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TESTIMONY OF

FRANK G. ZARB

ADMINISTRATOR

FEDERAL ENERGY ADMINISTRATION

BEFORE THE

SENATE FOREIGN RELATIONS COMMITTEE

SUBCOMMITTEE ON NEAR EAST AND SOUTH ASIAN AFFAIRS

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MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE,

IT IS A PLEASURE TO BE HERE TODAY, I FEEL THAT THESE HEARINGS, AND ONE OR TWO OTHERS IN WHICH I HAVE PARTICIPATED RECENTLY, ARE VERY VALUABLE IN THAT THEY SERVE AS A REMINDER AND DEMONSTRATION OF THE IMPORTANCE OF INTERNATIONAL CONSIDERATIONS TO OUR NATIONAL ENERGY POLICY. THEY SERVE TO REMIND US THAT WE MUST MAKE A REALISTIC APPRAISAL OF OUR DEPENDENCE ON IMPORTED OPEC (1) OIL AND DEVELOP A CONSTRUCTIVE RELATIONSHIP BETWEEN THE OIL PRODUCING AND CONSUMING COUNTRIES.

I WOULD LIKE TO TAKE THIS OCCASION TO OUTLINE FOR YOU SOME OF THE DISCUSSION I HAVE RECENTLY HELD WITH ENERGY LEADERS OF

VARIOUS GOVERNMENTS, INCLUDING OPEC MEMBERS, AND TO PROVIDE YOU WITH MY THINKING ON ISSUES RELATED TO THE TOTAL ENERGY POLICY OF THE UNITED STATES, INCLUDING THE INTERNATIONAL RAMIFICATIONS OF OUR DEPENDENCE ON MIDDLE EAST OIL.

OUR AIM IS TO ENSURE ADEQUATE SUPPLIES OF CRUDE OIL TO MEET U.S. NEEDS, AND TO OBTAIN THOSE SUPPLIES AT REASONABLE AND STABLE PRICES. THIS IS A GENERAL STATEMENT, AND IS PROBABLY A SHARED GOAL OF EVERYONE CONCERNED WITH ENERGY.

TO HELP US REACH THIS AIM, IT WILL BE BENEFICIAL TO HAVE A CLEAR UNDERSTANDING OF OPEC. THE OPEC CARTEL WAS ESTABLISHED IN 1960 WITH FIVE MEMBERS IN REACTION TO A REDUCTION IN POSTED PRICES BY THE MAJOR OIL COMPANIES. ALTHOUGH OPEC'S ONLY SUCCESS FOR OVER A DECADE WAS TO PREVENT PRICES FROM BEING LOWERED, OTHER COUNTRIES JOINED THE ORIGINAL GROUP SO THAT BY 1976, OPEC MEMBERSHIP IS AT 13. OPEC'S PRINCIPAL OBJECTIVE IS "THE UNIFICATION OF PETROLEUM POLICIES FOR THE MEMBER COUNTRIES AND THE DETERMINATION OF THE BEST MEANS FOR SAFEGUARDING THE INTERESTS OF MEMBER COUNTRIES INDIVIDUALLY AND COLLECTIVELY." THE ORGANIZATION CHARGE IS TO DEVISE WAYS AND MEANS OF ENSURING THE STABILIZATION OF PRICES IN INTERNATIONAL OIL MARKETS TO SECURE A STEADY INCOME TO ALL PRODUCING COUNTRIES AND A FAIR RETURN ON THEIR RESOURCE.

THE CARTEL HAS SHOWN TREMENDOUS SUCCESS AT ACHIEVING THESE AIMS. TODAY WE MUST RECOGNIZE THE FACT THAT AT THIS TIME OPEC HAS NEARLY EXCLUSIVE CONTROL OVER INTERNATIONAL OIL PRICES. OPEC IS ABLE TO LIMIT PRODUCTION TO THE LEVEL OF DEMAND AT THE PRICES IT SETS. NONE OF THE MEMBERS HAS SHOWN AN INCLINATION TO EMPLOY ITS SURPLUS PRODUCTION CAPACITY TO UNDERMINE THE PRICE LEVEL DETERMINED JOINTLY BY OPEC.

UNITED STATES DOMESTIC AND INTERNATIONAL ENERGY POLICIES SHOULD BE DESIGNED TO MINIMIZE THE LIKELIHOOD AND IMPACT OF ANOTHER EMBARGO AND TO SHIFT, OVER TIME THE SUPPLY/DEMAND RELATIONSHIP WHICH NOW OBTAINS IN THE INTERNATIONAL OIL MARKET. GIVEN THE REQUIREMENTS OF THE U.S. AND ITS ALLIES FOR OPEC OIL, THE SENSITIVITY OF OUR DOMESTIC ECONOMY AND OF OUR BALANCE OF PAYMENTS TO OIL PRICES, AND OUR VULNERABILITIES TO INTERRUPTED SUPPLIES, OUR PLAN MUST BE ONE WHICH WILL REDUCE OUR DEPENDENCE ON OPEC OIL BY DEVELOPING ALTERNATE SOURCES OF OIL AND GAS, ALTERNATE FORMS OF ENERGY, AND GENERALLY REDUCING CONSUMPTION. IN ADDITION WE MUST DEVELOP SUFFICIENT STOCKPILING TO PROVIDE A CUSHION AGAINST POTENTIAL FUTURE DISRUPTIONS.



FROM A STANDPOINT OF SOUND ECONOMIC, AS WELL AS NATIONAL SECURITY, THE UNITED STATES HAS NO ALTERNATIVE. IF WE

PURSUE SUCH A PLAN VIGOROUSLY WE WILL NOT ONLY IMPROVE OUR OWN POSTURE BOTH ECONOMICALLY AND POLITICALLY, BUT WILL CONTINUE TO STIMULATE SIMILAR ACTIVITIES IN OTHER CONSUMING NATIONS THEREBY BRINGING A BETTER BALANCE TO THE INTERNATIONAL OIL MARKET.

