S. Hrg. 100-171

IMPACT OF IMPORTS AND FOREIGN INVESTMENT ON NATIONAL SECURITY

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

S. 285, S. 470, S. 490, S. 694, and Section 171 of H.R. 3

WEDNESDAY, MARCH 25, 1987

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COMMITTEE ON FINANCE

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IMPACT OF IMPORTS AND FOREIGN INVESTMENT ON NATIONAL SECURITY

WEDNESDAY, MARCH 25, 1987

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to notice, at 10:05 a.m. in room SD-215, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman) presiding.

Present: Senators Bentsen, Baucus, Boren, Riegle, Rockefeller, Daschle, Packwood, Roth, Danforth, Chafee, Heinz, Wallop, and Durenberger.

[The press release announcing the hearing, and the prepared written statements of Senators Bentsen, Boren, Chafee, and Wallop follow:]

[Press Release No. H-29]

FINANCE COMMITTEE TO HOLD A HEARING ON THE IMPACT OF IMPORTS AND FOREIGN INVESTMENT ON NATIONAL SECURITY

WASHINGTON, DC.—Senator Lloyd Bentsen (D., Texas), Chairman of the Senate Finance Committee, announced Wednesday that the Committee will hold a hearing on the impact of imports on national security, including the provisions of S. 285, introduced by Senator Byrd; title V of S. 490, the Senate trade bill, introduced by Senators Bentsen and Danforth; S. 470, introduced by Senator Grassley; S. 694, introduced by Senator Bentsen and others; and section 171 of H.R. 3.

"Concern is increasing that American law designed to prevent imports from impairing our national security has not been effectively and promptly enforced," Senator Bentsen said. "We see a rising dependency on such basic elements of our economy as petroleum and the most important types of semiconductors, with imports accounting for 40 percent of domestic consumption."

The hearing will be held at 10:00 a.m. on Wednesday, March 25, 1987, in Room SD-215 of the Dirken Senate Office Building.

STATEMENT OF THE HONORABLE LLOYD BENTSEN AT A FINANCE COMMITTEE HEARING ON THE IMPACT OF IMPORTS AND FOREIGN INVESTMENT ON NATIONAL SECURITY

WEDNESDAY, MARCH 25, 1987

TODAY, THE FINANCE COMMITTEE WILL BE TAKING TESTIMONY ON THE IMPACT OF IMPORTS AND FOREIGN INVESTMENT ON OUR NATIONAL SECURITY. IN MY VIEW, THE ISSUE IS AN IMPORTANT ONE. IT IS ALSO AS TIMELY AS ANY ISSUE WE WILL ADDRESS.

THE NATIONAL SECURITY IMPLICATIONS OF IMPORT DEPENDENCE HAVE BEEN VERY MUCH IN THE HEADLINES IN RECENT WEEKS. I AM REFERRING, OF COURSE, TO THE ALMOST DAILY COMMENTARY ON THIS NATION'S GROWING RELIANCE ON FOREIGN OIL. IN ORDER TO BRING THE PROCESS OF ANALYSIS MUCH MORE BEFORE THE PUBLIC EYE, THE DEPARTMENT OF ENERGY ISSUED ITS LONG-AWAITED MARTIN REPORT ON ENERGY SECURITY JUST A FEW DAYS AGO. NOT SURPRISING WAS THE REPORT'S CONCLUSION THAT THERE IS A THREAT TO THE SECURITY OF THE UNITED STATES IN OVERDEPENDENCE ON IMPORTED OIL.

THE CONCLUSION WAS EXPECTED. THIS COUNTRY INDEED FACES A SERIOUS THREAT TO ITS NATIONAL SECURITY. ALL THE STATISTICS POINT TO IT. ALL THE TRENDS ARE BAD, AND ARE GETTING WORSE.

CONSIDER THE EFFECT OF CHEAP FOREIGN OIL ON DOMESTIC PRODUCTION OF PETROLEUM. CRUDE OIL PRODUCTION IN AMERICA HAS FALLEN BY 752,000 BARRELS PER DAY IN THE PAST YEAR, A DECLINE OF 8.2 PERCENT. PRODUCTION OF NATURAL GAS LIQUIDS IS OFF BY 123,000 BARRELS PER DAY, 7.4 PERCENT LESS THAN IT WAS A YEAR AGO. THE EXPERTS ARE SAYING THAT WE CAN EXPECT THESE DECLINES TO ACCELERATE IN THE WEEKS AHEAD.

CONSUMPTION IS ON THE RISE--RAPIDLY. TOTAL DOMESTIC DEMAND FOR PETROLEUM PRODUCTS IN 1986 WAS 3.3 PERCENT HIGHER THAN IT WAS IN 1985. IT'S UP ABOUT 2.6 PERCENT FROM THIS TIME A YEAR AGO. CONSUMERS ARE FORGETTING THE PAINFUL LESSONS OF THE PAST. CONSERVATION IS PASSE. WE ARE ON AN OIL BINGE.

AND IMPORTS OF OIL? THEY ARE WAY, WAY, WAY UP. IMPORTS OF CRUDE OIL ARE UP TO 3.6 MILLION BARRELS PER DAY, 22.5 PERCENT ABOVE THE LEVEL OF A YEAR AGO. IMPORTS OF PETROLEUM PRODUCT? UP 26 PERCENT IN THE PAST YEAR TO A LEVEL OF MORE THAN 2 MILLION BARRELS PER DAY. EXPRESSED IN TERMS OF A RANGE THAT ACCOUNTS FOR FLUCTUATIONS, WE NOW IMPORT BETWEEN 37 PERCENT AND 42 PERCENT OF THE PETROLEUM THAT WE USE.

THIS NATION IS BECOMING ADDICTED TO FOREIGN OIL. A NUMBER OF REPUTABLE STUDIES PREDICT THAT WE WILL BE IMPORTING MORE THAN HALF OF THE PETROLEUM WE CONSUME WITHIN THE NEXT FEW YEARS.

ONE STUDY SAYS THAT WE COULD CROSS THE 50 PERCENT MARK LATE NEXT YEAR IF CONSUMPTION CONTINUES ITS SHARP RISE.

SOME COMMENTATORS HAVE CALLED THE 50 PERCENT MARK A "PERIL POINT," AND WITH GOOD REASON. ALL THAT NEW OIL FLOODING INTO THE COUNTRY ISN'T COMING FROM CANADA, MEXICO, OR VENEZUELA. IT'S COMING FROM THE MIDDLE EAST, ESPECIALLY FROM SAUDI ARABIA. THE SOURCE OF THE SUPPLY IS EASILY EXPLAINED. THE SUPER-GIANT FIELDS OF THE PERSIAN GULF ARE THE FIELDS FROM WHICH OIL CAN BE LIFTED FOR PENNIES A BARREL. OVERDEPENDENCE ON THEM, HOWEVER, MAY COST US FAR MORE THAN WE CAN PAY.

FOR THAT REASON, I HAVE INTRODUCED S. 694, THE ENERGY SECURITY ACT OF 1987. THE PRIMARY CO-SPONSOR OF THE LEGISLATION IS MY GOOD FRIEND FROM WYOMING, SENATOR MALCOLM WALLOP. TWENTY-THREE OTHER SENATORS, REPUBLICANS AND DEMOCRATS FROM PRODUCING AND NON-PRODUCING STATES, HAVE JOINED US IN THIS EFFORT. WE BELIEVE THERE IS AN ACTION WE CAN TAKE TODAY TO PREVENT A CALAMITY TOMORROW.

S. 694 IS A STRAIGHTFORWARD BILL. IT PROPOSES NO DRASTIC, COSTLY REMEDY TO THE PROBLEM OF OVERDEPENDENCE ON IMPORTED OIL. IT SUPPOSES NO ADDITIONAL AUTHORITY IN THE PRESIDENT THAT HE DOES NOT ALREADY POSSESS UNDER SECTION 232 OF THE TRADE EXPANSION ACT OF 1962.

IT DOES NOT TIE THE PRESIDENT'S HANDS AND THEREFORE DOES NOT INVADE THE CONSTITUTIONAL DUTY OF THE PRESIDENT TO PRESERVE OUR NATIONAL SECURITY.

AT THE HEART OF S. 694 IS A SIMPLE IDEA. EACH YEAR WITH HIS BUDGET, THE PRESIDENT WILL SUBMIT TO CONGRESS A THREE-YEAR PROJECTION OF THE NATION'S DEPENDENCE ON FOREIGN OIL. IF THAT PROJECTION SHOWS THAT WE WILL SATISFY MORE THAN 50 PERCENT OF OUR CONSUMPTION WITH FOREIGN OIL IN ANY YEAR, THE PRESIDENT WILL BE REQUIRED TO PRESENT TO CONGRESS WITHIN 90 DAYS A PLAN TO HOLD OIL IMPORTS BELOW THE 50 PERCENT MARK. AT THE SOLE DISCRETION OF THE PRESIDENT, THAT PLAN MAY CONTAIN OIL IMPORT FEES, CONSERVATION INITIATIVES, INCENTIVES FOR DOMESTIC PRODUCTION, OR ANY COMBINATION OF THESE OR OTHER ACTIONS AIMED AT KEEPING THE LEVEL OF OIL IMPORTS DOWN. THE PLAN WILL LIE BEFORE CONGRESS FOR 90 DAYS AND WILL GO INTO EFFECT UNLESS CONGRESS DISAPPROVES IT BY JOINT RESOLUTION.

S. 694 DOES NOT CONTAIN THE SOLUTION TO THE NATION'S REAL ENERGY PROBLEM--THE NEGLECT OF NATIONAL ENERGY POLICY. WE SAW THAT NEGLECT AGAIN IN THE MARTIN REPORT--HUNDREDS OF PAGES OF ERUDITE DISCUSSION BUT NOT A SINGLE RECOMMENDATION. BUT S. 694 DOES DRAW THE LINE IN THE SAND. IT SENDS A SIGNAL AROUND THE WORLD THAT THERE ARE LIMITS TO THE QUANTITY OF OIL IMPORTS THAT WE WILL TOLERATE.

IT IS A SIGN TO OUR DOMESTIC PETROLEUM INDUSTRY THAT WE WILL NOT ALLOW THEM TO BE WIPED OUT BY FOREIGN GOVERNMENTS WIELDING INCREDIBLE POWER IN WORLD OIL MARKETS. IT IS A FIRST STEP TOWARD A RESPONSIBLE NATIONAL ENERGY POLICY FOR THE UNITED STATES.

THE ISSUE THAT I HAVE JUST DISCUSSED IS NOT CONFINED TO TRADE IN OIL, THOUGH THAT IS WHERE IT IS MOST OBVIOUS AT THE PRESENT TIME. A DEFENSE DEPARTMENT REPORT HIGHLIGHTS ANOTHER INDUSTRIAL SECTOR NEEDING ATTENTION. THE REPORT CONCLUDES THAT THE EXISTENCE OF A HEALTHY SEMICONDUCTOR INDUSTRY IS CRITICAL TO OUR NATIONAL DEFENSE BECAUSE WE MUST HAVE TECHNOLOGICALLY ADVANCED WEAPONRY.

AT THIS POINT, I WISH TO WELCOME OUR FIRST WITNESS, THE DISTINGUISHED MAJORITY LEADER OF THE UNITED STATES SENATE, THE HONORABLE ROBERT BYRD OF WEST VIRGINIA. SENATOR BYRD AND I SHARE AN INTEREST IN THE NATIONAL SECURITY DIMENSION OF THE TRADE DEBATE. IT WAS WITH A SENSE OF APPRECIATION THAT I REVIEWED HIS BILL--S. 285, THE NATIONAL SECURITY TRADE ACT OF 1987--AND BROUGHT IT BEFORE THE FINANCE COMMITTEE TODAY.

STATEMENT OF SEN. DAVID BOREN

MR. CHAIRMAN:

I commend you for calling this most important hearing. We have for too long ignored the national security implications of our rising demand for foreign sourced oil. The most recent figures from the American Petroleum Institute show a 24% increase in imports of oil and petroleum products over the past 12 month period. We are now importing over 6,000,000 barrels per day from foreign countries. When combined with the most recent rig count, only 766 currently operating, these numbers point the way towards only one conclusion - the United States will be forced to rely on foreign oil for over 50% of our energy needs by 1990. Mr. Chairman that is a risk we cannot take.

The Energy Security Act of 1987, which the distinguished Chairman introduced and which I am pleased to be an original co-sponsor, would put into place a framework that would not allow us to take that risk through inaction. This legislation requires the President to submit to Congress annually projections detailing anticipated domestic oil production, demand, and imports for a three year period. If imports are projected to exceed 50% the President is obligated to submit an energy plan to Congress within 90 days containing steps adequate to prevent us from exceeding that 50% threshold.

Mr. Chairman, I hope that any energy plan submitted by the President to Congress will be different in nature than the most recent report produced by the Energy Department. While I am glad to see the Department of Energy finally show some concern for the state of our domestic energy industry, the Report makes no specific recommendations. It is only in a letter to the President that Secretary Herrington makes some specific recommendations. Let me say briefly that before we give percentage depletion back to the major integrated oil companies we must first make sure that the small independent producer has some income. All of the percentage depletion in the world won't help you if you aren't making any money!

If Secretary Herrington is serious about helping our domestic producers he would consider recommending first, the removal of intangible drilling costs (IDC's) as a preference item for the alternative minimum tax; second, the repeal of the 65% limitation of depletion against taxable income; and third, the continued support of the repeal of the 50% net income limitation for depletion. Only then should we discuss the possibility of increasing the rate of percentage depletion.

Let me state in no uncertain terms that I believe a properly crafted import fee on foreign oil and refined petroleum products is the quickest way to return stability to our domestic industry. Domestic production has dropped over 800,000 barrels per day during the past 12 months. This hemorrhaging within the industry can only be stopped by decisive action, not by abstract academic studies. Believe me Mr. Chairman, if we don't act quickly to address the problem of price stability for our domestic energy industry, the problem will spill over into many other sectors of our economy - most notably the financial sector. During the past 12 months in Oklahoma alone, 24 banks have failed with deposits totaling over $2,785,000,000! If we don't act soon to bring stability to these distressed industries the worst may be yet to come.

Mr. Chairman, I want to thank you again for giving us the opportunity to discuss this important issue. I look forward to the testimony from today's witnesses.

STATEMENT BY
SENATOR JOHN H. CHAFEE
TO
SENATE COMMITTEE ON FINANCE
MARCH 25, 1987

FIRST, I WOULD LIKE TO THANK SENATOR BENTSEN FOR CALLING THESE HEARINGS ON A NATIONAL SECURITY POLICY. NOW I REALIZE THAT THESE HEARINGS ARE PRIMARILY FOCUSED ON ESTABLISHING A STRONG NATIONAL SECURITY POLICY REGARDING ALL IMPORTS. WHEN I REVIEW THE BILLS TO BE DISCUSSED TODAY, HOWEVER, I CAN'T HELP THINK ABOUT THE POSSIBILITY THAT WHAT WE ARE ABOUT TO DO HERE IS INITIATE A FOREIGN OIL IMPORT POLICY USING THIS COMMITTEE INSTEAD OF THE ENERGY COMMITTEE TO PROVIDE RELIEF FOR THE "OIL PATCH."

THESE FOUR SENATE BILLS, WHEN TAKEN TOGETHER, COULD GIVE THE PRESIDENT THE AUTHORITY TO PUT INTO PLACE AN OIL IMPORT FEE, SHOULD IT BE DEEMED IN THE BEST INTERESTS OF NATIONAL SECURITY).

NOW, I DO NOT WANT TO GIVE ANYONE HERE THE IDEA THAT I AM <u>NOT</u> IN FAVOR OF A STRONG NATIONAL SECURITY POLICY. HOWEVER, I BELIEVE THAT WE CAN HAVE ONE WITHOUT AN OIL IMPORT FEE -- A FEE WHICH WOULD BE DETRIMENTAL TO THE NORTHEAST, TO THE NATIONAL ECONOMY, AND COULD EVEN GO SO FAR AS TO CREATE GASOLINE RATIONING FOR THE COUNTRY AS A WHOLE.

I ENCOURAGE MY COLLEAGUES ON THIS COMMITTEE TO CLOSELY LOOK AT THESE BILLS AND CONSIDER WHAT DAMAGE THEY COULD DO TO THE ECONOMIC HEALTH OF THIS COUNTRY IF THEY PROVIDED A VEHICLE FOR THE IMPLEMENTATION OF AN OIL IMPORT FEE.

RATHER THAN DISCUSS ALL OF THE DAMAGE THAT COULD OCCUR, LET ME REFER TO THE ECONOMIC SECURITY REPORT TO THE PRESIDENT, AND TO APPENDIX D, WHICH GIVES AN OVERVIEW AND AN ANALYSIS OF SEVERAL OIL IMPORT FEE OPTIONS.

THE STUDY ANALYZES THE EFFECTS OF THREE DIFFERENT OIL IMPORT FEES: $10 PER BARREL, $5 PER BARREL, AND A VARIABLE FEE THAT ESTABLISHES A FLOOR PRICE FOR CRUDE OIL OF $22 PER BARREL. THE DEPARTMENT OF ENERGY FOUND THAT EACH OF THESE OPTIONS IMPOSES ECONOMIC COSTS ON THE ECONOMY THAT FAR OUTWEIGH THEIR ENHANCEMENT OF ENERGY SECURITY.

A $10 PER BARREL IMPORT FEE COULD REDUCE OIL IMPORTS IN 1995 BY UP TO 1.5 MILLION BARRELS PER DAY. OF THIS AMOUNT, 500,000 BARRELS WOULD RESULT FROM INCREASED DOMESTIC PRODUCTION, AND 1 MILLION WOULD RESULT FROM DECREASED CONSUMPTION. SUCH A FEE COULD ALSO ADD ABOUT 120,000 JOBS IN THE OIL INDUSTRY, BUT COULD COST 400,000 JOBS IN OTHER SECTORS. THE DEPARTMENT OF ENERGY (DOE) ESTIMATES THE COMBINED BENEFIT TO THE ECONOMY AT $46 BILLION (PRESENT VALUE).

HOWEVER, BECAUSE AN OIL IMPORT FEE WOULD RAISE U.S. ENERGY PRICES ABOVE THE WORLD LEVELS, AS WELL AS SLOW ECONOMIC GROWTH

AND INCREASE INFLATION AND UNEMPLOYMENT, A $10 FEE WOULD COST THE ECONOMY UP TO $200 BILLION. WE WOULD DRAIN AMERICA OF A NET $164 BILLION.

THE REPORT GOES ON TO STATE THAT A VARIABLE FEE WOULD REDUCE THE RISK OF NEW INVESTMENTS AND SUPPORT OIL INDUSTRY PROFITS AND EMPLOYMENT LEVELS. HOWEVER, FOR EVERY $1 PER BARREL THAT DOMESTIC PRICES EXCEED THE WORLD PRICE LEVEL, THE COSTS TO THE CONSUMER WOULD INCREASE BY APPROXIMATELY $4 BILLION PER YEAR. DOE ESTIMATES THAT A $22 FLOOR PRICE FOR OIL COULD COST THE ECONOMY $135 BILLION, ASSUMING THAT LOW OIL PRICES PREVAIL.

IN THIS REPORT, THE ADMINISTRATION, THIS TIME THROUGH SECRETARY HARRINGTON, CLEARLY STATES ITS OPPOSITION TO ANY OIL IMPORT FEE. IF THIS COMMITTEE OR THE SENATE ITSELF INSISTS UPON CONTINUING DOWN THIS ROAD AGAIN, I WILL DO EVERYTHING WITHIN MY POWER TO RESIST IT.

THANK YOU.

STATEMENT OF SENATOR MALCOLM WALLOP

FINANCE COMMITTEE HEARINGS ON MAJOR PROPOSALS TO AMEND SECTION 232 OF THE TRADE EXPANSION ACT OF 1962

MARCH 25, 1987

I applaud the Chairman for holding this hearing -- it is particularly appropriate not only from the standpoint of pending trade legislation, but from the threat the present state of our domestic oil and gas industry imposes upon our national security.

In that regard, I was pleased to once again join with the Chairman in reintroducing the Energy Security Act of 1987. When the Senator from Texas and I introduced the same bill last summer we stood alone. Now, with what is approaching 30 cosponsors, I would say that the measure has gained the attention of our colleagues. I am committed to the basic presumption of this legislation which declares that U.S. energy security requires a national energy policy in which foreign oil dependence will not exceed 50 percent of consumption. Mr. Chairman, it is time our nation says "Never Again" to OPEC and finally mean it. I will support your efforts in every way I can to see that S. 694 is enacted into law.

Mr. Chairman, after reading the rather lengthy list of factors the Secretary of Commerce and the President are required to take into account under Section 232 of the Trade Expansion Act -- factors such as the domestic production needs for projected national defense requirements, domestic industry capacity to meet these requirements; imports in terms of their quantities, availability and character, and use as they affect such industries and U.S. capacity to meet national security requirements; impact of foreign competition on the economic welfare of domestic industries, and the list goes on -- it would appear that America's oil and gas industry would have a classic textbook example of a 232 case to provide to the Secretary of Commerce. Obviously, the industry either believes it does not have a case, or that the process and the outcome is either too time consuming or too ineffective or both. It is my hope that the hearing today will help us examine how Section 232 does, or does not work.

As far as some of the "national security" factors I just mentioned, right now I can list several, both on the national level and on the state level, that would seem to qualify as threats to our national security as a result of our increasing imports of foreign oil:

- U.S. imports of crude oil and petroleum products climbed upward in 1986 by 20 percent to 6.1 million barrels a day from 5.1 million in 1985 according to the latest DOE monthly petroleum supply publication.

• Total imports in 1985 reached the highest level since 1981.

• While our first, second and third supply nations are in the Western Hemisphere -- Canada, Venezuela and Mexico -- there has been a significant increase of crude and refined products from OPEC nations. According to DOE, these imports averaged 2.8 million barrels per day or 46 percent of total imports which is an increase of close to one million barrels per day or 51 percent in only one year.

• 1986 shipments from Saudi Arabia averaged .7 million barrels per day which is almost four times the .2 million barrel per day average of 1985.

• What may be worse is OPEC's ever present manipulation over price and supply. According to one oil-market expert, John Henke, out of Johns Hopkins, the Saudis have only developed 15 out of the 50 non-commercial fields they have right now. If they invest in development they alone can produce 25 million barrels a day by 1995 at a cost of production of 30 cents a barrel development cost, operating cost -- everything.

• Compare that to U.S. costs. In Wyoming, the average well was 7,225 feet deep and cost $610,000 in 1984 and that cost has risen since then. This compares to the typical well in Colorado that is 5,946 feet and costs $320,000 to drill, or Texas at 4,996 feet and $335,000 to drill, or Louisiana at 2,741 feet at a cost of $111,000. (These figures are from the Petroleum Association of Wyoming).

• Recently, the American Petroleum Institute surveyed the economic conditions of 10 major oil producing states: Alaska, California, Colorado, Kansas, Louisiana, New Mexico, North Dakota, Oklahoma, Texas and Wyoming and found some frightening facts.

• In Wyoming, there was a 35 percent decline in completed wells from 1985 to 1986. Nationwide there was a 41 percent decline.

• The average number of drilling rigs declined 61 percent from 1985 to 1986 from 93 to 36 in Wyoming. Nationwide that number was less than half of what it was a year before.

• Wyoming bankruptcy filings increased 30 percent from 1985 to 1986, and ours was noted as one of the smallest in the oil producing states.

• In 1985 Wyoming had an unemployment rate of 7.1 percent which was slightly below the national average of 7.2 percent. While the national rate declined to 7.0 in 1985, Wyoming's climbed to 9.0 percent.

• Last year about 145 banks failed nationally, but 89 of those, or 61 percent were in oil producing states.

• State services are also affected. In Wyoming's case the state legislature cut the budget and drew over $100 million from a reserve account to sustain the service level to the state.

Surely, the net effect of all these examples, if allowed to continue, will severely impair America's national security and any hope we ever entertained for an energy secure future. Mr. Chairman, I will continue to support your efforts to improve and stimulate the present ailing condition of our domestic oil and gas industry.

The CHAIRMAN. I would like to advise the Senators and the witnesses that we have some unexpected time constraints this morning, and I hope everyone will understand our situation.

The Senate came in at 9 this morning, and a roll call vote on the cloture motion is scheduled for 12:00. We have requested consent to meet after 11, and we expect that request to be granted. However, the noon vote—for all practical purposes—will end this morning's meetings.

The Secretary of Commerce will be arriving at 11:15, and we will need to move to his testimony as soon as he arrives, so Senators will have an opportunity to complete their series of questions of him.

We will take full statements of all witnesses, and Senators will pursue questions of those particular witnesses.

I would like to state that what we are doing this morning is taking testimony on the impact of imports and foreign investments in this country. In my view, that issue is a very important one. It is also timely, as timely as any issue that we are going to address.

The national security implications of import dependence have been very much in the headlines in recent weeks. I am referring, of course, to the almost constant comment on this nation's growing reliance on foreign oil. In order to bring the process of analysis much more before the public eye, the Department of Energy issued its long-awaited Martin Report on energy security just a few days ago. It really was not surprising that the report's conclusion was that there is a threat to the security of the United States in overdependence on foreign oil.

That conclusion was expected. This country indeed faces a serious threat to its national security, and all the statistics point to that. The trends are bad, and they are getting worse.

Consider the effect of cheap foreign oil on domestic production of petroleum. Crude oil production in America has fallen by 752,000 barrels per day in the past year. Now, that is a decline of 8.2 percent. Production of natural gas liquids is off by 123,000 barrels per day, 7.4 percent less than it was a year ago. The experts are saying that we can expect these declines to accelerate in the weeks ahead—almost 1 million barrels a day fewer.

Consumption is on the rise, and it is on the rise rapidly. Total domestic demand for petroleum products in 1986 was 3.3 percent higher than it was in 1985. It's up about 2.6 percent from this time a year ago. Consumers are already forgetting the painful lessons of the past. Conservation is passe. We are on an oil binge.

And imports of oil? Well, they are way, way, way up. Imports of crude oil are up to 3.6 million barrels per day. That is 22.5 percent above what they were just a year ago. Imports of petroleum products? Up 26 percent in the past year to a level of more than 2 million barrels per day. Expressed in terms of a range that accounts for some fluctuations, we now import between 37 percent and 42 percent of the petroleum that we use.

This nation is becoming addicted to foreign oil. A number of reputable studies predict that we will be importing more than one half of the petroleum we consume within the next few years. One study says that we could cross that late next year if consumption continues its sharp rise.

Some commentators have called the 50 percent mark a "peril point", and I think with good reason. All that new oil flooding into this country isn't coming just from Canada, Mexico, or Venezuela. Much of it is coming from the Middle East, especially from Saudi Arabia. The source of the supply is easily explained. The super-giant fields of the Persian Gulf are the fields from which the oil can be lifted for pennies a barrel. Overdependence on them, however, may cost us far more than we can pay.

For that reason, I have introduced S. 694, the Energy Security Act of 1987. The primary cosponsor of the legislation is my friend from Wyoming, Senator Malcolm Wallop. Twenty-three other Senators, Republicans and Democrats—and they are from producing and non-producing states—have joined in this effort. We believe there is an action that we can take today to prevent a calamity tomorrow.

S. 694 is a straightforward bill. It proposes no drastic, costly remedy to the problem of overdependence on imported oil. It supposes no additional authority in the President that he does not already possess under Section 232 of the Trade Expansion Act of 1962.

It does not tie the President's hands and therefore does not invade the constitutional duty of the President to preserve our national security.

At the heart of S. 694 is a simple idea. Each year with his budget, the President will submit to the Congress a three-year projection of the nation's dependence on foreign oil. If that projection shows that we will satisfy more than 50 percent of our consumption with foreign oil in any year, then the President will be required to present to the Congress within 90 days a plan to hold oil imports below the 50 percent mark. At the sole discretion of the President, that plan may contain oil import fees, conservation initiatives, incentives for domestic production, or any combination of these or other actions aimed at keeping the level of oil imports down. The plan will lie before Congress for 90 days and will go into effect unless Congress disapproves it by joint resolution.

S. 694 does not contain the solution to the nation's real energy problem—the neglect of national energy policy. We saw that neglect again in the Martin Report—hundreds of pages of discussion but not a single recommendation. But S. 694 does draw a line in the sand. It sends a signal around the world that there are limits to the quantity of oil imports that we will tolerate.

It is a sign to our domestic petroleum industry that we will not allow it to be wiped out by foreign governments wielding incredible power in world oil markets. It is a first step toward a responsible national energy policy for the United States.

This issue that I have just discussed is not confined to trade in oil, though that is where I think it is most obvious at the present time. A Defense Department report highlights another industrial sector needing attention. The report concludes that the existence of a healthy semiconductor industry is critical to our national defense, because we must have technologically advanced weaponry.

At this point, I want to welcome our first witness, the distinguished majority leader who has been long-concerned with this problem, The Honorable Robert Byrd of West Virginia. Senator Byrd and I have shared a deep interest in this trade debate and the dimensions of it, and particularly the national security viewpoint. And it was with that sense of appreciation that I review his bill—S. 285, The National Security Trade Act of 1987—and bring it before the Finance Committee today.

And I am very pleased—with all of the demands on his time—that he has placed such a priority on it, and am delighted to welcome him to this committee. Senator Byrd.

Senator HEINZ. Mr. Chairman?

The CHAIRMAN. Yes.

Senator HEINZ. I would like to make a brief opening statement.

The CHAIRMAN. If you would make it brief. Our problem, Senator, is that we—as I accounted a moment ago—the Senate is in session. We have asked for permission to meet after 11:00. We have Secretary Baldrige, and I would be delighted to welcome you.

Senator HEINZ. Mr. Chairman, I understand that.

The CHAIRMAN. I would be delighted with a 60-second opening statement.

Senator HEINZ. Mr. Chairman, I thank you. I would just like to observe that nearly every industry that has sought import relief, with the possible exception of the mushroom growers in my home state of Pennsylvania, has made a national security argument, whether the provision of law they were using allowed for it or not.

Obviously, we do need some better means of making a judgment when such a claim is made. Recent history also suggests we need a firm time limit for making it. The machine tool case—which I am sure will be everybody's favorite example today—if it proved nothing else, demonstrated that we can literally surrender a large chunk of an industry during the time an Administration takes to make up its mind on what to do.

The result of that case may well be what is a common problem with trade relief, which is too little, too late.

The case of oil, which the Chairman mentioned in his opening statement at some length, is different from other situations, and a strong argument can be made for its special and separate consideration. And, of course, as an occasional advocate myself of legislation that is sector specific, I would not want to object to the Chairman's opening the door to sector specific amendments to the trade bill. However, as a long time opponent of oil import fees, I must state, for the record, that I have some reservations about Senator Bensten's bill; and those reservations are centered around a process in his bill that could implement such a fee without Congress ever voting on it, and for that matter could result in far broader steps without congressional action.

Now, I hope that those problems represent what you might call "drafting errors" that can be corrected, and that we will carefully consider such issues as we move ahead. And, I do look forward to hearing our witnesses' testimony.

The CHAIRMAN. Senator Roth, do you want to make a comment?

Senator ROTH. I will be very brief, Mr. Chairman. I know the majority leader wants to speak. First of all, I want to say I have been very pleased to join the majority leader this year, as well as in the past, on this very important problem of national security in trade.

While I have a strong commitment to liberal trade policies, there is no question that there is a very, very important relationship between national security and trade. We must be sure that in enacting legislative change to improve our laws, that we do not threaten industries vital to our national defense.

I want to say that I appreciate the fact that the Chairman and my good friend, Senator Danforth, have included as part of the omnibus bill our legislation in almost its entirety. It is not a matter to be taken lightly. History is replete with illustrations of where countries have lost a war because they did not have the necessary industry at home. And, for that reason, Mr. Chairman, I am delighted that the majority leader is here. And, I look forward to working with him to get this important legislation enacted. Welcome, Senator Byrd.

The CHAIRMAN. Thank you very much. Senator Danforth.

Senator DANFORTH. I have no statement, Mr. Chairman.

The CHAIRMAN. Senator Chafee.

Senator CHAFEE. I have no statement, Mr. Chairman.

The CHAIRMAN. Mr. Majority Leader, we are delighted to have you here today.

STATEMENT OF HON. ROBERT C. BYRD, U.S. SENATOR FROM THE STATE OF WEST VIRGINIA

Senator BYRD. Mr. Chairman, thank you. And, I thank the other members of the committee. I thank those who have spoken.

Two months ago, I introduced on behalf of myself and the distinguished Senator from Delaware, Senator Roth, S. 285, which amends Section 232 of our trade law. It is designed to ensure that industries critical to our national security will obtain prompt relief when they are vitally threatened by imports. Before addressing that specific legislation, I would like to discuss the link between national security and the overall trade and competitiveness legislation.

Our national security ultimately depends not only on defense preparedness, but also on our economic strength. To achieve economic strength in the modern world economy, we must have an effective trade and competitiveness policy. This Administration has not devised, adopted, or carried out such a policy. In fact, its record in trade negotiations, education, training, civilian technology, and exchange rates has largely been one of neglect. It is a record that has made us less competitive and has thereby weakened our national security.

Like the members of this committee, I have had many private discussions on trade policy with foreign officials and businessmen; and they invariably begin by demanding free trade for their exports to the United States.

The United States—the bulwark of the free world—has been neglecting its industrial base. This great nation has been sacrificing its economic strength in the pursuit of outmoded trade policies. The United States still hews to policies that may have made sense in the late 1940's, when the United States enjoyed overwhelming strength in the world economy. But, with so many formidable competitors today, we must reconsider whether our current trade and competitiveness policies still make sense.

We have all heard the charge that any trade bill coming out of a Democratic Congress will inevitably be protectionist. It gets repeated; and it gets repeated so often that I would like to put it in some historical perspective. During each of the last two Congresses, I appointed task forces to investigate trade and competitiveness issues. One of those task forces was headed by this committee's current and very distinguished chairman, Senator Bensten. These task forces concluded that the United States needs to put some backbone into our trade posture. These task forces also strongly recommended that we put more resources into certain domestic programs that can help to improve our competitiveness.

Democrats have a long history of pragmatism on trade. Back in 1930, it was a Republican President who joined a Republican-controlled Congress to erect the high Smoot-Hawley tariff walls. A few years later, the Roosevelt New Deal ushered in a new policy under reciprocal trade agreements. Under that policy, Congress delegated authority to the President to negotiate a permanent reduction in U.S. trade tariffs on items of interest to foreign exporters. In return, however, our major trade partners would have to reduce their barriers to exports from the United States to a comparable degree. That approach became institutionalized when we created the General Agreement on Tariffs and Trade, or the GATT, immediately after World War II.

It is no secret that the GATT philosophy is in trouble today, and for good reason. GATT principles govern perhaps 5 or 10 percent of world trade. In addition, major new competitor nations have come on the scene. Their late arrival means that they have not participated in previous GATT negotiations and, thus, while they reap the advantages of our open markets, they have not made concessions to open their own markets to American products. More importantly, most of them have internal economic structures very different from ours and those of other GATT founders. Some of these countries put limits on consumers and on workers that we find objectionable. A number of major foreign competitors, most notably Japan, have a mercantilist bent: they are well organized to export and discriminate against import.

What should Congress do to redress this inequitable situation? The Congress obviously cannot manage detailed international negotiations. But, it can start the Administration on the proper track, make it difficult for the Administration, or anybody, to veer off the course, and provide the necessary tools to reach the intended destination.

