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OFFSHORE OIL LEASING: KEY TO U.S. ENERGY SECURITY

INTRODUCTION

At the peak of the energy crisis, in 1979, Congress sought to spur offshore energy exploration by enacting the Outer Continental Shelf Leasing Act Amendments (OCSLAA). This called for the ". . . expedited exploration and development of the Outer Continental Shelf [OCS]. . . ." In keeping with this mandate, the Reagan Administration in 1982 announced an unprecedented five-year leasing program to open up the nearly one billion acres of OCS controlled by the federal government for consideration as oil and gas development sites. The billion acres were divided into 41 "lease offerings." More important, most of the 41 offerings would be on a so-called "area-wide" basis, so that the tracts with the greatest potential to hold oil and gas deposits would be leased first. The importance of the Outer Continental Shelf cannot be overestimated. Currently, OCS reserves contribute 11 percent of U.S. oil production and 25 percent of U.S. natural gas production. More important, as much as 59 percent of future oil, and 36 percent of future natural gas, discoveries are expected to occur offshore. Therefore, the five-year lease offering represents a critical step toward assuring U.S. energy security.

This proposal came under attack. As a result of concerns voiced by coastal state governors, 18 of the proposed 41 lease offerings were postponed. Department of Defense objections based on a number of national security concerns led to the removal from consideration of a further 107 million acres. Bowing to pressure from state governments and environmental groups, Congress imposed successive leasing moratoria on many of the most promising tracts, ultimately tying up more than 50 million acres believed to contain more than 2.1 billion barrels of oil.

The problem of congressionally imposed moratoria was compounded this July when Secretary of the Interior Donald P. Hodel

abruptly announced a preliminary agreement with a handful of California Congressmen. Still in preliminary form, the agreement calls for the removal of some 6,310 tracts, amounting to 36 million acres on the California Outer Continental Shelf, from consideration for oil or gas leasing through the year 2000. This comprises more than 97 percent of the total available off the California coast and includes the bulk of the most promising prospects. In fact, only about 15 percent of the 150 tracts on which leasing will be permitted are thought by the industry to hold more than marginal potential of containing significant amounts of oil or gas.

While the Interior Department has been careful to note that the agreement is not final, many observers within the industry were stunned by its announcement. It not only reversed nearly five years of Reagan Administration policy concerning the Outer Continental Shelf, but did so at a time when congressional sentiment regarding OCS leasing seemed to be moving in favor of developing the nation's oil resources.

Critics of the original Reagan five-year leasing schedule claim that such an aggressive program would lead to severe environmental damage from spills and that sensitive fish and wildlife habitats would be destroyed. They also argue that the oil industry does not have the capability to exploit fully the amount of acreage being offered for lease. And they maintain that the proposed bidding system would not allow the government to receive, as required by law, a "fair market value" for the leases.

On close examination, these arguments have little merit. They also overlook the fundamental point that leasing OCS tracts is necessary to maintain America's energy security. Despite the softening of prices and relative availability of world oil supplies at present, the nation's energy vulnerability clearly has not ended. What many observers ignore is that it has been the greater reliance on market forces and the reduction of U.S. regulatory barriers to energy production that have halted spiraling prices and spot shortages. This relief could be short-lived if these policies were not expanded.

Key to such expansion is more comprehensive development of the U.S. Outer Continental Shelf. Such development is in the national interest and poses none of the dangers its critics suggest are present. Examples:

- o During the course of drilling some 31,000 offshore oil and gas wells over the past 32 years, there has been only one major spill. And that has had no lasting harmful effects on the environment.
- o There is ample scientific evidence to indicate that OCS oil and gas development ironically can benefit local marine and other wildlife.

- o A far greater danger to the environment is caused by the tanker traffic carrying imported oil. This is certain to increase should the U.S. fail to develop OCS oil and gas resources.
- o The U.S. still obtains up to 30 percent of its petroleum from foreign sources, many of which are politically unstable.
- o Up to 60 percent of future U.S. oil and gas discoveries are expected to be found on the U.S. Outer Continental Shelf.
- o The new federal revenues generated by increased offshore oil and gas drilling would help reduce the federal deficit.