THIS KIND OF APPROACH NEED NOT, AND SHOULD NOT, BE CONSIDERED CONFRONTATIONAL. INDEED, WHILE WE ARE PUTTING OUR OWN ENERGY HOUSE IN ORDER WE SHOULD CONTINUE TO PURSUE A POLITICAL ENVIRONMENT OF COOPERATION WITH OTHER CONSUMERS, AS WELL AS THE POTENTIAL BASED ON THE RECOGNITION ON A CONTINUED BUT CHANGING STATE OF INTERDEPENDENCE.

IF WE CAN TAKE STEPS TO REDUCE OUR ENERGY CONSUMPTION AND BRING ON ALTERNATIVE SOURCES OF SUPPLY, THEN WE WILL BEGIN LIMITING TO SOME EXTENT THE PRICE DOMINANCE OF THOSE WHO NOW CONTROL THE WORLD'S "EXCESS CAPACITY." AND, BECAUSE OF THE SIZE OF THE U.S. SHARE OF THE WORLD ENERGY MARKET, SUCH A COMPREHENSIVE NATIONAL ENERGY PROGRAM WOULD PROVIDE STRONG U.S. LEADERSHIP IN PROMOTING GREATER INTERNATIONAL STABILITY AND COOPERATION, THUS FURTHER INCREASING THE PROSPECTS FOR STABLE WORLD OIL PRICES, AND SECURE SOURCES OF SUPPLY.



DURING THE PAST FEW MONTHS, I HAVE HAD THE OPPORTUNITY TO VISIT VENEZUELA, SAUDI ARABIA, IRAN AND KUWAIT, AMONG THE OPEC COUNTRIES, AND EGYPT, ISRAEL, JAPAN AND THE U.K., AND TO DISCUSS WITH ENERGY LEADERS A WIDE RANGE OF ENERGY ISSUES. I WOULD LIKE TO SHARE WITH YOU PARTICULARLY SOME PERSONAL OBSERVATIONS WITH RESPECT TO THE OPEC COUNTRIES.

FIRST, OIL FOR OPEC MEMBERS IS A POLITICAL AS WELL AS ECONOMIC COMMODITY. THE FEELING IS WIDESPREAD THAT THE DEVELOPED WORLD HAS BEEN SUBSIDIZED BY THE OIL PRODUCERS FOR TOO LONG. OPEC "GOT OUR ATTENTION" IN 1973-74 WITH THE EMBARGO AND THE ATTENDANT PRICE RISE, AND THEY INTEND TO CONTINUE TO OBTAIN ECONOMIC BENEFITS FOR THEMSELVES AND, TO A LESSER DEGREE, FOR THE NON-OIL PRODUCING DEVELOPING COUNTRIES. THEIR SPECIFIC ECONOMIC GOALS INCLUDE MAXIMIZING OIL REVENUES, INDUSTRIALIZING THEIR COUNTRIES, AND IMPROVING LIVING STANDARDS.

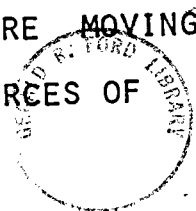


SECOND, PROGRESS TOWARDS PEACE IN THE MIDDLE EAST IS AN INTEGRAL PART OF THE "TOTAL PACKAGE" THAT WILL MITIGATE THE "POLITICS OF OIL" FOR THE ARAB MEMBERS OF OPEC, WHO (2) ALONG WITH THREE OTHER ARAB STATES ARE MEMBERS OF OAPEC (THE ORGANIZATION OF ARAB PETROLEUM EXPORTING COUNTRIES). OAPEC IS AN ECONOMIC INSTITUTION, IN PART, PROMOTING ECONOMIC DEVELOPMENT FINANCED BY OIL REVENUES IN ITS MEMBER STATES, BUT IT IS ALSO A POLITICAL COORDINATING UNIT WITH RESPECT TO OIL, DESIROUS OF INFLUENCING THE OUTCOME OF PEACE IN THE MIDDLE EAST. REMEMBER, IT WAS OAPEC, ~~NO~~ OPEC THAT INSTITUTED THE EMBARGO. HOWEVER, IT WAS OPEC THAT RAISED PRICES AFTER THE EMBARGO.

I SEE NO EVIDENCE TO SUGGEST THAT MARKET FORCES WILL CAUSE OIL PRICES TO COME DOWN, PARTICULARLY IF THE WORLD ECONOMY CONTINUES TO RECOVER AND PRICES OF INDUSTRIAL GOODS CONTINUE UPWARD. SAUDI ARABIA AND KUWAIT WILL PROBABLY FIND IT POLITICALLY UNATTRACTIVE TO CONTINUE TO OPPOSE PRICE INCREASES IN THE FACE OF A CLEAR CONSENSUS OF REVENUE HUNGRY FELLOW OPEC MEMBERS. ON BALANCE FOR SAUDI ARABIA, OPEC STABILITY WILL BE MORE IMPORTANT THAN PRICE LEADERSHIP. SUBSEQUENT TO THE BALI OPEC MEETING, IN RESPONSE TO MY QUESTION, ONE MINISTER SAID THAT IN DECEMBER THE PRICE INCREASE WILL BE "A MINIMUM TEN PERCENT." WHEN ASKED WHY IT WAS NECESSARY TO RAISE PRICES, HE REPLIED IN ALL CANDOR

"BECAUSE THERE'S AN OPPORTUNITY TO DO SO."