S. 490 of the omnibus trade bill, of which I am one of the cosponsors, attempts to guarantee enforcement of agreements already reached. That is a critical objective and I support it. But, I believe we must go further. To address the problems of the 1980's and 1990's, we need some tough bargaining to reach new agreements.

Congress should set clear guidelines for bilateral negotiations and for multilateral negotiations. At the same time, we should make sure that the President has the leverage and the flexibility to be most effective. When negotiating with mercantilist nations, it may not suffice to negotiate solely for changes in specific official government rules or practices or programs. We may have to insist on foreign commitments in terms of practical outcomes rather than mere technical rules changes.

The United States could benefit from a new round of international trade negotiations, but only if it enters into the Uraguay Round with the proper objectives—along with sufficient resolve and willingness to use leverage. To resolve the pressing trade problems of the 1980's and 1990's requires more than just tinkering with the old GATT framework. The traditional GATT focus on tariffs, quotas, subsidies, and dumping cannot cope with the challenge posed by the "new mercantilism" of Japan and the "new Japans". These nations are our most rapidly advancing trade competitors. The new mercantilism does not fit within the old GATT mould. Successful trade negotiations would help to reduce the growing conflicts between these mercantilist trading nations and relatively open economies like our own.

Contrary to the message of some editorial writers and columnists, we do not face a choice of extremes: free trade on the one hand, or protectionist isolation on the other. We have steered this country away from the excesses of Smoot-Hawley in the 1930's, as I have indicated, toward pragmatic trade liberalization. We still retain the traditional goals of accessible markets, trade expansion, and global economic growth. Our commitment to improved training, education, science, research, and technology will advance those goals. We cannot achieve open markets or trade expansion in today's world economy with the naive free trade position characteristic of much of this Administration. It is time to make more pragmatic use of our leverage.

In the desire to modernize our approach to trade, Speaker Jim Wright and I agreed early on that trade and competitiveness legislation would be on our top priority list of bills in this first session of the 100th Congress. We both believe that this legislation must be comprehensive, effective, and forward-looking. An effective program to enhance competitiveness must go hand in hand with a stronger trade policy.

So, the Congress is now hard at work fashioning that legislation. House and Senate committees are actively conducting hearings and drafting legislation. I commend this committee in particular for its work on trade and competitiveness legislation. The House leadership expects a floor vote on trade and competitiveness legislation in late April. Senate committee chairmen, including you, Mr. Chairman, have indicated that they plan to begin their markups on provisions for an omnibus Senate bill to be taken up on the floor soon thereafter.

You and I have had many discussions. And you have indicated that it is your plan, as soon as possible after the House bill comes over and you have had an opportunity to take a look at that in the committee, to be prepared for floor action on legislation. And, may I assure you that you have my complete support, and I will be making every effort to expedite the call up of this legislation and the handling of it, on the Senate floor, as soon as you and the others of your committee are ready.

Now, there have been some indications that the Administration plans to work with us on this legislation. And, I want to say that I am hopeful that the Administration has finally decided to accept tough and effective measures to resolve our trade and competitiveness problems.

We urgently need trade and competitiveness legislation. Last year's $170 billion trade deficit reflects the huge magnitude of our ongoing trade problems and the necessity of improving our competitiveness for the future.

We have lost our traditional first place position among the world's exporting nations. As our exports have dropped, Germany's exports have soared far above us. Six years ago, Japan exported barely half as much as we exported. Today, Japan exports almost as much as we do. Since both of these nations are much smaller than we are, this provides further evidence of the need to work hard to improve our competitive position.

We have also been transformed from the world's largest creditor nation to the world's largest debtor. In 1981, the nation still enjoyed a $6 billion surplus in overall trade, including both goods and services.

For most of the six decades after World War I, the nation had been enjoying trade surpluses and expanding our credit position abroad. By 1981, the nation had accumulated a "nest egg" credit position of roughly $141 billion. That was worth an average of $1,750 for each of America's 80 million families. So, we see at the top of the chart, $141 billion. That represented the creditor position of these United States in 1981. Now in a few short years, we have squandered this nest egg—as you see, the line was in the black until about 1982-83, or about 1984, and then it went into the red. And so, we have squandered this nest egg of $141 billion in our creditor position to the point that we are now, in these United States, we have increased our indebtedness to foreigners by $141 billion.

So that by the end of 1986, we had gone into debt to foreigners to the tune of $248 billion—roughly $3,000 per family. Some experts predict that, in each of the next several years, this nation will sink another $2,000 deeper into foreign debt for each American family.

So, Mr. Chairman, there you are—plain as the nose on your face. A picture is worth a thousand words. We have dropped from a creditor position in which we stood at $141 billion in surplus where foreigners owed the United States $141 billion in 1982, 1981, to the point now that we owe the foreigners $248 billion. So we find ourselves in hock to the rest of the world.

We would not have dreamed it. We would not have dreamed in 10 years that we would have seen this catastrophic shift from the world's largest creditor nation to the world's greatest debtor nation.

Make no mistake about it, such large debts undermine our economic strength and, ultimately, our national security. They have already constrained the ability of our monetary authorities to bring down interest rates to stimulate our sluggish economy. As we are forced to service these huge foreign debts in the future, we will have fewer resources with which to defend our country, our national security.

Industry after industry has been battered by lost exports and displacement by imports. In the last six years, our imports of manufactured goods have doubled while our manufactured exports have dropped by 20 percent in real terms.

Now, looking, again, at the chart. Our trade balance in manufactured goods has plummeted from a $17 billion surplus—the green figure there, just above the horizontal line—$17 billion surplus in 1980 down to $139 billion deficit in 1986. We would have at least 10–15 percent more jobs and production in manufacturing today if we had maintained that surplus and the same growth in domestic demand.

Let's take a look at high technology, high technology products. You will see that our $27 billion surplus—that is the blue line—$27 billion surplus of 1980 has what? Evaporated. Gone. And it has been replaced by a $3 billion deficit. And who would have thought that? That the United States would have dropped from a $27 billion surplus in high tech, to a $3 billion deficit in six years. In the key computer and business equipment industry, imports have skyrocketed 451 percent in the last six years.

Let's take a look at agriculture. In agriculture, our strong $23 billion surplus—this is the red line—our strong $23 billion surplus of 1980 shriveled into a mere $4 billion surplus last year, the bread basket of the world. Over those six years, exports withered by 36 percent while imports grew 23 percent.

As it has been confronted by each new trade crisis, whether it was the soaring dollar, the squeeze on our exports from Third World debt, or the many problems of specific industries, the Congress has had to goad the Administration into taking remedial action.

We have often been assured that a falling dollar would quickly cure our trade problem. The dollar has been falling relatively sharply for more than two years. Yet, the evidence so far shows a widening trade deficit. Even with adjustments for inflation, imports have grown and exports have failed to rise.

The practical results of recent trade negotiations have been just as disappointing. There have been a running series of negotiations on trade practices in Japan. We recognize that our problems with Japan are not unique, but that they are emblematic of problems we face around the globe. Japan has come to symbolize what we fear most in trade: namely the challenge to our high technology industries, the threat of government nurtured competition, and the multitude of barriers to U.S. exports. If we can find a way to come to terms with Japan over trade problems, we can manage our difficulties with other countries.

Japan is making decisions based on its own self interests and its perception of U.S. policy priorities. At this committee's first trade hearing, Senator Danforth asked whether Japan should take our threats seriously after watching the U.S. only bluff retaliation for 10 years. Ambassador Robert Strauss, former U.S. Trade Representative, replied with a blunt, a blunt "no."

At least annually, particularly as the Congress has considered trade legislation, U.S. and Japanese trade negotiators have touted major new initiatives favorable to U.S. exporters to Japan. For example, three years ago Japan agreed to work to increase its imports of U.S. coal. My state of West Virginia has been a major supplier of coal to Japan. Since that time, U.S. exports have fallen and our share of Japan's coal imports has fallen from 21 percent to 11 percent.

General economic conditions have favored a rapid expansion of U.S. exports to Japan. Between 1980 and 1986, the Japanese yen strengthened relative to the dollar and the Japanese economy grew twice as fast as the U.S. economy.

And I would like to take a look at the chart. Despite very favorable economic conditions and a series of Japanese concessions on specific trade practices, U.S. exports to Japan have remained flat. This is the flat blue line as seen on the chart. U.S. exports to Japan have remained flat for the last six years. During those same years, Japan almost tripled its exports to the slower growing U.S. economy. This is represented by the red line on the chart. You will see here, by the red line, that the imports from Japan into the United States increased from 33 billion around 1980 to 86 billion in 1986—almost tripled.

So, as a result, the bilateral trade deficit ballooned, as I say, from a $12 billion deficit favoring Japan in 1980 to a $62 billion deficit favoring Japan in 1986. In other words, the deficit favoring Japan in those six years as against the United States has quintupled.

Japan has ample resources to buy more imports. Last year, Japan exported $86 billion more goods and services to the rest of the world than it imported. As we see right here at the blue line, it went from +$5 billion in goods and services, creating a deficit in favor of Japan, to about $86 billion—the blue line—in 1986, which makes for an $81 billion change, as represented by the deep blue on the bar graph—an $81 billion change. Now, that is progress for Japan, I would assume.

If world trade and the world economy are going to continue to expand, then not only Japan should step up its imports, but Germany, Taiwan, and Korea also have trade surpluses. And you will note, Mr. Chairman, take Germany for example, which in 1981 came up from a −$5 billion trade balance to a $36 billion surplus in 1986, making for a $41 billion—represented by the green on the bar graph—$41 billion positive growth in their goods and services trade balance. And the same can be seen for Taiwan and for Korea.

So, what you see, Mr. Chairman, is almost the mirror image with the United States showing $147 billion deficit over these six years—represented by the red line on the chart—and almost the equivalent, $146 billion pick up in the trade balances of Korea, Taiwan, Germany, and Japan. In other words, while they have grown, while they have expanded their imports to the rest of the world, we have been like a sponge. We have absorbed it by our trade and accounts deficit; $147 billion is the tune we are playing—by the red bar, showing our deficit—while the mirror image of that $147 billion is reflected up above, looking like water, upside down, is the almost equivalent bar of $146 billion. So, what I am saying is these other countries should buy more imports from us and the rest of the world. For several years, the United States has shouldered the burden of expanding world trade alone. We must now insist on a reduction in our deficits in tandem with a reduction in the surpluses of Japan, Germany, Taiwan, and Korea.

In the past few years, as Congress has begun to move on trade legislation, the Administration has showcased a few negotiated "victories." Few of these victories have lived up to their press releases. The recent Paris agreement by Japan and Germany to expand their economies and their imports appears so far to provide one more example of a hollow victory.

Last week's 93 to 0 vote in the Senate on semiconductors and telecommunications gives telling evidence of this nation's weak-kneed trade policy, even when our national security is at stake. Both industries are critical to our national security, and both industries face serious competition from Japan. The evidence indicates that Japan is failing to abide by its agreements to provide fair access to its market in both industries. The Senate should not have to pass resolutions calling on the President to enforce our international agreements. As a matter of course, foreign nations should expect penalties when they fail to comply with agreements they have entered into.

As we proceed with legislation this year, we might anticipate more press releases describing successful trade negotiations, But, I predict that Congress will pass an effective legislation in support of credible trade negotiations and more tangible results.

Mr. Chairman, I have been talking about the need as to our national security. I will, in the interest of saving time, I am ready to press on to try to close my remarks by directing my attention just to Section 232 of the trade law.

This section needs repair to ensure prompt, effective responses when appropriate. And, as I indicated at the beginning, Senator Roth and I have introduced legislation, S. 285, which has been referred to the committee, to simply revise Section 232 in three respects.

First, when an industry petitions for relief under Section 232, the Administration should be required to make a decision within a reasonable period of time. Current law permits the Commerce Department to take an entire year to make a recommendation and puts no time limit on the President's decision as to whether to implement that recommendation.

The lack of a deadline has resulted in very long delays in some cases. If there ever was a case of "justice delayed is justice denied", I believe it was indicated a few minutes ago—the recent experience of the machine tool industry. The machine tool industry filed a petition for import relief on the grounds of national security in early 1983. A year later, the Commerce Department determined that machine tool imports did, indeed, threaten national security and recommended relief. But there was no action on the case until just a few months ago—almost four years after the case was filed—when the President finally negotiated export restraints by four leading exporters.

My bill and S. 490 reduce the time period for the Commerce Department from one year to six months and require a Presidential decision within another 90 days.

A second problem of current law is the absence of a role for the Department of Defense. More than any other agency, that Department should know whether the production of a particular industry is vital to national security and whether that production is being impaired by imports. So, I am glad to note that S. 490 tracks the legislation introduced by Mr. Roth and myself, in requiring that a report by the Department of Defense be included in the recommendation to the President.

Our bill does go further than S. 490 with respect to a third revision of Section 232. Our bill explicitly authorizes the President to negotiate export restraints on imports that threaten national security. To obtain such an agreement, it also permits him to threaten and to use import restrictions on other products.

When S. 490 was being drafted, an objection was raised that this change to Section 232 would be "protectionist" because it could result in import restrictions on products not related to national security. But, the same possibility exists in several provisions of U.S. trade law, particularly Section 301. For example, in the recent dispute with Europe over new barriers to our corn exports, the U.S. was prepared to use the leverage of restrictions on wine and cheese.

Other provisions of S. 490 would widen the scope for incidental import restrictions. For example, the proposed change in Section 301 would, under certain conditions, mandate retaliation that benefits various other industries—I'll call them extraneous industries. Surely the President should have the option of using as much leverage as he is mandated to use in run-of-the-mill unfair trade cases. The addition of the third element of our bill would eliminate this anomaly in S. 490.

S. 490 permits the President unilaterally to impose quotas on specific imports threatening the national security. However, he will often prefer to negotiate export restraints as he did in the case of machine tools. Negotiated export restraints have several advantages. The government of the exporting nation may find negotiated restraints more amicable because that government will participate in the outcome. The threatened U.S. industry may prefer negotiated arrangements because those arrangements can be more finely crafted than quotas can be enforced by Customs. Even the industry's customers may prefer export restraints because unilateral quotas enforced by Customs can disrupt the flow of imports for their use.

To obtain a satisfactory agreement, the President may at times benefit from the ability to threaten import restrictions on a wider range of imports. We should explicitly provide the President with that authority.

I would hope that the committee will adopt the language of S. 285, in its entirety.

As this committee develops a general trade bill over the next few weeks, I am confident, Mr. Chairman, that you will give national security interests your very close attention. All too often, I think the national security interests are overlooked when discussion is going on concerning trade legislation. For the sake of national security, we must do more than tighten Section 232. We need to improve the competitiveness of our national industrial base and to restore the credibility of our trade policy.

Mr. Chairman, I ask unanimous consent that my entire statement be included in the record. And, I thank you.

The CHAIRMAN. Mr. Leader, without objection that will be done. I would say to the distinguished Majority Leader that his efforts have had a profound effect and influence on the structuring of

S. 490. And the vast majority of his bill and Senator Roth's bill, S. 285, has been included in S. 490. And we are very pleased to have him bring to our attention the additional issues that are raised in S. 285, and we will certainly be giving serious consideration to those.

I want to congratulate you on an excellent presentation and a very graphic display, through those charts, of just what has been happening. I would say to my colleagues that on the questioning, the sequence of arrival is Heinz, Danforth, Roth, Chafee, Rockefeller, Durenberger, Wallop, Baucus, Boren, Daschle, and Riegle.

I would also remind them, those that were not here at the time, that we have some unexpected time constraints in that the Senate is in session and went in at 9:00. And we are asking unanimous consent at 11:00 that we be allowed to continue. I anticipate we will receive that, but we have a Cloture vote scheduled at 12. And we have a number of witnesses yet to testify—a number of important witnesses. We have Senator Grassley who has been waiting, and we have other witnesses that we would like to have an opportunity to present their statements. And those that are not presented orally will be, obviously, taken for the record.

Senator WALLOP. Mr. Chairman, with that in mind, I would just ask that the statement that I have on this hearing today be inserted in the record.

The CHAIRMAN. Fine, Senator Wallop. We will accept that.

Senator BOREN. I would like to make the same request.

The CHAIRMAN. And Senator Boren. Are there others?

Senator CHAFEE. I would.

The CHAIRMAN. I thank Senator Chafee for that. And we will have Governor Sinner and Secretary Baldrige, and then others subsequent to that. Now, with that in mind, such questions as are directed to the Majority Leader. Senator Danforth.

Senator DANFORTH. Mr. Leader, thank you very much for your presentation. Your bill would permit the President to restrict the imports of those products which are found to be of national security concern, but also would allow him and restrict the imports of other products and services. I was wondering, why the expansion of authority? Let's suppose a country exports two products to the United States.

One is a product which causes national security concern. The other is something that has no security value at all, let's say pencils. It would seem that if there was a national security problem, the President should be able to take action with respect to the product that does pose the security problem. But, the pencils would seem to me to be an extraneous matter.

Senator BYRD. Well, I mentioned that earlier and I refer to remarks, when I referred to the corn exports and the wine and cheese leverage that was used. I think what Senator Roth and I are seeking here are results. And if it takes, if it takes a threat of action on extraneous items in order to get the results that we want in the interest of our own national security, then I think that the President should have that additional tool. He has that, as I indicated, in Section 301.

And we recently saw what I thought was a fairly good display of the utilization of that, of that——

Senator DANFORTH. But that was in order to force open another market. Clearly, if the question is an unfair trade practice and another market is closed, there has to be some form of retaliation that is available to us. This, it would seem to me, is not a matter of retaliation, but rather a question of a product that is coming into this market which we find has national security implications. And, it would seem to me that the more direct way of dealing with that, and the way that we do deal with it in the bill that some 56, Senators have introduced, is to simply provide for restricting the importation of that specific product, rather than getting us into the business of retaliation.

It seems to me it isn't a question of retaliation, as a 301 case would be, where you have an unfair trade practice which is shutting out American products, but instead it is simply a question of national defense concern where the importation of the product itself is presenting the problem.

Senator BYRD. Well, Senator Danforth, the question is not one of retaliation so much as it is one of results. And, it seems to me that this additional leverage might be needed in the interest of our national security.

Senator DANFORTH. Mr. Leader, do you have any general thoughts as to the question of Presidential discretion in trade matters? This is going to be one of the large debates, I think, with respect to the bill. Some say that the President needs maximum flexibility—that trade is one concern for the country, foreign policy is another concern—that we should not be hemming in Presidential discretion on trade decisions. Others say that, generally, when Presidents use the discretion they are given, the flexibility they are given, then trade takes the back seat and, as a result there is no credibility for trade policy because we are forever diminishing the importance of trade compared to other national objectives.

Are you concerned about Congress getting into the business in this legislation or other proposed legislation of unduly limiting the authority of not just President Reagan, but subsequent presidents, in determining matters that have both foreign policy and trade implications?

Senator BYRD. Well, there's no question that the President has to have that flexibility that you speak of. At the same time, I think we have seen ourselves debilitated by Administrations that have gone in the wrong direction too far. I think one can carry that kind of flexibility too far.

And it seems to me that while we expect the President to have the flexibility he needs in carrying out his foreign policy and his trade policy, at the same time we have seen this country weakened by Administrations that have gone too far—being too flexible, seemingly bending over backwards to our own detriment.

And it seems to me Congress, which is the first branch, so mentioned in the first sentence of the first article of the United States Constitution—the 200th anniversary of which is this year—represented to the people, well as I indicated in my statement, should not be expected to run the day-to-day business of determining what tariffs and duties we will apply and what we will not.

Congress certainly has to provide some stiffening of the backbone of an Administration, and in some senses direction. And we have been on the wrong course too long. I would not expect Congress to take on the chore of administering every jot and tiddle of the trade laws of this country. Something has to be done. And, in the interest of our national security, I—the Senator has heard me say this before, and I hate to belabor this point—but I was a welder in World War II and worked in the shipyards in Baltimore, Maryland and Tampa, Florida. I helped to build the victory ships and the liberty ships. And, we all remember that the United States was the arsenal of democracy—the United States provided the ships and the guns and the submarines and the planes to the Soviet Union and to England, when they stood off the attacks of Hitler.

But, I wouldn't, I wouldn't need to be a welder in the next war. I'd get a job in a hot dog stand or a hamburger stand, or at Hecht's or K Mart or Sears. And we are all proud of the growth of these service industries and we want them to continue to grow. And that's where the jobs are coming from. And our, the Administration keeps talking about the increased number of jobs, and that's all well and good, and we want to see those jobs continue to grow.

But they are not manufacturing jobs. We have seen our steel industries wither, and our fellow alloy industries, atrophy—and our machine tools industries, our glass industries, our leather goods industries, our shoe industries, one industry after another.

And so, yes, flexibility. The President has to have that. The Administration has to have flexibility. But at the same time, we have got to give the President more leverage and insist that he use it. And that's I think what I am trying to say here today. We won't be able to furnish the other countries of the world with the ships and the submarines and the planes and the tanks and the guns and the armored vehicles, if we don't do something to protect our national industries.

And that's what the bill that Senator Roth and I have is all about.

Senator DANFORTH. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Roth.

Senator ROTH. Thank you, Mr. Chairman. I really have no questions. I would like to make a couple of comments. The distinguished Majority Leader is, of course, right in emphasizing the importance in maintaining a strong national security base. That, of course, is the purpose of the legislation that we have proposed, and the purpose of incorporating it into our omnibus bill.

I think, in the interest of fairness, it should be pointed out that I certainly agree with the Leader and his concern about the trade deficit. But, I think it should also be pointed out that during this same period, all has not been gloom and doom. Much of it has been positive.

This country has, is entering its 51st month of economic recovery. That's a very, very long period of time, and I think a very positive thing in our economic policy. It should also be pointed out that during the period, there has been the creation of many jobs—of something like 11-12 million jobs. Now, there's a major argument going on and I understand that—as to the nature of these jobs, some future time I would like to address that.

But, I think it is interesting that in the last few months, something like 800,000 jobs have been created. If we go back to 1980, we had double-digit inflation, we had double-digit interest rates—and the situation, of course, has tremendously improved in both of these areas.

So, I think there is much that is positive. Unfortunately, the amount of activity—for example, manufacturing does not necessarily create more jobs. There is no direct correlation between the creation of jobs and the trade imbalance.

Economists tell us that even today manufacturing continues to consist of 24 percent of gross national product, but we have lost jobs in that sector, partly because of automation—and I guess we have been forced to automation because of competition.

I think there are some things that have been very positive that have happened in the last several years, and will continue to happen. But, like the distinguished Leader, I do think it's very important that we give the Administration the tools to address this problem of maintaining a strong security base. And I look forward to working with him on this matter in the future.

The CHAIRMAN. Thank you. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman. I want to join in the welcome to the distinguished Majority Leader here today. I will say that I don't approve of everything he says such as his characterization of the Administration as weak-kneed and various matters like that, but so be it.

The point I'd like to make, Mr. Leader, is as follows. That the evidence we have had before us here today is, exactly as you say, that the trade deficit is $170 billion. But, the testimony we have had is that only $15-20 billion of that can only be ascribed to unfair trade practices.

Now, let's say it might even be $30 billion. Nonetheless, that means $140 billion of the trade deficit is due to legitimate excellence, if you would, or better prices, better quality, whatever it might be on the part of our trading partners. It seems to me that we have to be extremely careful not to say that that's wrong. If somebody is building a better mousetrap and shipping it here and we are buying it that's not necessarily wrong.

I strongly believe that—and I'd like your comments on this point—that the trade bill is only going to be able to solve a very small portion of this trade deficit. You have stressed some of the particular matters. But, let's say that those measures take care of $30 billion. Now, we then move on to the larger problem which you refer to, i.e. competitiveness.

I think that is as important to this Congress as the trade bill. You have touched on some of the matters, such as strengthening civilian research and technology, worker retraining, and basic education. Those things are what we might call long-term goals. I do hope that this Congress and, of course, you in particular in your powerful position as Leader, will carefully investigate what we might do specifically to take care of matters now.

For example, I appeared before a group of manufacturers not long ago who are trying to compete against foreign products. They were complaining about the problems that they have with product liability insurance. There are similar problems with the antitrust laws, export controls, and the Foreign Corrupt Practices Act. There are a host of these issues. I'm not really asking a question as much as making a statement.

I hope that you, in your position, could help expedite those particular matters and give consideration to them in the various committees which have jurisdiction. Do you think that might be possible?

Senator BYRD. Oh yes. I think, may I say to the distinguished Senator—there are people who refer to our getting into a trade war if we, if we do certain things.

And apparently, what I have said here today has conjured up energies of protectionism—perhaps it has. We are in a war and we are going to have to fight this war on many fronts, as the Senator has pointed out—many fronts. Competitiveness is, we want to improve the competitiveness position of this country.

And I'm not advocating that we send legislation to the White House that is just retaliative in nature, we have got to broaden the terms of this debate. It's no longer an argument between protectionism and free trade. It boils down to the issue of survival. And we simply have to do something to contribute to the survival of American industries—not only survival, but a rejuvenation of those industries.

Other countries look out for their best interest. We see that in the barriers that they erect to our goods. We don't, apparently are not looking out after our interest. We are afraid of something, and I don't know what it is. We are already in a war and we are getting beaten. We are getting mugged in the international streets and marketplaces.

Senator CHAFEE. But Mr. Leader——

Senator BYRD. If I may just finish. May I say that while you are quite right—we have to deal with this on many fronts—we are talking about legislation here today. We are talking about a bill that your colleague and mine, Senator Roth, introduced, and we want that legislation written into this overall comprehensive piece of legislation.

The Congress can't do this job alone, obviously. Legislation isn't going to do it alone. It's not a simple task, there is no simple answer, there is no easy answer. But, I take it that the committee here is going to try to develop legislation that will attack in this war on a comprehensive broad front. And other committees have indicated that they too will get out components of legislation that is under the jurisdiction of their committees, and those components, some of which will have been referred to either directly or implicitly by the distinguished Senator, and we hope to put all those pieces of legislation into one piece of legislation and send it to the President.

The Congress can't do everything. Most of this probably lies in the implementation of the laws, or laws already on the books that haven't been put in force, I would assume. I have heard that.

And, so it is up to the Administration, the Executive Branch. But I hear what the Senator is saying, and he can be assured that I want to do what I can to further this battlefront all across, all across in every sector. And I'll be listening to what the Senator has to say and his, I want his advice and his counsel and help in dealing with this matter. It's not a one sector approach, it's not a one battle approach—it's a comprehensive approach that doesn't just involve one committee. It will involve several committees.

And, I shall join with the Senator in trying to deal with this problem across all of the fronts.

Senator CHAFEE. Thank you very much.

The CHAIRMAN. May I remind the Senators once more that the Majority Leader is a very interesting witness, but we also have Governor Sinner waiting to testify, and Secretary Baldrige arriving, and we have a Cloture vote at 12:00 and quite a number of other witnesses. So, if you would keep that in mind with your questioning. And with that comment, I will now call on Senator Rockefeller, who is a colleague of the distinguished Majority Leader.

Senator ROCKEFELLER. Mr. Chairman, I don't have a question for the Majority Leader, but I certainly want to compliment him on his excellent testimony. He speaks not only from the West Virginia experience, but for the nation on these matters. He has observed, as have I, years in West Virginia in which unemployment was at the 21 percent level. He has watched coal, steel, chemicals to some degree, textiles, shoes, glass, and all of our basic industries in that state decline by up to 50 percent in unemployment.

He understands the need for acting quickly on these matters. And I think in national security decisions where they affect trade, slow movement, unpredictability of movement, is our worst enemy. He is asking for faster action and wants to take stronger action. And I think it is characteristic of his strong views on trade in matters of competitiveness, that is the nature of his testimony.

I point out to the Senator from Rhode Island that it was Senator Byrd, back in 1983, who pulled the first competitiveness task force together to take on a number of issues not directly related to a trade bill, but related to the trade problem. He did so again a year ago. I was privileged to serve on that task force. As he has indicated, he has tackled this across-the-board. Not only trade legislation, but competitiveness matters, on an incremental short-term and a long-term basis. I compliment the Majority Leader on his testimony. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Senator Durenberger.

Senator DURENBERGER. I'll pass, Mr. Chairman.

The CHAIRMAN. All right. Senator Daschle.

Senator DASCHLE. Thank you, Mr. Chairman. I too would like to withhold questions in the interest of time, but simply compliment the Majority Leader for really creating the environment here in Washington to put this legislation and this whole issue on a fast track. It's in the, it's imperative, I think, that this nation deal with the issue that we direct it—as he has—to national security, that we confront this issue, not in a sector fashion as he has outlined this morning, but in a comprehensive way, recognizing the various impediments to trade and the importance that we deal with all of them.

So, I commend him on his fine testimony this morning, and I appreciate his leadership on the whole issue.

Senator BYRD. Mr. Chairman, I thank all Senators, and I thank you for the courtesy that has been extended to me. I especially thank my colleague, Senator Rockefeller, who brings to the committee not only the experience of being a Senator—and a good one—but also the experience of having been Governor of a state which is a raw material state, which is a highly industrialized state, and which has suffered much in our basic industries.

And we're talking about the industries—if any industries can be denominated as industries that are very important to national security, certainly the steel industry, the coal industry, the glass, the ferroalloys, the plastics, the chemicals industries—all of these are bound in West Virginia, or once did, and they are hurting.

And I thank him. And I thank you again, Mr. Chairman.

The CHAIRMAN. Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman. Mr. Leader, I join the others here in complimenting you on your leadership, not only in Section 232, but addressing trade and competitiveness so strongly, so forcefully, so early in this session. I am reminded of the first conference you called of our Democratic Party, and I am impressed with not only the subject you chose that we address—namely, trade and competitiveness—but also that you are able to hold 55 Senators in one room, at one time, for five hours.

That's the first time I have ever seen that accomplished around here. And I think it's because you have put your finger on a nerve—that is trade and competitiveness. Senators understand how important that is, talking to their people at home. And you provide leadership to move us off in that direction, and we are all very thankful for it.

And you will also recall, as will you, Mr. Chairman, that during that meeting we found out how competitive competitiveness is with various committee chairmen also wanting to get in on the efforts of helping solve our trade and competitiveness problems. But, you provide real leadership here, and we all appreciate it.

Senator BYRD. Mr. Chairman, I thank the Senator.

The CHAIRMAN. Thank you very much, Mr. Leader. We're delighted to have you this morning.

Our next witness is Senator Grassley.

[The prepared written statement of Senator Robert C. Byrd follows:]

Statement of
Senator Robert C. Byrd
Before the
Senate Committee on Finance
March 25, 1987

Mr. Chairman, thank you for this opportunity to come before your distinguished committee to discuss trade and national security. Two months ago, I introduced S. 285, which amends Section 232 of our trade law. It is designed to ensure that industries critical to our national security will obtain prompt relief when they are vitally threatened by imports. Before addressing that specific legislation, I would like to discuss the link between national security and the overall trade and competitiveness legislation.

Our national security ultimately depends not only on defense preparedness but also on our economic strength. To achieve economic strength in the modern world economy, we must have an effective trade and competitiveness policy. This Administration has not devised, adopted, or carried out such a policy. In fact, its record in trade negotiations, education, training, civilian technology, and exchange rates has largely been one of neglect.

It is a record that has made us <u>less</u> competitive and thereby weakened our national security.

Like the members of this Committee, I have had many private discussions on trade policy with foreign officials and businessmen. They invariably begin by demanding free trade for their exports to the U.S.

The U.S. -- the bulwark of the free world -- has been neglecting its industrial base. This great nation has been sacrificing its economic strength in the pursuit of outmoded trade policies. The U.S. still hews to policies that may have made sense in the late 1940's, when the U.S. enjoyed overwhelming strength in the world economy. But, with so many formidable competitors today, we must reconsider whether our current trade and competitiveness policies still make sense.

We have all heard the charge that any trade bill coming out of a Democratic Congress will inevitably be "protectionist." It gets repeated so often that I would like to put it in some historical perspective. During each of the last two Congresses, I appointed task forces to investigate trade and competitiveness issues. One was headed by this committee's current chairman, Senator Bentsen. These task forces concluded that we need to put some backbone into our trade posture. These task forces also strongly recommended that we put more resources into certain domestic programs that can improve our competitiveness.

Democrats have a long history of pragmatism on trade. Back in 1930, it was a Republican President who joined a Republican-controlled Congress to erect the high Smoot-Hawley tariff walls. A few years later, the Roosevelt New Deal ushered in a new policy of reciprocal trade agreements. Under that policy, Congress delegated authority to the President to negotiate a permanent reduction in U.S. trade tariffs on items of interest to foreign exporters. In return, however, our major trade partners would have to reduce their barriers to exports from the U.S. to a comparable degree. That approach became institutionalized when we created the General Agreement on Tariffs and Trade, or the GATT, immediately after World War II.

It is no secret that the GATT philosophy is in trouble today, and for good reason. GATT principles govern perhaps 5 or 10 percent of world trade. In addition, major new competitor nations have come on the scene. Their late arrival means that they have not participated in previous GATT negotiations and, thus, while they reap the advantages of our open markets, they have not made concessions to open their own markets to American products. More importantly, most of them have internal economic structures very different from ours and those of other GATT founders. Some of these countries put limits on consumers and workers that we find objectionable. A number of major foreign competitors, most notably Japan, have a mercantilist bent: they are well organized to export but not to import.

What should Congress do to redress this inequit ble situation? The Congress obviously cannot manage detailed inter- n tional negotiations. But, it can start the Administration on the proper track, make it difficult for the Administration to veer off course, and provide the necessary tools to reach the intended destination.

S. 490 attempts to guarantee enforcement of agreements already reached. That is a critical objective and I support it. But we must go further. To address the problems of the 1980's and 1990's, we need some tough bargaining to reach new agreements.

Congress should set clear guidelines for bilateral negotiations and for multilateral negotiations. At the same time, we should make sure that the President has the leverage and flexibility to be most effective. When negotiating with mercan- tilist nations, it may not suffice to negotiate solely for changes in specific official government rules. We may have to insist on foreign commitments in terms of practical outcomes rather than mere technical rules changes.

The U.S. could benefit from a new round of international trade negotiations, but only if it enters into the Uruguay Round with the proper objectives -- along with sufficient resolve and willingness to use leverage. To resolve the pressing trade problems of the 1980's and 1990's requires more than just tinkering with the old GATT framework. The traditional GATT focus on tariffs, quotas, subsidies, and dumping cannot cope with the challenge posed by the "new mercantilism" of Japan and the "new Japans." These nations are our most rapidly advancing trade competitors. The new mercantilism does not fit within the old GATT mould. Successful trade negotiations would help to reduce the growing conflicts between these mercantilist trading nations and relatively open economies like our own.

Contrary to the message of some editorial writers, we do not face a choice of extremes: free trade or protectionist isolation. Democrats steered the country away from the excesses of Smoot-Hawley in the 1930's toward pragmatic trade liberalization. We still retain the traditional goals of accessible markets, trade expansion, and global economic growth. Our commitment to improved training, education, science, research, and technology will advance those goals. We cannot achieve open markets or trade expansion in today's world economy with the naive free trade position characteristic of much of this Administration. It is time to make more pragmatic use of our leverage.

In the desire to modernize our approach to trade, Speaker Wright and I agreed early on that trade and competitiveness legislation would be on our top priority list of bills to pass in this first session of the 100th Congress. We both believe that this legislation must be comprehensive, effective, and forward-looking. An effective program to enhance competitiveness must go hand in hand with a stronger trade policy.