Put simply, U.S. energy security requires the Reagan Administration to stay on course and carry out its five-year OCS leasing program. While some might seek short-term political gain by embracing congressional programs that will lock up the vast OCS, the long-term cost is the energy security of the nation. Secretary Hodel's preliminary agreement should be rejected, as should any attempt to curtail the number of lease offerings. Instead, the Reagan Administration should proceed with its wise five-year leasing plan.

AMERICA'S CONTINUING IMPORT VULNERABILITY

Although it is less than a decade since Americans last waited in long lines to purchase gasoline, the combination of declining prices and an easing of the supply crunch has led to growing complacency about oil imports. The image of OPEC ministers vainly struggling to maintain prices in a market awash in crude oil may provide considerable psychological satisfaction, but it masks the U.S. vulnerability to import disruptions.

While imports of petroleum products and crude oil have declined substantially from their 1977 peak of 47.7 percent, they still constitute nearly a third of all U.S. petroleum consumption--roughly the amount they did in 1972, the year before the Arab oil boycott. Even though the U.S. is no longer heavily dependent on the Middle East as a source of supply, nearly half the U.S. imports come from Latin America and the Caribbean, another highly volatile region. Therefore, it can be said that, rather than eliminating the nation's import vulnerability, America has exchanged one form of vulnerability for another. While the danger of an interruption of Western Hemisphere imports might be less than that of imports from the Middle East, it is nonetheless real.

Oil import dependency can be reduced in two ways: conservation and additional production. Great strides have been made in both areas in recent years, in large part because of market-oriented policies. But more must be done to increase domestic oil output. Key to this is the oil and gas available on the

Outer Continental Shelf. To be sure, a policy of OCS development raises legitimate environmental concerns. These should be addressed, but with the understanding that OCS development is an urgent energy priority.

OFFSHORE OIL DEVELOPMENT AND ENVIRONMENTAL DEGRADATION

One of the most powerful environmental images of the early 1970s was the television presentation showing hundreds of volunteers trying to clean crude oil off of birds after the 1969 Santa Barbara oil spill. Yet, despite the lingering impression of this incident, the record of the offshore oil industry is remarkably free of serious accidents leading to serious environmental damage. Even the Santa Barbara spill caused no lasting harm to the California ecosystem. More important, it was the only incident in 32 years of offshore drilling that resulted in a significant amount of oil reaching shore. Since 1969, more than five billion barrels of oil have been produced by wells offshore; fewer than 800 barrels have been spilled as a result of blowouts.

By contrast, according to the National Academy of Sciences, 41 percent of ocean pollution is caused by river runoffs. Tankers and other transportation systems account for another 20 percent. Natural oil seeps account for 15 percent, while municipal and industrial sources amount to 11 percent. In contrast to these sources of ocean pollution, all U.S. offshore oil and gas drilling contributes only 5/100ths of 1 percent to the total amount of petroleum-related pollutants in the world's oceans.

THE HABITAT QUESTION

Environmentalists warn that offshore oil drilling helps destroy ecologically sensitive fish and wildlife habitats. On close examination, this charge too seems to have little merit. Where there is legitimate concern over wildlife such as seals or sea otters, of course, special care can be taken in drilling operations to assure their continued survival. In some areas, drilling lease stipulations require such steps.

Ironically, activities associated with oil drilling in some cases have helped local marine and wildlife populations to flourish. Example: The banks built along canals in conjunction with oil drilling operations in Louisiana provide nesting areas for birds and have helped increase their populations. Example: Local fish use offshore platforms as breeding grounds. Indeed, the experience with offshore platforms has been so positive that there have been several attempts in Congress to enact legislation allowing companies to leave platforms behind to serve as artificial reefs after they conclude oil drilling and development operations. In September 1982, Florida accepted the donation of a platform for just such a purpose, as did Alabama the following year.