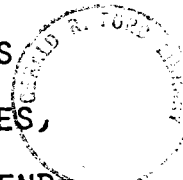
FOURTH, AT THE SAME TIME, THERE IS GENUINE CONCERN ABOUT WHAT THE U.S. MIGHT DO TO REMOVE ITSELF FROM THE WORLD MARKET THROUGH DEVELOPMENT OF ITS OWN AMPLE RESOURCES. THE STRATEGIC PETROLEUM RESERVE ALSO CAME IN FOR CRITICISM, INCLUDING AN OAPEC NEWSLETTER EDITORIAL CLAIMING IT WAS AIMED AT UNDERCUTTING OPEC (MORE LIKELY OAPEC) UNITY TO DEFUSE THE POWER OF OIL AND ISOLATE IT AS AN ISSUE FROM THE OVERALL MIDDLE EAST QUESTION. I SPENT A GREAT DEAL OF TIME DEFENDING OUR DOMESTIC ENERGY PROGRAMS, POINTING OUT THE ECONOMIC BENEFITS OF CONSERVATION AND DEVELOPMENT OF ALTERNATE ENERGY SOURCES (FOR EXAMPLE, REDUCED FOREIGN EXCHANGE DRAIN, "IMPORTED OIL IS OUR MOST EXPENSIVE ENERGY RESOURCE") AS WELL AS THE SECURITY ASPECTS (FOR EXAMPLE, "IF THE CHARGE IS DEFENDING OUR NATIONAL INTEREST, THEN INDEED I'M GUILTY"); I ALSO SPENT A GOOD DEAL OF TIME SUGGESTING COOPERATION IN THE FIELDS OF INFORMATION EXCHANGE, ENERGY R&D, JOINT PROJECTS, AND THE LIKE. INITIALLY OUR CLAIMS OF COMPETITIVE COAL AND NUCLEAR OPTIONS AND INCREMENTAL OIL AND GAS WERE MET WITH SKEPTICISM, BUT LATER CONCERN ABOUT POSSIBLE LOSSES IN MARKET POSITION AS IT BECAME CLEAR THAT WE ARE MOVING FORWARD IN OUR QUEST TO PROVIDE ALTERNATIVE SOURCES OF ENERGY AND DECREASE CONSUMPTION.



I DO NOT WISH TO SUGGEST THAT WE HAVE BROKEN THE OPEC PRICE HOLD, OR FOR THAT MATTER, THAT WE ARE VERY LIKELY TO BREAK IT OVER THE NEXT 10 YEARS. FAR FROM IT. THE DEGREE OF SUCCESS OPEC HAS ENJOYED SINCE 1970 WHEN IT BEGAN TO OPERATE COHESIVELY COMPARED TO THE PREVIOUS 10 YEARS IS INCENTIVE ENOUGH FOR THE MEMBERSHIP TO WORK OUT ITS DIFFERENCES. BUT THEY ARE BEGINNING TO SEE THE LIMITS TO THEIR POWER AND TO MORE CAREFULLY ACCESS OUR PROGRESS TOWARD LOWERED DEPENDENCE. THEY ARE STILL PLANNING TO BUILD REFINERIES AND PETROCHEMICAL PLANTS AND FINANCE THEM WITH CRUDE EXPORT EARNINGS FROM HIGHER PRICED OIL. BUT THEY ARE BEGINNING TO WONDER. THIS IS NOT THE TIME FOR US, THEREFORE, TO REST ON OUR MODEST LAURELS. THERE ARE AREAS OF COOPERATION TO BE EXPLORED WITH OPEC MEMBERS. AT THE SAME TIME AT HOME, THE ECONOMIC INCENTIVES FOR CONSERVATION AND RESOURCE DEVELOPMENT PRESENT THE MEANS TO INCREASE OUR STRENGTH. ONLY THE COMMITMENT IS NEEDED.

WITH THIS INTRODUCTION I WOULD LIKE TO TURN TO A MORE SPECIFIC DISCUSSION OF THE OIL FACTOR IN OUR MIDDLE EAST POLICY.

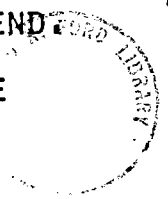
IN VOLUME TERMS, THE IMPORTANCE OF OPEC IS STAGGERING. THE FREE WORLD NOW USES ABOUT 50 MILLION BARRELS OF OIL PER DAY. SOME 60 PERCENT OF IT IS PRODUCED IN OPEC NATIONS. THE INTERNATIONAL OIL INDUSTRY KEEPS 800 MILLION BARRELS OF OIL MOVING AT ALL TIMES: IT LIFTS, TRANSPORTS, REFINES, AND MARKETS 9 BILLION BARRELS PER YEAR OF OPEC OIL FOR END-USE CONSUMPTION.



OPEC'S PROPORTION OF WORLD RESERVES IS EQUALLY STAGGERING. OVER 68 PERCENT OF THE WORLD'S PROVED RESERVES ARE IN OPEC COUNTRIES; ABOUT 50 PERCENT ARE IN ARAB OPEC COUNTRIES. SAUDI ARABIA ALONE HAS 23 PERCENT OF THE TOTAL AND PROSPECTS FOR FINDING SIZEABLE ADDITIONAL SUPPLIES THERE ARE GOOD.

THE U.S. ALONE CONSUMES ABOUT ONE-THIRD OF THE WORLD'S DAILY OIL PRODUCTION, OVER 16 MMBD. OUR TOTAL OIL IMPORTS (CRUDE AND PRODUCT) AMOUNT TO 6.5 MMBD CURRENTLY, LARGELY FROM OPEC SOURCES. BEFORE THE 1973-74 EMBARGO, CRUDE OIL FROM ARAB NATIONS MADE UP ABOUT 22 PERCENT OF U.S. OIL IMPORTS. THEY AMOUNT TO NEARLY 45 PERCENT NOW. SAUDI ARABIA HAS BEEN THE NUMBER 1 SUPPLIER OF U.S. CRUDE OIL IMPORTS SINCE NOVEMBER 1975 AND WAS SECOND FOR THE WHOLE OF 1975. OTHER MAJOR SUPPLIERS ARE NIGERIA, LIBYA, INDONESIA, ALGERIA, CANADA, THE UNITED ARAB EMIRATES, IRAN AND VENEZUELA. AMONG OUR MAJOR SUPPLIERS, ONLY CANADA IS NOT A MEMBER OF OPEC, AND AS YOU KNOW CANADA RAPIDLY IS PHASING OUT ITS EXPORTS TO US.

RECENT, WIDELY PUBLICIZED FIGURES SHOWING U.S. IMPORTS EXCEEDING DOMESTIC PRODUCTION MAY BE CONSIDERED A SHORT TERM FLUKE BUT THEY ARE INDICATIVE OF A LONG TERM TREND. THE TREND SHOULD BE OF CONCERN; IT IS NOT GOING TO BE REVERSED QUICKLY.



