

**Testimony by  
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Department of Energy  
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Committee on Government Reform  
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Mr. Chairman, Members of the Subcommittee:

Thank you for giving me the opportunity to appear before this Subcommittee today to discuss the volatility of U.S. gasoline markets.

Gasoline price volatility should come as no surprise. President Bush foresaw the potential for gasoline price volatility when he unveiled his National Energy Policy (NEP) three and a half years ago. The NEP noted that energy demand was rising and would continue to rise, and recommended that we take steps to meet that growing demand, most notably by increasing domestic production of energy and by encouraging energy efficiency and conservation.

In the NEP, we said that energy supplies were being limited by restricted access to Federal lands and that regulatory uncertainty and overlap, in combination with low historical profitability and low rates of return, was contributing to a lack of investment in refineries.

The NEP also noted that our nation's energy infrastructure – our network of pipelines, refineries, generators, and transmission lines – was antiquated and would need to be updated to deal with an ever-expanding economy.

The NEP recognized the potential for price volatility as a result of increasing demand and tightened supplies for crude oil and gasoline both here in the United States and around the world. That potential has become reality.

Gasoline and oil prices are high because of tight supply and demand conditions worldwide. Gasoline demand has risen rapidly over the past year, as the U.S. and world economies have emerged from a period of slow growth. In particular, the U.S., Chinese, and other Asian economies are growing rapidly and well beyond experts' projections, which has boosted oil demand.

The price of West Texas Intermediate (WTI) crude oil rose by 40 percent in six months, peaking over \$42 in June. Since then, the WTI price has dropped by several dollars, and that there are encouraging signs of increasing crude oil and gasoline supplies. The balance between current oil supply and demand continues to be tight, but there have been a number of recent positive developments I want to note.

The first is that the world's major oil producers have acknowledged prices were too high, and they have committed to do something about it. Worldwide production is already 3 million barrels per day more than last year, and more production is expected to be added this month and next. Second, our crude oil inventories are now at 305 million barrels, the highest level in nearly two years and just 3 million barrels lower than the 5-year average for this time of year. Higher levels of crude oil inventories should help add flexibility to the U.S. oil market and thus reduce price pressures.

Winston Churchill once spoke of finding security in diversity. Increased domestic production of our economic oil reserves should be the cornerstone of diversity of oil supply for the United States.

The United States continues to be a major oil producer. According to the Energy Information Administration, the U.S. is currently producing about 5.8 million barrels of crude oil per day, making us the world's third-ranked producer behind only Saudi Arabia and Russia – and we still have considerable reserves to draw on. Because U.S. oil fields are mature, they are more expensive to produce.

Today 377 billion barrels of currently uneconomic and unrecoverable oil await cost-effective technologies, in addition to 22 billion barrels of proved reserves. To help tap that immense resource, we are concentrating the Office of Fossil Energy's oil Research and Development efforts on highly promising technologies with big potential payoffs.

We're working on prolonging the life of mature fields through greater use of CO<sub>2</sub> injection by finding economic ways to bring CO<sub>2</sub> produced at fossil fuel power plants to the oil fields.

We're working on improved imaging and diagnostic tools such as the recently announced new cross-well electromagnetic imaging tool that can "see through" the rocks between widely separated oil wells; distinguish the oil, water and gases in a reservoir; and measure changes over time.

And we're developing microhole drilling technology that could reduce drilling costs by as much as two-thirds compared to a conventional well, reduce

disposal costs for drilling fluids and cuttings by 20 percent, significantly lower the environmental impact of drilling activities, and open up access to 218 billion barrels of oil in mature basins less than 5,000 feet deep.

We're also working to increase access to high priority areas for oil and gas in the Rocky Mountain states, while protecting the environment.

We are making progress on boosting domestic production but more must be done. We need a comprehensive energy bill that would do more to increase domestic oil production than any other single thing we can do: encourage large-scale domestic petroleum production in the Arctic National Wildlife Refuge (ANWR).

According to estimates by the United States Geological Survey, ANWR holds between 5.7 and 16 billion barrels of recoverable reserves, with a mean estimate of 10.4 billion barrels -- and that assumes the use of drilling technology now nearly a decade old. ANWR offers us the prospect of secure, domestically produced oil equal to almost 19 years worth of imports from Saudi Arabia.

Congress in 1995 authorized development of ANWR's oil resources. Had that bill not been vetoed by President Clinton, we could today be enjoying the benefit of up to one million barrels of oil per day from ANWR, according to EIA estimates, vastly improving our energy security and beneficially influencing world oil prices. To illustrate the impact ANWR's oil production could have on our security, consider this: the West Coast of the United States, the destination for Alaskan oil, today imports 780,000 barrels of oil per day. ANWR could be

supplying all of that demand with a considerable amount left over for use elsewhere.

We have lost almost a decade to debating the merits of developing ANWR. Debate continues even as advances in exploration and production technology have made arguments over the impact of ANWR's development on the environment more tenuous. And with each passing year, our growing reliance on foreign sources of energy makes it more urgent that we take advantage of our domestic oil resources.

Congress authorized development of ANWR once, and it should do it again – and soon. This time the President will sign the legislation and we will be able to get started on developing ANWR's oil resources for the long-term benefit of the American people.

The higher gasoline prices we are experiencing have prompted all sorts of proposals for action, one of them being that we use the Strategic Petroleum Reserve to affect the oil market and reduce gasoline prices. Some propose that we stop filling the SPR as a way to affect world oil prices and gasoline prices at the pump, despite the fact that such a small change in demand would have a negligible effect on prices.