The Congress is now hard at work fashioning that legislation. House and Senate committees are actively conducting hearings and drafting legislation. I commend this committee in particular for its work on trade and competitiveness legislation. The House leadership expects a floor vote on trade and competitiveness legislation in late April. Senate committee chairmen, including you, Mr. Chairman, have indicated that they plan to begin their markups on provisions for an omnibus Senate bill to be taken up on the floor soon thereafter.

There have been some indications that the Administration plans to work with us on this legislation. After several years of thwarting trade legislation, the Administration now is talking in more cooperative tones about writing trade and competitiveness legislation this year. Like many of you, I hope that the Administration has finally decided to accept tough and effective measures to resolve our trade and competitiveness problems.

[CHART 1]

We urgently need trade and competitiveness legislation.

Last year's $170 billion trade deficit reflects the huge magnitude of our ongoing trade problems and the necessity of improving our competitiveness for the future.

We have lost our traditional first place position among the world's exporters. As our exports have dropped, Germany's exports have soared far above us. Six years ago, Japan exported barely half as much as we did. Today, Japan exports almost as much as we do. Since both of these nations are much smaller than we are, this provides further evidence of the need to improve our competitiveness.

We have also been transformed from the world's largest creditor nation to the world's largest debtor. In 1981, the nation still enjoyed a $6 billion surplus in overall trade, including both goods and services.

For most of the six decades after World War I, the nation had been enjoying trade surpluses and expanding our credit position abroad. By 1981, the nation had accumulated a "nest egg" credit position of roughly $141 billion. That was worth an average of $1,750 for each of America's 80 million families.

In a few short years, we have squandered this nest egg that took six decades to build up. Worse than that, we have gone on a spending spree based on foreign credit. Last year alone, we increased our indebtedness to foreigners by $141 billion. By the end of 1986, we had gone into debt to foreigners to the tune of $250 billion -- roughly $3,000 per family. Some experts predict that, in each of the next several years, this nation will sink another $2,000 deeper into foreign debt for each American family.

Make no mistake about it, such large debts undermine our economic strength and, ultimately, our national security. They have already constrained the ability of our monetary authorities to bring down interest rates to stimulate our sluggish economy. As we are forced to service these huge foreign debts in the future, we will have fewer resources with which to defend our national security.

Industry after industry has been battered by lost exports and displacement by imports. In the last six years, our imports of manufactured goods have doubled while our manufactured exports have dropped by 20 percent in real terms.

[CHART 2]

Our trade balance in manufactured goods has plummetted from a $17 billion surplus in 1980 down to a $139 billion deficit in 1986. We would have at least ten percent more jobs and production in manufacturing today if we had maintained that surplus and the same growth in domestic demand.

In high technology products, our $27 billion surplus of 1980 has evaporated and been replaced by a $3 billion deficit. In the key computer and business equipment industry, imports have skyrocketed 451 percent in the last six years.

In agriculture, our strong $23 billion surplus of 1980 shriveled into a mere $4 billion surplus last year. Over those six years, exports withered by 36 percent while imports grew 23 percent.

As it has been confronted by each new trade crisis, whether it was the soaring dollar, the squeeze on our exports from Third World debt, or the many problems of specific industries, the Congress has had to goad the Administration into taking remedial action.

We have often been assured that a falling dollar would quickly cure our trade problems. The dollar has been falling relatively sharply for more than two years. Yet, the evidence so far shows a widening trade deficit. Even with adjustments for inflation, imports have grown and exports have failed to rise.

[CHART 3]

The practical results of recent trade negotiations have been just as disappointing. For example, the Administration has had a running series of negotiations on trade practices in Japan. We recognize that our problems with Japan are not unique, but that they are emblematic of problems we face around the globe. Japan has come to symbolize what we fear most in trade: the challenge to our high technology industries, the threat of government nurtured competition, and the multitude of barriers to our exports. If we can find a way to come to terms with Japan over trade problems, we can manage our difficulties with other countries.

Japan is making reasonable decisions based on its own self interests and perception of U.S. policy priorities. At this committee's first trade hearing, Senator Danforth asked whether Japan should take our threats seriously after watching the U.S. only bluff retaliation for ten years. Ambassador Robert Strauss, former U.S. Trade Representative, replied with a blunt "no."

At least annually, particularly as the Congress has considered trade legislation, U.S. and Japanese trade negotiators have touted major new initiatives favorable to U.S. exporters to Japan. For example, three years ago Japan agreed to work to increase its imports of U.S. coal. Since that time, U.S. exports have fallen and our share of Japan's coal imports has fallen from 21 percent to 11 percent.

General economic conditions have favored a rapid expansion of U.S. exports to Japan. Between 1980 and 1986, the Japanese yen strengthened relative to the dollar and the Japanese economy grew twice as fast as the U.S. economy.

Yet, despite very favorable economic conditions and a series of Japanese concessions on specific trade practices, U.S. exports to Japan have remained flat for the last six years. During those same years, Japan almost tripled its exports to the slower growing U.S. economy. As a result, the bilateral trade deficit ballooned from a $12 billion deficit favoring Japan in 1980 to $62 billion last year.

[CHART 4]

Japan has ample resources to buy more imports. Last year, Japan exported $86 billion more goods and services to the rest of the world than it imported. We all know that the U.S. trade deficit is far too large. Few people realize, however, that Japan's surplus is much larger when compared to the size of its economy.

If world trade and the world economy are going to continue to expand, Japan must rapidly step up its imports. Japan is not alone. Germany, Taiwan, and Korea also have trade surpluses that amount to the mirror image of the U.S. trade deficit. They all must buy more imports from us and the rest of the world. For several years, the U.S. has shouldered the burden of expanding world trade alone. We must now insist on a reduction in our deficits in tandem with a reduction in their surpluses.

In the past few years, as Congress has begun to move on trade legislation, the administration has showcased a few negotiated "victories." Few of these victories have lived up to their press releases. The recent Paris agreement by Japan and Germany to expand their economies and their imports appears so far to provide one more example of a hollow victory.

Last week's 93 to 0 vote here in the Senate on semiconductors and telecommunications gives telling evidence of this nation's weak-kneed trade policy, even when our national security is at stake. Both industries are critical to our national security and both face serious competition from Japan. The evidence indicates that Japan is failing to abide by its agreements to provide fair access to its market in both industries. The Senate should not have to pass resolutions calling on the President to enforce our international agreements. As a matter of course, foreign nations should expect penalties when they fail to comply with agreements they have entered into.

As we proceed with legislation this year, we should anticipate more press releases describing successful trade negotiations. This time, I predict, Congress will achieve effective legislation in support of credible trade negotiations and more tangible results.

As we reduce our trade deficit in coming years, we must make every effort to improve competitiveness and to raise our productivity. In recent years our productivity has been improving less than 1 percent annually. Last year, it did not improve at all.

As a nation, we are already living 4 percent beyond our means as indicated by last year's $170 billion trade deficit. To the extent that we succeed in reducing the trade deficit, we will produce more than we consume. That will put downward pressure on our standard of living. Unless we get to work and raise productivity faster, we will suffer some very hard times in coming years.

For that reason, we welcome the Administration's apparent conversion to the cause of competitiveness. Democrats in Congress have long championed some of the ideas in the President's competitiveness package, ideas such as strengthening civilian research and technology, providing worker retraining, and supporting basic education. Effective legislation in those areas can improve productivity. We look forward to working with the President to improve his proposals in these and other critical areas.

The upcoming competitiveness legislation will improve our overall economic strength and thereby our national security. However, we should also be concerned that imports may badly injure specific industries critical to our national security.

For example, a recent study by the National Research Council concluded that the Department of Defense has already become too dependent on imports of certain electronics equipment.

Section 232 of the trade law addresses this problem. Unfortunately, it stands in need of repair to ensure prompt, effective responses when appropriate. To repair Section 232, I have introduced S. 285 which has been referred to your committee.

My bill would revise Section 232 in three respects. First, when an industry petitions for relief under Section 232, the Administration should be required to make a decision within a reasonable period of time. Current law permits the Commerce Department to take an entire year to make a recommendation and puts no time limit on the President's decision whether to implement that recommendation.

The lack of a deadline has resulted in very long delays in some cases. If ever there was a case of "justice delayed is justice denied," it was the recent experience of the machine tool industry. The machine tool industry filed a petition for import relief on the grounds of national security in early 1983. A year later, the Commerce Department determined that machine tool imports did threaten national security and recommended relief. But there was no action on the case until just a few months ago -- almost four years after the case was filed -- when the

President finally negotiated export restraints by four leading exporters.

Both my bill and S. 490 reduce the time period for the Commerce Department from one year to six months and require a Presidential decision within another 90 days.

A second problem of current law is the absence of a role for the Department of Defense. More than any other agency, the Department of Defense should know whether the production of a particular industry is vital to national security. Again, I am happy to say that S.490 tracks my legislation in requiring that a report by the Department of Defense be included in the recommendation to the President.

My bill does go further than S. 490 with respect to a third revision of Section 232. My bill explicitly authorizes the President to negotiate export restraints on imports that threaten national security. To obtain such an agreement, it also permits him to threaten and use import restrictions on other products.

When S. 490 was being drafted, an objection was raised that this third change to Section 232 would be "protectionist" because it could result in import restrictions on products not related to national security. However, the same possibility exists in several provisions of U.S. trade law, particularly Section 301. For example, in the recent dispute with Europe over new barriers to our corn exports, the U.S. was prepared to use the leverage of restrictions on wine and cheese.

Other provisions of S. 490 would widen the scope for incidental import restrictions. For example, the proposed change in Section 301 would, under certain conditions, mandate retaliation that benefits extraneous industries. Surely the President should have the option of using as much leverage in defense of national security as he is mandated to use in run-of-the-mill unfair trade cases. The addition of the third element of my bill would eliminate this anomaly in S. 490.

S. 490 permits the President unilaterally to impose quotas on specific imports threatening the national security. However, he will often prefer to negotiate export restraints as he did in the case of machine tools. Negotiated export restraints have several advantages. The government of the exporting nation may find negotiated restraints more amicable because that government will participate in the outcome. The threatened U.S. industry may prefer negotiated arrangements because those arrangements can be more finely crafted than quotas enforced by Customs. Even the industry's customers may prefer export restraints because unilateral quotas enforced by Customs can disrupt the flow of imports for their use.

To obtain a satisfactory restraint agreement, the President may at times benefit from the ability to threaten import restrictions on a wider range of imports. We should explicitly provide him with that authority.

For these reasons, I urge this committee to adopt the language of my bill, S. 285, in its entirety.

As this committee develops a general trade bill over the next few weeks, I'm confident that you will give national security interests your close attention. For the sake of national security, we must do more than tighten Section 232. We need to improve the competitiveness of our industrial base and to restore the credibility of our trade policy. Thank you.

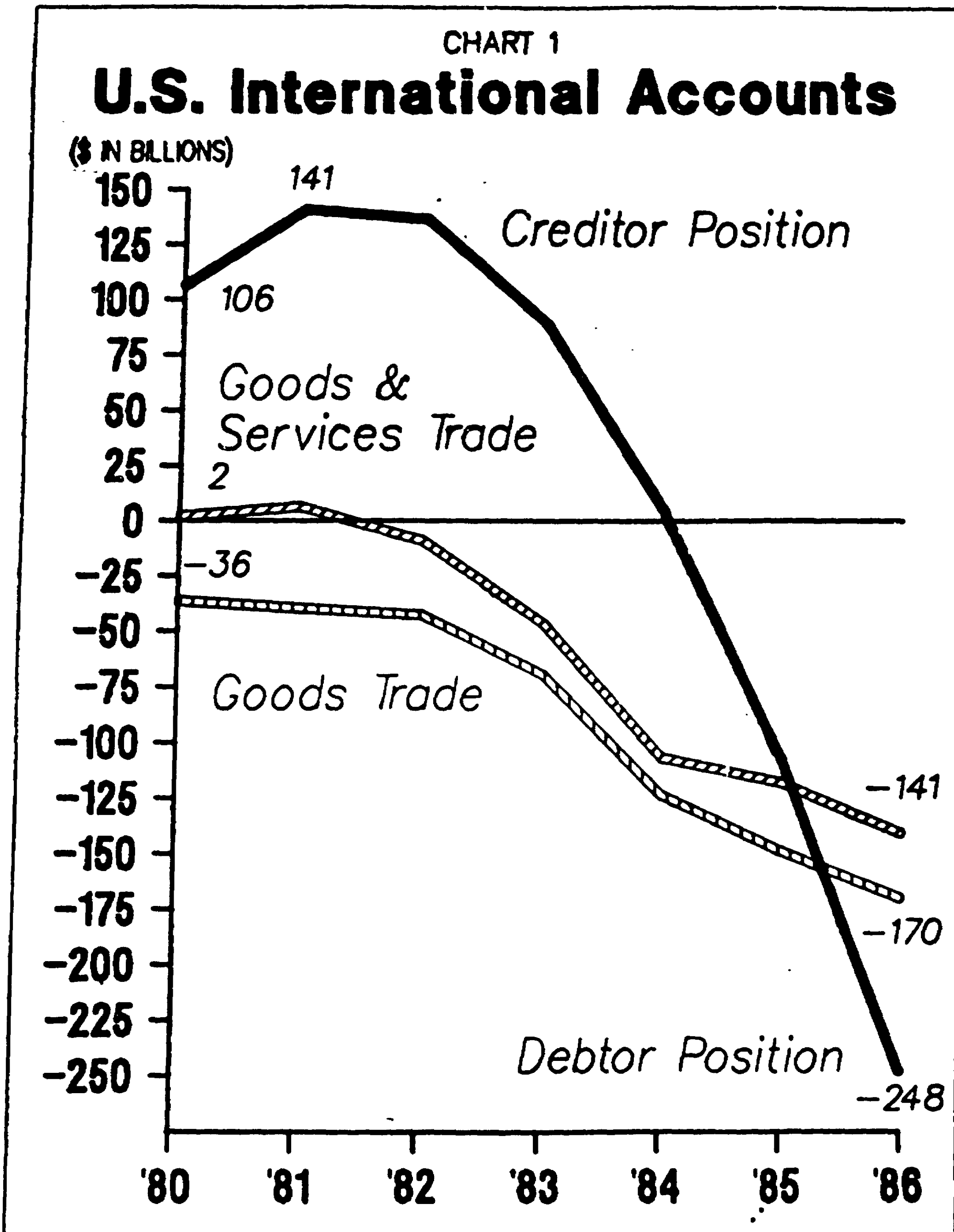
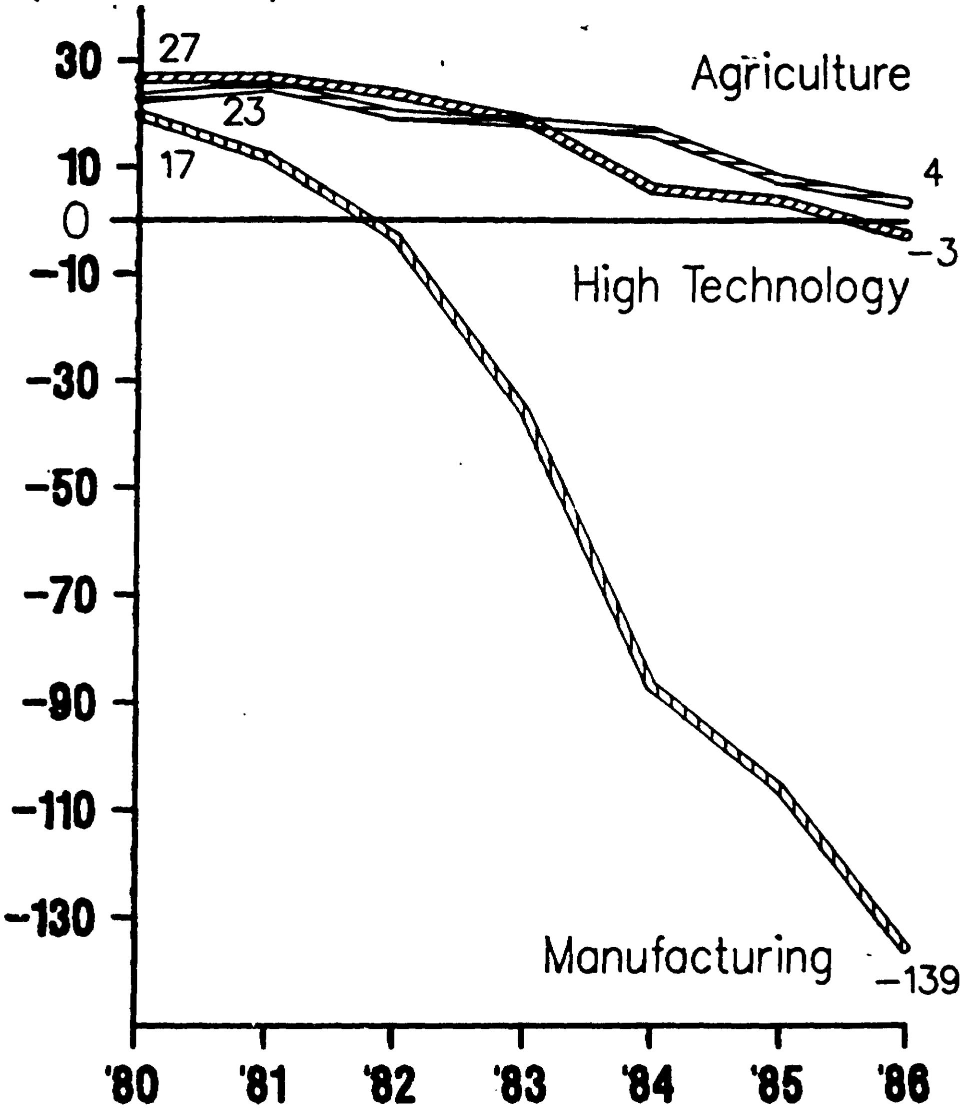


CHART 1
U.S. International Accounts
($ IN BILLIONS)
150
125
100
75
50
25
0
-25
-50
-75
-100
-125
-150
-175
-200
-225
-250
141
106
Creditor Position
Goods &
Services Trade
2
-36
Goods Trade
-141
-170
Debtor Position
-248
'80
'81
'82
'83
'84
'85
'86

CHART 2

U.S. Trade Balance by Sector

($ IN BILLIONS)



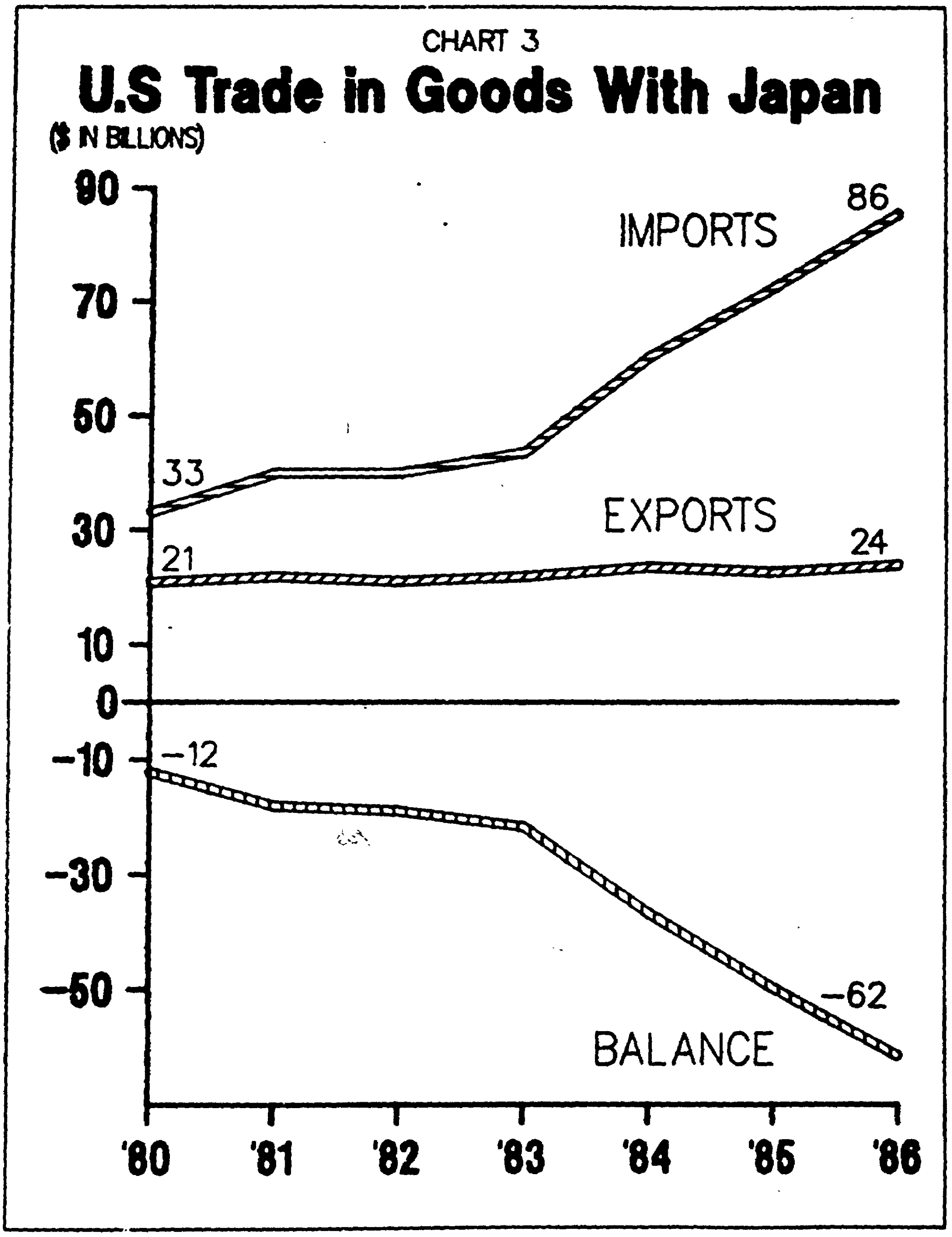
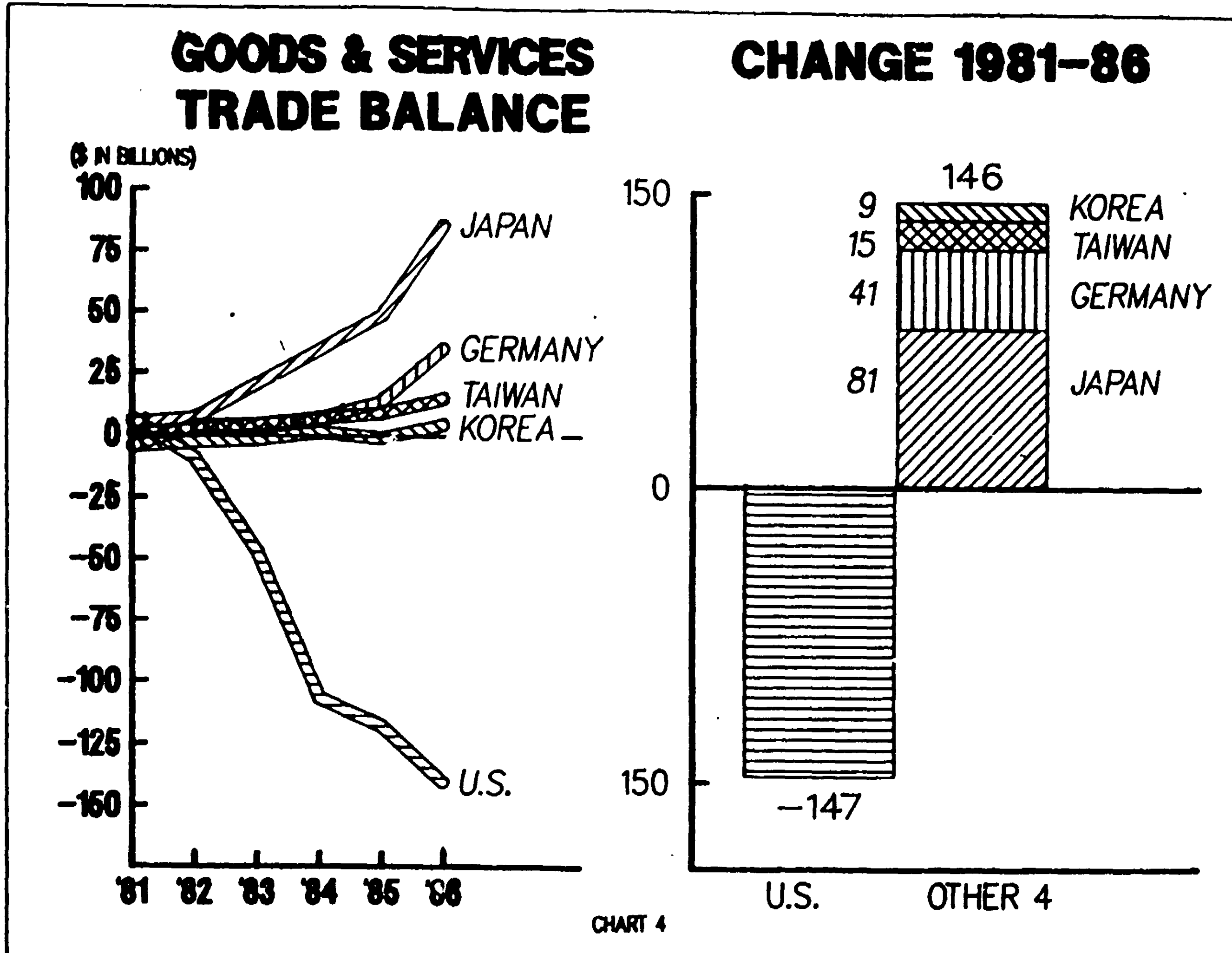


CHART 3
U.S Trade in Goods With Japan
($ IN BILLIONS)
90
70
50
30
10
0
−10
−30
−50
IMPORTS
86
33
EXPORTS
21
24
−12
−62
BALANCE
'80
'81
'82
'83
'84
'85
'86


GOODS & SERVICES
TRADE BALANCE
($ IN BILLIONS)
100
75
50
25
0
−25
−50
−75
−100
−125
−150
'81
'82
'83
'84
'85
'86
JAPAN
GERMANY
TAIWAN
KOREA
U.S.
CHANGE 1981–86
150
0
150
146
9
15
41
81
KOREA
TAIWAN
GERMANY
JAPAN
−147
U.S.
OTHER 4
CHART 4

STATEMENT OF HON. CHARLES E. GRASSLEY, U.S. SENATOR FROM THE STATE OF IOWA

Senator GRASSLEY. Good morning, Mr. Chairman, and members of the committee. And of course, it seems rather strange for me—after six years serving on this Finance Committee—to be here giving testimony rather than hearing it. But, I am very happy to be with you and to discuss with you what I consider a vital element of trade legislation.

And, Mr. Chairman, I compliment you for your leadership in this area and for the legislation that you have introduced, particularly the omnibus trade bill. And also I compliment Senator Byrd for his legislation that he has introduced, of which I am here to testify on a similar piece of legislation. I have no pride of authorship; I just feel that whether you accept Senator Byrd's approach or my approach, it is very essential that we have this type of legislation as a very key element of any trade legislation that passes.

While a member of this committee, I had the privilege of having my bill last session, S. 1679, included as Title 10 of the omnibus trade legislation. Several of the members of the committee co-sponsored that bill, and some entered into a colloquy on the Senate Floor relative to the 232 case filed by the National Machine Tool Builders Association.

This is a new year, and of course, it's a new Congress. And the problems incurred by the machine tool builders were resolved when the President initiated VRA's. But that does not negate the need to address what I consider a flaw in the trade legislation that we now have on the books. It is for that very reason that I introduced S. 470 this year and appear before you this morning in support of that legislation, and asking your careful consideration of my approach.

Under current law, 232 petitions are filed with the Secretary of Commerce. He has one year from that time of the filing to make an independent investigation, and to submit his recommendations to the President. Now, that's where the flaw exists, because present law gives the President an unlimited amount of time to make a decision. My bill corrects this discrepancy by doing the following:

First, it forces the President to decide 232 cases before him within 90 days of receiving the recommendation of the Secretary of Commerce.

Second, if the President fails to act within that 90-day period of time, the Secretary's recommendations would go into effect automatically.

My bill does not in any way take away any of the discretion that the President currently possesses under the law—either to decide the type of remedy to initiate, or to recommend no relief at all.

Mr. Chairman, Section 232 was intended by Congress to be used sparingly—only in situations where the national security is truly threatened. It has never been intended to be a guise for protectionism. Now, only 15 industries have availed themselves of this section of the trade law, and to my knowledge, only once has import relief been granted.

I watched as the machine tool industry's 232 case languished in the White House for over 18 months—and that was after Congress passed the Houidille Petition that I sponsored unanimously, in November of 1982.

In that 30-month period of time that followed the industry's filing, imports rose over 40 percent of U.S. consumption. Machine tool manufacturers closed domestic facilities and began sourcing their products offshore. Forty percent of the machine tool employees lost their jobs.

Faced with this kind of decline in a vital industry while waiting for relief to be granted, I am convinced that we must close this major gap in our trade law. The very foundation of our national security and economic well-being rests upon this issue, and we cannot afford to close our eyes to it.

When the President finally acted on the machine tool case, Secretary of Commerce Baldrige has this to say, and I quote:

"As a result of this action the domestic machine tool makers will make an additional $800 million during the next five years."

Assistant Secretary of Commerce Paul Freedenberg said, and I would quote:

"The combination of import restraints and modernization will preserve over ten thousand jobs that otherwise would have been lost."

With those kinds of results, I can't imagine us, in this Congress, allowing this or any other President's inaction to cause the loss of a domestic industry and its employees so vital to our national security.

Mr. Chairman, as you well know, a filing under Section 232 could be for any industry vital to our national security. What I am recommending today is that we provide a forum in which: first, Section 232 is used for the purpose it was intended; second, the Secretary of Commerce be given ample time to conduct an independent investigation; third, the President acts within 90 days of the Secretary's recommendation, rather than having unlimited time to do so; and fourth, failure of the President to act will result in the Secretary's recommendations going into effect automatically; and yet, in the fifth point, none of the President's discretion on relief is diminished.

I believe the President must be forced to act within a given time frame so that vital industries can get down to business, and so that they can be competitive.

I would hope that you would see the urgent need to include a provision in the trade bill along these lines, and along those which Senator Byrd has outlined, so that our reputation as a paper tiger in international trade will be diminished, and we will be at the bargaining table in the strong position we ought to be in future years.

The CHAIRMAN. Thank you, Senator. We appreciate your statement. We miss you on the committee and are delighted to have your contribution this morning.

Secretary Baldrige has arrived, and I would ask the Senators if they would defer questions. Thank you very much, Senator.

Our next witness is the Honorable George Sinner, the Governor of the State of North Dakota.

[The prepared written statement of Hon. Charles E. Grassley follows:]

SENATOR CHARLES E. GRASSLEY

IMPACT OF IMPORTS AND FOREIGN INVESTMENT ON NATIONAL SECURITY

FINANCE COMMITTEE HEARING

MARCH 25, 1987

MR. CHAIRMAN:

GOOD MORNING. IT SEEMS RATHER STRANGE THAT...AFTER SIX YEARS OF SERVING ON THE FINANCE COMMITTEE...I AM GIVING TESTIMONY RATHER THAN HEARING IT AND ASKING QUESTIONS. NEVERTHELESS, IT IS A PLEASURE FOR ME TO BE WITH YOU THIS MORNING TO DISCUSS WHAT I CONSIDER TO BE A VITAL ELEMENT OF TRADE LEGISLATION.

WHILE A MEMBER OF THIS COMMITTEE, I HAD THE PRIVILEGE OF HAVING MY BILL...S. 1679...INCLUDED AS TITLE TEN OF LAST YEAR'S OMNIBUS TRADE LEGISLATION. SEVERAL OF THE MEMBERS OF THE COMMITTEE CO-SPONSORED THAT BILL...AND SOME ENTERED INTO A COLLOQUY ON THE SENATE FLOOR RELATIVE TO THE 232 CASE FILED BY THE NATIONAL MACHINE TOOL BUILDERS ASSOCIATION.

THIS IS A NEW YEAR AND A NEW CONGRESS...AND THE PROBLEMS INCURRED BY THE MACHINE TOOL BUILDERS WERE RESOLVED WHEN THE PRESIDENT INITIATED VRA'S. BUT THAT DOES NOT NEGATE THE NEED TO ADDRESS WHAT I CONSIDER A FLAW IN TRADE LAW. IT IS FOR THAT VERY REASON THAT I INTRODUCED S. 470 THIS YEAR AND APPEAR BEFORE YOU THIS MORNING.

UNDER CURRENT LAW, 232 PETITIONS ARE FILED WITH THE SECRETARY OF COMMERCE. HE HAS ONE YEAR FROM THE TIME OF THE FILING TO MAKE AN INDEPENDENT INVESTIGATION, AND SUBMIT HIS RECOMMENDATION TO THE PRESIDENT. IT IS AT THIS POINT THAT I BELIEVE THE "FLAW" EXISTS. PRESENT LAW GIVES THE PRESIDENT AN <u>UNLIMITED</u> AMOUNT OF TIME TO DETERMINE WHETHER HE AGREES WITH THE SECRETARY'S FINDINGS.

MY BILL CORRECTS THIS DISCREPANCY BY DOING THE FOLLOWING:

FIRST, IT FORCES THE PRESIDENT TO DECIDE 232 CASES BEFORE HIM WITHIN 90 DAYS OF RECEIVING THE RECOMMENDATION OF THE SECRETARY OF COMMERCE.

SECONDLY, IF THE PRESIDENT FAILS TO ACT WITHIN THE 90 DAY PERIOD, THE SECRETARY'S RECOMMENDATION WOULD GO INTO EFFECT AUTOMATICALLY.

MY BILL DOES NOT TAKE AWAY ANY OF THE DISCRETION THE PRESIDENT CURRENTLY POSSESSES UNDER THE LAW...EITHER TO DECIDE ON THE TYPE OF REMEDY TO INITIATE...OR TO RECOMMEND NO RELIEF AT ALL.

MR. CHAIRMAN, SECTION 232 WAS INTENDED BY CONGRESS TO BE USED SPARINGLY...ONLY IN SITUATIONS WHERE THE NATIONAL SECURITY IS TRULY THREATENED. IT HAS NEVER BEEN INTENDED TO BE A GUISE FOR PROTECTIONISM. ONLY FIFTEEN INDUSTRIES HAVE AVAILED THEMSELVES OF THIS SECTION OF THE TRADE LAWS... AND TO MY KNOWLEDGE ONLY ONCE HAS IMPORT RELIEF BEEN GRANTED.

I WATCHED AS THE MACHINE TOOL INDUSTRY'S 232 CASE LANGUISHED IN THE WHITE HOUSE FOR OVER EIGHTEEN MONTHS. IN THE THIRTY MONTHS THAT FOLLOWED THE INDUSTRY'S FILING, IMPORTS ROSE OVER FORTY PERCENT OF U.S. CONSUMPTION. MACHINE TOOL MANUFACTURERS CLOSED DOMESTIC FACILITIES AND BEGIN SOURCING THEIR PRODUCTS OFFSHORE. FORTY PERCENT OF THE MACHINE TOOL EMPLOYEES LOST THEIR JOBS.

FACED WITH THIS KIND OF DECLINE IN A VITAL INDUSTRY WHILE WAITING FOR RELIEF TO BE GRANTED, I AM CONVINCED THAT WE MUST CLOSE THIS MAJOR GAP IN OUR TRADE LAW. THE VERY FOUNDATION OF OUR NATIONAL SECURITY AND ECONOMIC WELL-BEING RESTS UPON THIS ISSUE, AND WE CANNOT AFFORD TO CLOSE OUR EYES TO IT.