THE PRESIDENT HAS PROPOSED A PROGRAM OF CONSERVATION AND RESOURCE DEVELOPMENT, WHICH, IF IMPLEMENTED, COULD GIVE THIS COUNTRY SOME ENERGY SECURITY BY 1980 AND MORE BY 1985, TO SUSTAIN A SUPPLY INTERRUPTION WITH MANAGEABLE ECONOMIC DISRUPTION. UNLESS MAJOR PORTIONS OF THIS PROGRAM ARE ADOPTED TO STIMULATE PRODUCTION AND CURTAIL DEMAND THE UNITED STATES COULD BE IMPORTING MORE THAN 10 MMBD OF OPEC OIL BY 1985. AS MUCH AS 55 PERCENT OF THAT PROJECTED TOTAL U.S. IMPORT DEMAND WOULD COME FROM ARAB SOURCES.

IT IS CORRECT TO POINT OUT THAT OUR FORECAST OF INCREASED IMPORT DEPENDENCE IS ONE OF THE REASONS WE NOW HAVE MANDATED A STRATEGIC STORAGE SYSTEM. UNITED STATES STRATEGIC RESERVES ARE SCHEDULED TO EQUAL AT A MINIMUM 500 MILLION BARRELS AND AS MUCH AS 1 BILLION BARRELS. THE BILLION BARREL LEVEL WOULD PROTECT US AGAINST A POSSIBLE SHORTFALL OF AS MUCH AS 3 MILLION BARRELS PER DAY FOR ALMOST A YEAR. WHILE THIS RESERVE WOULD PUT US INTO MUCH BETTER SHAPE THAN WE WERE IN 1973-74, AND WHILE THE INTERNATIONAL EMERGENCY PROGRAM (IEP) WOULD HELP CONSIDERABLY TO BALANCE SUPPLY SHORTFALLS AMONG PARTICIPATING COUNTRIES, WE CANNOT CONTINUE TO PUT OF



DECISIVE ENERGY POLICIES -- UNLESS WE WANT TO SEE OUR SUCCESSORS IN THESE SAME SEATS IN 1985 ASKING THE SAME QUESTIONS WE ARE FACING TODAY AND GIVING MORE GRIM ANSWERS.

I MENTION THESE POINTS BECAUSE IT IS IMPORTANT TO APPRECIATE THE SIGNIFICANCE OF THE EXTENT TO WHICH THE U.S. WILL HAVE TO DEPEND ON INTERNATIONAL SUPPLIES OF OIL IN THE FUTURE -- IF WE ARE UNWILLING TO COMMIT OURSELVES TO STRIVE FOR A SIGNIFICANT REDUCTION IN OUR LEVEL OF IMPORTS THROUGH EXPANSION OF ENERGY PRODUCTION AND REDUCTION OF ENERGY CONSUMPTION.


WE MUST MOVE FORWARD SWIFTLY PARTLY BECAUSE MANY ALTERNATIVE ENERGY SOURCES NEED LONG LEAD TIMES BUT ALSO BECAUSE EVENTS IN THE PRODUCER COUNTRIES ARE ADVANCING SWIFTLY.

AT THE BEGINNING OF THE 1970'S, THE WORLD OIL MARKET WAS DOMINATED BY INTERNATIONAL OIL COMPANIES HEADQUARTERED IN THE U.S., NETHERLANDS, AND THE U.K. THOSE CONDITIONS GENERALLY ASSURED A SUPPLY OF OIL AT PREDICTABLE AND STABLE PRICES, BECAUSE UNDER THEIR PRODUCING CONCESSIONS, THE COMPANIES DETERMINED THE RATE OF OIL DEVELOPMENT AND PRODUCTION AS WELL AS THE PRICE OF CRUDE MARKETED INTERNATIONALLY. MOREOVER, THE INTERNATIONAL

OIL INDUSTRY MAINTAINED CONTROL OVER EXCESS PRODUCTION
CAPACITY IN VARIOUS OIL PRODUCING COUNTRIES

THAT CONTROL, TOGETHER WITH THE FACT THAT THE UNITED STATES HAD EXCESS OIL PRODUCTION CAPACITY OF ITS OWN RENDERED THE OIL SUPPLY DISRUPTIONS ATTEMPTED IN THE 1950'S AND 1960'S INEFFECTIVE AND SHORTLIVED.

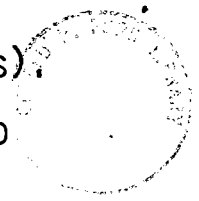
TODAY HOWEVER, PRICES AND TERMS OF ACCESS TO OIL, AND THE PRODUCTION LEVELS FOR THE INTERNATIONAL OIL MARKET ARE SET BY THE OPEC MEMBER STATES. THEIR OWN NATIONAL OIL COMPANIES ARE MOVING TO ESTABLISH REFINERIES AND RELATED FACILITIES IN THEIR OWN COUNTRIES TO TRANSPORT AND MARKET PETROLEUM PRODUCTS INTERNATIONALLY, A DEVELOPMENT WHICH WILL FURTHER STRENGTHEN OPEC CONTROL OVER WORLD OIL MARKETS. A SUBSTANTIAL AMOUNT OF EXCESS PRODUCTION CAPACITY EXISTS IN THE OIL EXPORTING COUNTRIES; HOWEVER THOSE COUNTRIES HAVE SHUT-IN ONE-FOURTH OF THEIR PRODUCTIVE CAPACITY TO SUSTAIN A WORLD PRICE MORE THAN FIVE TIMES THE 1973 LEVEL. THE CHANGES IN CONTROL OVER ESTABLISHED OIL PRODUCTION AS WELL AS THE RELATIVE DEARTH OF IMMEDIATE ALTERNATIVE SOURCES OF ENERGY SUPPLY MEAN THAT WE CAN PROBABLY EXPECT CONTINUED UPWARD PRICE PRESSURE FROM OPEC



AND POSSIBLY FURTHER PRODUCTION CUTBACKS UNLESS THE MEMBER STATES OF OPEC PERCEIVE THAT SUCH ACTIONS WOULD BE TO THEIR OWN DISADVANTAGE.