The concerns about fish and wildlife habitats being damaged by offshore oil operations are not supported by the facts. Rather than posing a threat to the marine ecosystem, offshore drilling can enhance it and increase local marine populations. More important, even if an accident occurs similar to the spill at Santa Barbara, studies by the Interior Department, National Academy of Sciences, and American Petroleum Institute agree that any disruption of the environment would at worst be transitory. Nature repairs itself in a remarkably short time.

AREA-WIDE LEASING

Economic objections also are being raised to the proposed five-year leasing schedule. Some of these challenge the original program's basic approach, known as area-wide leasing.

The term "area-wide leasing" does not accurately convey the meaning of the concept. It does not mean, for example, that all of the nearly one billion acres of the U.S. Outer Continental Shelf under federal control would be leased for oil and gas exploration. Rather, it means simply that all of the area would be available for consideration for oil and gas leases. Any one of a variety of factors, ranging from environmental concerns to lack of potential oil and gas could prevent a particular tract from being leased. All that area-wide leasing implies is that no tract would be excluded automatically from the bidding process merely because an official in the Department of the Interior did not believe that anyone wanted to submit a bid on it.

There are a number of major advantages to the area-wide leasing approach. It allows the bidders to consider the whole geological structure rather than one small portion of it. Ecology tends to be as much of an art as a science, and most oil companies have highly individual criteria for making exploration decisions. Allowing a firm to take a whole structure into consideration gives the U.S. the full benefits of a diversity of approaches and drilling philosophies. The result is maximum energy yield from each acreage offering.

Under the area-wide leasing approach, there are periodic reofferings of areas previously unleased. This allows knowledge gained from operations in leased tracts to have an impact on the bidding process. The oil industry is replete with examples of discoveries that have been made on the basis of new information in areas that previously had been thought to hold little or no potential.

A major objection to area-wide leasing is that it will not yield a "fair market" return to the federal government for the leases granted. The trouble is, there is no objective standard of fair market value. In practice, a fair market value is achieved when a willing seller and willing buyer come together with full

information and agree on a price. To circumvent the market and arbitrarily fix a value is not only impossible, but economically inefficient and potentially very costly.

The fair market value of a tract leased in 1980 when oil prices appeared to be climbing rapidly, for example, might be quite different from the fair market value of that same tract today.

A final objection to the area-wide leasing contends that industry does not have the capability to explore and develop effectively the entire Outer Continental Shelf. This is true. But the area-wide leasing program does not call for leasing the entire OCS. It simply makes available for lease most of the OCS. In practice, less than 7 percent of the tracts offered for lease have been leased; less than 1 percent of the total acreage offered will be drilled.

The reasons: Only a small portion of the Outer Continental Shelf offers any potential for oil or natural gas. What area-wide leasing does is ensure that areas with potential become available for exploration. And offering these tracts on an area-wide basis allows an entire geologic structure to be assessed. This permits drillers to optimize development of a particular field, ensuring a maximum recovery of the available oil in place. Nor is there shortage of equipment to develop the leases. In 1981, the oil industry began a 50 percent expansion of its drilling fleet of offshore rigs, involving a capital expenditure of more than \$12 billion. The U.S. geophysical fleet (ships used to perform the geologic studies that precede exploration and development) similarly began a more than \$100 million 40 percent expansion.

Offshore rigs now can operate in water markedly deeper than previously. There are currently 134 rigs capable of drilling in depths of up to 2,500 feet; 18 rigs can operate in more than 2,500 feet of water; four can drill in 6,000-foot depths, and one rig is certified for depths of 10,000 feet. Even water depth does not appear to be a constraint.

None of the economic objections to the area-wide leasing approach appears to have merit. Rather, area-wide leasing is a very rational policy for developing America's Outer Continental Shelf oil and gas deposits.

THE PRELIMINARY INTERIOR DEPARTMENT AGREEMENT

The preliminary agreement reached in late summer by the Interior Department and a group of California Congressmen effectively would foreclose all but a small portion of that state's Outer Continental Shelf to oil and gas exploration. Had the agreement been concluded, it would have undermined much of the Reagan Administration's progress toward a sound energy policy.