WHEN THE PRESIDENT FINALLY ACTED ON THE MACHINE TOOL CASE, SECRETARY OF COMMERCE BALDRIDGE SAID,

" AS A RESULT OF THIS ACTION THE DOMESTIC MACHINE TOOL MAKERS WILL MAKE AN ADDITIONAL $800 MILLION DURING THE NEXT FIVE YEARS".

ASSISTANT SECRETARY OF COMMERCE PAUL FREEDENBERG SAID,

" THE COMBINATION OF IMPORT RESTRAINTS AND MODERNIZATION WILL PRESERVE OVER TEN THOUSAND JOBS THAT OTHERWISE WOULD HAVE BEEN LOST".

WITH THOSE KINDS OF RESULTS, I CAN'T IMAGINE US ALLOWING THIS OR ANY OTHER PRESIDENT'S INACTION TO CAUSE THE LOSS OF A DOMESTIC INDUSTRY AND ITS EMPLOYEES SO VITAL TO OUR NATIONAL SECURITY.

MR. CHAIRMAN, AS YOU WELL KNOW, A FILING UNDER SECTION 232 COULD BE FOR ANY INDUSTRY VITAL TO OUR NATIONAL SECURITY. WHAT I AM RECOMMENDING TODAY IS THAT WE PROVIDE A FORUM IN WHICH:

(1) SECTION 232 IS USED FOR THE PURPOSE IT WAS INTENDED;

(2) THE SECRETARY OF COMMERCE IS GIVEN AMPLE TIME TO CONDUCT AN INDEPENDENT INVESTIGATION;

(3) THE PRESIDENT ACTS WITHIN 90 DAYS OF THE SECRETARY'S RECOMMENDATION, RATHER THAN HAVE UNLIMITED TIME TO DO SO;

(4) FAILURE OF THE PRESIDENT TO ACT WILL RESULT IN THE SECRETARY'S RECOMMENDATION GOING INTO EFFECT AUTOMATICALLY; YET

(5) NONE OF THE PRESIDENT'S DISCRETION ON RELIEF IS DIMINISHED.

I BELIEVE THE PRESIDENT MUST BE FORCED TO ACT WITHIN A GIVEN TIME FRAME SO THAT VITAL INDUSTRIES CAN GET DOWN TO BUSINESS...AND BE <u>COMPETITIVE</u>.

I THANK THE COMMITTEE FOR PERMITTING ME TO TESTIFY THIS MORNING. I WOULD HOPE THAT YOU WOULD SEE THE URGENT NEED TO INCLUDE A PROVISION IN THE TRADE BILL ALONG THESE LINES, AND THOSE WHICH SENATOR BYRD HAS OUTLINED AS WELL. I COMMEND YOU FOR HOLDING THIS HEARING AND FOR YOUR WISDOM IN PUTTING TRADE ON THE FRONT BURNER.

IT'S TIME FOR US TO STOP BEING A PAPER TIGER IN THE INTERNATIONAL TRADE ARENA. WHILE IT'S FINE TO PROMOTE <u>FREE</u> TRADE...IT'S MORE IMPORTANT TO PROMOTE <u>FAIR</u> TRADE... PARTICULARLY WHEN WHAT IS AT STAKE IS OUR NATIONAL SECURITY.

THANK YOU.

STATEMENT OF HON. GEORGE SINNER, GOVERNOR OF THE STATE OF NORTH DAKOTA

Governor SINNER. Thank you, Mr. Chairman. I am here as the Chairman of the Interstate Oil Compact, which is a compact of 29 states that represent oil producing interests in the United States, and a group of states that are interested in the long-term security of the United States.

In the interest of your schedule, I'm going to just comment off-the-cuff as it were, rather than go through the testimony that has been delivered to the committee.

First of all, the IOCC, which I mentioned represents 29 states, passed a resolution at its last meeting that calls upon the President of the United States to declare the existence of an emergency adversely affecting the national security, and to impose immediately a variable tariff on imported crude oil and refined products.

The resolution also urges that in the event that the President fails to act, the member states of the IOCC call upon the Congress to enact legislation requiring the imposition of a variable tariff on imported crude oil and refined products "properly structured to encourage the efficient use of the nation's petroleum resources in accordance with the principles of conservation and, simultaneously, to protect the nation's legitimate interest in its welfare and its national security."

Mr. Chairman, it makes a mockery of the discussion of trade to talk about free trade, when three-fourths of the world's oil is marketed by governments. We run across this phenomenon in many areas of world trade. And it's ironic that countries that market by national ownership in their national marketing policy, have the audacity to come to this country and lecture to us about free trade.

Third, I think it's a badly overlooked fact in the world trade agreements that nations simply do need domestic reliable production for up to three-fourths, or even 80 percent of major import commodities for their national security. Look at what Europe has done in food production, because they have been hungry.

What this country has not learned through its hunger for oil in the early 70's is that its national security is vitally involved in a secure domestic source of production for liquid fuels, particularly oil.

Finally, for those states that are in the production sector, it's one thing to talk about macroeconomics in the grand terms of theoretic discussions, but economies in the production states are being decimated while all of this goes on. The foreclosures and liquidations in the oil industry are rising rapidly this year. We thought we had seen the worst last year. But, the fact is that there was a lag effect, and many companies that had the ability to hang on a little while hung on, and are now falling prey to their shortage of cash flow and the unreliability of their industry, and the lack of reliance on the part of creditors to give them credit.

It seems to me that the country has suffered from an acute case of myopia when we have imposed, societally imposed, incredible costs on our production sector, from Workmen's Compensation, to Unemployment Insurance, Social Security, Income Withholding, Environmental Protection Agency law, OSHA requirements, Equal

Opportunity requirements, the highest level of liability insurance cost in the history of the world—then saddled them for many, many years with a 30-40 percent exchange rate. And then, to add insult to injury, berated these production industries for being unable to compete in a world in which many of the competitors have few, if any, of this societally imposed costs.

The United States, it seems to those of us in the IOCC, particularly in the acute field of liquid fuels, is at risk of giving away its national security for some euphemism called "free trade", which has no reality in fact in the world's trade.

Mr. Chairman, the IOCC supports the variable tariff concepts, but applauds your efforts and your committee for its work in securing a workable way to control the imports of oil. Thank you very much.

The CHAIRMAN. Governor Sinner, time has expired and I obviously, as Chairman of this committee, would like very much to pursue the line of testimony that you have given. I think it is important and extremely helpful, and we'll take your full statement into the record.

But, we do have the Secretary of Commerce waiting, and I know we want to develop further questions with him.

Governor SINNER. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much for your statement. It will be helpful and we'll take it in its entirety.

Mr. Secretary, we are pleased to have you here this morning, and apologize for the delay in your appearance. Good to have you.

[The prepared written statement of Hon. George Sinner follows:]

STATEMENT OF THE HONORABLE GEORGE A. SINNER
GOVERNOR
STATE OF NORTH DAKOTA

Governor Sinner. Thank you, Mr. Chairman. I am here as the Chairman of the Interstate Oil Compact, which is a compact of 29 states that represent oil producing interests in the United States, and a group of states that are interested in the long-term security of the United States.

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Thirdly, I think it's a badly overlooked fact in the world trade agreements that nations simply do need reliable domestic production for up to three-fourths, or even 80 percent, of major import commodities for their national security. Look at what Europe has done in food production because they have been hungry.

What this country has not learned through its hunger for oil in the early 70's is that its national security is vitally involved in a secure domestic source of production for liquid fuels, particularly oil.

Finally, for those states that are in the productive sector, it's one thing to talk about macroeconomics in the grand terms of theoretic discussions, but economies in the productive states are being decimated while all of this goes on. The foreclosures and liquidations in the oil industry are rising rapidly this year. We thought we had seen the worst last year. But, the fact is that there was a lag effect, and many companies that had the ability to hang on a little while hung on, but are now falling prey to their shortage of cash flow, the unreliability of their industry, and the lack of reliance on the part of creditors to give them credit.

It seems to me that the country has suffered from an acute case of myopia when we have placed incredible societally-imposed costs on our productive sector, from Workmen's Compensation, to Unemployment Insurance, Social Security, Income Withholding, Environmental Protection Agency law, OSHA requirements, Equal Opportunity requirements, the highest level of liability insurance cost in the history of the world, and then saddled them for many, many years with a 30-40 percent exchange rate. And then, to add insult to injury, we have berated these productive industries for being unable to compete in a world in which many of the competitors have few, if any, of these societally-imposed costs.

It seems to those of us in the IOCC that the United States, particularly in the acute field of liquid fuels, is at risk of giving away its national security for some euphemism called "free trade", which has no reality in fact in world trade.

Mr. Chairman, the IOCC supports the variable tariff concepts, but applauds your efforts and your committee for its work in securing a workable way to control the imports of oil. Thank you very much.

APPENDIX A

GOVERNORS AND THEIR REPRESENTATIVES OF MEMBER STATES

ALABAMA
Governor Guy Hunt

ALASKA
Governor Stephen Cowper

ARIZONA
Governor Evan Mecham

ARKANSAS
Governor Bill Clinton

Official Representative:
E. Boyd Alderson

CALIFORNIA
Governor George Deukmejian

Official Representative:
M. G. Mefferd

Associate Representative:
Claire T. Dedrick

COLORADO
Governor Roy Romer

GEORGIA (Associate)
Governor Joe Frank Harris

Associate Representative:
William H. McLemore

IDAHO (Associate)
Governor Cecil Andrus

ILLINOIS
Governor James R. Thompson

INDIANA
Governor Robert D. Orr

Official Representative:
Norman C. Hester

Associate Representative:
Victor R. Gallagher

KANSAS
Governor John Hayden

KENTUCKY
Governor Martha Layne Collins

Official Representative:
George H. Warren, Jr.

LOUISIANA
Governor Edwin W. Edwards

Official Representative:
George W. Hardy, III

MARYLAND
Governor William D. Schaefer

Official Representative:
Kenneth N. Weaver

MICHIGAN
Governor James J. Blanchard

Official Representative:
R. Thomas Segall

MISSISSIPPI
Governor Bill Allain

Official Representative:
Dlynn Braswell

MONTANA
Governor Ted Schwinden

Official Representative:
James C. Nelson

NEBRASKA
Governor Kay Orr

NEVADA
Governor Richard H. Bryan

Official Representative:
Richard Reyburn

NEW MEXICO
Governor Garrey Carruthers

Official Representative:
William J. LeMay

GOVERNORS AND THEIR REPRESENTATIVES
OF MEMBER STATES

NEW YORK
Governor Mario M. Cuomo

Official Representative:
William D. Cotter

NORTH CAROLINA (Associate)
Governor James G. Martin

NORTH DAKOTA
Governor George A. Sinner

Official Representative:
Nicholas J. Spaeth

OHIO
Governor Richard F. Celeste

Official Representative:
J. Kearney Shanahan

OKLAHOMA
Governor Henry Bellmon

Official Representative:
Lew O. Ward

OREGON (Associate)
Governor Neil Goldschmidt

PENNSYLVANIA
Governor Robert Casey

SOUTH CAROLINA (Associate)
Governor Carroll Campbell, Jr.,

Official Representative:
Rep. T. W. Edwards

SOUTH DAKOTA
Governor George Mickelson

Official Representative:
John J. Smith

Associate Representative:
Fred V. Steece

TEXAS
Governor William P. Clements, Jr.

Official Representative:
Walter H. Mengden, Jr.

Official Representative:
Philip F. Patman

UTAH
Governor Norman H. Bangerter

Official Representative:
Dianne R. Nielson

VIRGINIA
Governor Gerald L. Baliles

Official Representative:
Gene Dishner

WASHINGTON (Associate)
Governor Booth Gardner

Official Representative:
Brian J. Boyle

WEST VIRGINIA
Governor Arch A. Moore, Jr.

Official Representative:
John H. Johnston

WYOMING
Governor Mike Sullivan

Official Representative:
Craig Newman

Official Representative:
Howard M. Schrinar

RESOLUTION ON CRUDE OIL IMPORT TARIFF

WHEREAS, the Organization of Petroleum Exporting Countries has sought to effect a program to control the world price of crude oil; and

WHEREAS, certain of the member states of the Organization of Petroleum Exporting Countries have engaged in "dumping" crude oil and refined products on the world petroleum market; and

WHEREAS, the resultant supply-demand response has caused a severe dislocation of the world petroleum market, particularly by severely decreasing prices and creating serious price instability; and

WHEREAS, the decline in crude oil prices and the dumping of crude oil and refined products and resultant decline in and instability of crude oil prices have caused the premature abandonment of thousands of wells in the United States and stifled exploration for new reserves and made the full exploitation of known but untapped reserves or producing reserves not fully developed economically unfeasible; and

WHEREAS, a healthy and dynamic petroleum industry is vital to both the economic welfare and national security of this country and essential to the full and efficient use of its petroleum resources in accordance with the principles of conservation; and

WHEREAS, a failure to respond to these acts and conditions will seriously and permanently impair the nation's interest in the full and efficient use of its hydrocarbon resources and will further impair the economic welfare and security of the nation; and

WHEREAS, Congress has previously recognized that international dumping of products and commodities can occur and imperil legitimate national interests and has accordingly authorized the President of the United States to impose variable tariffs to prevent such damaging effects; and

WHEREAS, the above recited acts, conditions and consequences constitute an emergency adversely affecting the national security requiring immediate and appropriate action;

NOW, THEREFORE, BE IT RESOLVED that:

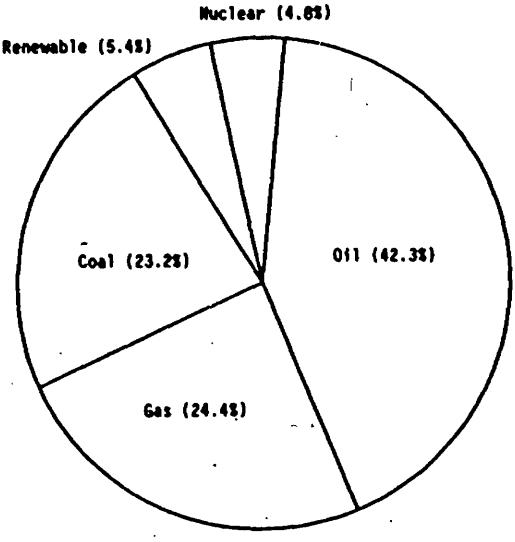
(1) The member states of the Interstate Oil Compact Commission hereby call upon the President of the United States to declare the existence of an emergency adversely affecting the national security and to impose a variable tariff on imported crude oil and refined products in the manner authorized by Congress.

(2) In default of presidential response to the above recited acts, conditions and responses or in the event any response would be inadequate by reason of legal restrictions or insufficient presidential response, the member states of the Interstate Oil

Compact Commission call upon the Congress of the United States to enact legislation requiring the imposition of a variable tariff on imported crude oil and refined products properly structured to encourage the full and efficient use of the nation's petroleum resources in accordance with the principles of conservation and simultaneously to protect the nation's legitimate interest in its economic welfare and its national security.

U.S. CONSUMPTION OF ENERGY BY SOURCE

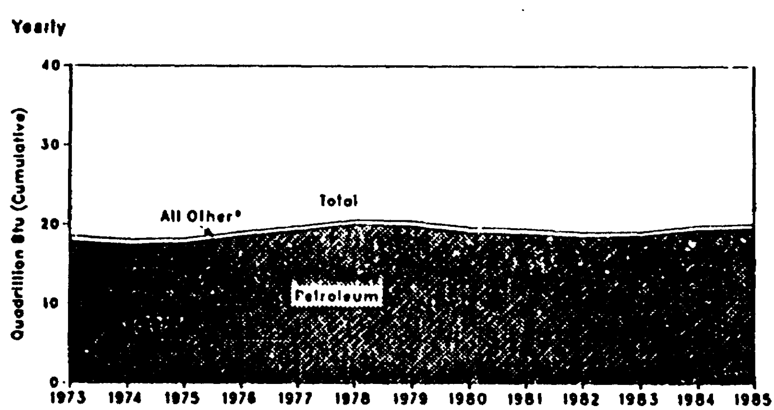
ACTUAL USAGE 1984



SOURCE: DOE/EIA, 1985.

Figure 1

Consumption of Energy by the Transportation Sector



*Includes coal, natural gas, electricity, and electrical system energy losses.

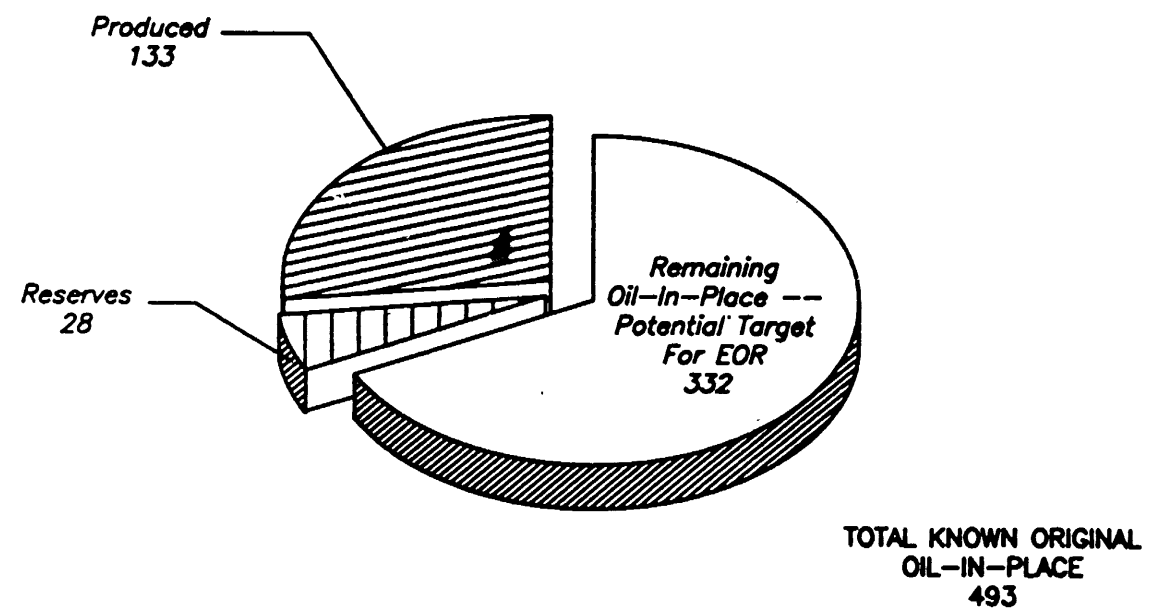
Monthly Energy Review November 1985
Energy Information Administration

Figure 2

CURRENT DISTRIBUTION OF DOMESTIC OIL RESERVES

(Billions of Barrels)

AS OF 1984



SOURCES: EIA, 1984
API/AGA/CPA, 1979

Figure 3

FY87 ENERGY R&D FUNDING

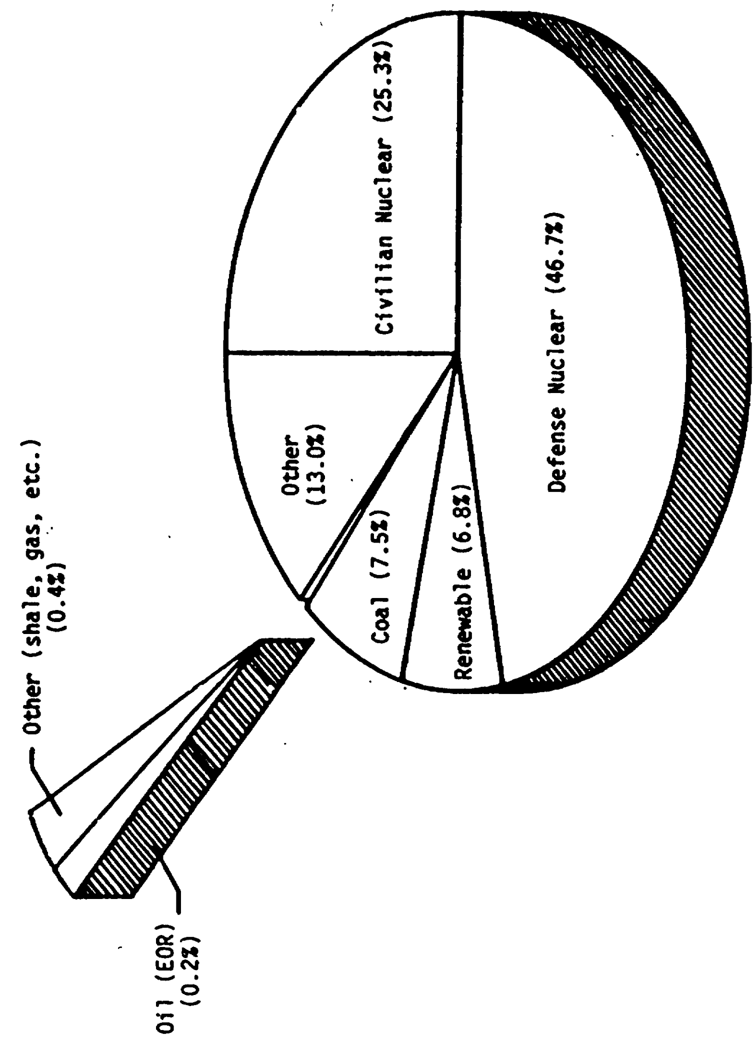


Figure 4

STATEMENT OF HON. MALCOLM BALDRIGE, SECRETARY, DEPARTMENT OF COMMERCE

Secretary BALDRIGE. Thank you, Mr. Chairman.

I am pleased to appear before this committee today. There is a relationship between trade, foreign investment, and national security. The point I want to drive home today, Mr. Chairman, is simple and it's clear—national security is comprised of both economic and military security. One depends on the other. We should never forget that. As a matter of fact, I'd go a step further and say that military security is founded on economic security. You cannot have one without the other.

Since the Second World War, our country's international economic and security responsibilities have multiplied. Rapid technological and industrial innovation has made the world smaller, more complex, and increasingly interdependent. It is a true global economy. We no longer have the luxury of being an intermittent player in that arena.

Until recently, our defense base preparedness program relied almost exclusively on our industries' ability to meet mobilization requirements for a global conventional conflict—plus developing national resource requirements, management plans, and controls.

We know we must continue these programs, but we must take many other factors into account in our defense base planning. We have got to respond to changes in the world economy, changes that are critical to the national security.

The United States has lost its technological preeminence in a number of key high technology industries. And this is a cause for concern, because our nation's defense edge is based on technological strength rather than on numerical supremacies.

This is all the more critical because defense capabilities are affected by technological developments in the commercial sector. Therefore, the loss of production capabilities in industries such as semiconductors or machine tools may have a multiplier effect through the defense industrial base.

The United States and its allies have become dependent upon energy and raw materials located in unstable regions of the world. Supply interruptions could have significant negative effects on our defense base, on our overall economy, and on our foreign policy.

There are several steps we can take, Mr. Chairman, to ensure that the U.S. industrial base remains a key component of our defense preparedness.

Section 232 is one. Our industrial capability is a key line of defense both for mobilization purposes and for our current procurement needs. Although imports are needed in many industries, they can also erode industrial capabilities needed for national security purposes. When this happens, it doesn't matter whether we are confronting fair or unfair trading practices.

The statute dealing with this issue is Section 232 of the Trade Expansion Act. It authorizes the President to adjust imports to remove a national security threat based on findings submitted by the Department of Commerce.

It is essential, however, that we use caution in using 232 once we identify imports from friendly countries as a national security threat. Since many of our trading partners depend on the U.S. security umbrella, we can often address those concerns through bilateral discussions and without the formal use of 232. In this regard, we recently concluded voluntary restraint agreements with Japan and Taiwan that will curtail the level of their machine tool exports to the United States for the next five years, providing U.S. industry time to rebuild its production capabilities.

Among the most important issues raised by pending Section 232 amendments are proposals to reduce the amount of time available for Commerce to conduct investigations, for the President to make his decision in these cases, and to require a formal Defense Department assessment of its needs for the product under investigation. I believe all three are inadvisable changes.

Our experience in conducting 232 investigations has convinced us that it would really be inadvisable to establish a six-month time limit on the completion of our investigations. We have completed every 232 investigation as quickly as feasible. We always commit the necessary resources to the investigations—it is such an important law—and top Commerce officials have always made themselves available to ensure cooperation from the interagency community.

Now, the machine tool case did take longer than expected—it took too long. That was due to some unusual circumstances related to the Administration's redrafting the national security planning guidelines. It wasn't really the fault of the existing Section 232 procedures. We are all committed in the Administration to timely deliberations in any 232 case.

And I think the same goes for Presidential limitations—90-day time limit. Their 232 investigations really concern the ability of domestic industries to meet national security requirements. That is a different and really a broader concern, more complicated in a lot of cases, than those issues addressed by unfair trade statutes. Imposition of a time limit may not allow the President sufficient opportunity to balance the national security, foreign policy, and trade concerns that are raised uniquely by a 232 case. The President needs flexibility to choose the right time to act.

And finally, we oppose proposals to require the Defense Department to prepare a formal assessment of its needs for the product under investigation and to state whether they do or do not support Commerce's findings. Under 232, we already consult with DOD to identify defense requirements. And it is inappropriate to require Executive Branch agencies to publish possible interagency disagreements on national security issues.

We must be prepared to act before our problems become too economically or politically difficult. If we wait until a strategic industry is almost gone, the cost to bring it back is prohibitive. So, in addition to administering 232, Commerce cooperates with other agencies in conducting in-depth evaluations to identify competitive deficiencies and production bottlenecks in defense industries and seeks to develop appropriate remedies.

We are also working closely with our allies in the NATO Industrial Planning Committee to develop a coordinated approach toward efficient production and procurement. The recently completed NATO Ammunition study identified our inability to rapidly increase production within the alliance and prompted NATO Secretary General Carrington to propose cooperation toward an effective multilateral means to correct this problem.

Offsets? Well, as we seek to maximize the benefits of international cooperation in defense trade, we must also recognize that some transactions among allies can be inimical to the competitiveness of our key defense industries.

In recent years, offset requirements in defense trade have proliferated. Offsets can be broadly defined as a range of industrial and commercial compensation practices—coproduction, technology transfer, countertrade—that are imposed as a condition of the purchase of military exports. These transactions arose in the 1950's due to the legitimate need to rebuild the defense industrial bases in Western Europe and Japan after World War II. Offset agreements made the base of unfavorable economic conditions by reducing the impact of military equipment purchases on the budgets and trade accounts of these countries. They also helped standardization and modernization of allied forces.

In more recent years, the offset requirements of our allies continued to increase even though their economic standing improved dramatically. The range and magnitude of offsets has increased very significantly. Between 1980 and 1984, U.S. military exports totalled $47 billion, and nearly half had associated offset agreements. Furthermore, 75 percent of these offset obligations are to our industrialized allies, such as Canada, Japan, and European NATO countries, countries with which we have trade deficits.

These countries seek not only to augment their military capability, but to increase employment, and to enhance their commercial competitiveness, and to obtain advanced technology.

Given the international scope of military offset agreements, an international approach should be developed to address this problem. Since most of the countries requiring and offering offsets are U.S. allies, we should seek to develop multilateral understandings with them on the use of offsets.

We strongly favor, Mr. Chairman, a policy of open investment. And we have sought to expand the freedom of international investment flows in bilateral and multilateral arenas. And I think we have had some real success on that. However, we must consider very carefully the national security implications of foreign control of industries that are essential to our technological and defense base.

These concerns led me to express my reservations over the proposed Fujitsu acquisition of Fairchild Semiconductor. Japan has free access to our market, while our access to their market is restricted. Their companies enjoy the cost advantages of selling, in both Japan and the United States, the world's largest market. Our companies operate at a clear disadvantage because they are not permitted access to Japan's market.

And we are having problems under last year's semiconductor agreement. Japan has a closed supercomputer market. We continue to struggle to crack Japan's telecommunications market. As Secretary of Commerce, I can only conclude that the common objective of the Japanese government and industry is to dominate the world electronics market. Given the importance of this market to U.S. Industry in general and our defense base in particular, we cannot stand by idly.

I think we need to define our policy on foreign direct investment as it relates to strategic industries.

Energy Security. Any discussion involving security of our industrial base would be incomplete without a review of the steps needed to ensure a stable flow of oil and gas to the United States.

The Administration is committed to the principle that reliance on market forces combined with the maintenance of SPR, Strategic Petroleum Reserve, is the most effective means to promote U.S. energy security. It is my understanding that the purpose of S. 694 is to provide a comprehensive national oil security policy by limiting oil imports to 50 percent of U.S. oil consumption.

Mr. Chairman, I am concerned about the economic and national security problems posed by rising oil imports. However, I am also concerned that steps to impose a ceiling on U.S. oil imports would add an undesirable political dimension to world energy trade by forcing us to selectively limit purchases from various countries.

And I am concerned about the negative effect of import controls on the overall U.S. economy. In view of these and other related concerns, I think that the proposed bill is not the most effective way to address the problem.

We also oppose the imposition of an oil import fee. I recognize that an import fee would help increase domestic oil and gas production and preserve jobs in the industry. However, such a fee would raise the cost of oil and its substitutes in the United States above the levels paid in other countries. This would reduce U.S. economic growth, it would increase inflation, it would reduce our competitiveness in foreign and domestic markets, and it would eliminate more jobs in other economic sectors than would be created in the energy sector.

Export Controls. Just as we don't support import controls without a sound justification, we likewise don't favor export controls that do not enhance our national security. We have made and plan to make a number of regulatory changes that will improve the level of U.S. security and the level of U.S. competitiveness.

It is time now to remove any and all unwarranted controls currently imposed on the very private sector companies we need to keep us technologically superior to our adversaries.

Our ultimate objective is to ensure opportunities for all our industries to be competitive without government intervention. As you know, the President has established the goal of ensuring American competitive preeminence into the 21st century.

And his initiative calls for a wide range of specific actions in each of these areas. I think an examination of the trade provisions of S. 490 and the Administration's trade bill shows that we have identified many of the same areas for attention: government regulations should not unnecessarily impede legitimate business opportunities; government programs should effectively promote U.S. exports; government should strengthen the protection of intellectual property rights; government should provide an open and fair trade environment.

This agreement on goals is providing the basis for our successful bipartisan effort to make responsible and effective trade legislation.

So, the initiatives I have described today, Mr. Chairman, are complex and yet my basic message is simple—our military security is founded on a resilience of our industrial base and our overall economic security. In today's world, an effective policy to maintain our industrial base cannot be considered a luxury or an afterthought. On the contrary, a responsive, technologically competitive defense base is a cornerstone of this nation's deterrent posture. Taking effective action to preserve our defense industries is the "ounce of prevention" required to assure that this nation, to assure this nation of an ability to meet any crisis we may confront.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Secretary. You comment on the Martin Report from the Department of Energy. That report points out the increasing dependency on foreign oil supplies, and particularly from unstable OPEC suppliers. And that creates a risk of supply that can give us some serious problems on national security.

Now, you go on and refer to the DOE study and say that one of the constructive recommendations is expanding the leasing and development of Alaskan and Outer Continental Shelf petroleum resources. Who do you think is going to drill at these prices?

See, what we say and what those who are sponsoring S. 694 say; we don't lay it on the Administration as to what to do, but we say get off the dime. If it passes 50 percent, that has to be a peril point. And we should have learned something from what happened to us in 1973 and 1974. We say, do something.

We are looking at a situation now where, when we are talking about automobiles, we say we don't worry as much about the mileage they get.

We say to the GSA and buildings, forget about the thermostats. And we are seeing consumption go up. And we have seen almost 1 million barrels lost in the last 12 months in this country

We have seen stripper wells flood—you don't bring them back. Once you lose that water flow, the idea that you can turn them back on by going out and shifting a valve is wrong. You know, you know, you know better than that. But some of the folks don't seem to know that.

And that is what concerns us very deeply. It doesn't do you any good to say you've got tanks and airplanes and bombers, if you don't have the fuel to run them. So, I have a deep concern on this issue, and I frankly support just what Governor Sinner has said—a variable import fee. But, I know that's a hill to climb, particularly with the opposition of the Administration.

But, the bill we are now talking about is one to recognize that we have a peril point here, then saying to the Administration—do something. Tell us what we can do to turn it around. What is the objection to that, Mr. Secretary? That's not necessarily an import fee.

Secretary BALDRIGE. Well, I thought that the thrust was toward an import fee. And as I said before, we think that that would hurt more than it would help. We did see U.S. imports of oil rise substantially in 1986—1 million barrels a day. But, about one-third of that increase, we figure, was due to inventory build-up. We could get the imports being half of U.S. oil consumption by 1995. I know that you don't credit the SPR with doing all that much, but when we're talking about national security, the fact that—at the present fill rate—there will be, there is enough oil in there now for over 90 days, I think it is 96 days, if we had imports cut off.

The CHAIRMAN. Mr. Secretary, I support that. I support not just the 75,000 but the 100,000 barrels a day being put in it. I strongly support that. I think that is right.

But, I look at a new report from Morgan Guaranty just on the trade deficit and the transfer of wealth to this country. The import bill could rise $30 billion or more by the end of the decade.

But most of the surveys I see, CRS, CBO, most of them say that we are going to pass 50 percent in 1989, 1990, 1991—not even mid-1995. It is right here upon us. And what we are saying is a survey made by the President once a year for the next three years. And if in any one of these years it passes 50 percent, then come to us with a plan to help turn that around.

Whether you are talking about conservation, whether you are talking about incentives to the industry, or whether you are talking about an import fee, or a combination of those factors, we give that discretion to the Administration.

Secretary BALDRIGE. Well, I'll certainly convey those thoughts to Secretary Harrington, Mr. Chairman.

The CHAIRMAN. You know, you and I share an awful lot of thoughts on this trade problem.

Secretary BALDRIGE. Yes we do.

The CHAIRMAN. And I agree that the military defenses of our country are for naught if you don't have a sound economy. And I'm seeing here an incredible transfer of the wealth of our country. And in addition to that, I think an increased vulnerability on national security.

And it deeply disturbs me, and I'm looking for answers. I defer to my distinguished colleague, Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman. Just for those who don't eminently follow everyone's career here, I want to report that I've known Secretary Baldrige for 46 years. We were in the same class in college. Now that that outstanding information has been delivered——

Secretary BALDRIGE. And you were on the wrestling team, Senator. And I never saw you get pinned. [Laughter.]

Senator CHAFEE. Thank you very much. Now——[Laughter.]

Secretary BALDRIGE. But I forget just what weight you wrestled at. It was a little less than it is now. [Laughter.]

Senator CHAFEE. You were way ahead before you came with that last one. [Laughter.]

Mr. Chairman, I would just like to say two things. Well, first I'll get on with a point you make, Mr. Secretary, on Section 232.

I don't really understand your objections to the time limitation on the President making his decision. I thought the Point that has been made here by Senator Grassley and others really makes sense. Now, it may be that the time is too short, and that by having it 90 days, the tendency will be for the President to say no because he hasn't really had enough time to examine it.

What's the matter with that deadline?

Secretary BALDRIGE. Well, my personal opinion, Senator, is that that's not a drop-dead issue. We obviously think it's better—I doubt if our minds could be changed on this—we think it's better to leave all the flexibility you can the Executive Sector. But I think if this committee feels that strongly about some kind of a limit, we could get together and talk about it. I don't know what the right one is, but I think the Administration would be willing to at least sit down and talk that through.

Senator CHAFEE. Well, I think the deadlines are important. Nobody knows more about business than you, having been active for so many years as a successful businessman. But it seems in this matter, as in the matter of export controls which you have testified about before the banking committee, the tremendous problem detriment is that businesses get no answer. There have been especially long delays in the export controls area which is a separate subject.