WITH RESPECT TO PROBLEMS OF PRICE AND SUPPLY GENERALLY, POTENTIAL PURCHASERS CAN ENJOY LOWER OPEC PRICES ONLY IF OPEC NATIONS COMPETE WITH EACH OTHER, OR WITH OTHER ALTERNATIVE SUPPLIERS, TO SELL MORE FOR LESS. CONTROL OVER SUPPLY NOT SHOWN A GREAT WILLINGNESS TO CUT PRICES TO COMPETE WITH EACH OTHER. IF ALTERNATIVE NON-OPEC SOURCES OF SUPPLY COULD BE DEVELOPED, THEN OPEC NATIONS MIGHT FACE SOME GREATER DEGREE OF SELLING COMPETITION.

TERMS OF ACCESS TO OPEC CRUDE OIL RESOURCES ARE BOUND TO CHANGE. EVEN NOW OPEC COUNTRIES, IN THE MIDDLE EAST AT LEAST, ARE INCREASINGLY INSISTENT ON OIL INDUSTRY PARTICIPATION IN INDUSTRIALIZATION PROJECTS, MOST IMPORTANTLY IN EXPORT REFINERIES, PETROCHEMICAL FACILITIES, AND GAS LIQUEFACTION PLANTS IN EXCHANGE FOR SECURE CRUDE OIL SUPPLIES. IN ARABIA, IRAN, AND KUWAIT ALONE PLANS FOR NEW REFINERIES -- IF COMPLETED ON SCHEDULE -- WOULD ADD AS MUCH AS 3.5 MMBD TO CAPACITY BY THE MID-1980'S (CRUDE EXPORT CAPACITY BY 1985 IS ESTIMATED AT 23 MMBD FOR THE THREE NATIONS). MODERNIZATION PLANS FOR EXISTING FACILITIES COULD ADD



AN ADDITIONAL 1 MMBD. PRESENT REFINERY CAPACITY IN THESE THREE NATIONS IS ABOUT 2 MMBD. (TOTAL PRODUCT EXPORTS FROM THESE COUNTRIES IN 1975 WAS 1.1 MMBD. THEIR TOTAL CRUDE EXPORTS EQUALED ABOUT 14 MMBD.) SEVEN OTHER OPEC COUNTRIES HAVE PLANS WHICH WOULD ADD AN ADDITIONAL 4.3 MMBD IN REFINERY CAPACITY.


MUCH OF THE PRODUCT FROM THESE PLANNED FACILITIES IS MEANT FOR THE EXPORT MARKET. NEW PROBLEMS WILL HAVE TO BE FACED AND OVERCOME IF THE PRODUCERS ARE TO SUCCEED IN THEIR EFFORTS. THEY WILL HAVE TO COMPETE WITH GROWING REFINERY CAPACITY WORLDWIDE AND WILL FACE STIFF OPPOSITION FROM CONSUMER COUNTRIES WHOSE FUTURE PLANS INCLUDE INCREASING CRUDE AND DECREASING PRODUCT IMPORTS. THE EXTENT TO WHICH OPEC NATIONS EITHER INDIVIDUALLY OR IN CONSORT, WILL TRY TO IMPOSE A REQUIREMENT TO BUY A CERTAIN PERCENTAGE MIX OF CRUDE PRODUCT IS DIFFICULT TO DETERMINE. BUT IT IS A REAL THREAT. HOW SUCCESSFUL OPEC WOULD BE IN CARRYING OUT A THREAT WOULD DEPEND HEAVILY ON THE SHAPE OF WORLD DEMAND AT THE TIME; IF SURPLUS CRUDE AND REFINERY CAPACITY WERE AVAILABLE; AND IF CONSUMERS WERE ABLE TO "SHOP" FOR MORE FAVORABLE TERMS. OTHER PROBLEMS, SUCH AS THE INTERCHANGABILITY OF TANKERS FROM CRUDE TO PRODUCT AND BACK AGAIN WILL HAVE TO BE CONSIDERED.



FOR THE MAJOR OIL COMPANIES, THE ECONOMICS OF MIDDLE EAST REFINERIES HAVE ONLY LIMITED ATTRACTION. EVEN THE NEW REFINERIES, WITH THE EXCEPTION OF KUWAIT'S, WILL NOT HAVE THE SOPHISTICATED CRACKING AND REFORMING EQUIPMENT OF HIGH OCTANE GASOLINE PRODUCING UNITS. HIGHER VALUE YIELDS WILL BE REALIZED IN CONSUMER COUNTRY REFINERIES. IN MOST OPEC COUNTRIES, INCENTIVE WAGES FOR IMPORTED SKILLED LABOR MUST BE PAID AND ALMOST ALL CONSTRUCTION MATERIAL WILL HAVE TO BE IMPORTED. NEVERTHELESS, PLANS SEEM TO CALL FOR THE REFINERIES TO BE BUILT ANYWAY, AS ONE MIDDLE EAST OFFICIAL SUGGESTED "TO REPLACE WORN OUT EUROPEAN REFINERIES".

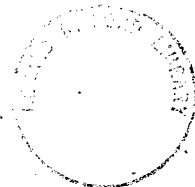
I WOULD LIKE TO DISCUSS FOR A MOMENT SOMETHING I MENTIONED EARLIER -- THE PRIMARY ROLE OF SAUDI ARABIA IN OUR SUPPLY SITUATION AND IN THE WHOLE ENERGY PICTURE.

SAUDI ARABIA HAS A UNIQUE ROLE IN OPEC WHICH HAS BEEN DEMONSTRATED BY ITS ACTIONS IN VIENNA LAST FALL AND IN BALI IN MAY. THE COUNTRY IS THE WORLD'S LARGEST OIL EXPORTER, HAS THE WORLD'S LARGEST SUPPLY OF PROVEN RESERVES, AND HAS THE MOST OIL PRODUCING CAPACITY SHUT-IN (4 MMBD). THE SAUDIS HAVE HAD A LONG AND POSITIVE ASSOCIATION WITH U.S. OIL COMPANIES AND ARE CURRENTLY NEGOTIATING WITH THE U.S. OPERATING COMPANY, ARAMCO, TO COMPLETE 100 PERCENT OWNERSHIP OF THE COMPANY'S PRODUCING ASSETS IN SAUDI ARABIA.



