial nations. Worldwide oil production -- and consumption -- will never much exceed 65 million barrels a day, and we are already very close to that level. Oil, the fuel of choice, that has driven the vast economic expansion since World War II will no longer be available in increasing quantities to fuel the further growth of the world's economy.

Prices will inevitably reflect the increasing pressures of demand against constrained supply. Saudi leverage for moderating price increases within OPEC has already been significantly reduced. With little or no excess capacity the inevitable movement of prices, save in the face of worldwide recession, will be upward.

Under these circumstances, it is understandable, and has become fashionable, to rail against the OPEC cartel. That, no doubt, is emotionally satisfying. But we should fully understand that no amount of invective or fistshaking is likely to change the realities of supply and price. The OPEC nations possess some eighty percent of the Free World's proven oil reserves -- and that percentage is likely to increase. Moreover, market forces

presuppositions: what supplies are likely, what prices are acceptable, what fuels are acceptable, what risks are acceptable, and what environmental and other regulations are workable.

Domestic crude oil production, we should recognize, is not going to increase and is likely to decline over the next decade. Decontrol will merely slow down the rate of decline. If we work terribly hard and if we are terribly lucky in the frontier areas, we may be able to keep crude oil production close to present levels. The United States, after all, is currently producing as much oil as is Saudi Arabia. But we are exploiting our own proven reserves about six times as rapidly. That cannot continue for long.

The prospects for domestic natural gas production happily are more promising. But we are unlikely over the next decade to increase production significantly above present levels. Therefore, overall, we shall not see additional domestic supplies of hydrocarbons. If oil imports are stabilized at 8.5 million barrels a day either through deliberate import restriction or lack of availability, we shall have to look elsewhere -- if the economy is to continue to grow.

Despite the substantial and pleasing efficacy of conservation, additional energy will continue to be required for economic growth. The energy

coefficient has now been reduced to .5 or .6. We should strive to keep it there -- and I am confident we shall succeed. Nonetheless the use of coal and nuclear power will jointly have to grow -- at the rate of six percent annum if we are to maintain moderate economic growth.

It is as simple as that. With the availability of hydrocarbons basically stable, coal and nuclear must grow more rapidly in percentage terms from their present relatively low base. But coal use will not grow sufficiently rapidly, so long as the mechanics of the Clean Air Act remain unchanged. While we can support the retention of ambient air quality standards, we cannot achieve the necessary growth of coal use in the face of the existing mechanical and legislative impediments. The well-known psychological and procedural obstacles to the construction of nuclear power plants will also have to be overcome.

Quite bluntly, unless we achieve the greater use of coal and nuclear power -- over the next decade, this society may just not make it.

For the longer run, we should proceed with the production of synfuels. Synfuels, however, will not significantly affect the equation for the decade ahead. By the 90s such production could represent a useful augmentation of supply. It is no panacea. Yet, if we had inaugurated such a program a decade ago, the oil market would

QUESTIONS AND ANSWERS
FOLLOWING
ADDRESS OF
JAMES R. SCHLESINGER
THE SECRETARY OF ENERGY
BEFORE
THE NATIONAL PRESS CLUB

AUGUST 16, 1979
Washington, D.C.

Q. We will try to move quickly through the questions here. Mr. Secretary, to begin with we had a number of questions on this subject -- do you still support both the result and the methodology of the recent DOE preliminary report exonerating the oil industry from culpability in the oil shortage this summer?

A. Sure. That is the short answer. The methodology is fine. The results were indicated to be tentative, depending on further explorations. We have, as you know, 600 auditors. Now we are still working over the major refineries, looking for signs of moral imperfection or culpability. They may yet come up with something.

We have an independent auditor also at work. We have indicated that when these results are available, they will be ground into the final report.

There is somewhere the belief that sooner or later somebody is going to come up with evidence that there is a conspiracy out there akin to the old Standard Oil trust, and so when the evidence of the first blush does not appear, we are urged to go back and find some more.

I expect that we will be subjected to such urgings continuously over the years ahead.