Turning to another matter, Mr. Chairman, I'd like to say this about the efforts to encourage oil production in the United States. I, as you know, am not for an oil import fee. However, I, as just one member of this committee, would certainly be receptive to doing something.

Now, for instance, I noticed in Governor Sinner's testimony where he mentions on page 2—is it Sinner or Sinner?

Governor SINNER. Sinner, just like my record.

Senator CHAFEE. Governor Sinner's testimony on page 2, where he is discussing what is happening to the stripper wells. Nearly one-half of a million stripper wells in the country, 450,000, are threatened by the low prices.

Now, I thought that last year in the tax reform bill we did something to help the stripper wells, but maybe we ought to do more. Mr. Chairman, I would be willing to look at that. I know you and Senator Boren and others, such as Senator Wallop, have been deeply interested in this, and I would be willing to look at some tax incentives to permit our oil industry to survive. Of course, I could not support an oil import fee because of its effect on my region, and also its effect nationally. But I just want to say that I would be glad to work with you on other approaches, Mr. Chairman.

The CHAIRMAN. I appreciate the Senator's shared concern on that one. And I am having some things done and some numbers run on other approaches, and I'll be looking forward to discussing them with you to see what you think about them—and with the Administration I might add.

Senator CHAFEE. Mr. Chairman, I know that both of us, and certainly Chairman Rostenkowski, have taken the view that we don't want to tamper at all with the tax reform bill. However, I don't think anything is written in stone, and if there is something that could be done—absent an oil import fee—I again want to say I'd be willing to look at it.

The CHAIRMAN. Thank you very much, Senator.

Senator CHAFEE. I want to thank the Secretary very much.

The CHAIRMAN. You know, Mr. Secretary, I think in this statement of yours—it's quite a powerful statement—this point that, "As Secretary of Commerce, I can only conclude that the common objective of the Japanese government and industry", common objective, "is to dominate the world electronics market." I noted too that Ambassador Yeutter, in his speech down, I believe it was in New Zealand, made some comments about a concern if and when, if ever, Japan really started being an open market.

I look also at the point on machine tools and your statement in regard to that. But I also saw the extraordinary length of time it took. Your department did its work within the one year, as I recall, from March 1983 filing—but it wasn't until December 1986 the Administration announced the VRAs and the other actions to provide relief to that industry.

Would you tell me once more why it took that long? Doesn't that argue for some kind of a specified time limit? Don't time limits sometimes, if they're faced, get people off the dime and get them moving?

Secretary BALDRIGE. As I said, Mr. Chairman, I can't stick up for the time it took on machine tools. We went through in the Administration a complete reevaluation of the national security plan. It took too long on machine tools. I don't know of another case where it has taken that long, and I think that was an exception. But, as I told Senator Danforth, I mean Senator Chafee, I don't feel that's a make or break issue on this particular point.

I think we should sit down and talk about it and see if we can't work something out.

The CHAIRMAN. All right. I'm sure we will be getting together and talking about some of these differences and trying to reconcile them. Senator Chafee?

Senator CHAFEE. Nothing, Mr. Chairman.

The CHAIRMAN. Mr. Secretary, we are very pleased to have you this morning. You were good to come with your crowded schedule, and it will be helpful to us.

Secretary BALDRIGE. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Our next witnesses are a panel with Mr. Charles Gentry, Chairman, Task Force on Petroleum Imports, Texas Independent Producers and Royalty Owners Association; and Mr. Juan Benitez, who is the President and Chief Operating Officer, Micron Technology, Boise, Idaho.

With the limitations on time, let's add Mr. Rothschild to the panel, Mr. Edwin Rothschild.

Mr. Gentry, if you will proceed, please.

[The prepared written statement of Hon. Malcolm Baldrige follows:]

TESTIMONY OF THE HONORABLE MALCOLM BALDRIGE

Secretary of Commerce

Senate Finance Committee

March 25, 1987

Good Morning Mr. Chairman, Members of the Committee,

I am pleased to appear before this Committee today to discuss the relationship between trade, foreign investment and national security. The point I want to drive home is simple and clear: national security is comprised of both economic and military security. One depends on the other. As a recent study by the National Academy of Sciences concluded:

> "Dramatic alterations in the economic and technological environment have created a need of a broader definition (of national security) that recognizes explicitly the importance of maintaining the economic vitality and innovative capability of the United States."

This broader definition affects the way we look at both defense and economic issues. Since the Second World War, our country's international economic and security responsibilities have multiplied. Rapid technological and industrial innovation has made the world smaller, more complex and increasingly interdependent. We no longer have the luxury of being an intermittent player in the global arena.

In this regard, we need to consider the appropriate scope for international cooperation in defense planning with our allies. Clearly, we need to work with our allies and friends to maximize the efficiencies of Free World defense industrial production. At the same time, we must never forget that the Free World depends heavily on the U.S. defense umbrella. Therefore, we must structure our cooperation in such a way to maintain American production capabilities in critical high technology industries.

Until recently, our defense base preparedness programs relied almost exclusively on our industries' ability to meet mobilization requirements for a global conventional conflict -- plus developing national resource management plans and controls.

We know we must continue these programs, but we must take many other factors into account in our defense base planning. Specifically, we must consider:

-- the impact of imports on our defense industrial base;

-- the effect of military offset agreements on the competitiveness of our key defense industries;

-- the national security implications of foreign investment in the United States;

-- the impact of export controls on high technology industries; and

-- the importance of a reliable supply of raw materials.

We must respond to changes in the world economy, changes that are critical to the national security.

-- The United States has lost its technological preeminence in a number of key high technology industries. As a result, we now depend on other countries for a wide range of state-of-the-art end-products and manufacturing equipment. This is a cause for concern because our nation's defense edge is based on technological strength rather than on numerical superiority. Excessive dependence on foreign sources for technological advances is also a long term threat to our overall economic well being.

-- This is all the more critical because defense capabilities are affected by technological developments in the commercial sector. Therefore, the loss of production capabilities in industries such as semiconductors or machine tools may have a multiplier effect throughout the defense industrial base.

-- The United States and its allies have become dependent upon energy and raw materials located in unstable regions of the world. Supply interruptions could have significant negative effects on our defense base, our overall economy and our foreign policy.

There are several steps we can take to ensure that the U.S. industrial base remains a key component of our defense preparedness.

Section 232 National Security Investigations

Our industrial capability is a key line of defense both for mobilization purposes and for our current procurement needs. Although imports are needed in many industries, they can also erode industrial capabilities needed for national security purposes. When this happens, it doesn't matter whether we are confronting fair or unfair trading practices. We must take action if imports erode critical portions of our industrial base and in such a way that we could not meet national security needs in an emergency.

The statute dealing with this issue is Section 232 of the Trade Expansion Act. It authorizes the President to adjust imports to remove a national security threat based on findings submitted by the Department of Commerce.

Imports from friends and allies can erode critical U.S. production capabilities. A Section 232 finding that imports from friendly countries pose a security threat doesn't downgrade the importance of our mutual strategic, political and economic relations. It only means that imports from that country are hurting our domestic production capabilities that are needed for our national defense and the collective security of the Free World.

It is also essential that we use caution in using 232 once we identify imports from friendly countries as a national security threat. Since many of our trading partners depend on the U.S. security umbrella, we can often address these concerns through bilateral discussions and without the formal use of Section 232. In this regard, we recently concluded Voluntary Restraint Agreements with Japan and Taiwan that will curtail the level of their machine tool exports to the United States for the next five years, providing the U.S. industry time to rebuild its production capabilities.

We have also informed Switzerland, West Germany and the other leading machine tool suppliers that their exports may not surge and undermine the integrity of these VRAs. This program will increase market shares for domestic manufacturers, maintain critical production capabilities, allow the industry to return to profitability and increase investment in research and development.

The machine tool industry has the primary responsibility for improving its own competitive position. However, the Government should help this process for national security purposes. We now have in place a coordinated Domestic Action Plan involving Defense and Commerce Department programs designed to assist the industry in its revitalization efforts.

I have met with the leading industry officials and think that they recognize that they must use this opportunity to improve their overall competitive position so that the domestic industry will be able to retain and increase its market share and maintain its domestic production capacities when the import restraint program is concluded.

I would now like to turn my attention to the proposed amendments to Section 232.

Among the most important issues raised by pending Section 232 amendments are proposals to: 1) reduce the amount of time available for the Department of Commerce to conduct investigations; 2) limit the amount of time available to the President to make his decision in these cases; and 3) require a formal Defense Department assessment of its needs for the product under investigation. I think that all three represent inadvisable changes to the Section 232 statute.

Our experience in conducting Section 232 investigations has convinced us that it would be inadvisable to establish a six month time limit on the completion of our investigations. We have completed every 232 investigation as quickly as feasible. We always commit the necessary resources to the investigations, and top Commerce officials have always made themselves available to ensure cooperation from the interagency community.

Although the machine tool case took longer than expected, this was due to the unusual circumstances related to the Administration's redrafting of national security planning guidelines, and not by any fault of the existing Section 232 procedures. All of us in the Administration are committed to timely deliberations in any Section 232 case.

We similarly oppose the imposition of a 90-day time limit on Presidential Section 232 decision-making. Section 232 investigations concern the ability of domestic industries to meet national security requirements, a broader concern than that addressed by the unfair trade statutes. Imposition of a time limit on Section 232 cases may not allow the President sufficient time to balance the national security, foreign policy and trade concerns raised uniquely by a 232 case.

Finally, we oppose proposals to require the Defense Department to prepare a formal assessment of its needs for the product under investigation and to state whether they do or do not support Commerce's findings. The Section 232 statute and regulations already require us to consult with DOD to identify defense requirements. These requirements are incorporated into each Section 232 investigation. Further, it is inappropriate to require Executive Branch agencies to publish possible interagency disagreements on national security issues.

U.S. Industrial Capabilities and International Cooperation

We must be prepared to act before our problems become too economically or politically difficult. If we wait until a strategic industry is almost gone, the cost of bringing it back is prohibitive. In addition to administering Section 232, Commerce cooperates with other agencies in conducting in-depth evaluations to identify competitive deficiencies and production bottlenecks in defense industries and seeks to develop appropriate remedies.

For example, we recently completed a study of the ball and roller bearing industry with the DOD Joint Logistics Commanders. This study reviewed production bottlenecks as well as the trade, industry and economic issues related to the competitiveness and long-term viability of this critical industry. As a result of this study, DOD is implementing a Domestic Action Plan which requires domestic procurement of all bearings for defense systems. DOD will also be allocating significant R&D funds to help improve the industry's technological base and competitive position.

We are also working closely with our allies in the NATO Industrial Planning Committee to develop a coordinated approach toward efficient production and procurement. The recently completed NATO Ammunition study identified our inability to rapidly increase production within the alliance and prompted NATO Secretary General Carrington to propose cooperation toward an effective multilateral means to correct this problem.

Offsets in Defense Trade

As we seek to maximize the benefits of international cooperation in defense trade, we must also recognize that some transactions among allies can be inimical to the competitiveness of our key defense industries.

In recent years, offset requirements in defense trade have proliferated. Offsets can be broadly defined as a range of industrial and commercial compensation practices (coproduction, sub-contractor production, licensed production, overseas investment, technology transfer, countertrade) that are imposed as a condition of purchase of military exports. These transactions arose in the 1950's due to the legitimate need to rebuild the defense industrial bases of Western Europe and Japan after the devastation of World War II. Offset agreements made the best of unfavorable economic conditions by reducing the impact of military equipment purchases on the budgets and trade accounts of these countries. They also enhanced standardization and modernization of allied forces, and strengthened U.S. ties to the buyer countries.

In more recent years, the offset requirements of our allies continued to increase even though their economic standing improved dramatically. The range and magnitude of offsets demanded has increased significantly. Between 1980 and 1984, U.S. military exports totalled $47.8 billion. Of this, nearly half ($22.4 billion) had associated offset agreements totalling $12.2 billion. Furthermore, 75 percent of these offset obligations are to our industrialized allies, such as Canada, Japan, and European NATO countries, countries with which we have trade deficits.

These countries seek not only to augment their military capability, but also to increase employment, to enhance the commercial competitiveness of current and future products, to obtain advanced technology in both the military and civilian sector, to promote targeted domestic industries, and to gain entrance to new markets.

Proponents of offsets indicate that they are a fact of life in international trade and that the alternative to offering offsets is to lose sales to foreign competitors. They also assert that offsets strengthen the alliance among participating countries and contribute to the industrial economies of our allies. Therefore, these transactions serve the broad national interests of the United States.

Although I recognize the positive aspects of offset agreements, I am concerned that direct offsets, in the form of coproduction, licensed production, subcontracting and technology transfer, may contribute to the competitiveness of foreign producing nations and have a negative effect on some subsectors of the U.S. industrial base. Over the long run, offsets could be detrimental to our national security by weakening the competitive position of industries vital to our national defense.

Given the international scope of military offset agreements, an international approach should be developed to address this problem. Since most of the countries requiring and offering offsets are U.S. allies, we should seek to develop multilateral understandings with them on the use of offsets.

Foreign Investment in Defense Industries

We strongly favor a policy of open investment and have sought to expand the freedom of international investment flows in bilateral and multilateral arenas. However, we must carefully consider the national security implications of foreign control of industries essential to our technological and defense base.

These concerns led me to express my reservations over the proposed Fujitsu acquisition of Fairchild Semiconductor. We are having problems under last year's semiconductor agreement; Japan has a closed supercomputer market and we continue to struggle to crack Japan's telecommunications market. As Secretary of Commerce, I can only conclude that the common objective of the Japanese government and industry is to dominate the world electronics market. Japan has free access to our market while our access to their market is restricted. Their companies enjoy the cost advantage of selling in Japan and the United States, the world's largest market; our companies operate at a clear disadvantage because they are denied access to the Japanese market. Given the importance of this market to U.S. industry in general and our defense base in particular, we cannot stand by idly.

I think that we need to define our policy on foreign direct investment as it relates to strategic industries.

Energy Security

Any discussion involving the security of our industrial base would be incomplete without a review of our dependence on foreign energy supplies and the steps needed to ensure a stable flow of oil and gas to the United States.

The Administration is committed to the principle that reliance on market forces combined with the maintenance of the Strategic Petroleum Reserve (SPR) is the most effective means to promote U.S. energy security. The Administration has dramatically increased the oil inventory of the Strategic Petroleum Reserve and removed regulatory barriers to the market-based development of energy resources. The President has decontrolled oil prices, has pushed for comprehensive deregulation of natural gas prices and elimination of the Windfall Profits Tax.

In short, the way to promote energy security is not to restrict our access to energy sources but to increase domestic energy production.

In response to the Committee's concerns, I would like to discuss S.694. It is my understanding that the purpose of this bill is to provide a comprehensive national oil security policy by limiting oil imports to 50 percent of U.S. oil consumption. In the event that oil imports in a given year threaten to exceed this level, the President is required to make policy recommendations to limit imports. The options available to the President include financial incentives for domestic producers, an oil import fee, and expansion of the Strategic Petroleum Reserve (SPR).

Mr. Chairman, I am concerned about the economic and national security problems posed by rising oil imports. I am also concerned about the impact on the trade deficit of higher oil import bills and the economic dislocation that lower oil prices have wreaked on the U.S. oil industry.

At the same time, I think that the proposed bill is not the most effective way to address the problem. My reasons are as follows:

A 50 percent limitation on oil imports will force the U.S. to selectively limit oil purchases from various foreign sources. Such a policy would add an undesirable political dimension to world energy trade. Government efforts to allocate our oil imports among our various suppliers could not be divorced from trade and bilateral political relations with those nations. Further, such an action could have a significant negative impact on producers that rely on the receipts from oil earnings for most of their foreign exchange and to service foreign debt.

I also oppose the imposition of an oil import fee. I recognize that an import fee would help increase domestic oil and gas production and preserve jobs in the industry. It would also limit the ability of OPEC to raise prices in the future. However, such a fee would raise the cost of oil and its substitutes in the U.S. above the levels paid in other countries. This would reduce U.S. economic growth, increase inflation, reduce our competitiveness in foreign and domestic markets, and eliminate substantially more jobs in other economic sectors than are created in the energy sector.

The recent Department of Energy (DOE) Study on Energy Security supports this view. DOE found that an import fee would reduce U.S. GNP and have inflationary effects. Next, an oil import fee would constitute an "energy tax" on consumers. From a trade perspective such an action would reduce U.S. competitiveness in energy-consuming industries and raise unwarranted frictions with our principal suppliers.

The DOE study reconfirms a number of the measures the Administration is pursuing to promote U.S. energy security. The study also includes a number of constructive recommendations such as expanding the leasing and development of Alaskan and Outer Continental Shelf petroleum resources. We are continuing our review of the DOE study and will participate in the interagency discussions of this report.

In short, I support efforts to prevent oil imports from posing a threat to our economy and national security. The DOE Study represents an attempt to define the issues and provide a basis for the Administration to work the problem in cooperation with the Congress and the public. Within the Commerce Department, I can assure you that we will take whatever actions are necessary and appropriate to maintain U.S. energy security.

Export Controls

Just as we do not support import controls without a sound justification, we likewise do not favor export controls that do not enhance our national security. In his competitivess initiative, the President called for regulatory and legal reform of the export control system. We have made and plan to make a number of moreregulatory changes that will improve both the level of U.S. security and the level of U.S. competitiveness.

We are proud of the fact that, over the past six years, our export control program has made significant strides in stemming the flow of Western technology to the Soviets. To achieve this, however, some undue controls may have been implemented. It is now time to remove any and all unwarranted controls currently imposed on the very private sector companies we need to keep us technologically superior to our adversaries.

As I have stated repeatedly today, our national security demands a strong and competitive defense industrial base.

Mr. Chairman, I am submitting for the record a copy of the Administration's statement on export control reform initiatives which was forwarded to the Congress last week. Assistant Secretary Paul Freedenberg will be pleased to brief you and any interested members of the Committee at your convenience on the various elements of the program.

The President's Competitiveness Program and S.490

Our ultimate objective is to ensure opportunities for all our industries to be competitive without government intervention. As you know, the President has established the goal of ensuring American competitive preeminence into the 21st century. To fulfill the Federal Government's responsibilities, the President has launched a six-point program to:

- increase investment in human and intellectual capital;
- promote the development of science and technology;
- better protect intellectual property;
- enact essential legal and regulatory reforms;
- shape the international economic environment in ways that improve access for U.S. exports and ensure fair trade; and
- eliminate the budget deficit.

The President's initiative calls for a wide range of specific actions within each of these areas. The President's proposals define a partnership between the U.S. Government and the private sector. In the long term, our greatest source of strength has to be the productivity of Americans, both management and workers. We are under no illusion that further Government involvement in the private sector is a panacea for improving our competitiveness. In fact, many of our proposals are based on further reducing government's role.

While the Federal Government cannot guarantee American competitiveness, our actions can support the success of private sector efforts. Congress and the Administration agree that there is much the Government can and should do. In fact, an examination of the trade provisions of S.490 and the Administration trade bill shows that we have identified many of the same areas for attention:

- Government regulations should not unnecessarily impede legitimate business opportunities;
- Government programs should effectively promote U.S. exports;
- Government should strengthen the protection of intellectual property rights;
- Government should provide an open and fair trade environment.

This agreement on goals is providing the basis for our successful bipartisan effort to craft responsible, effective trade legislation. To do so, we must also recognize basic differences in our approach. The Administration opposes provisions that would:

- violate our international obligations under the GATT;
- remove the President's discretion to review trade findings by the ITC and USTR and in other areas as well; or
- prompt our trading partners to enact "mirror" legislation that we would find unacceptable.

Conclusion

The initiatives I have described today are complex and yet my basic message is simple: military security is founded upon a resilient industrial base and our overall economic security. In today's world, an effective policy to maintain our industrial base cannot be considered a luxury or an afterthought. On the contrary, a responsive, technologically competitive defense base is a cornerstone of this nation's deterrent posture. Taking effective action to preserve our defense industries is the "ounce of prevention" required to assure this nation of an ability to meet any crisis that we may confront.

Thank you.

STATEMENT OF CHARLES GENTRY, CHAIRMAN, TASK FORCE ON PETROLEUM IMPORTS, TEXAS INDEPENDENT PRODUCERS AND ROYALTY OWNERS ASSOCIATION [TIPRO], DALLAS, TX

Mr. GENTRY. Mr. Chairman and members of the committee, my name is Charles Gentry, and I am a partner in a Dallas law firm, working primarily with independent oil and gas producers. I am here today representing TIPRO, the Texas Independent Producers and Royalty Owners Association, as its Task Force Chairman on Petroleum Imports. We would ask, Mr. Chairman, that the prepared remarks which were previously submitted would be contained in the record in its entirety, and that I'll make my remarks very brief in the interest of time.

TIPRO has approximately 4,500 producer and royalty owner members who have an interest in Texas oil and gas production, and therefore is very affected by any legislation of the kind of S. 694.

We appreciate the opportunity to speak to S. 694, specifically on the broader issues of S. 694 in recognizing the national security concerns involved in undue reliance of our nation on oil imports. While the bill does not specify what must be done in the event oil imports exceed the peril point standard provided, it would finally establish a statutory requirement that the President act to initiate a corrective energy policy when oil imports are deemed excessive.

In analyzing S. 694, our task force considered various amendments that would enable the process, in our opinion, to better achieve its important purposes. Some of these were that we consider that 40 percent was a more realistic peril point figure than the 50 percent. We felt it important to mandate to the President that one of the energy policy initiatives to be included would be a variable import fee when that standard is reached and breached.

And, as has been referred to here several times, the tightening of the time frame in which corrective action must be taken. So, while TIPRO endorses the concept in S. 694 as a move forward in the effort to cope with our serious energy crisis, it still remains convinced that a political way must be found to secure immediate and effective remedial relief that can resolve the issue within a realistic time frame.

Our Association believes that industry conditions will cause the peril point of 50 percent to occur in the relatively near future. TIPRO welcomes a mandate that the Administration will be statutorily required to act. Nevertheless, the Association urges serious consideration of its proposed amendments to the bill, particularly those amendments which would assure reasonably quick action once the peril point is reached. And those amendments are contained in Appendix B to our prepared statements, Mr. Chairman.

In conclusion of this very brief summary of our statement, Mr. Chairman, TIPRO believes and continues to believe that an import fee system is the only instrument available to provide the economic fusion into the domestic petroleum industry which is needed to maintain its ability to maximize recovery of domestic oil and gas and thereby keep imports to a level that does not threaten our nation's security, whether it be economic or military, both of which are absolutely essential to political independence.

Thank you, Mr. Chairman, for having held this hearing, and we would be very pleased to provide any follow-up that you would desire.

The CHAIRMAN. Mr. Gentry, I appreciate very much the brevity of your statement, because the vote has just started, and I am apparently now by myself here. So, Mr. Benitez, if you'd give your statement.

[The prepared written statement of Mr. Charles Gentry follows:]

STATEMENT

R. Charles Gentry, Chairman
Task Force on Petroleum Imports
National Energy Policy Committee

Mr. Chairman and Members of the Committee:

My name is Charles Gentry, and I am a partner in the Shank, Irwin, Conant, Lipshy and Casterline law firm in Dallas, Texas. I appear here today as Chairman of the Texas Independent Producers and Royalty Owners Association's Task Force on Petroleum Imports. TIPRO has approximately 4,500 producer and royalty owner members who have an interest in Texas oil and gas production.

Our Association appreciates this opportunity to speak to S 694, which recognizes the national security concerns involved in undue reliance by our nation on oil imports. While the bill does not specify what must be done in the event oil import flow exceeds the peril point standard provided, it would finally establish a statutory requirement that the President act to initiate a corrective energy policy when oil imports are deemed excessive.

In analyzing S 694, TIPRO's Task Force considered seeking amendments that would enable the proposal to better achieve its important purposes. These included changing the peril point standard from a 50 to a 40 percent ratio between total oil imports and domestic petroleum liquid demand, mandating a variable import fee when the standard is reached, and tightening the time frame in which corrective action must be taken. While TIPRO endorses the concept in S 694 as a move forward in the effort to cope with the serious energy crisis confronting our nation, it still remains convinced that a political way must be found to secure immediate and effective remedial action that can resolve the crisis within a realistic timeframe.

There is little need to recite at length the statistical indices underlining the serious energy problem now before us. While, in our opinion, the recently released Department of Energy study on this matter was seriously flawed in that it failed to provide solutions and summarily dismissed the oil import fee concept as an answer, the study did provide considerable data and information showing that the problem exists and is rapidly getting worse.

However, a brief summary of what has occured during the past year is enlightening. OPEC-generated price reductions of more than 50 percent for oil early last year initiated a devastating dismantling of the vital U.S. domestic petroleum producing industry. By the end of 1986, one-fourth of the industry's jobs had disappeared, over one-half of the well drilling activity had ceased, some 40,000 of the nation's marginal oil wells had been plugged, and domestic production had dropped by almost 800,000 barrels per day. Imports increased by over one million barrels daily to cover that production loss plus an increase in U.S. demand of some 300,000 barrels per day. The current import ratio to demand hovers around the 40 percent mark as a result and [illegible] percentage continues to climb.

Both the DOE and National Petroleum Council studies indicate further deterioration will occur in 1987 and during the rest of the decade. While DOE believes oil imports will not exceed 50 percent of domestic demand until the [illegible]-1990's, the NPC indicates it could occur before the end of the 1980's. TIPRO's analysis shows it could occur as early as June, 1988 (see attached chart, Appendix A).

Our Association believes industry conditions will cause the peril point of 50 percent to occur in the relatively near future. TIPRO welcomes a mandate that the Administration will be statutorily required to act. Nevertheless, the Association urges serious consideration of its proposed amendments to the bill, particularly those amendments which would assure reasonably quick action once the peril point is reached. (See Appendix B).

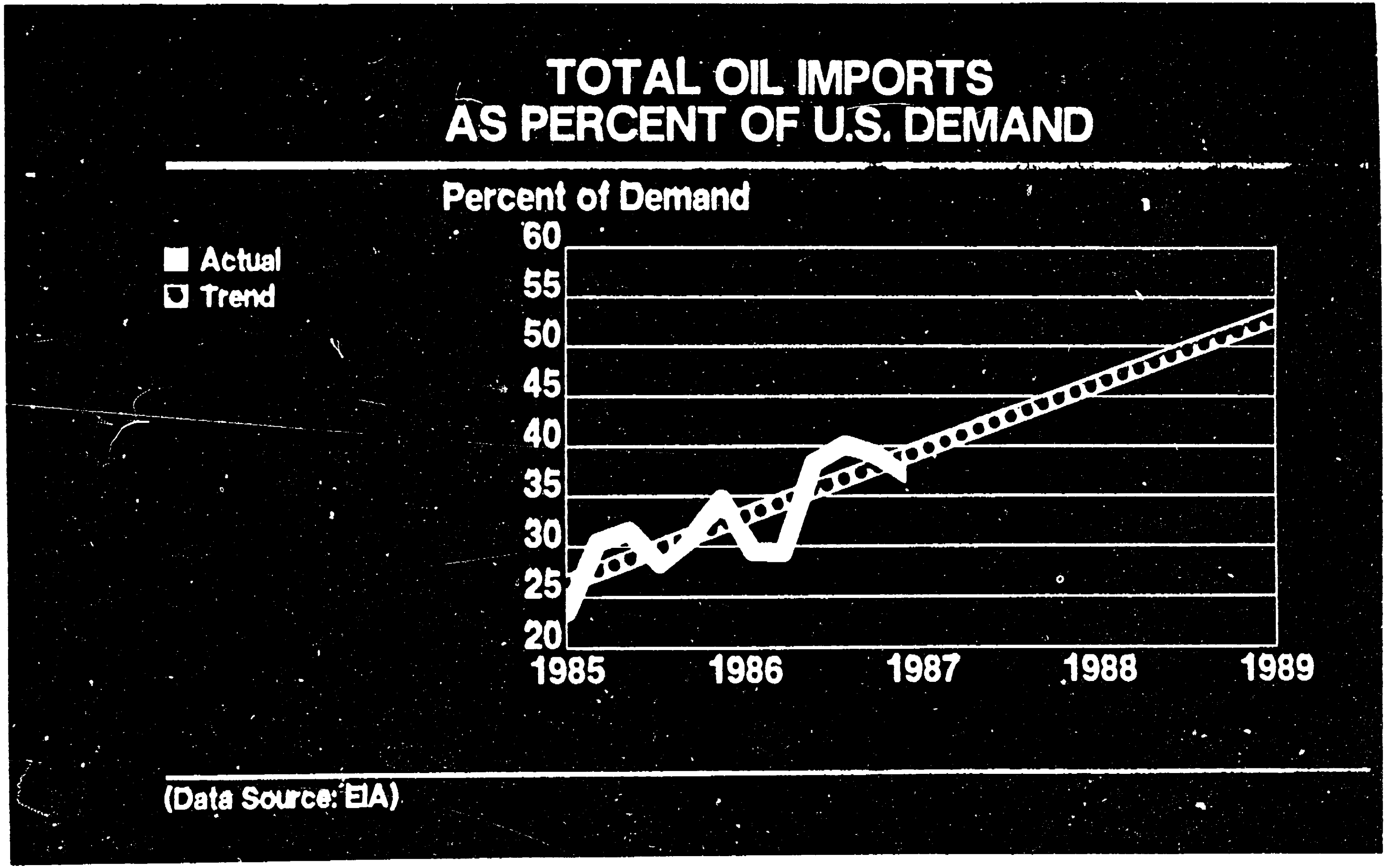
We would be remiss if we did not emphasize, as well, our long standing position recognizing the need for an oil import fee system. We believe such a system is needed to help restore the industry's ability to drill domestic wells before it is too late. We sincerely believe it is absolutely imperative for this nation to renew its domestic energy capabilities and thereby protect the nation's security by holding foreign imports to acceptable levels.

For these reasons, TIPRO also wishes to lend its strong support to S 285, which is also a subject of this hearing. The bill's proposal — to amend the Trade Act by tightening the time frame within which the Administration must establish findings and determine appropriate action when petitions seeking national security protection are filed — is most commendable. In fact, TIPRO has been frustrated in the past over the lack of such time requirements and currently has a petition before the Administration which has not been acted upon for several months.

Only twice in history has Section 232, the national security provision of the Trade Act, been successfully triggered. In 1957, national security findings resulted in the Voluntary Oil Imports Program. When that program failed to work, new findings resulted in initiation of the Mandatory Oil Imports Program by presidential proclamation in March, 1959. This quota program worked with mixed success for approximately 16 years, keeping the domestic petroleum industry in a survival mode during a long period of surplus supply.

Now we believe a new finding can and should be made in light of current conditions that would result in a tariff program. An import fee system, in our opinion, is the only instrument available to provide the economic fusion into the domestic producing industry needed to maintain its ability to maximize recovery of domestic oil and gas and thereby keep imports to a level that does not threaten our nation's security, whether it be economic, political or military.

We thank you Mr. Chairman and members of the Committee, for this opportunity to be heard on this vital matter of concern to our country.


TOTAL OIL IMPORTS
AS PERCENT OF U.S. DEMAND
Percent of Demand
Actual
Trend
60
55
50
45
40
35
30
25
20
1985
1986
1987
1988
1989
(Data Source: EIA)

PROPOSED TIPRO AMENDMENT TO S 694

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Section 1. SHORT TITLE.

This Act may be cited as the "National Energy Policy and Security Act of 1987."

Section 2. FINDINGS AND PURPOSES.

(a) Findings. — The Congress finds that —

(1) the United States is the leader of the free world and has world wide responsibilities to promote economic and political security;

(2) the exercise of traditional responsibilities here and abroad in foreign policy requires that the United States be free of the risk of energy blackmail in times of shortages;

(3) the level of the United States oil security is directly related to the level of domestic production of oil, natural gas and natural gas liquids;

(4) a national energy policy [~~should~~] must be developed which ensures that adequate supplies of oil and natural gas shall be available at all times free of the threat of embargo or other foreign hostile acts; and

(5) the ability of the United States to exercise its free will and to carry out its responsibilities as leader of the free world [~~could be~~] is jeopardized by an excessive dependence on foreign oil imports.

(b) Purpose. — The purpose of this Act is to establish a national energy security policy designed to limit United States dependence on foreign oil supplies.

Section 3. DUTIES OF THE PRESIDENT

(a) Establishment of Ceiling. — Within 30 days following passage of this Act, [~~T~~]the President shall establish a National Oil Import Ceiling (referred to in this Act as the "ceiling level") which shall represent a ceiling level beyond which foreign crude and oil product imports as a share of United States oil consumption shall not rise.

(b) Level of Ceiling. — The ceiling level established under subsection (a) shall not exceed the lesser of an average of [59]40 percent of United States crude and oil product consumption for any [~~annual~~] period of 90 consecutive days as determined by the Energy Information Administration or the average percent existing during the month of October, 1973.

[~~(c)~~] ~~Report. -~~
~~(1) The President shall prepare and submit an annual report to Congress containing a national oil security projection (in this Act referred to as the "projection"), which shall contain a forecast of domestic oil and NGL~~

~~demand and production, and imports of crude and oil product for the subsequent three years. The projection shall contain appropriate adjustments for expected price and production changes.~~]

[~~(2)~~ ~~The projection prepared pursuant to paragraph (1) shall be presented to Congress with the Budget. The President shall certify whether foreign crude and oil product imports will exceed the ceiling level during the next three years.~~]

[~~Section 4. CONGRESSIONAL REVIEW.~~

~~The Congress shall have 10 continuous session days after submission of each projection to review the projection and make a determination whether the ceiling level will be violated within three years. Unless disapproved or modified by joint resolution, the Presidential certification shall be binding 10 session days after submitted to Congress.~~]

Section [5]4. ENERGY PRODUCTION AND OIL SECURITY ACTIONS.

(a) Energy Production and Oil Security Policy.

(1) [~~Upon certification that the ceiling level will be~~] At any time the ceiling level as established in Section 3 has been exceeded, the President is required within [90] 60 days to submit an Energy Production and Oil Security Policy (in this Act referred to as the "policy") to Congress. The policy shall prevent crude and product imports exceeding the National Oil Import Ceiling. Unless disapproved or modified by joint resolution, the policy shall be effective [90] 30 session days after submitted to Congress.

(2) The Energy Production and Oil Security Policy [may] shall include a fee on all crude oil and petroleum product imports into the United States in an amount sufficient to establish the price per barrel of crude oil at no less than $22 and an equivalent price for products; and may also include —

[~~(A) oil import fee~~]
(A)[~~(B)~~] energy conservation actions including improved fuel efficiency for automobiles;
(B)[~~(C)~~] expansion of the Strategic Petroleum Reserves to maintain a 90-day cushion against projected oil import blockages; and
(C)[~~(D)~~] production incentives for domestic oil and gas including tax and other incentives for stripper well production, offshore, frontier, and other oil produced with tertiary recovery techniques.

STATEMENT OF JUAN BENITEZ, PRESIDENT AND CHIEF OPERATING OFFICER, MICRON TECHNOLOGY, INC., BOISE, ID

Mr. BENITEZ. Thank you, Mr. Chairman.

Good morning. My name is Juan Benitez. I am President and Chief Operating Officer of Micron Technology, Inc. I have provided the committee with a written copy of my testimony, and would ask that it be included in the record.

Thank you very much for allowing me to appear before you today. When I found out that we would be able to come before the committee to discuss the impact of imports on national security and defense, I specifically requested that I be able to testify. I have very personal reasons for wanting to be here.