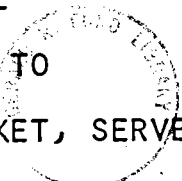
IN THE NEGOTIATIONS THUS FAR, IT HAS BEEN DETERMINED
THAT:

- ARAMCO WILL REMAIN THE OPERATING ENTITY FOR SAUDI ARABIA, MOVING THE BULK OF SAUDI ARABIA'S PRODUCTION TO MARKET THROUGH ITS PARENT COMPANIES, AND CONTINUING TO SPEARHEAD EXPLORATION AND DEVELOPMENT AND TO PROVIDE SERVICES RELATED TO OIL AND GAS PRODUCTION.
 - ARAMCO WILL REMAIN A 100 PERCENT U.S.-OWNED SERVICE COMPANY, WITH SAUDI ARABIA TAKING OVER FULL OWNERSHIP OF RESERVES, OUTPUT AND MOST PHYSICAL PRODUCING ASSETS, TAPLINE EXPECTED, THAT ARE CONTAINED IN SAUDI ARABIA.
 - ARAMCO WILL AGREE TO MARKET A MINIMUM OF 7 MILLION BARRELS OF OIL A DAY. VOLUMES LIFTED BY ARAMCO WOULD VARY WITH MARKET CONDITIONS AND WITH SAUDI PERCEPTIONS OF ARAMCO'S EXPLORATION EFFORTS.
 - PENALTIES FOR UNDERLIFTING WOULD NOT BE ON A "TAKE-OR-PAY" BASIS BUT WOULD BE "SIGNIFICANT."
- NO FURTHER DETAILS ARE NOW AVAILABLE ON THIS SCORE. CONTRACT DISCUSSIONS ARE NOT COMPLETE AT THIS TIME.



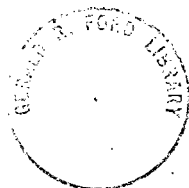
THE DEVELOPMENT OF LONG TERM CONTRACT SALES IS SIGNIFICANT FOR A NUMBER OF REASONS. SAUDI ARABIA HAS GIVEN NOTICE THAT IT WANTS TO SELL OIL AT A PREDICTABLE AND ACCEPTABLE LEVEL. THE COMPANIES WILL REMAIN THE LINKAGE MECHANISM BETWEEN SAUDI ARABIA AND THE CONSUMERS. LAST AND PERHAPS THE MOST SIGNIFICANT, THE IMPACT ON COMPETITION FOR MARKET SHARES WITHIN OPEC COULD BE CONSIDERABLE IF DEMAND FOR OPEC OIL IS DEPRESSED. AN OFFTAKE BY ARAMCO OF 7 MMBD OF SAUDI CRUDE IS THE EQUIVALENT OF BETWEEN 20 AND 25 PERCENT OF ALL OPEC OIL EXPORTS. MOREOVER THE SAUDI PRECEDENT MAY PROMPT OTHER OPEC MEMBERS TO SEEK CONTRACTUAL OFFTAKE GUARANTEES. AT LOW DEMAND LEVELS, THE MARKET FOR PRODUCERS WITHOUT LONG TERM CONTRACTS WOULD SHRINK SEVERLY, WHICH COULD PROMPT SOME LIMITED PRICE COMPETITION AMONG THESE COUNTRIES.

A WORD OF CAUTION SHOULD BE INJECTED AT THIS POINT. THE SAUDIS SHOULD NOT BE EXPECTED TO INCREASE PRODUCTION OR MAINTAIN IT TO THE POINT WHERE OPEC ITSELF COULD BE DESTROYED. SAUDI ARABIA IS A FOUNDING MEMBER OF OPEC AND HAS NO INCENTIVE TO BRING ABOUT ITS FALL, INDEED THE OPPOSITE IS TRUE. HOWEVER, THE CONSEQUENCES OF THESE NEGOTIATIONS WILL OFFER SOME DEGREE OF CERTAINTY AS TO SAUDI EXPORT LEVELS AND PERHAPS, IN A DEPRESSED MARKET, SERVE AS AN ADDED INCENTIVE TO OTHER PRODUCERS TO KEEP PRICES FROZEN OR OFFER SOME CONCESSIONAL TERMS TO PURCHASERS.




THE CAREFUL BALANCE BETWEEN POWER AND RESTRAINT ON THE PART OF SAUDI ARABIA AND THE REST OF OPEC WAS DEMONSTRATED AT THE OPEC CONFERENCE A MONTH AGO. NO GENERAL PRICE HIKE WAS ENACTED, PROBABLY DUE TO SAUDI DETERMINATION TO CONTINUE THE PRICE FREEZE. THE MARKET POWER OF THE SAUDI POSITION IS WELL ILLUSTRATED AS IT HAD THE SUPPORT OF ONLY ONE OR TWO OTHER STATES. BEYOND THIS, HOWEVER, A NUMBER OF OTHER FACTORS AIDED THEIR SUCCESS. PREOCCUPATION WITH CONTRACT ARRANGEMENTS WITH THE OIL COMPANIES AND LITTLE PRIOR PUBLICITY ABOUT THE DESIRABILITY OF A PRICE INCREASE MADE IT EASIER FOR IRAN, USUALLY THE MAJOR PRICE HAWK, TO TAKE A MORE MODERATE POSITION AT THE CONFERENCE. AS AN ADDED BONUS, THE OPEC NATIONS WERE ABLE TO REAP POLITICAL BENEFITS IN THE INTERNATIONAL ARENA BY CONTINUING THE FREEZE "TO AID WORLD ECONOMIC RECOVERY." AS I MENTIONED EARLIER HOWEVER, OPEC HAS SAID WITH A GREAT DEGREE OF FIRMNESS THAT PRICES WILL INCREASE IN DECEMBER.

I HAVE STRESSED, IN THIS TESTIMONY AND IN OTHERS, THE NEED TO FIND WAYS TO COOPERATE WITH THE OPEC NATIONS. I WOULD LIKE TO EXPAND ON THIS THEME BRIEFLY BEFORE I RESPOND TO QUESTIONING.