- Q. Several questioners are asking you to comment on the report about the prospects that a milder than expected recession and a colder than expected winter might push oil imports up to the 8.2 million barrel a day limit the President has set much sooner than expected.
- A. Improbable, very improbable for 1979; there was a margin for error in the ceiling that was established and there continues to be. I think that there has been in some respects some confusion between net imports and gross imports. Net imports will not approach the ceiling, irrespective of the winter or a mild recession.

I do not think that the recession is likely to be that mild, in any event.

Q. Paraphrasing a number of other questions on the Mexican gas negotiations, has President Lopez Portilla reneged on a pledge to Ambassador Luce to accept a \$3.40 a thousand cubic foot price and demand \$3.75 instead, and would you evaluate the prospects for that sale ever coming about now?

A. I have no intention to comment directly on the negotiations. I hope as I have all along that we shall come to some accommodation with regard to price, that it is equitable from the standpoint of all countries.

In recent months, the tone of the negotiations has been encouraging. There has been a loss of momentum in recent weeks. I hope that that momentum is restored.

Q. What differences, if any, do you see between a Schlesinger Department of Energy and a Duncan Department of Energy?

A. Charles Duncan, who is a good man and a patriot, will be subjected to something the constitution prohibits, namely, cruel and inhuman punishment, and I shall not be. From a subjective standpoint, that is a pleasing development.

Q. What specifically do you think the United States should do if there is another Iranian oil interruption, and what lessons do you think the United States has learned, although you touched on them, from the last Iranian cutoff?

A. What was it that Alfred North Whitehead said about the suspension of disbelief? I think during the crisis as it resulted in gasoline lines, there was some momentary suspension of disbelief in the basic oil problem.

What we learned, what we have learned I would hope, first, that we should do one of two things -- either the major oil companies should move toward allocation fractions much more rapidly than they did in the first quarter of this year, or the Department of Energy should be given greater authority to determine such fractions.

I think that if we had moved more rapidly in the first quarter, the burdens of the second quarter would have been mitigated.

A second problem that we will have to recognize is a difficult one to accept. There is no power in the American Constitution or in the general will of the American people or from God above that will permit us to control both price and supply at the same time; that the consequences of maintaining price controls

are to affect supply. Overall, the United States received a smaller percentage of its historical share of the world oil supplies partly as a result of the prices that we experienced.

Germany, to take another case, just has gone on building inventories using more and more fuel during the entire period.

Thirdly, with regard to our domestic scene, once again, there is no one ingenious enough to substitute for the effect of the market. Consequently, there is no way that government bureaucrats, particularly with the limited powers that they have, are in a position to determine allocations under a system of price control and allocations.

Inevitably the effect of imposing allocations is to shift the pattern of demand so that any allocations based upon historical shares which reflect some concept of equity will inevitably result in the mis-allocation of fuel supplies. Those are the lessons I think we should learn. I am not entirely confident that we have learned them.

Q. On the wall out here in the National Press Club foyer there is a copy of the journalist's code of ethics that was written by Walter Williams some 50 or 60 years ago, and I notice that with a very bemused smile on his face, the Secretary was reading it as he came in, and given that, would you please evaluate for good or ill the effect of media coverage on the energy crisis, including, of course, the Three Mile Island accident and coverage of the various ups and downs of Carter programs in Congress?

A. I do not know whether this is intended as comic relief or something else! I am intending to copy down the first paragraph of that code. It talks about the requirements of the journalist as ultimately to serve, to perform a public service and the ultimate public service that the journalist can perform is to provide the American people with the necessary knowledge to deal with the realities of today and the trends that will be brought tomorrow.

That is a very high responsibility imposed on the fourth estate. My experience in these recent months has been that it has not been well fulfilled. The complexities of this issue have never been fully brought out into the American people, with the exception I think of a few noteworthy newspapers, but I want to stress that overall the performance has not been a good one.

This is an immensely complex issue, and it bears, as I attempted to say earlier, on the survival of this Country, of its institutions and of its freedoms. These longer-run trends were never brought out at the grass roots level. Much of the information that was delivered was in terms of attacks on government institutions or on the oil industry.

As I indicated before, let me say that demagoguery will provide no more crude oil, and demagoguery in journalism is no more savory than any place else.

I think that we have a lot that we can learn and we must learn if we are to make these adjustments. During the energy crisis, there was a woman who drove into a station in Bethesda who said angrily, "it is the duty of the government to provide me with my gasoline."