I am an American, but I was born and spent my early years in Cuba. As a young man, I experienced many devious techniques used by Communists and others who do not believe in either democracy or human values. Believe me, our national defense is one of the most important issues that concerns me. I hope it is one of the most important issues to you as well.

Micron Technology, Inc. is a semiconductor manufacturer located in Boise, Idaho. At our facility in Boise the company designs, manufactures, and markets dynamic random access memory components, known as DRAMs, one of the most widely used semiconductor components in computer systems. We are the only American-owned company manufacturing DRAMs which has its entire production process onshore. We currently employ approximately 1,300 people, manufacturing product families for both 64K and 256K DRAMs. We are also producing prototypes of our 1 Megabit DRAM, the latest generation of memory products.

Our production line has been certified by the Defense Electronics Supply Center. We have received military drawing approval for several of our products, and we have received Qualified Products Listing for one of our 256K DRAMs. Although our program is still in the early stages, we intend to continue to develop our military program.

Perhaps the most important thing that I can tell you today is that we are still here. Despite severe, unfair trading practices and overproduction of DRAM's by Japanese manufacturers, Micron is still in business and manufacturing DRAMs in the United States. Other members of the U.S. industry have not been able to survive. In 1985, Mostek Corporation—of course, from your home state, Mr. Chairman—once an industry leader in DRAM production, was closed down and sold. At about the same time, Motorola, Intel Corporation, and National Semiconductor withdrew from the DRAM market.

The problems experienced by American DRAM manufacturers are not accidental. In the mid-1970's, the Japanese government decided that computers and information services were the kind of industries that Japan targeted to dominate. With government assistance and a deliberate program of price cutting, overproduction, and sales below cost, Japanese manufacturers have been able to capture approximately 85 percent of the worldwide market for DRAMs.

The Korean government and Korea's largest companies are now trying to emulate the Japanese and have embarked on a similar program.

Despite the filing of several dumping cases, the United States-Japan Semiconductor Trade Agreement, and a tremendous effort by people like Secretary Malcolm Baldrige, Bruce Smart, and Gil Kaplan of the Commerce Department; and Ambassador Clayton Yeutter and Michael Smith of the Office of the United States Trade Representative, Japanese manufacturers continue to over-produce and sell below cost. They have made a mockery of our good intent to have the Agreement work.

The impact on our national defense of the Japanese strategy on DRAMs is significant. Since they have already driven most U.S manufacturers out of the DRAM business, many of our major companies have already lost the ability and technology to provide our military with the necessary semiconductor and computer products essential to our defense.

More importantly, because of an increasing dependence on foreign technology, the Defense Department itself is relaxing some of the requirements with regard to foreign products. They include allowing foreign subcontractors to provide components for military use, permitting production to take place offshore rather than within the boundaries of the United States, and approval of products of foreign manufacturers for military drawings and Qualified Products Listings.

The CHAIRMAN. Mr. Benitez, we'll take your remarks in their entirety, but I have to ask you to summarize them. I see your time has expired.

Mr. BENITEZ. Thank you, Mr. Chairman.

The CHAIRMAN. Because I must not miss this vote. Mr. Rothschild.

[The prepared written statement of Mr. Juan Benitez follows:]

DRAMs which has its entire production process onshore. We currently employ approximately 1300 people, manufacturing both 64K and 256K DRAMs. We are also producing prototypes of our 1 Megabit DRAM, the latest generation of memory product. Micron is a merchant manufacturer which means we sell our product largely in the open market rather than produce it for our own use.

Our production line has been certified by the Defense Electronics Supply Center. We have received military drawing approval for several of our products, and we have received Qualified Products Listing for one of our 256K DRAMs. Although our program is still in the early stages, we intend to continue to develop our military program.

Perhaps the most important thing I can tell you today is that we are still here. Despite severe price cutting and overproduction of DRAMs by Japanese manufacturers, Micron is still in business and manufacturing DRAMs in the United States. Other members of the U. S. industry have not been able to survive. In 1985, Mostek Corporation, once an industry leader in DRAM production, was closed down and sold. At about the same time, Motorola, Intel Corporation and National Semiconductor withdrew from the DRAM market. Recently, Motorola has made an agreement with a Japanese company to provide Motorola with DRAM chips for assembly and resale.

The problems experienced by American DRAM manufacturers are not accidental. In the mid-1970s the Japanese government decided that computers and information services were the kind of high value-added industries that Japan targeted to dominate and that the entry into the industry would be through volume production of semiconductors and other components. Joint research and development projects were set up among the major manufacturers. Low or no interest loans and export assistance were provided. Through a deliberate program of price cutting, overproduction, and sales below cost, Japanese manufacturers have been able to increase their worldwide share of the DRAM market from approximately 40% in the late 1970s to 85% today. The Korean government and Korea's largest companies are now trying to emulate the Japanese and have embarked on a similar program.

In June 1985, because of persistent sales of 64K DRAMs by the Japanese below cost, Micron Technology filed its semiconductor antidumping case with the International Trade Commission and the Department of Commerce. Although there were many skeptics at the time, the case has now run its course, we have prevailed at every stage of the proceedings, and an antidumping order is now in effect. After we commenced our petition, the President's Task Force on Trade became involved, and as a result, the Commerce Department self-initiated an antidumping petition concerning 256K and above DRAMs from Japan. That case, together with a companion case concerning EPROMs, is currently under a suspension agreement as a result of the U. S.- Japan Semiconductor Trade Agreement.

Despite the dumping cases, the Trade Agreement, and a tremendous effort by excellent people like Secretary Malcolm Baldridge, Bruce Smart and Gil Kaplan of the Commerce Department and Ambassador Clayton Yeutter and Michael Smith of the Office of the United States Trade Representative, the Japanese manufacturers are not honoring the Trade Agreement as they continue to overproduce and sell below cost. Only recently have the Japanese made any real effort to control the abuses of their industry in our markets. It is likely to be too little too late.

The impact on our national defense of the Japanese strategy on DRAMs is significant. The Japanese are not simply interested in the semiconductor market. They are interested in controlling the worldwide computer industry. They have already driven most U.S. manufacturers out of the DRAM business. Many of our major companies have already lost the ability and technology to provide our military with the necessary semiconductor and computer products essential to our defense.

More importantly, because of an increasing dependence on foreign technology, the Defense Department itself is relaxing some of the requirements with regard to foreign products. They include allowing foreign subcontractors to provide components for military use, permitting production to take place offshore rather than within the boundries of the United States, and approval of products of foreign manufacturers for military drawings and Qualified Products Listings.

The loss of a U.S. DRAM manufacturing base, the increasing dependence on foreign technology, and the relaxation of restrictions on use of foreign products has already significantly weakened our country's ability to defend itself if foreign sources were disrupted by world conflict. There has been much talk recently that the Department of Defense should subsidize research and development for U.S. semiconductor manufacturers. We disagree. We are deeply concerned that any project or consortium funded by our government will simply become an industry welfare program. We believe that military programs should be directed to military goals and not the commercial success or failure of U.S. semiconductor manufacturers.

What we really need to maintain a healthy semiconductor and computer industry is vigorous enforcement of our trade laws. Our markets are more open than any in the world because we believe in free trade. The problem is we are the only country playing by the rules. Other countries seem unwilling to open their own markets or prevent abuse of ours. This does not mean that we should abandon our principles. It means we should prevent others from exploiting our position. It is extremely important to realize that foreign countries and their companies will continue to take advantage of us as long as we let them. We must make it abundantly clear that if someone wants to participate in our markets, they must play by the rules of democracy and free competition. If our trade laws are violated, the response should be swift, sure and expensive for the offender, not just a slap of the hand and a promise not to do it again.

Let me finish by saying that I am not an apologist for American industry. America has nothing to apologize for. The object of international trade and competition should be to raise the standard of living in other countries, not lower our own. We should be proud of our accomplishments. As J.R. Simplot often says, "America must be doing something right because everybody else wants what we got." Thank you.

STATEMENT OF EDWIN S. ROTHSCHILD, ASSISTANT DIRECTOR, CITIZEN/LABOR ENERGY COALITION, WASHINGTON, DC

Mr. ROTHSCHILD. Mr. Chairman, I ask that my entire testimony be accepted into the record. And I want to make——

The CHAIRMAN. Each statement will be taken in its entirety.

Mr. ROTHSCHILD [continuing]. Make some very short points. I know that time is tight.

Number one, with respect to the decline in domestic production concern that you've expressed of the 1 million barrels per day, EIA has also made an analysis that—looks at the 700,000 barrels a day that we've experienced—and said that not all of that is permanent. Some of it is delayed development, some of it is delayed drilling, some of it is delayed maintenance on wells. With the higher prices that are now, occurred since the mid of last year, there are producers that are going back and increasing their development and doing the maintenance that wasn't done before.

So, I look at other studies that show that we aren't going to see the decline that we saw over the last year continue. In fact, it may just level out.

Second, can't confuse the increasing dependence with increasing vulnerability. While we may become more dependent, 50 percent is not a magic number. I think you've heard testimony from Economist Phil Verleger, who says that as long as the U.S. isn't vulnerable to oil blackmail, there is absolutely nothing wrong with being dependent 50 percent. It doesn't matter whether we're 10 percent or 80 percent dependent. A supply disruption is going to have the same effect on the United States.

And, therefore, what is key is the strategic petroleum reserve to deal with a supply disruption.

Finally, with respect specifically to S. 694 as laid out in our testimony, I think there are some very specific problems with the way that it is currently constructed, and we point out those problems.

Thank you, Mr. Chairman.

[The prepared written statement of Mr. Edwin S. Rothschild follows:]

TESTIMONY

OF

EDWIN S. ROTHSCHILD
ASSISTANT DIRECTOR
CITIZEN/LABOR ENERGY COALITION

Mr. Chairman and members of the Committee, my name is Edwin S. Rothschild. I am the assistant director of the Citizen/Labor Energy Coalition, a nationwide coalition representing over 12 million citizens who consume, oil, natural gas, electricity and other fuels and which, since 1979, has been working for federal and state policies which provide consumers with safe and affordable supplies of energy. We very much appreciate the opportunity to testify today on S. 694, the "Energy Security Act of 1987."

The Citizen/Labor Energy Coalition recognizes that rising oil imports raise important questions concerning U.S. vulnerability to sharp changes in oil prices and oil supply disruptions. We also recognize that U.S. vulnerability has been exacerbated by the hands-off energy stance of the current Adminstration. Over the past six years, the Reagan Administration has made major cuts in energy R&D and conservation programs. These cuts, although partially restored by Congress, have still resulted in the virtual loss of photovoltaic and other renewable energy development in this country as well as a dramatic slowdown in residential, commercial and industrial conservation efforts.

Although we may agree on the nature of the energy problems confronting the nation, C/LEC has serious reservations about the efficacy of S. 694, the Energy Security Act, in providing the solution to the nation's energy vulnerability problems. My testimony will focus on our reservations regarding an over-broad delegation to the executive branch of congressional authority, vague statutory provisions and triggering mechanisms, and an implicit effort to impose an oil import fee by "backdoor" means.

BROAD DELEGATION OF CONGRESSIONAL POWER

S. 694 establishes a two-part process under which action is required to be taken to prevent crude and petroleum product imports from exceeding half of projected U.S. petroleum demand. (The bill does not indicate whether import and consumption levels are to be combined for crude oil and products or calculated separately.)

In the first stage, the President would submit as part of the annual budget a certification of whether the 50% level would be violated during the following three years, and Congress would then have 10 days of continuous sessions to review the projection and disprove or modify it through joint resolution.

Under the provisions of this bill, for example, the President could certify to Congress in 1987 that in 1990 the 50 percent ceiling would be breached. Such a delegation of congressional authority places the burden of disproving the reliability and accuracy of the projection on Congress, as opposed to requiring the Executive Branch to demonstrate its correctness. Congressional oversight is thwarted and legislative review short-circuited. Moreover, it is highly unlikely that Congress would be able to act within such an extremely short period of time, especially since there are no expedited procedures provided for floor consideration.

In the second stage, the President would be required to submit within 90 days, upon certification that imports will exceed 50% of demand, a policy to prevent violation of the National Oil Import Ceiling. This policy may include imposition of an oil import fee, conservation actions, expansion of the Strategic Petroleum Reserve, and domestic oil and gas production incentives. Congress would have 90 days in which to review the policy and disapprove or modify it through a joint resolution.

For the President to decide on a policy within 90 days is, in and of itself, a very short period of time. It certainly is an insufficient amount of time to obtain advise from relevant government agencies and comments from the public. Without such input and review, this section would violate the due process provisions of the Administrative Procedure Act, which require public input and comment into administrative\regulatory decision-making.1

With respect to the requirement that Congress would only have 90 days to review the policy, it is highly unlikely that Congress would be able to act in that amount of time, again particularly because of the absence of expedited procedures. The ability of Congress to pass any piece of major, controversial legislation in 90 days is doubtful at best. Even if action should be possible, given the likelihood of a presidential veto, it would take a two-thirds majority of both houses to block any policy.

In other words, should S. 694 pass, Congress would in all probability be giving the President the ability to impose any number of highly debatable and controversial policies unilaterally. Under this legislation the President of the United States could not only impose an oil import fee at any level, but also, under energy conservation actions, he could impose gasoline and diesel fuel rationing and natural gas supply curtailments. He could impose a 25 cents per gallon or 50 cents per gallon gasoline tax or a Btu tax on all fuels. He could devise petroleum allocation rules limiting oil use by some industries in favor of others, some regions versus others.

Under "production incentives for domestic oil and gas," the President could allow oil companies to drill for oil and gas in the Arctic National Wildlife Range, in currently restricted waters off California and other environmentally sensitive areas. He could order the decontrol of all natural gas prices. He could remove the restrictions on burning high sulfur oil. He could allow petroleum refiners to use lead to increase gasoline octane levels. He could provide for an increase in the depletion allowance, despite its budgetary implications.

We do not believe that those programs and policies should be ceded to any president and allowed to be implemented without full public debate and discussion. Under S. 694, the administration could propose and implement policies, which are objected to by over half of each House of Congress, to deal with potential violations of the import ceiling which are only projected to occur two or three years down the road. And that could happen with no findings, no public hearings, and no justification of the assumptions used. Moreover, there appear to be no time limits on the actions. Major policies could be imposed even if the violation of the National Oil Import Ceiling is expected to be short in duration or appear to be allowed to continue even after imports have long since declined.

Instead, we believe that, while Congress may require presidential recommendations on policy, it should not abrogate its responsibility to act on that policy before it is implemented. Otherwise, programs which could have potentially large negative effects on various sectors and regions of the country and which could have profound implications for overall economic and budgetary policies could be undertaken even in face of Congressional and public opposition.

VAGUE STATUTORY PROVISIONS

Throughout this bill there are vague statutory provisions and triggering mechanisms. The first is the establishment of an oil import ceiling where the ceiling level "shall not exceed 50 percent of United States crude and oil product consumption for any annual period." In 1986 the United States consumed an average of 12.5 million barrels per day of crude oil and 16.1 million barrels per day of petroleum products. As drafted, the bill seems to mean that the total of crude and petroleum product imports cannot exceed the combined total of 12.5 million barrels per day of crude oil consumed and 16.1 million barrels per day of petroleum products consumed or 28.6 million barrels per day of crude oil and petroleum products. Rather than "crude and oil product consumption," the legislation would make more sense if consumption were defined simply as consumption of "petroleum products."

Another problem with the definition is the question of gross versus net imports (imports less exports). "Net imports" is a more accurate measure of import dependency. If, however, gross imports as a percentage of total petroleum product consumption is used, it would result in a higher percentage than if net imports were used. Using 1986 as an example, gross imports totaled 6.1 million barrels per day and net imports were 5.3 million barrels per day. In percentage of total petroleum product demand, gross imports represented 38 percent, while net imports represented 33 percent -- a significant difference.

Another problem is whether imports for the Strategic Petroleum Reserve should be counted. A reasonable argument can be made that they should not, since they are not destined for immediate consumption.

Even more important is the grounds on which the 50 percent level has been selected. Recognizing that U.S. oil production will decline even at prices ranging between $18 to $20 per barrel, what makes 50 percent the level which ought to trigger a presidential action. Whether the United States imported only 10 percent of its oil or 65 percent of its oil, an international disruption in the world oil market would still have the same impact on the U.S. What protects the U.S. is not a limit on oil imports, but a large Strategic Petroleum Reserve.

Another vague section concerns the Presidential "report to Congress containing a national oil security projection..., which shall contain a forecast of domestic oil and NGL demand and production, and imports of crude oil and oil product for the subsequent three years." In this "projection" the President is to "certify whether foreign crude and oil product imports will exceed the ceiling level for any year during the next three years." Anyone familiar with oil supply, demand and price projections knows how unreliable they are. The language in this bill would use projections rather than facts to determine U.S. energy policy. To demonstrate how dangerous such a policy would be, one need only look back and examine some of the Administration's recent oil projections. In 1983 the Energy Information Administration projected that in 1985 U.S. net petroleum imports would total 5.2 million barrels per day. They were off by 900,000 barrels per day. In 1983 the EIA projected the average imported crude oil price in 1985 would be $34.06 per barrel. They were off by more than $7 per barrel.1

Another defect in this bill is that only one criteria is used to determine when U.S. energy security is threatened. As we have witnessed over the last 15 years, one of the most devastating impacts on the U.S. economy has been the large and sudden increase in oil and energy prices. Moreover, oil producers are today denouncing the large drop in oil prices. Yet, no where in this bill is price mentioned as a criteria with respect to energy security.

Since an oil import fee heads the list of possible answers to reduce import dependence, there should at least be

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1 See Energy Forecasts for 1985, Energy Information Administration, DOE/EIA-0495, September 29, 1986, p. viii.

consideration of price in making a determination. Of course, it then becomes necessary for the President to determine whether administered or competitively determined low, medium or high prices pose a threat to energy security. Clearly, since the aim of this legislation is to obtain artificially administered prices, a presidential discussion of prices must be avoided at all costs.

While virtually ceding energy policymaking to the executive branch, S. 694 does so without even providing guidelines for how policies should be created. In the Energy Policy and Conservation Act, under which the president was allowed to propose rationing and energy conservation plans, subject to Congressional review and expedited action, very specific criteria, guidelines and analyses were required to be met.

Under Section 201(d)(4)(E) of EPCA, for example, any rationing or energy conservation contingency plan had to be accomplished by evaluations of the effects on vital industries, employment, the "economic vitality" of individual states and regions, "the availability and price of consumer goods and service" and the GNP. Other sections required that the "mobility needs of the handicapped" be taken into consideration and set out procedures for consultations with the states. Those requirements were spelled out though Congress still had to act on the contingency plans before they could even be put on the shelf. In S. 694 those requirements are missing, but policies can be enacted without Congressional approval.

C/LEC believes that any policy designed to combat energy vulnerability must at minimum take into consideration:

1. The need to protect energy users, particularly residential and other "inelastic" users, from sudden price increases. The oil disruptions of 1973-74 and 1978-79 were remarkable not just because of the price burdens they placed on individual residential, agricultural, commercial and industrial consumers, but on the enormous and long-term price shocks they placed on the whole economy, including double-digit inflation and deep recessions.

2. The need to guarantee access to energy supplies for key sectors of the economy, including agricultural users, vital industries, and residential consumers.

3. The need to adopt policies that protect the environment to the maximum extent practicable.

4. The need to recognize regional disparities in energy dependence and thereby to balance regional impacts.

S. 694 is silent regarding its relationship to other laws. For example, Sec. 232(b) of the Trade Expansion Act of 1962 provides ample authority for the Secretary of the Treasury to determine whether oil imports are entering the United States in such quantities or under such circumstances as to threaten to impair national security. This law authorizes the President to impose oil import fees or quotas or any other measure to limit oil imports. Under this law, the President does not need congressional approval. The question then arises, if the President already has authority to deal with this problem, why is this legislation necessary?

UNDERLYING ASSUMPTIONS: VULNERABILITY VS. DEPENDENCE

As has been said repeatedly since the oil disruptions of the 1970's, there is a difference between energy dependence and energy vulnerability. Importing energy, whether in the form of oil, natural gas or electricity, from Canada and Mexico is a substantially different matter than importing energy from the volatile Persian Gulf. Similarly, receiving energy imports from Caribbean or South American neighbors, where greater energy sales will allow these poor countries to repay loans to U.S. banks, or from European allies such as Great Britain and Norway does not add to our energy vulnerability. It creates interdependence and relationships of mutual benefit.

Since the United States is unlikely to become independent of imported sources of oil in the near future, the question is not really what level of dependence is a cause for concern, but rather whether the United States is vulnerable to oil supply disruptions. In this regard, one must examine the adequacy of the Strategic Petroleum Reserve, which, along with several other contingency plans, provides adequate protection against the supply and price distortions created by a supply disruption.

While this legislation appears to be "a modest" proposal dealing with increasing oil dependence and vulnerability, it is really aimed at finding a "backdoor" way to impose a very costly oil import fee on the nation. An oil import fee is, to be sure, a very controversial proposal, one which provides some benefits, but many more costs to the nation as a whole.

OIL PRICES, MARKETS AND ENERGY SECURITY

The underlying premise of S. 694 is that the Organization of Petroleum Exporting Countries is in full control over the world oil market, can effectively limit output and artificially maintain prices at whatever level is desirable for its members. Thus, this argument would claim that in the 1970's OPEC used its power to drive up prices, to flex its muscles and obtain billions of dollars in new revenues. Similarly, in the 1980's, this argument would hold that OPEC is driving prices down to obtain a greater share of the market at the expense of U.S. oil producers. This is mythology posing as analysis. The facts are far more complex and less distressing.

Many highly regarded oil economists no longer believe that OPEC can control the world oil market, if it ever did. Philip Verleger, a respected oil market analyst, recently testified,

> To achieve a return to the market stability of the past, producers need to exert control over output in a fashion which will achieve the effect of the market structure which existed in 1972. Both prices and consumption need to be stabilized. Uncertainty must be eliminated. Oil will not be "decommoditized" simply by ending the current glut because the return to a tight market will not eliminate uncertainty. Instead, prices will once again spiral upward. Oil can only be removed from the list of economic commodities through the establishment of joint producing agreements and maintenance of sufficient surplus capacity in producing countries. This is an outcome which seems beyond the ability of the members of OPEC. Thus, I am led to the conclusion that oil has become a commodity.[2]

Even though oil is a commodity, it is still true that OPEC, and particularly Saudi Arabia, can influence the market. From September 1985 through August 1986 Saudi Arabia, supported by the Reagan Administration, gave up its role of swing producer[3] and initiated a short-lived oil price war. By July 1986 oil prices in the spot market were less than $10 per barrel, a price far more reflective of competitive forces than the current price of $18 per barrel.

This $18 per barrel price, agreed to at the December OPEC meeting, supported by the Aramco partners (Chevron, Exxon, Mobil

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2 Testimony of Philip K. Verleger before the Subcommittee on Fossil and Synthetic Fuels, Committee on Energy and Commerce, House of Representatives, 99th Cong., 1st Sess., Hearings on Oil Outlook: Price, Supply, Mergers, Imports and Taxes, July 11, 1985, p. 165.

3 With production capacity of 10 million barrels per day, Saudi Arabia can, more than any other nation, lower or raise its production to effect supply and prices. Up until August 1985, the Saudis had behaved in the same way that the Texas Railroad Commission used to behave. It had restricted its output in order to maintain world oil prices at an artificially high and arbitrary level.

and Texaco) and the Reagan Administration,4 is considered by Chevron's chairman George Keller to be an adequate price for the U.S. oil industry. According to Texas Governor Clements, it is a "survival" price.

But, of course, in a market in which oil has become a commodity, there is no certainty that the combination of Saudi Arabia, the Aramco partners and the Reagan Administration will succeed in supporting and maintaining the $18 per barrel price, which is why a segment of the domestic oil industry, fearful of competitive market pricing, is seeking federal price protection in the form of an oil import fee, a floor price or some equivalent.

THE DOE "ENERGY SECURITY" REPORT AND THE OIL IMPORT FEE

The most recent analysis of the changing oil market and the oil import fee is contained in the Department of Energy's report to the President on "Energy Security." Its findings and conclusions are instructive. With regard to the impact of lower oil prices on high-cost production (a portion of U.S. stripper well production), the report found:

> ...Lower oil prices will accentuate the short-term decline in oil production from high-cost sources, but this result is totally consistent with normal economic behavior.5

and

> For the most part, high-cost reserves will not be lost as a result of reduced exploration and development activities; these high-cost reserves will merely be used at a later date. Only some quantities of stripper well production may be lost indefinitely.6

With regard to imposing an import fee to protect U.S. security, to raise U.S. oil production and reduce oil imports, the report reached the following conclusions:

> A $10 import fee, for example, could raise 1995 U.S. oil production by 500,000 barrels per day compared to what would otherwise occur.

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4 On his recent trip to Saudi Arabia Treasury Secretary James Baker, at a meeting with King Fahd, affirmed U.S. support for the $18 per barrel price.

5 Energy Security, A Report to the President of the United States, United States Department of Energy, March 1987, p. 22.

6 Ibid., p. 23.

A $10 fee could add about 120,000 jobs in the oil industry; but it could reduce employment in other sectors by about 400,000.

An oil import fee would raise the cost of oil and oil substitutes in the United States (not just oil). Raising energy prices for U.S. consumers above the levels paid in other countries would seriously reduce the Nation's economic growth, increase inflation, and reduce U.S. competitiveness in both foreign and domestic markets.

Not all the additional revenue provided to the domestic oil industry would be re-invested in oil projects.

An import fee is essentially a "drain America first" program. A fee raises the U.S. crude oil price and encourages accelerated production of U.S. reserves, leaving smaller reserves here for future production and impairing long-term energy security.7

The economic costs listed for fixed import fees extend to any variable fee that actually affects prices. Just as with a fixed fee, a variable fee that raised oil prices would reduce GNP, reduce U.S. employment, and contribute to inflation.8

OPPOSITION TO AN OIL IMPORT FEE

In recent years the U.S. Senate has rejected oil import fee legislation by overwhelming margins. President Reagan has repeatedly stated his opposition to such a proposal as contrary to his "free market" philosophy. There is widespread opposition to an oil import fee by energy users. The electric utility industry, the petrochemical industry, the transportation industry, the independent marketing segment of the oil industry and average household consumers are unanimous is opposing an oil import fee.

Except for spokesmen who support the economic interests of domestic oil producers, there is widespread recognition that an oil import fee is bad energy policy, bad economic policy, bad trade policy, bad tax policy and bad foreign policy. For example, even the Independent Petroleum Association of America testified last year before this committee that,

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7 Ibid., p. 73.

8 Ibid., p. 74.

> Protecting the economy and national security against an overdependence on foreign produced energy are a legitimate concern of the federal government warranting, under extreme circumstances, intervention in the market place. However, taxes, tariffs, fees or quotas on imported petroleum would be counter-productive to the national interest at this time.
>
> All proposed forms of import taxes would cause significant market distortions, resulting in artificial entitlement and allocation programs which only compound, not solve, market distortions.9

At the same hearing the then Deputy Secretary of Energy Danny Boggs also severely criticized import fee proposals. He stated, that the Administration did not

> ...dispute the difficult financial conditions that the domestic industry has experienced with falling oil prices, but the limited respite that producers can be granted from the realities of world oil pricing does not justify raising costs to all domestic oil users.10

Boggs also recognized the national security implications of U.S. vulnerability to international oil disruptions. To this concern, Boggs testified:

> The most effective energy security policy is to maintain an adequate strategic oil stockpile (as we do in the U.S.) and to encourage other oil consuming countries to increase their stockpiles to reasonable levels and to encourage flexible response measures for use in the event of an oil supply disruption.11

Also testifying was E. Allen Wendt of the State Department, who raised serious concerns about an oil import fee's impact on U.S. foreign policy. "An import fee," testified Wendt, "may pose

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9 Testimony of James C. Phelps, Chairman of the Joint Task Force on Petroleum Imports of the Independent Petroleum Association of America, before the Subcommittee on Energy and Agricultural Taxation, Committee on Finance, U.S. Senate, February 27, 1986.

10 Statement by Danny J. Boggs, Deputy Secretary, U.S. Department of Energy, before the Subcommittee on Energy and Agricultural Taxation, Committee on Finance, U.S. Senate, February 27, 1986, p. 5.

11 <u>Ibid.</u>, p. 7.

difficulties under the General Agreement on Trade and Tariffs...Even were a judgment made that imposition of an import fee was justifiable as a measure (necessary to protect our essential security interests), adversely affected GATT members which suffer demonstrable injury would be entitled to compensation or retaliation. U.S, exports to those member countries could suffer as a result."12 Similarly, Wendt argued, "A new import tax would set back relations with our neighbors and our closest allies, some of whom have appealed to us not to adopt an import fee."13

CONCLUSION

In short, this legislation would allow a President to do whatever he wanted to do on grounds of "energy security," while it would severely hamper Congress's ability to vote its disapproval. And in the event Congress did disapprove, the President could veto it and thereby make it exceedingly difficult for Congress to reverse the President's decision. This legislation would, in effect, turn the legislative process on its head, expand presidential power at the expense of Congress and require two-thirds majorities, as opposed to simple majorities, to prevent presidential action.

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12 Statement of E. Allen Wendt, Deputy Assistant Secretary of State for International Energy and Resources Policy, before the Subcommittee on Energy and Agricultural Taxation, Committee on Finance, U.S. Senate, February 28, 1986, p. 2.

13 Ibid., p. 6.

The CHAIRMAN. Thank you. Gentlemen, I apologize to each of you for not being able to give you more time. But, we'll take your full statements for the record.

They just handed me a note and told me I better get on my way.

With that we'll stand adjourned. Thank you.

[Whereupon, at 12:12 p.m., the hearing was concluded.]

[By direction of the chairman the following communications were made a part of the hearing record:]

74-098 - 88 - 5

Statement of
Ford Motor Company
Senate Finance Committee Hearings on S.694

As a manufacturer of cars and trucks, Ford Motor Company is affected importantly by U.S. energy policy. We have a number of concerns regarding S.694, but are confining these comments to the committee record to the provision in Section 5 that concerns improved fuel efficiency for automobiles.

When automotive fuel efficiency standards were first implemented under the Energy Policy and Conservation Act (EPCA), gasoline prices were controlled and there was not a wide variety of fuel-efficient vehicles from which a consumer could choose. Today, the conditions are far different.

Now that gasoline prices are decontrolled, car buying decisions are closely tied to the price of gasoline. For example, in 1979-80 when oil supplies were threatened and fuel prices soared, the average fuel economy of all new cars sold in the U.S. increased to a level 4 mpg over the standard. The sudden change primarily reflected an abrupt consumer shift toward smaller cars and engines.

The basic intent of EPCA has been accomplished: the average fuel economy of all cars sold in the U.S. today exceeds 27.5 mpg. There are nearly 100 small car models with a metro-highway fuel economy of 30 mpg or more from which the consumer can choose. And, today's Ford Crown Victoria has twice the fuel economy of its 1975 counterpart and better fuel economy than the smallest car Ford produced in 1975.

Oil import levels will not be appreciably reduced by increasing the automotive fuel economy standards.

. Industry lead time requirements would not permit a manufacturer to make the kinds of product changes necessary to improve its fleet average fuel economy within the three years specified in the bill. To achieve a significant improvement in fleet average fuel economy would require a manufacturer to substantially redesign all its products -- a process that takes up to five years for each product line.

The amount of additional energy conservation that would result from higher fuel economy standards would be minimal. For example, a one mpg increase in the fuel economy of the average car from the present levels would reduce U.S. oil consumption by only about one tenth of one percent annually.

. By comparison, the annual reduction in fuel consumption due to the replacement of older vehicles now in operation is some 25 times greater, or 3 percent annually. This means that by the year 2000, fuel consumption for the U.S. vehicle fleet will be reduced 25% from today's levels, without any additional legislative authority or regulation.

. Consumers have no additional incentive to shift to smaller, more fuel efficient vehicles than their needs would otherwise demand in the absence of substantial fuel price increases. Dramatic increases in the fuel efficiency of larger cars has greatly improved their desirability. They are no longer the 8-10 mpg gas guzzlers, but now achieve 23-24 mpg.

The marginal benefits of increasing fuel economy standards have to be weighed against the substantial costs to consumers and the domestic automobile industry.

- Given today's technology, it is not possible for manufacturers to meet higher standards and still offer consumers a full range of small, mid-size and larger cars and trucks. If fuel economy standards were to be increased, U.S. manufacturers could not satisfy today's demand for a full line of products while still providing the level of comfort and function that consumers want and need.

- Higher standards could force domestic manufacturers to restrict the production of larger vehicles and engines, as well as require major new investments in products and technology at a time when it is vital to improve cost competitiveness with foreign manufacturers. Ironically, these market needs might be met instead by foreign competition. Japanese and Korean producers are developing and beginning to introduce products in the mid-size and larger segments that have traditionally been the strength of U.S. domestic manufacturers. These foreign manufacturers would not face EPCA restrictions on larger cars and engines because of credits built up from years of predominantly small car production. Further, foreign manufacturers have the additional flexibility of averaging together vehicles built in the U.S. and abroad. In fact, EPCA's two-fleet requirement acts as a disincentive to foreign manufacturers to increase their U.S. content.

Ford believes that fuel economy is well established as an important consumer purchase consideration and that the market will continue to demand competitive fuel economy in all market segments. We urge Congress not to enact any legislation that would have the effect of increasing the fuel economy standards.

General Motors Corporation

JAMES D. JOHNSTON
VICE PRESIDENT

April 13, 1987

The Honorable Lloyd Bentsen
Chairman
Senate Finance Committee
United States Senate
703 Senate Hart Office Building
Washington, D. C. 20510

Dear Mr. Chairman:

Attached for the record of your March 25, 1987 hearing on S. 694, the Energy Security Act of 1987, are General Motors' comments regarding that bill. As you can see from the comments, General Motors is very concerned about the authority which this bill would provide to increase fuel economy standards for passenger cars outside of the rulemaking process established by Congress in the Energy Policy and Conservation Act of 1975. As a result, S. 694 could result in higher standards being implemented without adequate consideration of the four criteria Congress established for setting fuel economy standards and with only a very short leadtime for the manufacturers to respond. GM's comments suggest some other measures which should be considered to reduce the oil vulnerability of the U.S.

We look forward to working with your committee to develop some of these alternative approaches to improving our energy security.

Sincerely,

James D. Johnston

kjm
Attachments

1660 L Street, N.W. Washington D.C. 20036

The Energy Security Act of 1987

General Motors welcomes the opportunity to submit comments for the record on S.694, "The Energy Security Act of 1987," introduced by Senator Lloyd Bentsen on March 10, 1987.

Provisions of S. 694

Under S.694, the President would be compelled to submit to Congress an energy policy ("Energy Production and Oil Security Policy"), designed to prevent oil imports from exceeding a U.S. consumption rate of 50 percent. The President would be obligated to consider in the policy some or all of the following measures:

- oil import fee
- energy conservation actions, including improved automotive fuel efficiency
- expansion of the Strategic Petroleum Reserves to maintain a 90-day cushion against projected oil import blockages
- production incentives for domestic oil and gas, including tax and other incentives for stripper well production, offshore, frontier, and other oil produced with tertiary recovery techniques

While it is unclear how the "improved automotive fuel efficiency" mandate would be accomplished, the bill grants full authority to the

President to compose and implement an energy plan solely to "prevent crude and product imports from exceeding an oil import ceiling" (set in the bill at 50 percent). Thus, to whatever extent S.694 would result in or require increasing the Corporate Average Fuel Economy (CAFE) standards separate from the long-established rulemaking guidance under the Energy Policy and Conservation Act (EPCA), General Motors believes S.694 would be counterproductive and harmful to the interests of consumers and those who work in our facilities.