IN FORUMS SUCH AS THAT AVAILABLE THROUGH THE CIEC DIALOGUE WE SEEK AN IMPROVED BASIS FOR NORTH/SOUTH COOPERATION BASED ON A RECOGNITION OF INTERDEPENDENCE AND MUTUAL INTEREST IN A STABLE, DEVELOPING GLOBAL ECONOMY. TO THE EXTENT THAT WE SUCCEED IN THIS OBJECTIVE, IT SHOULD IMPROVE OUR ABILITY TO ACHIEVE STABILITY OF OIL PRICES AND SUPPLIES. I SHOULD CAUTION HOWEVER, THAT THE PRESENT CONFERENCE IS NOT APT TO RESULT IN ANY MAJOR CHANGES IN OUR RELATIONSHIP WITH OPEC; IT IS A BEGINNING EFFORT AND HELPS TO KEEP CHANNELS OF COMMUNICATION OPEN.

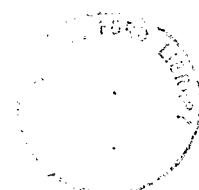
MOST OF THE OPEC COUNTRIES ARE PUBLICLY CONCERNED ABOUT THEIR OIL BEING A DEPLETABLE RESOURCE IN A WORLD WHERE THEY SEE DEMAND CONTINUING TO GROW. THEY THEMSELVES PLAN TO MODERNIZE AND INDUSTRIALIZE, AND THEY KNOW THAT OTHER LESS DEVELOPED COUNTRIES HOPE TO ADVANCE THEIR OWN SOCIETIES, MAKING THEM MORE ENERGY INTENSIVE. THUS THE INTEREST OF MOST PRODUCERS IN ENERGY TECHNOLOGY IS AS INTENSE AS THAT OF THE INDUSTRIALIZED COUNTRIES, AN AREA OF POTENTIAL COOPERATION BETWEEN PRODUCERS AND CONSUMERS. THE UNITED STATES HAS PROPOSED TWO NEW INSTITUTIONS TO PROMOTE THE EFFICIENT FLOW OF TECHNICAL INFORMATION, INVESTMENT AND ENTREPRENEURIAL CAPABILITIES AMONG NATIONS. THESE ARE AN INTERNATIONAL ENERGY INSTITUTE AND AN INTERNATIONAL RESOURCES BANK.



THE INTERNATIONAL ENERGY AGENCY HAS ALREADY BECOME A FORUM FOR COOPERATION AMONG CONSUMER COUNTRIES. THE LONG TERM EFFORTS OF THE IEA ARE TO DEVELOP ADDITIONAL ENERGY SUPPLIES AND PROMOTE CONSERVATION AS WELL AS TO RESTORE A MEASURE OF BALANCE IN THE DETERMINATION OF OIL PRICE IN THE WORLD'S OIL MARKET.

----- LAST WEEK, SECRETARY KISSINGER RECOMMENDED THAT -----
THE IEA INCREASE ITS EFFORTS TO DEVELOP ALTERNATIVE ENERGY SOURCES, FIX GOALS FOR REDUCED DEPENDENCE ON OIL IMPORTS BY 1985, AND INTENSIFY NATIONAL EFFORTS TO REDUCE THE GROWTH OF DEMAND FOR ENERGY. HE ALSO RECOMMENDED THAT WE LOOK BEYOND THE NEXT DECADE TO THE POST-OIL ERA AND PLAN COOPERATIVE RESEARCH AND DEVELOPMENT EFFORTS IN SUCH AREAS AS SOLAR POWER AND NUCLEAR FISSION. I COULD NOT AGREE MORE WITH THE SECRETARY.

TO REITERATE THE GOAL OF U.S. GOVERNMENT POLICY IS TO HAVE A SECURE SOURCE OF SUPPLY AT A REASONABLE PRICE BOTH NOW AND IN THE NEXT DECADE AND BEYOND, A GOAL ADDRESSED BY THE ADMINISTRATION'S ENERGY PROGRAM. BY ATTEMPTING TO INCREASE OUR CONSERVATION EFFORTS AND TO DEVELOP ALTERNATIVE SOURCES OF ENERGY -- BOTH THROUGH DEVELOPING NON-OPEC SOURCES OF HYDROCARBONS AND BY DEVELOPING



NON-CONVENTIONAL ENERGY SUPPLIES SUCH AS NUCLEAR AND SOLAR POWER -- WE CAN EFFECTIVELY INCREASE OUR STRENGTH TO RESIST ARBITRARY PRICE INCREASES AND REDUCE OUR RELATIVE RELIANCE ON OPEC.

AS WE SEARCH FOR OTHER WAYS TO INCREASE OUR LEVERAGE WITH OPEC WE SHOULD TEST THESE ALTERNATIVES TO SEE THEY MEET OUR GOALS. WE NEED TO HAVE A GOOD IDEA OF OUR ACTIONS BEFORE WE TAKE THEM SO WE MAY BENEFIT AND NOT SUFFER FROM CHANGE. WITH THIS FOCUS IN MIND I WOULD LIKE TO COMMENT BRIEFLY ON THE PRESENT ROLE OF THE INTERNATIONAL OIL COMPANIES IN OUR RELATIONSHIP WITH OPEC AND ON SOME ALTERNATIVE POLICIES THAT HAVE BEEN DESIGNED TO CHANGE THE COMPANIES' SUPPLY ARRANGEMENTS.

THE INTERNATIONAL OIL COMPANIES, DESPITE THEIR LOSS OF CONTROL OVER PRICE AND PRODUCTION, WILL REMAIN IMPORTANT TO THE COMMERCIAL MARKETING OF OPEC OIL -- AND TO THAT EXTENT THEY WILL CONTINUE TO EXERCISE SOME INFLUENCE IN THAT MARKET. THE EMBARGO AND PRODUCTION CUTBACKS OF 1973-74 DEMONSTRATED THE EXTENT OF OPEC CONTROL OVER WORLD PRICES AND SUPPLY BUT THAT CUTBACK IN SUPPLY ALSO DEMONSTRATED THE INABILITY OF OPEC TO CONTROL WHETHER A SPECIFIC NATION RECEIVED OIL.