There is also some talk about releasing a million barrels of oil a day from the SPR for 30 to 60 days, despite the negative implications for energy security and the terrible precedent of market meddling it would set.

With these proposals swirling around it is worth taking a minute to review and clarify the Administration's view on the role of the Strategic Petroleum Reserve.

We believe that abandoning our stated goal of filling the Strategic Petroleum Reserve is wrong from a national security point of view.

On November 13, 2001, President Bush directed Secretary Abraham to fill the Reserve up to its 700 million barrel capacity as a deliberate and cost-effective way to strengthen American energy and national security. He has been very clear that the Reserve is in place in case of major disruptions of energy supplies to the United States which could arise from a variety of events, including natural disasters, international disruptions of exports, and, of course, terrorist attacks. We face a tough and determined enemy in the war on terror, and filling the Strategic Petroleum Reserve to its 700 million barrel capacity can only serve to strengthen our position in that war.

Moreover, we adopted a plan for transparently filling the Reserve by a predictable amount and over a certain length of time in order to impact markets as little as possible. The current rate of fill is about 105,000 barrels per day, less than one percent of world demand exceeding 80 million barrels per day. While a moderate fill policy is unlikely to have a market impact, if we had heeded the calls to suspend filling the SPR, both energy and national security vulnerabilities would be markedly higher.

The Energy Information Administration estimates that the impact on gasoline prices of filling the reserve is at most one or two cents per gallon. Given

the substantial year over year change in gasoline prices, one or two cents is inconsequential, and pales by comparison to the difference between one service station and another.

Secretary Abraham recently stated the Administration position on this proposal very clearly when he said, "...imperiling the national security for the sake of a minimal reduction in price would be nothing short of irresponsible. Simply put, the Reserve is for the long-term protection of the American people, not to cut the price of gas by two cents."

We remain confident that basic supply security exists. At the same time, there should be no question that the United States and the other countries with similar strategic reserves are prepared to draw on those reserves if circumstances warrant. We are both prepared and determined to use our Reserves to offset any terrorist-related or other significant disruption in supply.

As I stated earlier, the world oil supply-demand equation is largely responsible for the higher gasoline prices we are experiencing this year. But other factors also play a part. If today we were producing an additional one million barrels per day from domestic sources, oil production in the rest of the world had increased substantially, and the SPR stood filled to capacity and ready to do its job in the event of a national security emergency, we would still be faced with a serious and long-standing obstacle to lower gasoline prices: insufficient or outdated domestic pipeline and refinery capacity.

The United States has not seen a new refinery built since 1976, and the expansion of existing refineries has slowed in recent years. The result is that our

refineries are running at near-total capacity of about 96 percent. This means that even if additional crude oil supplies were available, we could produce very little additional gasoline to meet rising demand. Yet the EIA projects that, by 2025, U.S. gasoline consumption will increase by 47 percent from current levels and consumption of transportation distillate – which is mostly diesel —will increase by 73 percent from current levels.

To meet this growing demand, we will need both additional refining capacity and higher product imports, but both of these potential sources of new supply face challenging economic and regulatory hurdles.

In order to help assure supply will be available when needed, Secretary Abraham last month asked the National Petroleum Council (NPC) to undertake a high-priority, fast-track study of American refining capacity.

The purpose of the NPC, as you know, is to advise, inform, and recommend actions to the Secretary of Energy with respect to any matter relating to oil and natural gas. Its comprehensive report called *Balancing Natural Gas Policy*, which was released last September, outlined the long-term policies and actions needed to meet our long-term natural gas needs.

The new refinery study is intended to identify the nation's future demand for refined products, our domestic capacity to meet future needs, the barriers to meeting future demand, and the capital factors that will drive supply growth. The NPC will also examine how worldwide capacity will affect our access to petroleum products.

Because the market watches crude oil inventory levels very closely, and because they play an important role in setting prices, the NPC will also study issues related to the nation's oil inventory levels. We have assumed 270 million barrels of crude oil as the minimally acceptable inventory for operations without technical or logistical bottlenecks for a number of years now. In order to develop policies that will best serve the American people, we need to know whether this 270 million barrel level is an accurate estimate of a minimum domestic operating level in the refining industry in 2004, or whether it should be updated.

If there is one thing a smoothly functioning market needs, it is accurate, timely, up-to-date information. To help secure that information, the United States has signed on to the Joint Oil Data Initiative, an international effort to improve the availability and timeliness of international oil market data, and we continue to work cooperatively with our neighbors, Canada and Mexico, to improve energy data sharing.

Let me say in conclusion that our Administration will continue to monitor developments affecting the prices of gasoline.

We will continue to be vigilant to ensure consumers are protected.

We will continue to respond to local incidents that may produce regional price spikes, working with industry and state and local governments on a case-by-case basis.

We will maintain the SPR in a state of readiness to respond to any supply emergency.

We will continue to encourage energy efficiency and conservation measures.

We will continue our discussions with OPEC and non-OPEC producers about actions they can take to support a growing world economy.

We will continue the research and development programs that promise a long-term solution to our energy and environmental concerns: a new era of hydrogen-based energy and reduced reliance on oil.

And we will continue to work with Congress to pass comprehensive energy legislation to help provide for America's energy and economic security.

This concludes my testimony, Mr. Chairman, and I would be glad to respond to any questions the Subcommittee may have.

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