In giving the agency CAFE standard-setting authority, Congress required NHTSA to determine the most feasible fuel efficiency for the industry by examining (1) technological feasibility; (2) economic practicability; (3) the effect of other Federal motor vehicle standards on fuel economy; and, (4) the need of the nation to conserve energy. Consideration of all four criteria is required to assure that the CAFE standards both meet the goals of EPCA and preserve the economic viability of auto manufacturers. S.694 not only does not acknowledge these criteria established by Congress, but it also elevates one of them -- the need of the nation to conserve energy -- to a position of dominance over the other three. This monumental change in the balance of these factors is clearly in conflict with what Congress intended when it passed EPCA in 1975. EPCA assures that CAFE standards will not be set at a level that would create adverse economic impacts on workers, auto manufacturers, consumers and the general economy.

In addition, under S.694, the President would be allowed to implement "improved automotive fuel efficiency" within a matter of a few months. We cannot easily modify our products or product mix to meet a short lead time modification in a major regulation like CAFE. Recognizing this, Congress required in the CAFE statute that auto manufacturers be given 18 months lead time prior to the start of a model year in which CAFE standards are going to be increased. Slashing this period to a few months could create great turmoil for the industry without any guarantee that there would be justification for such actions. General Motors believes S.694 could have the effect of disrupting automobile production seriously, by circumventing the rulemaking process and by giving the President an unparalleled amount of discretionary authority.

More broadly, however, General Motors believes that the decontrol of oil prices has made it desirable to reexamine whether the continuation of the existing CAFE legislation is necessary. By analogy, these concerns associated with the current CAFE program apply to S.694 to an even greater degree.

Congress' goal for improved automotive fuel efficiency as contained in the Energy Policy and Conservation Act has largely been realized. In 1986, the average fuel economy of the nation's total fleet of new cars exceeded the original Congressional goal of 27.5 miles per gallon. Such achievements did not come without cost: General Motors alone spent $50 billion on new products, plants and equipment to improve fuel economy and to keep our products competitive in the marketplace.

Today, however, the CAFE program is jeopardizing the competitiveness of domestic full-line manufacturers and the jobs of their employes. The Department of Transportation has found the costs of CAFE standards outweigh their benefits and has recommended that CAFE requirements be repealed. In a letter to Congressman John Dingell, Transportation Secretary Dole said CAFE standards are no longer necessary because oil price decontrol has made the price of gasoline an effective, market-based control on fuel economy. She has also noted that "CAFE standards provide a serious distortion in the automotive industry that is detrimental to the economy; that EPCA results in unequal burdens on full-line manufacturers; and, that the provisions of EPCA once intended to preserve U.S. jobs now threaten to cause substantial foreign outsourcing of large car production."

General Motors, for example, is a full-line manufacturer, offering vehicles in every segment of the automotive market. Because the average of all a manufacturer's vehicles must be computed for the CAFE level, a full-line manufacturer -- one whose offerings include family-size vehicles -- must compensate for its sales of such larger, relatively less fuel-efficient vehicles with sales of smaller, relatively more fuel-efficient cars.

Absent a technological solution, and none are foreseen, there are few alternatives to raising CAFE which are available to full-line manufacturers who compete successfully in all market segments. Those alternatives include restricting products; initiating pricing incentives to alter product sales mix, thereby reducing the cash flow available to a manufacturer to invest in vehicle programs and modernize facilities; and, increasing outsourcing to shift vehicles into the "import" fleet. Any of these constraints imposed by CAFE can result in job losses and other adverse effects to the entire economy.

While compliance with the current CAFE standards is a risky burden for domestic full-line manufacturers, it is by contrast, not a burden for producers of mostly smaller cars such as the Japanese. To the extent that S.694 could force the CAFE standards higher than dictated by conditions in the energy market, these disadvantages to U.S. producers would be worsened and the advantages to foreign producers increased.

Several foreign manufacturers. especially the Japanese, have virtually no CAFE obstacles to overcome in exploiting the larger or luxury segment of the market. These manufacturers are not currently constrained by the problems associated with complying with the CAFE standards because they have a large base of smaller cars, and credits from selling these cars in the past, which can be used to offset the introduction of larger, less fuel-efficient cars. CAFE standards and S.694 have their largest impact on full-line manufacturers who produce a number of family-size vehicles that American consumers have traditionally needed. The larger and luxury car market segment is the area in which domestic manufacturers have excelled.

CAFE standards and S.694 would make it much more difficult for U.S. full-line manufacturers to maintain their competitive edge. Both the Europeans and Japanese have increased their products in the larger car categories in recent years. For example, Toyota, Nissan and Honda are now offering larger, higher-performing and luxury cars in the U.S. By 1990 it is expected that Nissan and Toyota will offer even larger cars and that Mazda and Hyundai will join them.

So at the very time Japanese manufacturers will be increasing their efforts in the larger and luxury segments, CAFE standards and the fuel-efficiency improvements that could be mandated under S.694 could hinder

American manufacturers in these segments and handicap their ability to respond to the competitive environment. The Department of Commerce has estimated that sales of Japanese upscale vehicles in the U.S. will almost triple by 1990.

Furthermore, the Commerce Department has estimated that even with no CAFE-related cutbacks, the domestic manufacturers' current 81 percent share of the U.S. luxury car market segment is likely to fall to less than 78 percent by 1990. Even though this decline may appear small in percentage terms, it affects the most profitable segment of the market. Performance in this segment by domestic manufacturers over the next several years will be critical in establishing their long-term competitive position.

Not only are the Japanese well-positioned to capitalize on the CAFE constraints that domestic auto manufacturers face, they are committed to capturing more and more sales. For example, the Japanese government has recently proposed eliminating the higher tax rate for larger cars manufactured and sold in Japan. While such changes would improve sales prospects for U.S. cars in Japan, it will also make it easier for Japanese auto manufacturers economically to produce large cars for sale in both the home and export markets. Such a move illustrates the willingness of the Japanese government to modify domestic regulations to improve the competitive position of their manufacturers.

<u>Other Provisions of S. 694</u>

Even as it threatens substantial harm in the automotive sector of the economy by its narrow focus on a single issue -- oil imports -- S.694 presumes any and all foreign sources of oil contribute to "excessive" dependence. However, much of our oil and the world's oil comes from a highly diverse group of relatively secure foreign sources such as Canada, Norway, Mexico and Great Britain. These foreign sources also contribute to our energy supplies without the same economic and political concerns posed by OPEC.

In addition, General Motors believes that our energy security is not exclusively tied to domestic oil and natural gas production, as S.694 implies. It is also tied to a variety of alternatives, including coal, nuclear and hydro, as well as worldwide import sources. In an oil supply emergency, protection is afforded most by the ability to shift rapidly to other sources of energy.

With respect to the four specific actions the bill recommends pursuing to insure domestic energy security, requiring improved automotive fuel efficiency would achieve nothing of consequence toward improving U.S. energy security -- either by increasing the nation's flexibility to respond to a supply disruption or to even prevent it.

General Motors also opposes import fees because they do not introduce stability in the price of oil, as advocates for this mechanism believe. Rather, such a fee would merely raise both the floor and the average price that oil users could expect to pay, without reducing any peaks that may result from time to time. Further, an import fee would not prevent a disruption in supply.

Instead, the U.S. needs to devote more time and resources to developing the Strategic Petroleum Reserve and removing barriers to the production and more efficient use of energy in the U.S. Actions such as total decontrol of the wellhead price of natural gas, improved transportation of natural gas, relaxation of the restrictions to the use of more coal in the U.S., removal of barriers to the development of alternative fuels (such as methanol) and repeal of the Windfall Profits Tax, can all help address the problem of increasing imports without the more stringent measures permitted by S.694.

Conclusion

In conclusion, General Motors is concerned about energy availability and price. We share Congress' goal for a strong domestic energy industry and believe there are already reliable resources in this area to insure flexibility in the event of a future supply disruption. General Motors supports policies that contribute to our energy security and well being, but it cannot support the proposals recommended in the Energy Security Act of 1987. In a time when the domestic auto industry is working to maintain world competitiveness, we need to avoid programs that will not work or that would impose burdensome and unproductive costs on workers and manufacturers.

WRITTEN SUBMISSION OF THE INDEPENDENT REFINERS COALITION REGARDING REFINED PETROLEUM PRODUCT IMPORTS AND NATIONAL SECURITY SUBMITTED TO THE SENATE FINANCE COMMITTEE, U.S. SENATE
April 9, 1987

Mr. Chairman and Members of the Finance Committee:

The Independent Refiners Coalition (IRC) is pleased to submit comments regarding the effect of imported gasoline and other refined petroleum products on U.S. national security.

A STRONG REFINING INDUSTRY IS ESSENTIAL TO NATIONAL SECURITY

A strong domestic refining industry is as essential to U.S. national security as an adequate supply of crude oil. This linkage exists because crude oil is useless to the civilian economy and the military until it is refined into products. Just as the United States must have an adequate supply of crude oil, the United States must have sufficient refining capacity to use it.

The maintenance of adequate domestic refining capacity is a problem of national security to the U.S. government. To U.S. refiners, maintaining capacity is an economic problem. Our statement explains how political and economic factors have reduced U.S. refining capacity from 18.6 million barrels a day (mmb/d) in 1981 to 15 mmb/d today, and highlights the factors which threaten to cause further reductions in U.S. refining capacity.

The nation will be forced to continue importing crude oil because domestic reserves are insufficient to meet domestic demand. Given this situation, there is simply no justification--either from a national security or economic perspective--for increasing our dependence on imported refined products at the expense of U.S. refining capacity. It just doesn't make sense. The indisputable result of such an increase is greater vulnerability to supply disruptions and price volatility in key products like gasoline, diesel, military and civilian jetfuel, and home heating oil.

The United States must retain enough refining capacity to be essentially self-sufficient in meeting U.S. demand for refined products--at both peacetime and crisis levels. The statistics show that U.S. refining capacity was barely capable of meeting <u>peacetime</u> demand requirements in 1986. Any additional gasoline demand increase would likely result in greater dependence on gasoline imports.

To the extent that gasoline and other refined product imports displace any more domestic refining capacity, such imports create a national security threat and undermine the primary purpose of the Strategic Petroleum Reserve--to supply crude oil to U.S. refineries in the event of a crude oil supply disruption.

INCREASING GASOLINE IMPORTS THREATEN U.S. REFINING CAPACITY

In this regard, increasing imports of gasoline and gasoline blendstocks are the greatest threat to the maintenance of sufficient U.S. refinery capacity. Gasoline accounts for just under half of total U.S. refinery output. Gasoline production and sale is most essential to overall U.S. refinery profitability and the maintenance of capacity.

According to the Department of Energy (DOE), total refined product imports increased from about 1.6 mmb/d in 1982 to about 2 mmb/d in 1986, an increase of 25 percent. However, the mix of these imports has shifted toward the higher-value-added, light refined products like gasoline and naphthas. According to DOE, imports of gasoline and gasoline blendstocks have increased from 103 thousand barrels per day (mb/d) in 1981 to 454 mb/d in 1986, an increase of 349 percent. According to the Department of Commerce (DOC), imports of gasoline and naphtha have increased from 191 mb/d in 1981 to 544 mb/d in 1986. Since about two barrels of oil are used to make a barrel of gasoline, every barrel of gasoline imported can displace about 2 barrels of domestic refining capacity.

THE ACTUAL CAPACITY OF THE U.S. REFINING INDUSTRY

According to the Department of Energy, U.S. "operable" refining capacity is 15.4 mmb/d. "Operable" refining capacity includes both operating refineries and refineries which are idle but supposedly capable of being returned to service within 90 days. However, according to the most recent detailed study of the U.S. refining industry, entitled U.S. Petroleum Refining (completed by the National Petroleum Council (NPC) in November 1986) 470 mb/d of this capacity had been shut down since January 1, 1986. According to the NPC engineers, this capacity should more realistically be classified as "inoperable." If the NPC engineers are correct, actual U.S. "operable" capacity is just under 15 mmb/d. It must be noted that the NPC study is by far the most credible analysis of the U.S. refining industry available. Other studies, including a DOE study released in June of 1986, are merely compendiums of opinion and conclusion by comparison to the NPC study.

There is No Excess Refining Capacity in the United States

Unfortunately, the Department of Energy (DOE) failed to establish a minimum level of refining capacity to meet U.S. national security requirements in its new study, Energy Security. The making of this determination is becoming more critical because U.S. refining capacity has demonstrated a clear downward trend since 1981. In Energy Security, DOE paints a rosy, superficial picture and simply asserts that there is plenty of refining capacity in the United States to meet any current or future national security situation--with no supporting analysis of that conclusion.

In fact, as the NPC's more detailed study makes clear, the U.S. refining industry's output is now capable of covering only current peacetime demand for normal and peak periods. The NPC analysis belies any "happy talk" about the existence of excess refining capacity in the United States. On a global basis, according to British Petroleum statistics, the United States -- the world's major refined products consumer -- has the lowest self-sufficiency ratio of production to consumption of any world region.

Utilization Rates Approached Maximum Capacity in 1986

Historically, an 85 percent utilization rate has been the highest sustainable annual operating rate for the refining industry. At 15 mmb/d of capacity, this utilization means a crude oil input to refineries of 12.75 mmb/d of crude oil. In 1986, crude oil inputs to U.S. refineries averaged over 13 mmb/d and reached a high of 13.3 mmb/d. Clearly, refineries actually operating reached very high short-term utilization rates in 1986. If 15 mmb/d of capacity were operating at a crude oil charge of 13.3 mmb/d, the actual utilization rate would be 89 percent.

According to DOE, the domestic refining industry produced an average of 6.755 mmb/d of gasoline in 1986 and 7.1 mmb/d of gasoline during peak periods, while U.S. gasoline demand averaged 7.018 mmb/d in 1986 and reached 7.5 mmb/d during peak periods. The difference was supplied by imports. Clearly, we have already reached the maximum gasoline manufacturing capacity estimated by the NPC.

The first major conclusion of the NPC study is:

> "Based on the 1988 data from the NPC Refinery Survey and modeling results, the U.S. refining industry is approaching maximum gasoline manufacturing capacity."

The report also states:

> "Motor gasoline manufacturing capability in 1988 is estimated both by modeling and survey results to be 6.7-6.8 mmb/cd on an annual average crude oil charge of about 13 mmb/cd...the maximum capability to produce gasoline for portions of the year is estimated to be 7.0-7.4 mmb/cd...At the 6.8 mmb/cd gasoline production rate, downstream conversion units are fully utilized and octane enhancing units are nearing full capability...The model shows that when downstream capacity is fully utilized, crude oil distillation capacity is operating at about 84 percent of calendar day capacity. Thus, very little additional gasoline production could be accomplished by increasing crude oil charge above 13 mmb/cd."

NPC makes the critical observation that simply comparing total "operable" capacity against crude oil inputs to determine refinery utilization will overstate the system's real capacity, because it does not account for the extremely high utilization of "downstream" refining capacity, which is essential to the production of low-lead gasoline. In other words, the DOE's method of reporting utilization can be used to imply that there is excess refining capacity which simply doesn't exist.

The NPC says that some debottlenecking could be accomplished that would raise U.S. refinery capacity above 6.8 mmb/d of gasoline production on a consistent basis. However, additional environmental constraints examined by the NPC, including lower sulfur emissions from diesel fuel and a reduction of the gasoline Reid Vapor Pressure index, would at least offset this increase and could actually reduce U.S. refinery output from current levels. For example, the National Petroleum Refiners Association (NPRA) just published a study of the financial impact on U.S. refiners of meeting the Environmental Protection Agency's (EPA) proposed diesel fuel sulphur reduction target for 1991. Estimated cost to the domestic industry would be $6.65 billion to meet EPA's proposed requirement.

NATIONAL SECURITY CONSIDERATIONS AND THE U.S. REFINING INDUSTRY

The greatest refined product import dependency problem exists in PADD I, the East Coast region. In 1986, PADD I imported 1.3

mmb/d of products, or 67 percent of total U.S. product imports of 2.0 mmb/d. A disruption of petroleum imports would hit PADD I hardest and could strain delivery systems supplying PADD I with crude oil and refined products. By comparison, PADD III, the Gulf Coast region, imported 2 mmb/d of crude oil and only .1 mmb/d of products. Dispensing Strategic Petroleum crude oil to the refineries in the Gulf Coast region would be easier than to the other PADDs.

If military fuel demand from U.S. refineries increased rapidly due to a crisis, a significant disruption of civilian sector refined product supplies would occur to the extent that total U.S. demand exceeded refinery capacity. A significant disruption could also occur to the extent that military demands forced U.S. refineries to adjust their product slate to produce higher volumes of refined products other than unleaded gasoline. This would reduce unleaded gasoline production significantly even if all U.S. refineries were running at peak capacity, because unleaded gasoline accounts for 70 percent of all gasoline supplied. Regional disruptions could magnify these shortfalls, affecting the supply of other products as well. The implications of a U.S. capacity shortfall could exceed its effect on the United States alone.

Low crude oil prices have decreased U.S. oil production by approximately 10 percent since last February and renewed U.S. dependence on Persian Gulf suppliers. However, U.S. crude oil dependence on the Middle East (defined to include North African OPEC producers) is still lower than that of Europe and Japan. For example, Europe depends on Middle Eastern OPEC crude oil imports for 59 percent of its crude oil imports (4.6 mmb/d out of 7.9 mmb/d total imports), and Japan depends on Middle Eastern OPEC for 58 percent of its total imports (2.6 mmb/d out of 4.5 mmb/d). A Middle East crisis could place higher demands on U.S. refinery output if refineries in Europe and Japan were cut off from a huge percentage of their crude supplies. Preliminary analysis also indicates increased dependency on Middle East crude imports in Eastern Canada. A disruption in supply would affect Canadian exports of refined products to the U.S.

Obviously, any crisis involving the NATO forces would also place great demands on the U.S. refining industry. If European and Japanese refinery capacity were reduced due to a conventional conflict, U.S. refineries would have to supply far greater amounts of refined products to service NATO forces. A conflict or crisis involving the Middle East and a NATO mobilization would clearly strain the logistical supply system for refined petroleum products. The scenarios do not anticipate any disruption of supply from Latin America, Central America or the Carribbean, though the Atlantic sea lanes could very well be affected.

While it is difficult to determine the precise nature of conflict scenarios, a shortfall in crude supplies to our allies would almost certainly entail increasing output of products from U.S. refineries. It could also entail the distribution of SPR crude oil and U.S. refined products under the International Energy Agency sharing agreements. Recently, the escalation of hostilities in the Iran-Iraq war has forced the U.S. government to renew its pledge, both in word and in deed, to defend international shipping channels and the free flow of crude oil through the Strait of Hormuz.

THE ECONOMIC FACTORS AFFECTING U.S. REFINERS

The end of U.S. oil price controls and entitlements--coupled with higher oil prices, increased gasoline conservation and fuel switching after 1980--caused the shutdown of smaller, less efficient refineries between 1981 and the end of 1983, when operable capacity fell to 16.1 mmb/d. Since that time, the combined effect of increased gasoline and blendstock imports, the United States' unilateral imposition of gasoline lead phasedown requirements and other pollution abatement measures, and the effect of inequitable tariff and non-tariff barriers in other nations have shut down approximately 1 mmb/d of addtional U.S. capacity.

If crude oil prices stay low enough to continue to stimulate increased gasoline demand, U.S. refiners must make the decision whether to add capacity or to let imports take a larger share of the U.S. gasoline and gasoline blendstock market. It is currently projected that U.S. gasoline demand may rise by 2 percent in 1987 over 1986 levels. Continuation of low crude prices, on the other hand, will stimulate foreign refinery production to capture higher value-added product sales. U.S. refiners must decide whether the economic climate will allow them to risk increases in capacity.

If imports increase during a high demand period and do not subside as demand falls (for instance, if oil prices increase), the U.S. refining industry will be threatened with further shutdowns. While the U.S. has no excess refining capacity, massive overcapacity still exists in other world regions--the Middle East, the EEC, Japan and some non-market economies. In many cases, refineries in these areas are government-controlled. Government-controlled refineries may not respond to market conditions--such as oversupply or low prices--if their crude oil costs are subsidized or if their losses are absorbed by government treasuries. In particular, government-controlled refineries are resistant to shutdowns and capacity reductions resulting from the buildup of excess capacity.

These factors, coupled with changes in the U.S. tax laws, significantly increase the costs and the risks of adding refinery capacity in the United States to meet increased U.S. product demand. These factors also reduce the profitability of existing operations and can act to shut down more U.S. capacity.

Why U.S. Refining Operations Must be Profitable

Refining profitability is affected by the relationship between crude oil prices and refined product prices. If crude oil prices increase faster than refined product prices, refiners lose money, and visa-versa. While utilization rates have been high recently, that does not necessarily mean that refineries in the United States or abroad have been profitable. U.S. refiners began to experience negative refining margins again in late 1986. Platt's Oil Import/ Export Report (March 9, 1987) lists a number of European refineries closing down "to avoid running crude and incurring negative margins."

The critical point here is that the industry must be profitable to make the needed investments. During the 1980s, U.S. and other world refiners have faced long periods of negative margins on refining operations. Yet imports of gasoline increased during periods when netback analysis showed that foreign refiners were experiencing losses by selling in the U.S. market.

For U.S. refiners, profits on the sale of gasoline and other light products are essential to overall profitability. In comparison to heavier refined products like residual fuel oil--which sometime sell for less than crude oil itself--lighter products represent greater value-added returns. In that respect, a difference of even 1 ¢/gal for gasoline at the wholesale level can mean the difference between profit and loss. A 100 mb/d U.S. refinery, producing about 50 mb/d of gasoline, stands to gain or lose thousands of dollars daily on gasoline sales.

The tendency among industry and government analysts to lump crude oil, refining and marketing operations together has disguised both short and long-term losses on refining operations. Unless the refining sector can operate as a stand-alone profit center, its subsidization by other profit areas drains resources away from domestic oil exploration, affecting major integrated oil company refining operations as well as independent refiners.

<u>Environmental Regulations Raise U.S. Refiner Costs Unilaterally</u>

The combined cost impacts on U.S. refiners of pollution abatement and gasoline lead phase down, according to IRC analysis, translate into a U.S. gasoline production cost disadvantage of about 5¢ per gallon of gasoline compared to foreign refiners which do not incur these environmental protection costs. The Congressional Budget Office and the Environmental Protection Agency have analyzed the cost impact of these environmental regulations on U.S. refiners and have concluded that the impact is about 2.7¢ per gallon. However, these analyses do not compare U.S. refiner's costs against the real advantage given to foreign refiners which do not have to meet U.S. lead phasedown standards on their total gasoline pool. Foreign refiners can export high-octane unleaded components (blendstocks), while adding more lead to low-octane components for their domestic gasoline supply. This advantage can translate into over $2.00 per barrel when the foreign refiner exports gasoline and blendstocks to the United States.

According to the NPC's refining study, the imposition of new EPA environmental constraints on diesel fuel sulfur emissions and gasoline Reid Vapor Pressure will place additional costs on U.S. refiners,and will lower U.S. refinery output, unless additional capital expenditures are made by the U.S. industry.

As noted, the National Petroleum Refiners Association (NPRA) has just released its survey on the cost of EPA's proposed diesel desulfurization to .05 wt% and 20 vol% aromatics by 1991. The industry estimates the cost at $6.65 billion to meet EPA's proposed goals, equivalent to 15.5 cents per gallon of highway diesel fuel. Of 139 refineries responding to the NPRA survey, 53 refineries with 900,499 b/d of associated diesel production capacity reported that they would be unable to install the needed facilities because of financial burden or environmental permitting constraints. Smaller refineries would be hardest hit. NPRA also discovered that even if refineries could make the needed adjustments, it is not certain that the construction and engineering industries could construct all needed facilities by 1991. The U.S. Government must act to ensure that a cleaner environment is not purchased with more U.S. refinery shutdowns and greater product import dependency.

Again, foreign refiners will not bear these costs on gasoline and refined product exports until their governments take positive action to reduce environmental emissions--by requiring the same large-scale investment in environmental controls which the U.S. government has required.

The U.S. government must understand, and act to offset, the competitive disadvantages placed on U.S. refiners in the area of environmental protection. This is not to say that these environmental efforts are not necessary--but their unilateral imposition on U.S. refiners, with no offseting cost placed on imports, provides an unfair marketplace advantage to foreign suppliers and can act to further reduce U.S. capacity. U.S. refiners cannot "invest their way out" of this situation.

Unequal Tariff and Nontariff Barriers Distort Refined Product Flows

The current U.S. tariff on finished gasoline imports is a flat rate of 1.25 cents per gallon, or 52.5 cents per barrel of gasoline for nations with Most Favored Nation (MFN) status. So-called "Column 2" imports -- imports from non-MFN nations -- are tariffed at 2.5 cents per gallon. Virtually all U.S. gasoline imports enter under Column 1 status because most refined-product-exporting nations fall under Column 1. This tariff structure was established in 1958, when finished gasoline sold for about 11.55 cents per gallon wholesale. The effective ad valorem equivalent rate at that time was 10.8 percent. As gasoline prices have risen, the flat rate U.S. tariff has effectively declined, while foreign governments' ad valorem tariffs have risen with prices.

A large quantity of imported gasoline enters the U.S. in the form of components, which are blended together to make finished gasoline. While the tariff rate on blendstocks meant for gasoline use should also be at least 1.25 cents per gallon, there is currently no "actual use" requirement to determine whether components are actually used as gasoline. As a result, some imports are misclassified at the lower rate for petrochemical and unfinished oil feedstocks of only .25 cents per gallon. Other high-octane components may be classified as other chemicals at higher rates of duty. Congress should adopt legislation which clearly mandates an "actual use" test for imports in keeping with the ITC's specific recommendations to end the misclassification problem.

The European gasoline tariff on U.S. gasoline and gasoline from other nations not favored by the EEC's Generalized System of Preferences (GSP) is 6 percent ad valorem. At current prices of about 54 cents per gallon, the European tariff on any U.S. gasoline export would be 3.24 cents per gallon, compared to the U.S. tariff on European exports of 1.25 cents per gallon. For refiners, a penny a gallon can determine profit or loss. U.S. gasoline exports to Europe are effectively foreclosed. As U.S. gasoline imports increase on the East Coast and the Gulf Coast, there is no offsetting outlet for displaced U.S. gasoline production.

In the past, the EEC allowed duty-free GSP entry of refined products and petrochemicals from the Middle East. However, concern over dramatically increased Saudi and other Middle Eastern nations' petrochemical shipments caused the Community to impose tariffs of 12.5 to 13 percent on petrochemical products from these producers.

There is a real possibility that the EEC will impose higher ad valorem tariffs or volume restrictions on refined product imports from the Middle East in lieu of duty-free preference levels. The EEC has engaged in talks with the Gulf Cooperation Council concerning tariffs on increased imports of refined products.

The EEC estimates that about 1 mmb/d of new OPEC export product from the Middle East and North Africa will hit world markets by 1990. The EEC says that it should take about 40 percent of this new product, with Japan and Asia taking 35 percent and the U.S. taking 25 percent. Such market division is contrary to International Energy Agency (IEA) policy which states that market forces should determine the flow of trade. In addition, European imports are primarily of distillate and residual fuels, which means that excessive amounts of gasoline and blendstocks from foreign refineries are more likely to be diverted, directly or indirectly, to the U.S. by EEC actions.

Japan has finally begun to accept gasoline imports due to pressure from the International Energy Agency (IEA). However, imports may be purchased only by Japanese refiners, allowing them to retain domestic market shares despite some announced capacity reductions. Thus, the likelihood that market forces will increase flows of excess gasoline and refined products from foreign refineries to Japan and the Far East is uncertain at best.

U.S. refiners have been able to export small quantities of gasoline to Japan recently--an encouraging development which we hope will grow. Imports from Saudi Arabia into the U.S. West Coast have also increased by a similar amount. However, these developments are insignificant and do not offset the far greater increase in imports to the East and Gulf Coasts. The potential distortions predicted by the IRC two years ago are a growing reality.

FOREIGN GOVERNMENT CONTROL OF REFINING IS INCREASING

On an international level, the U.S. refining industry is in competition with large, state-owned oil, refining and marketing companies. Unfair competition by state-owned enterprises is a problem which is faced by U.S. industries on an ever-widening basis -- particularly in energy-related trade.

Approximately 90 percent of the world's oil and gas reserves are owned by governments. Governments also control the vast majority of global refining capacity. Some 50 percent of the Free World's refining capacity is now owned or controlled by governments which also own and control the exploitation of their nations' oil and natural gas reserves. In the non-market-economy nations, refining is completely controlled by the government. In nations where excess refining capacity exists, that capacity can be kept operating by absorbing its losses into profits from crude oil sales through the state enterprise structure.

The potential for governments to subsidize their refineries and the marketing of refined products is a major source of concern to U.S. refiners, particularly in the independent sector. Refining companies which do not own significant crude oil reserves cannot subsidize refining losses by crude oil profits. U.S. energy and economic policy should not accept or promote such subsidization.

The extent to which unfair government subsidization has actually occured or is occuring is the subject of intense debate. In its May 1985 study on foreign government natural resource pricing, the ITC reported "Netback calculations on Saudi export sales of petroleum products do indicate the practice of pricing below export levels the crude petroleum that goes into the Saudi refining industry." U.S. refiners cannot be expected to compete against such subsidies in Saudi Arabia or any other nation.

If product prices do not allow U.S. refiners to recover OPEC crude oil prices plus operating costs, new OPEC exports could shut down U.S. refining capacity. In addition, the East/West Center reports that Mid-East joint venture refineries cannot recover full investment costs at current crude oil prices.

Petroleum Intelligence Weekly (1-19-87) reports that "Saudi Arabia's commitment to pricing products from its new export refineries on a market-related basis has not wavered, despite OPEC's resurrection of fixed crude oil prices...State Petromin [the Saudi government oil company] evidently wants to fully exploit the flexibly-priced alternative offered by refined product exports." The same issue reports that there could be a swing away from crude exports to product exports.

The demise of netback contracts on crude oil, coupled with the increase in product exports from the OPEC refineries, threatens to return both the U.S. refining sector and other world markets to the negative refining margins experienced in 1984-1985. The U.S. lost 1 mmb/d of refining capacity in that period alone. Recent statements in the press by Saudi Oil Minister Nazer confirm that the Saudis are running their export refineries at Jubail and Yanbu at over 100 percent of rated capacity. Also, the press reports that the Saudi's light product export refinery at Rabigh will be completed in 1988.

CONCLUSIONS

The U.S. refining industry is a vital link in the chain of energy and national security -- as essential to both as the oil production industry. U.S. refining capacity has reached a critical stage. Imports of light refined products like gasoline should not displace U.S. capacity. However, U.S. capacity could be displaced--by unfair trade practices, inequitable tariff and nontariff barriers, unequal environmental protection costs, and uneconomic excess capacity built and supported by foreign governments and state enterprises.

The IRC supports S. 694, which would limit U.S. crude and product imports to no more than 50 percent of U.S. demand. We wish to point out that dependence on crude oil imports will not directly function to diminish U.S. refining capacity, while increased dependency on gasoline and other product imports directly threatens U.S. refining capacity. We also support the proposed reforms to Section 232 of the Trade Expansion Act which would direct the Department of Commerce to proceed more expeditiously in evaluating national security threats.

The United States should offset the effects of higher U.S. environmental and lead phasedown costs on U.S. refiners compared to foreign refiner costs. We estimate the current U.S. disadvantage at about $2.20 per barrel and have prepared details of this calculation. Until other nations enact lead phasedown and other pollution abatement requirements for their domestic refiners, it is unfair to force U.S. refiners to compete against a legislated cost disadvantage.

Congress should seek equalization of world tariff and non-tariff barriers to refined product trade. The goal is to eliminate barriers. However, until this can be accomplished, the United States should equalize the terms of competition between European and U.S. refiners by converting the fixed-rate U.S. gasoline and blendstock tariff to an ad valorem tariff at least equivalent to the EEC's 6 percent ad valorem tariff on U.S. gasoline exports. Japan should remove remaining restrictions on gasoline and light product imports. These moves would rationalize excess capacity in two of the major areas where it still exists. These moves would better allow market forces to determine trade flows in gasoline and other refined products.

If gasoline and other product imports are being sold in the United States at prices which do not recover the market price of crude oil and refinery operating costs, the U.S. government should intervene to offset the injury to U.S. refiners by making unfair domestic subsidies actionable under U.S. trade law--as provided in Ways and Means Committee amendments on domestic subsidies in H.R. 3. This provision should be added to S. 490 or any comprehensive trade bill considered by the Committee and the Senate. Otherwise, discriminatory crude oil pricing policies of foreign governments could shut down more U.S. capacity. As OPEC regains oil price control and becomes capable of establishing an "official selling price" for crude oil again, the potential for certain foreign refineries to receive crude oil at less than the world market price becomes evident.

The Congress should also retain amendments in S. 490 to the non-market economy (NME) dumping laws which include a "Special Rule on Fungible Products." This amendment would aid U.S. refiners affected by unfair competition with non-market economy refiners.

In addition, S. 490 contains an amendment on State Trading which would equalize the terms of competition between privately owned refineries in the United States and government-controlled refineries in other nations. Article XVII of the GATT requires that state trading--investment, production and pricing policies--be conducted in accord with commercial considerations. The equalization of environmental costs and tariff barriers, together with the amendments to the dumping and countervailing duty laws referred to previously, are essential in the short run to correct the most egregious problems besetting U.S. refiners--and in turn affecting U.S. energy and national security. The State Trading amendment should act as the longer term solution to achieve a market environment for refined products in both U.S. and world markets.

Finally, if an oil import fee is adopted, an 11 percent higher fee must be placed on refined product imports in order to avoid legislating an automatic production cost advantage for foreign refiners. This figure does not include the $2.20 per barrel environmental cost disadvantage on gasoline production.

Report and Recommendations
of the Emergency Action Task Force
to the IPAA Executive Committee
Approved by the Membership Meeting
October 28, 1986

The United States has lost control of its energy future. The nation and the American people are therefore exposed to disruptive economic and security threats more serious than any development short of war. These threats stem from one reality: the Nation will be dependent on foreign oil for more than 50 percent of its oil requirements in approximately two years, and most of these imports will come from unstable and often hostile producers in the Persian Gulf which own 69 percent of the free world's known oil reserves.

By their control and manipulation of oil markets, production and prices, the dominant Persian Gulf producers have, in a matter of months, reduced the domestic petroleum exploration and development industry to economic shambles.

Through the tactic of deliberately collapsing world oil prices and the prices of competing fuels, these Persian Gulf governments have:

- threatened development of all U.S. energy resources such as crude oil, natural gas, coal and nuclear energy;
- caused the cancellation of U.S. development of future energy resources such as synthetic alternative fuels;
- damaged the strength of the national and international banking system;
- undermined conservation; and
- exacerbated our future balance of payments problem.

Unchecked and unchallenged, Persian Gulf oil producing countries have demonstrated a will and capacity to reduce America to a have-not status with respect to vital energy supplies. The dominant Arab OPEC oil producers proclaimed a two-fold purpose in their manipulation of petroleum markets and prices: (1) eliminate marginal, high-cost production of conventional energy, and (2) prevent development of energy alternatives substitutable for oil.