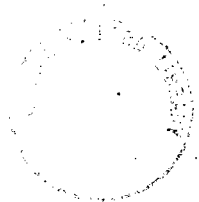
THE ROLE OF THE INTERNATIONAL OIL COMPANIES IS CRUCIAL TO AN UNDERSTANDING OF THE REASON FOR THAT WEAKNESS: THEIR CONTINUED CONTROL OF THE INTERNATIONAL DISTRIBUTION AND LOGISTICS SYSTEM, AND THEIR EQUITY INTERESTS IN THE REFINING AND MARKETING OF INTERNATIONAL OIL ARE THE PRINCIPAL COMPONENTS OF THEIR ROLE.

UNDER THE DIRECTION AND SURVEILLANCE OF IEA AND ITS PARTICIPATING COUNTRIES, THE COMPANIES HAVE THE PRIMARY ROLE IN KEEPING UP THE AGREED LEVELS OF STOCKS OF CRUDE OIL AND OIL PRODUCTS IN IEA MEMBER COUNTRIES. THEY ARE THE ESSENTIAL IMPLEMENTERS OF THE IEA'S EMERGENCY PROGRAM FOR SHARING AVAILABLE OIL SUPPLIES IN THE EVENT OF ANOTHER EMBARGO. IN ANOTHER AREA, THE OIL COMPANIES THROUGH NATIONAL GOVERNMENTS ARE PROVIDING DATA TO THE IEA SO THAT THE MEMBER GOVERNMENTS HAVE INCREASED, UP-TO-DATE KNOWLEDGE OF THE WORKINGS OF THE INTERNATIONAL OIL MARKET.

MANY OF THE POLICY OPTIONS CONSIDERED LAST YEAR IN AN EVALUATION OF THE OPTIONS OF THE UNITED STATES IN INTERNATIONAL PETROLEUM AFFAIRS (THE KRUEGER REPORT) PREPARED FOR THE FEA HAVE BEEN EXAMINED AS TO THEIR RELATIVE MERIT FOR REGULATING FUTURE OIL SUPPLY ARRANGEMENTS. THE REPORT ITSELF MAKES CLEAR IN A NUMBER OF CASES THE DISADVANTAGES INHERENT IN SOME OF THE POLICY OPTIONS IT

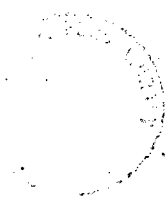
DISCUSSES, AND SOME OF THE OPTIONS DISCUSSED HAVE BEEN OVERTAKEN BY EVENTS. IN OTHER CASES THE ADMINISTRATION HAS MADE EVALUATIONS OF THE PROS AND CONS OF A PARTICULAR OPTION -- SOMETIMES IN CONNECTION WITH VARIOUS LEGISLATIVE PROPOSALS -- AND HAS MADE ITS POSITION CLEAR.

EPCA LEGISLATION, FOR EXAMPLE IS BEING IMPLEMENTED TO REMOVE FEDERALLY CREATED DISINCENTIVES AND RETURN A GREATER DEGREE OF FREEDOM TO U.S. OIL MARKETS. GENERALLY THE ADMINISTRATION FAVORS REMOVAL OF RESTRICTIONS AND REGULATORY BUREAUCRACY BECAUSE IT INTRODUCES DISTORTIONS INTO THE MARKET SYSTEM. OTHER PROPOSALS SUCH AS THAT SUGGESTING THE CREATION OF A GOVERNMENT-OWNED PETROLEUM CORPORATION HAVE BEEN CONSIDERED AND REJECTED OR MODIFIED. WE HAVE ON THE OTHER HAND TRIED TO IMPROVE BOTH OUR BILATERAL AND MULTINATIONAL EFFORTS AT COOPERATION AND COORDINATE. WE ARE CONTINUING TO OFFER TECHNICAL KNOWHOW TO THE SAUDIS AND OTHERS IN BOTH OUR JOINT COMMISSIONS; AND THROUGH THE IEA AND THROUGH CIEC. IN SUM THE KRUEGER ALTERNATIVES HAVE BEEN EVALUATED, SOME HAVE BEEN IMPLEMENTED, OTHERS REJECTED, AND OTHERS ARE STILL IN ABEYANCE PENDING FURTHER DEVELOPMENTS IN OUR EFFORTS TO AGREE UPON A TRUE, COMPREHENSIVE NATIONAL ENERGY POLICY.



IN CLOSING, LET ME ADD THAT I HAVE DISCUSSED OUR DEPENDENCE ON OPEC AS IT IS NOW AND AS WE SEE IT DEVELOPING. DECISIONS MADE NOW AND POLICIES PURSUED IN THE FUTURE WILL HAVE A GREAT DEAL TO DO WITH PEACE IN THE MIDDLE EAST, WITH NATIONAL AND INTERNATIONAL ENERGY POLICY, AND WITH THE ENHANCEMENT OF THE INTERESTS OF U.S. CITIZENS. THESE HEARINGS CAN BE A GOOD WAY TO INCREASE OUR KNOWLEDGE OF THE ISSUES AND TO EMPHASIZE THE IMPORTANCE OF CONGRESSIONAL AND EXECUTIVE BRANCH AGREEMENT SO THIS NATION CAN MOVE FORWARD TOWARDS DECREASED DEPENDENCE BUT INCREASED COOPERATION WITH OPEC.

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FOOTNOTES

(1) ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES -- THIRTEEN MEMBERS INCLUDE ALGERIA, ECUADOR, GABON, INDONESIA, IRAN, IRAQ, KUWAIT, LIBYA, NIGERIA, QATAR, SAUDI ARABIA, UNITED ARAB EMIRATES, AND VENEZUELA.

(2) OAPEC MEMBERS ARE ALGERIA, BAHRAIN, EGYPT, IRAQ, KUWAIT, LIBYA, QATAR, SAUDI ARABIA, SYRIA, UNITED ARAB EMIRATES.

(3) THE 19 NATION OECD HOUSED INTERNATIONAL ENERGY AGENCY FORMED IN NOVEMBER 1974.

(4) THE 27 NATION CONFERENCE ON INTERNATIONAL ECONOMIC COOPERATION, SOMETIMES REFERRED TO AS THE NORTH-SOUTH DIALOGUE. THE CONFERENCE FIRST CONVENED IN DECEMBER 1975.

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