What about that complex logistical chain that starts in the Persian Gulf and is subject to interruption by all sorts of political, economic and military events?

The fall of the Shah was a political cataclysm affecting the United States and its longer-term interests. It has started a chain reaction. It is altering the power balance within the Persian Gulf in ways that can affect the long-term fuel supplies, our economy and our political system.

Surely these kinds of issues to be conveyed to the American people are as significant as the arguments about when the local service station is to remain open and the rudiments of the odd-even system and I may say that that was, with all its defects, the tone of American journalism roughly from Pearl Harbor to the midpoint of the Vietnamese war. It was supportive of our nation's social purposes. Sometimes those social purposes were wrong, but we are not going to be able, in my judgment, to get through the next couple of decades unless we return to some degree to that understanding and the presence of our social purposes and why the government is attempting to do certain things.

Absent that, we will have great difficulties. I know that a free society cannot survive without a free press. Right now we are testing whether a free society can survive with a free press.

Q. Considering the legislation before Congress now from the President about creating some priority projects, energy projects designated priority energy projects, cutting through some of the bureaucratic delays involved in getting them approved, would you care to single out five or fewer projects that you think are most important, most realistic in terms of completion possibly over the next five or ten years?

A. The Energy Mobilization Board notably does not deal with nuclear projects. The main problem that we have had in recent years is in transportation facilities, pipelines and harbors. The most notable project, one that recently went down the tubes, was the Sohio project. We would hope to move ahead with the Alaska Natural Gas Pipeline, the Northern Tier Pipeline project, or its equivalent, seeing to it that the necessary permits are moved ahead and unequivocally there will be involvement of the Energy Mobilization Board in the development of specific mines or the drilling of specific oil fields, if indeed there are impediments.

The Energy Mobilization Board, unless it has the teeth and the force to get the job done, will not accomplish miracles. Therefore, I think it will have to be watched very carefully to see whether indeed it is provided with the necessary tools.

We have done some strange things in this Country in recent years in that through the growth of participatory democracy, we have given almost all groups through the right of involvement in the decision process the capacity to block a decision.

Everyone has the right to say no. No one singly can say go ahead, and it is this massive accumulation of law, procedure, right, litigation and sheer sabotage that we are attempting to unblock.

Q. A question I was handed says John O'Leary will make \$5,000 a speech. Are you worth \$10,000?

A. At a minimum!

Q. Can you explain for us what future plans you have if they are set yet?

A. And they are underpricing Jack! No, I have no plans except to get one or two portraits painted. The first one I am owed from my days as Secretary of Defense. The second one is conjectural given the policy at the present time that the cabinet members get photographed rather than painted. We will see what that outcome is. Aside from that, I plan to take considerable time off and ruminate about the future of the society.

- Q. It might be worthwhile to have those photographs taken with a Polaroid these days!

Next to the last question -- Dr. Schlesinger, what in your opinion are the benefits to the nation in terms of energy supplies of the Kennedy-Metzenbaum bill that would ban oil company mergers outside their own energy field?

- A. There is no benefit in terms of energy supply. Unless the bill is very carefully controlled, the Administration's position is if it increases energy supply, if energy supply is increased, that will be regarded as improving competition and consequently a merger can take place.

In the crudest anti-merger form, there would be no augmentation of supply possibly simply because the capital that needs to flow from the oil industry, as it liquidates its inventories, would be unavailable elsewhere and in terms of capital formulation, that is hardly a beneficial outcome.

I do not believe that the legislation was designed to have a beneficial outcome in terms of energy supply. I think that the calculations were more in terms of energy supply. I think that the calculations were more in the political realm.

- Q. Before I ask the last question, I want to present you with this certificate of appreciation for being here and for having been here many previous times in many previous roles and this National Press Club tie.

Thank you for being here. Perhaps this is the perfect ending for your last public appearance as Secretary of Energy.

As the first Secretary of Energy, do you agree, Mr. Secretary, with the motto of the Christophers that it is better to light one candle than curse the darkness?

- A. Yes. I trust that as a result of intelligent policy and the growth of an effective national consensus that we will still have those candles to light.

Thank you.