The U.S. must act immediately if it is to avoid new energy famines, which result from either deliberate foreign government policies, military hostilities, or violent terrorist acts in the volatile Middle East. The public best remembers this through the gasoline lines in the 1970s and the resulting economic dislocations. National self-interest requires that we recognize an obvious fact: an adequate secure supply of energy provides the underpinning of our economic and military strengths.

Entirely new economic and security concerns have been raised by the demonstrated market dominance of Persian Gulf oil producers. These concerns now require bold and far-sighted energy policy initiatives by the Federal Government which recognize the following considerations:

- Capital commitments require a climate of economic stability which will inspire confidence for unprecedented amounts of private, high-risk investment. For example, exploration and development to restore and maintain 1985 levels of domestic oil and gas production, for the rest of this century, will cost approximately $1 trillion.

- The United States possesses enormous potential untapped energy resources; however, these resources cannot be developed under the cloud of uncertainty created by the "economic terrorism" unleashed by low-cost oil producing nations in 1986.

- Unlike our allies in the Free World, the United States' role of world leadership requires that its principal energy objective must center upon development of assured domestic supplies. Otherwise, foreign energy supply disruptions can be used to compromise U.S. strategic and foreign policy objectives. We cannot lead if subjected to the threat of political "energy blackmail."

- While the Strategic Petroleum Reserve is an important response to a short term emergency, it is impossible to store sufficient energy to assure long-term secure supplies. Adequate secure energy resources can be provided only by robustly healthy and growing energy producing industries. Conservation, while a valuable supplement to energy sources, will not solve the problem either.

- U.S. crude oil production already is declining because of a collapse of drilling, irreversible abandonment of high cost production and insufficient enhanced recovery projects. Declining production, coupled with increased demand, will cause our nation's dependence on foreign oil to rise to intolerable levels, the bulk of which can only come from the vulnerable and volatile Middle East.

- U.S. natural gas exploration and development have drastically declined because of unrealistically low gas prices. Natural gas prices are historically related to oil prices and have been driven down in part because of Arab OPEC oil price decreases. Regulatory difficulties and end use controls have also adversely impacted the transportation and marketing of natural gas and have prevented this energy source from displacing substantial amounts of imported oil. Continuation of existing circumstances will assure significant disruptions of gas supply.

These considerations underscore the energy security implications of the distressed economic conditions in the domestic oil and natural gas industry.

Energy security is not limited to military defense. Industrial productivity, economic stability, transportation systems, and many of the necessities of all Americans are dependent on reliable supplies of oil and natural gas. Continued destruction of our domestic energy producing capabilities by the deliberate supply and price manipulation of foreign governments is intolerable.

CONCLUSIONS

There is no free market in crude oil. Prices are being deliberately manipulated by Persian Gulf countries with the intent to dismantle the domestic petroleum industry, thereby denying the United States the ability to determine its energy future. All domestic energy sources - oil, gas, coal, nuclear, synthetics, and renewables - and conservation are price related and are in jeopardy.

Our national security demands that the rising level of imports be stopped. A revitalized U.S. oil and gas industry, with adequate and stable prices, is the key to winning this battle.

Timing is critical. Once destroyed, our oil and gas industry cannot be quickly restored. Many years are required to train geologists, engineers and technicians. Five to ten years will lapse between conception of geological ideas and marketing of significant new production. Action must be taken now to preserve this vital industry, including its supply and service components.

Admiral John M. Poindexter, the President's National Security Advisor, has recently stated to Congress that there is an "emerging national security concern" caused by the probability that "the Persian Gulf will once again become the major supplies to the Free World." Under these conditions, Admiral Poindexter pointed out, "a major oil disruption will place severe strains on our entire range of political-military resources." We believe that these fears are confirmed by the facts set forth in this report.

RECOMMENDATIONS

Therefore, we urge the President to:

1) publicly identify the national security threat caused by manipulation of world oil prices by the dominant Arab OPEC countries,

2) declare to OPEC that the United States will take all actions necessary to prevent the destruction of the domestic energy industries,

3) announce his support for strengthening the collapsing oil and gas industry and related energy industries, and

4) support exploration and development incentives and remove regulatory impediments to oil and gas exploration and development by:

a) revising and enacting tax provisions, specifically including increased percentage depletion, more rapid expensing of lease and well costs, tax credits for exploration, and repeal of the windfall profit tax,

b) deregulation of natural gas, repeal of the Fuel Use Act, and elimination of existing impediments to transportation of natural gas from producers to end-users, and

c) opening of more federal lands for immediate exploration and development.

If the dominant Arab OPEC countries continue to hold oil prices below the level needed for the United States to maintain adequate reserves of oil and gas, we ask the President to take all appropriate actions to prevent OPEC control of our energy supplies and urge the use, whenever needed, of two actions specifically approved by the IPAA:

1) a floor price for crude oil to provide stability,

2) a variable import fee on crude oil and petroleum products, without exceptions or exemptions, to stabilize the price of domestic crude oil and products at an adequate level.

# # #

J Donald Annett
Vice President

Texaco USA

1050 17th Street NW
Suite 500
Washington DC 20036

April 8, 1987

The Honorable Lloyd Bentsen
Chairman
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Senator Bentsen:

Texaco shares your concern that United States energy security is in jeopardy. Unless action is taken by the U.S. Government to stabilize domestic production, our country will soon reach an unacceptable level of dependency on imported petroleum.

We were pleased to see that the recently released Department of Energy study confirms our concern that the rising tide of imports poses a serious threat to our country's national security. It is now appropriate for the Department of Energy, the Congress and the oil industry to carry this message of concern about the rising dependence on petroleum products to the American people.

The Department of Energy report identifies a number of policy options but makes no specific recommendations. It is important that we all now promptly review these policy options contained in the study, as well as those recently identified by the National Petroleum Council. The Government and industry together should then proceed to develop specific recommendations for action.

Texaco supports your bill, The Energy Security Act of 1987, which proposes a new energy policy mechanism. S.694 recognizes the close link between energy dependence and national security by defining a clear threshold of vulnerability. Such a threshold is needed to signal to the world that the U.S. will not sit idly by while our national security is being jeopardized.

Texaco also supports the concept of a flexible but accelerated process for various energy policy options to be proposed by the Administration and considered by Congress. We do suggest, however, lengthening the time horizon for the President's required projections from a three-year to a five-year period. This would allow sufficient time for the "action measure" to take effect.

Again, we appreciate your efforts to address this critical issue and ask that these comments be included in the official record of the Finance Committee of March 23, 1987.

Respectfully,

J Donald Annett

Division of Texaco Inc

U.S. Council for an Open World Economy
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Statement submitted by David J. Steinberg, President, U.S. Council for an Open World Economy, to the Senate Committee on Finance in a hearing on proposals to amend the "national security" clause (Section 232) of the trade legislation. March 25, 1987

(The U.S. Council for an Open World Economy is a private, non-profit, public-interest organization engaged in research and public education on the merits and problems of developing an open international economic system in the overall national interest. The Council does not act on behalf of any "special interest".)

There is considerable merit to requiring a definitive Presidential response, within a reasonable time, to a finding of import-related impairment of the mobilization base (under Section 232 of the trade act) by the administration official (currently the Secretary of Commerce) responsible for judging such petitions. Those who petition for government help in these proceedings are entitled to a definitive response, and the nation as a whole is entitled to assurance that the necessary attention is being given to claims of impairment of the national security. However, proposals that would only or primarily set time limits to the President's consideration of such findings would amount to little more than tinkering with a policy mechanism that needs structural overhaul. Proposals -- other than time constraints -- that would in any way curtail the President's discretion in these cases should be totally rejected.

The "national security" clause of the trade legislation was flawed from the very outset over 30 years ago. The overhaul needed to correct this defect (a reform which this Council alone has advocated) would rectify the statute's unwise designation of import restriction as the only action required of the President if he accepts a finding that imports of a product threaten the national security. I have argued for many years that import restriction (if justifiable at all) for legitimate national-security purposes should be only one component of a coherent adjustment strategy that seeks a durable solution to the particular weakness in the mobilization base. In the face of import-related impairment of the mobilization base (in effect, a contingency ultimately decided by the President), the statutory mandate for remedial action should be, not (as now) "adjusting" the imports as the only required remedy, but a coherent strategy to ensure solution of the mobilization problem through whatever remedies are deemed necessary and appropriate. The strategy should include reassessment of all statutes and regulations materially affecting the industry's ability to cope successfully with import competition and other challenges of change, in order to determine if there are any inexcusable inequities that demand correction. The strategy should systematically be reviewed by Congress every year to determine if everything that needs to be done is being done and if further legislation is advisable, as well as to make sure that import controls and other extraordinary assistance at public expense last no longer than is necessary.

If the government in the late 1950's had proceeded in this fashion from the finding of national-security impairment owing to unrestricted imports of petroleum, we might at least have alleviated the oil crisis of the 1970's. Instead of a coherent, cohesive petroleum strategy, we settled for oil import quotas and continued recourse to an assortment of tax breaks that had acquired a life of their own.

I endorse the purpose, and have no disagreement with the provisions, of the bill introduced by Senators Byrd and Roth (S.285), and Title V of S.490 (the omnibus trade bill) -- except for their omission of any mandate to the President to devise a coherent strategy (not limited to import restriction alone) addressing the real problems and needs of the particular industry in the context of the total national interest. The bill appears to permit Presidential actions in addition to the import restraint for which it explicitly provides -- namely, by providing that "the actions which the President may take ... shall include, but are not limited to" import restriction via unilateral action or international negotiation. However, this does not go far enough toward the overhaul I consider essential, in that the bill does not require a Presidential decision of the scope I have proposed -- aimed at ensuring solution of the mobilization weakness through a carefully structured program of governmental and private-sector measures, and at terminating at the earliest opportunity whatever import restrictions and other subsidies may have been found essential.

The President, of course, has always had the freedom to devise such a balanced, industry-adjustment strategy in Section 232 cases --necessarily, under present law, with import controls if he declairs impairment of national security. But such an approach to import-impact cases of whatever variety has yet to be accepted by any President, and at this juncture does not appear likely in Section 232 cases without the statutory mandate I have proposed. No bill introduced in this or (to my knowledge) any previous Congress requires or even suggests this kind of industrial policy for national-security or other purposes. The provision in S.694 requiring an Energy Production and Oil Security Policy for preventing oil imports from exceeding 50 percent of U.S. crude and oil-product consumption for any annual period approaches the standard I propose. But the policy components permitted appear limited to those specified in the bill, and recourse to a variety of components seems optional, not the requirement it ought to be. Nor is there provision for systematic Congressional review of any oil-security policy the President may institute.

American Association of Petroleum Geologists

Statement of John A. Taylor
before the
Subcommittee on Energy and Agricultural Taxation
of the
Senate Finance Committee

January 30, 1987

Thank you for the opportunity to be here today Mr. Chairman. I am representing the 35,000 U.S. member portion of the total 43,000 members of the American Association of Petroleum Geologists (AAPG) headquartered in Tulsa, Oklahoma, since 1917. I am a past officer of that organization and currently am chairman of the Committee on Government Affairs and am also a nominee for President Elect. I am a geologist and engineer and have been in the petroleum industry since 1946, and have worked in most of the oil areas of the U.S.

Three weeks ago our President, Mr. Bernold Hanson from Midland, Texas, Mr. Lawrence Funkhouser (President-Elect), from San Francisco, Dr. William Fisher (Past President), from Austin, Texas and I visited here with several Senators, Congressmen and with principals in the Departments of Interior and Energy. We had dispatched a letter to President Reagan on December 29, 1986, setting forth our great concern with the direction our industry is headed which we believe is driving our country toward a day of reckoning that bodes much trouble. The petroleum industry is already in trouble as to its economic condition and is fighting for survival. Our own membership showed an unemployment rate of 25% in September last year, but we believe the rate is considerably higher when non AAPG members and the continuing attrition rate since that time are included. We are especially concerned with supply of oil and gas when it appears that 1986 will have the largest drop in proven reserves in our history. Indeed, we lost 700,000 barrels of oil per day production during 1986 which is an 8% drop in one year. It takes exploration activity backed up by drilling rigs to find oil and gas, yet we dropped to half of the 1985 drilling rate during 1986 and continue to decline, the largest drop by far in our history.

Our letter to President Reagan is included in this statement. It cites our condition and sets forth our recommendations on how exploration might be encouraged. Also included in this statement are a series of charts that vividly point to our plight and where we are going unless something is done. The descriptive narrative with each chart speaks for itself.

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American Association of Petroleum Geologists

An International Geological Organization

BERNOLD M. "BRUNO" HANSON
President

P.O. Drawer 1269
Midland, TX 79702
(915) 684-5826

December 29, 1986

The President
The White House
Washington, D. C. 20500

Dear Mr. President:

I currently serve as president of the American Association of Petroleum Geologists, an organization whose U. S. membership of 35,000 ranks as the largest association of earth scientists in the world.

AAPG can no longer stand by and watch the petroleum exploration infrastructure in the United States destroyed. In the 70-year history of AAPG, this condition has never been equaled. We are the professional group most closely involved in the exploration for and the production of oil and natural gas.

From 1979 to 1985, oil and natural gas production was stabilized in the 48 contiguous states. From 1982 through 1985, petroleum imports were reduced to about 28 percent with the price of oil at approximately $26 per barrel. We were able to increase domestic reserves under this pricing structure and it is in the national interest of our country that we continue these efforts.

The United States and our national security can ill afford to become more dependent on foreign oil. We must bridge the differential between today's price of oil and the minimum price per barrel amount that will rejuvenate a viable domestic exploration and reserve growth program.

We propose a combination of the following steps to reduce the differential:

1. Increasing the current import tariff to $5 per barrel.

2. Adoption of tax incentives for sustaining production and encouraging exploration. The tax incentives to supplement the import tariff should be:

   A. Royalty Credits for Exploration
   The federal government received a considerable amount of money in 1985 as royalty for oil and natural gas produced

The President
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on federal lands. Each producer should be allowed a credit of up to 50 percent of the royalty monies owed to be used for certifiable exploration activities.

B. A Tax Moratorium on New Discoveries
New oil and natural gas discoveries should be granted tax exclusions until prices recover to the $26 per barrel range. Any discovery well and a minimum of four successful follow-up wells should be free of tax for the first 18 months of production. This would stimulate exploration investment, particularly by the many independent operators who drill approximately 80 percent of the wells in the U. S. and who rely on outside investors for risk capital. The federal government would receive tax benefits from these discoveries over the remaining life of the field, typically representing 90 to 95 percent of a new field's income producing capabilities.

C. Certain Incentives Sustaining Production

a. Remedial Work on Wells
A direct tax credit offsetting expenditures should be given for remedial work on producing wells. This will enhance domestic production and increase reserves.

b. Enhanced Recovery Project
A major portion of discovered oil remains in the reservoir after primary recovery. Enhanced oil recovery techniques could recover much of this vast resource, but require a minimum price of $26 per barrel for start-up purposes. An investment tax credit covering the difference between current prices and $26 per barrel would stimulate these projects and develop currently identified resources that would otherwise be left in the ground.

There is profound geologic evidence to assure the American public that if the above outlined exploration and development incentives are granted, based on a $26 price equivalent per barrel, we can maintain stable levels of domestic production and prudent levels of imports. All measures of exploration and development activity have been plummeting in recent years and will continue to do so unless remedial measures are taken. The nation's interest is in jeopardy.

Respectfully Yours,

Bernold M. Hanson

Bernold M. Hanson

BMH/jl

Following are a series of exhibits and comments compiled by John A. Taylor to demonstrate the status of hydrocarbon exploration and production in the United States in response to the drop in price.

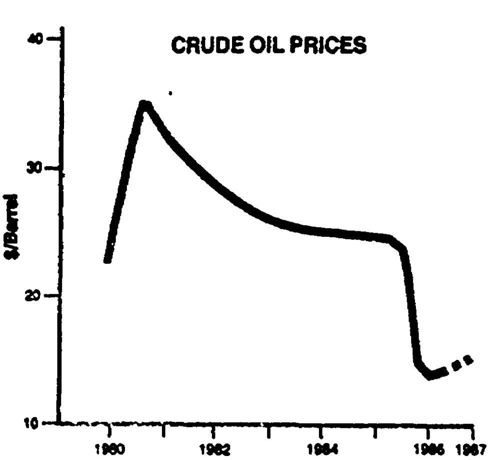

FIGURE 1 Source: Independent Petroleum Producers Association

Domestic crude oil prices have declined from $32 per barrel to $9 over the past several years, although recent cohesion within the OPEC states has brought the price back up to about $18. Annualized, 1986 prices would be about $13.20 per barrel. It may be hard to maintain the $18 price owing to the very large crude oil inventories stored worldwide. Finding costs in the United States range from $8-$11 per barrel, thus resulting in a lack of economic incentive for further oil reserve additions by exploratory drilling.

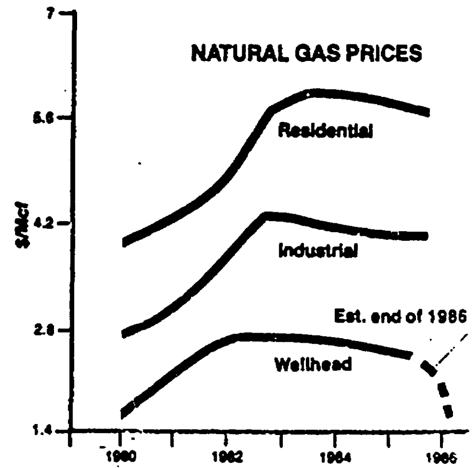

FIGURE 2 Source: Dept. of Energy

This chart, from the Department of Energy (DOE), shows the drastic cut in gas price to producers by pipeline companies over the past year, especially since March. Price is now estimated to be in the area of $1.5C per thousand cubic feet. Spot pricing was contributory t much of the drop. Annualized price in 1986 would be about $1.80 per thousand cubic feet.

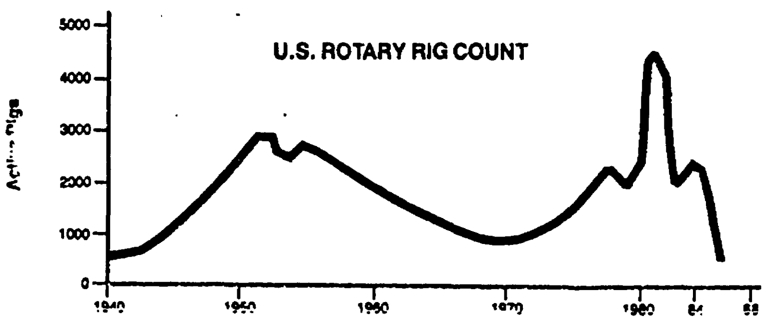

FIGURE 3 Source: Hughes Tool Co

It is easy to see that the graphical signature of the U.S. rig count is very similar to the crude oil price trend. The rig count is now the lowest since before World War II — the lowest since rig counts have been maintained. Without rigs running, oil and gas cannot be discovered. Note the similarities of the crude oil price graph and this one.

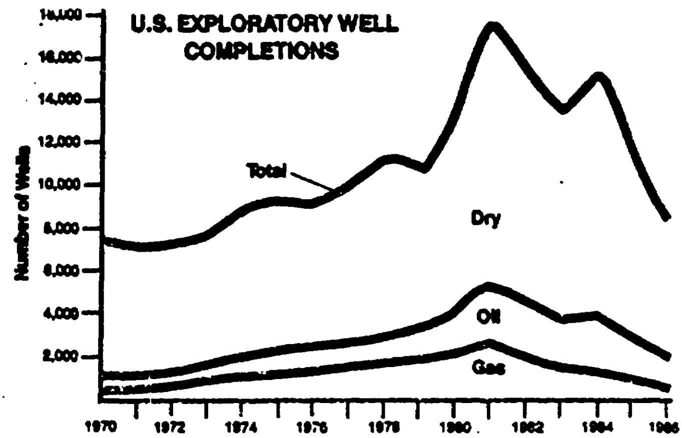

FIGURE 4

Source: American Petroleum Inst.

This demonstrates the rapid decline in the effort to find more oil and gas. The yield in new reserves per unit of effort would be even worse except for a significant increase in efficiency by industry — note the much greater decline in dry holes as compared to successful completions. The gain in gas completions as compared to that of oil in 1986 shows the shift of exploration efforts to the more favorable economics relative to gas, even though it too has suffered from price erosion.

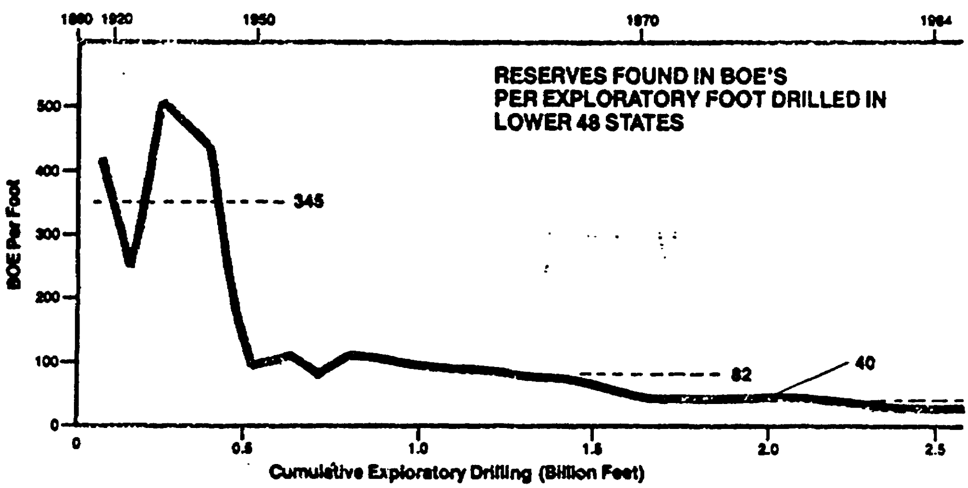

FIGURE 5

Reserves, plotted in barrels of oil equivalency (gas is valued at 6,000 cubic feet) and computed on a cumulative per-foot-drilled basis, reveals plateaus of yield. The first plateau from 1860 to the late 1940s averaged 345 BOEs per foot drilled. From 1950 to the late 1960s the yield plateaued at 82 BOEs per foot. We have been operating on a plateau of 40 BOEs per foot since that time. Even though the yield per foot has dropped, the value of the product has increased. The chart shows the abilities of geologists and improved recovery technology to provide a stable supply of reserves for prolonged price-stable periods. Industry only needs a reasonable, stable market and the encouragement to continue.

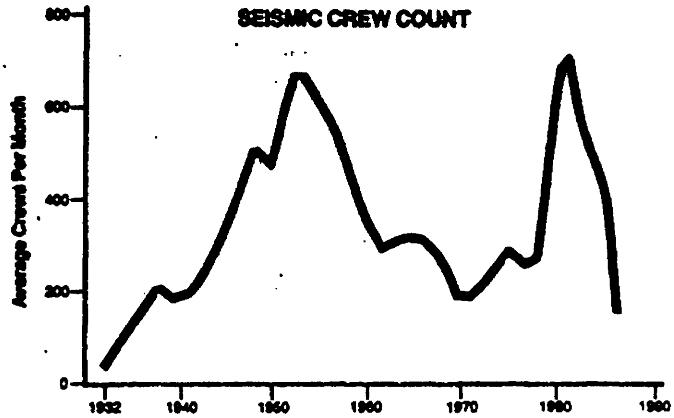

FIGURE 6

Source: Society Exploration Geophysicists

The seismic crew count is at its lowest since 1935. Records were first begun in 1932. Total land seismic crews plus marine seismic crews plummeted 56 percent, from 357 to 158 in the past year. Seismic crew activity has been one of the best indicators of future exploratory activity. This indicator demonstrates the dismantling of the U.S. petroleum industry to an extent never before seen in this century.

The situation is underscored by the results of an AAPG survey which showed an unemployment rate of 25 percent among Active members. We believe the rate to be even higher when other member categories and non-AAPG members are considered. Even the lay-offs in the early 1930s depression years did not approach these figures.

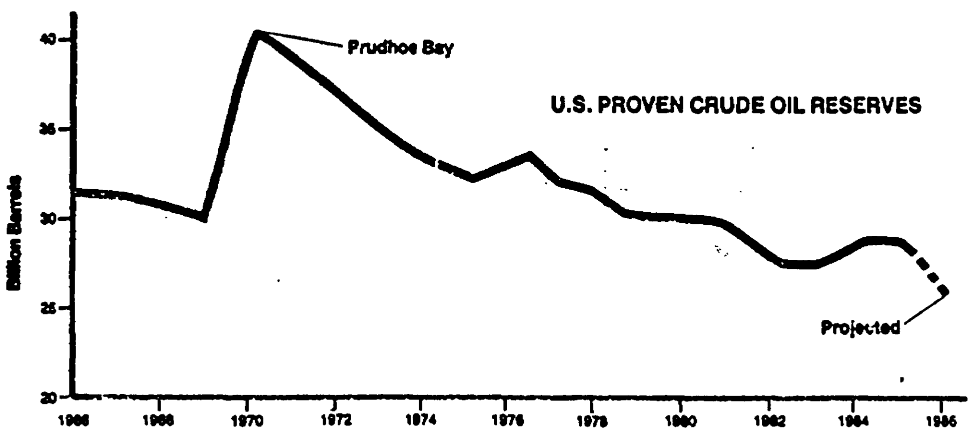

FIGURE 7

American Petroleum Institute
Energy Information Agency

From 1970 through 1978 proved crude oil reserves in the U.S. fell from 39 billion to 29.8 billion barrels. From 1979 through 1985, with increased levels of drilling, reserves dropped slightly, and in 1984 and 1985 U.S. reserves actually increased. But, 1986 figures will likely show a significant decline in oil reserves, perhaps to below 28 billion barrels. The combination of drastically reduced rig activity and write-downs in reserves due to decreased economics will cause this large drop. Thus, we become even more dependent upon foreign imports.

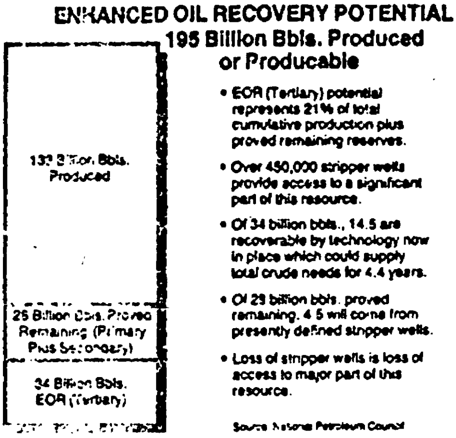

FIGURE 8

Stripper wells make up 15 percent of total crude oil production and their importance as a guardian to future supply is immense. They produce 10 barrels daily or less and are especially vulnerable to low prices. Economic projections indicate that at $10 per barrel, more than 40 percent of the stripper wells will be abandoned. At $15 it is estimated that 20 percent will be abandoned. Stripper wells provide access to the very large potential of remaining oil in place that cannot be produced by primary means or even from secondary recovery procedures. About two-thirds of the original oil in place still remains after these recovery processes have been undertaken. Enhanced oil recovery (EOR) projects such as steam, carbon dioxide, and chemical injection procedures must be employed to gain additional production.

Stripper wells are a national treasure, and yet stripper wells are now being plugged by large numbers owing to the artificially low prices for crude. A national resource is being destroyed. The capital investment to re-drill much of the EOR potential may be prohibitive.

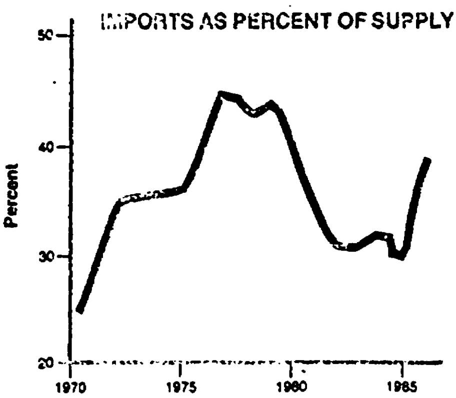

FIGURE 9

Industry was encouraged to increase supply in order to decrease our dependence on foreign imports, a program started in the mid-1970s. Imports had reached 46 percent in 1977, the highest ever. Industry effort brought that down to about 28 percent in 1983. But, by August 1986, it had increased to 40 percent. It is rapidly on its way to 50 percent because of the sharp drop in the drilling, the write down in reserves and the plugging out of much U.S. capacity owing to the poor economics of low priced crude oil.

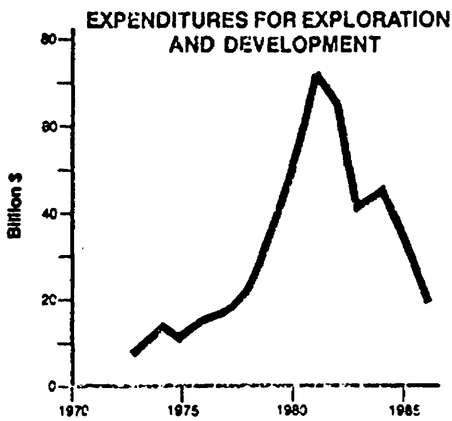

FIGURE 10 Source: H. F. Kepinger, Soc. Pet. Engrs.

This chart says it well. This figure indicated for 1986 is probably too high. When all the figures are in, it may be nearer to $15 billion rather than $18 billion. This is a drop from $33 billion in 1985 which in turn had dropped from a peak of $73 billion in 1981. Industry has continued to cut its expenditures leading to a continued re-trenching.

We have never asked for handouts but only reasonable incentives to balance the high risks we take. Furthermore, we have directed the Federal Government's attention to the strategic concerns on oil, and how the again increasing imports compromise that position by their effect on balance of payments and the cost of defending the sea lanes and overseas bases to guard those sources. The oil of the Persian Gulf is cheaply produced. Even today our government has dispatched an increased warship presence into the Persian Gulf. But, these costs of production are only the base of a pyramid, which includes price setting by OPEC, potential embargoes for political and stategic purposes, the interdiction of supplies by warring regional countries such as Iran and Iraq, and the task of defending the oil at its source and along its extensive and complex land and sea routes, against military predators and hostile regimes.

Mr. Chairman, we believe that we have been doing a good job in finding the oil and gas this country needs. We have done it well enough that, coupled with improving conservation measures, we had managed to bring the supply of oil and gas up in response to the demand in this nation and induce a price reduction thereby. This reduced imports from 46% in 1977 down to 28% in 1983 and thus enabled us to wield a much heavier hammer in the game of oil geopolitics. Now it's on its way back up, even reaching beyond 40%. We predict it will reach 50% much sooner than many of the public media and trade reports are projecting.

The country has a good thing going in those of us who will continue to devote high energy to the quest for petroleum if there are reasonable incentives to do so. Thank you, Mr. Chairman, for the chance to be here today and represent our views.

American Association of Petroleum Geologists

An International Geological Organization

BERNOLD M. "BRUNO" HANSON
President

P.O. Drawer 1269
Midland, TX 79702
(915) 684-5826

March 17, 1987

The Honorable Lloyd Bentsen
Chairman, Finance Committee
Room 205
Senate Dirkson Building
Washington, D. C. 20510

Dear Senator Bentsen:

I am formally enclosing the following information to supplement your Hearings on the "Impact of Imports on National Security" which is scheduled for March 25. Enclosed is a statement from John A. Taylor, chairman of our Governmental Affairs Committee, which he presented to the Senate Finance Committee on January 30, 1987. Also enclosed is a letter which I sent to President Reagan on December 29, 1986, and also some exhibits which further substantiate the critical issues affecting the future of the oil and gas industry in the United States.

While I was in Washington In January of this year, I had an opportunity to visit at length with Mr. Van McMurtry. He advised me that he thought the import tariff was a dead issue. Therefore, let us ignore that and go forward with some tax incentives as I have outlined in my letter to President Reagan. They are basically royalty credits for exploration on federal lands; a tax moratorium on new discoveries; and incentives to sustain production on remedial work on marginal wells; and, finally, tax relief on enhanced recovery projects. A fifth item that I would like to have would be the restoration of the depletion allowance to 27.5%.

Our organization deals with the exploration arm of the oil industry and it is through the efforts of geologists that we are responsible for and have found a great deal of oil in this country. We must get the price of oil up to the $26 per barrel equivalent on today's dollar so

The Honorable Lloyd Bentsen
Page 2
March 17, 1987

so that we can go forward and maintain stable levels of production and also reduce imports of crude oil and refined products.

I think Dr. William Fisher has supplied your committee with a great deal of information as to what we did in Texas from 1979 through 1985 when the price of oil was high enough for industry to go forward.

I appreciate all you are doing for industry and I hope that you can help this country in adding to our reserves that are so desperatly needed.

One of the most important issues that I think should be addressed would be the fact that the excess capacity that is available around the world, and this amounts to about five to eight million barrels, and if the Straits of Hormuz were blocked today, twice as much oil would be eliminated as is available in excess capacity around the world. This would leave the United States in very dire straits for its energy needs for the military.

As you well know, our industry is very capital intensive and in order for us to go forward with a viable exploration program, we definitely need some tax incentives so that we can attract non-industry money. I trust that this information will be of help to you and if you need anything else, please do not hesitate to contact us.

Yours very truly,

Bernold M Hanson

Bernold M. Hanson

BMH/jl
Encl.

American Association of Petroleum Geologists

An International Geological Organization

BERNOLD M. "BRUNO" HANSON
President

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March 17, 1987

The Honorable Philip R. Sharp
Chairman, Energy & Power Sub-committee
House Energy Commerce Committee
Room 2125
Rayburn House Office Building
Washington, D. D. 20515

Dear Mr. Sharp:

My understanding is that you are going to have a hearing in the House, entitled "U. S. Energy Security." I am enclosing the following information so that you might have some additional input during your hearing. Mr. John Taylor, chairman of our Governmental Affairs Committee, testified before the Senate Finance Committee on January 30, 1987, a copy of his statement is enclosed. On December 29, 1986, I wrote a letter to President Reagan addressing our concerns about the price structure of oil in the United States. I am also including some graphs and charts that we prepared and sent along to the President in an attempt to be straightforward with our facts and figures. Hopefully, you will be able to use these during your hearing.

When I wrote the letter to the President, oil was selling for $15 per barrel and we recommended increasing the import tariff to $5 per barrel to get it up to $20 and then add some tax incentives so that we could get the oil up to the $26 equivalent. We recommended that four tax incentives be adopted which would not cost the American public any additional fees at the gasoline pump and so that we can go forward to find the oil and gas reserves that are so desperately needed in this country. They were royalty credits on government lands; a tax moratorium on new discoveries; incentives to sustain production with remedial work on marginal wells; and, of course, enhanced recovery projects and tax benefits to the equivalent of $26 per barrel. In additional to this,

The Honorable Philip R. Sharp
Page 2
March 17, 1987

I highly recommend that you consider getting the depletion allowance up to 27.5 percent so that we can go forward and look for and find the necessary reserves that can be found by the geologic arm of the industry.

As you no doubt are well aware, this is a very capital intensified industry and in order for us to get outside capital, we desperately need these tax incentives. We are not asking for a handout, but only an opportunity to find the oil and gas in the United States.

I think one of the greatest concerns that you and your committee should address is the excess capacity of oil that is available around the world. At the present time, there is approximately eight million barrels of that oil, but if the Straits of Hormuz were blocked today or tomorrow, that would mean that twice as much oil would be lost as is available in excess capacity around the free world. This is indeed an alarming fact and I hope that you can convince your committee members to realize this important aspect of excess capacity.

If I can be of any further help to you or to your committee, please do not hesitate to call on me.

Yours very truly,

Bernold M. Hanson

Bernold M. Hanson

BMH/jl
Encl.