This tentative agreement imposed a moratorium through the year 2000 on OCS leasing on all but 150 of the 6,490 tracts available on the California OCS. Of the tracts to be available for lease, only a small proportion were believed to hold any promise of yielding significant oil and gas resources. All of the 36 million acres affected by the action previously had been closed to leasing by congressionally imposed moratoria. But the Interior Department's action endorsed the moratoria and thus contradicted the intent of the Outer Continental Shelf Leasing Act Amendments (OCSLAA) and the Administration's stated goal of achieving a market-based energy policy.

The agreement would have allowed the foreclosed acreage to be opened to drilling in the event of an energy emergency as defined by the Energy Policy and Conservation Act of 1976. This stipulation, though, was little more than cosmetic; it ignored the reality of OCS oil development. In frontier areas such as OCS, up to 15 years can pass from the time a lease is granted to when oil production begins. Even in established areas, the process can take from three to five years. Therefore, the exemption for an emergency really is a tactic to mollify those who may object to the moratoria on national security grounds. Similarly, a provision allowing drilling of three test wells in 1992 does not change the fundamental fact that the new moratorium would prevent the development of most of California's OCS until well into the next century.

The most puzzling aspect of the preliminary agreement is that it seemed to circumvent the carefully designed process by which the current federal offshore leasing policy was developed. More than 5,000 pages of testimony and countless hours of consultations preceded its adoption. It has survived numerous court challenges. It is among the most thoroughly debated and considered policy documents ever issued by the federal government. To reverse its conclusions after a brief consultation with a handful of Congressmen from only one of the affected states is reckless. It invites massive litigation and dispute.

The agreement would become final if it were to be approved by Interior Secretary Hodel this month. The Department of the Interior held field hearings in California during August to gather more information on the matter, and as a consequence, the Interior Department has suggested that the acreage made available for lease under the current proposal be replaced with other tracts, which are believed to hold greater prospect of support. Still even this modification falls far short of what is needed: a return to the successful Reagan policy of relying on market forces to encourage domestic energy development.

CONCLUSION

The development of the nation's offshore oil and gas resources must remain a major objective of domestic energy policy. Even

today, the Outer Continental Shelf reserves contribute 11 percent of the oil and 25 percent of the natural gas produced in the U.S. More important, as much as 59 percent of future oil, and 36 percent of future gas, discoveries are expected to occur on the Outer Continental Shelf. It is a resource the nation can ill afford to ignore.

To develop offshore oil and gas, the pace of the five-year leasing program must be quickened. Successive congressional moratoria have hindered OCS development and locked up more than 50 million acres of prime offshore tracts. These moratoria not only have prevented development, but have lost valuable time to reduce America's dependency on imported oil.

In moving to accelerate the offshore leasing schedule, the federal government should advise the public of the facts regarding the environmental consequences of offshore oil operations. Numerous studies, including those by the National Academy of Sciences, indicate almost no damage from offshore drilling.

Today the U.S. is falling behind other nations in development of its offshore resources. Total U.S. offshore production has dropped from a high of more than 615 million barrels of oil in 1971 to 436.5 million in 1983. By comparison, the rest of the world nearly doubled its offshore output during the same period, from 2.4 billion barrels annually to 4.5 billion barrels. The share of world offshore production accounted for by U.S. offshore production has decreased from 21 percent of the total to only 9 percent of the total.

Declining U.S. offshore production has been offset in large part by oil imports from nations that have followed a more aggressive offshore development policy. Example: two main sources of U.S. oil imports are Britain's North Sea Field and Mexico's Gulf of Mexico Campeche Trend. Similarly, new offshore fields in Asia are providing increasing amounts of oil to the U.S.

Oil imports already account for nearly half of the U.S. balance of trade deficit. The increased outlays for foreign crude oil that will be necessary if U.S. offshore resources are not developed can only make the U.S. payments balance even grimmer. The environmental consequences of a failure to capitalize on America's domestic resources could be severe as well. While offshore oil drilling accounts for only about 5/100ths of the world's ocean pollution, spills from tankers and other ocean transportation account for some 20 percent. This traffic, of course, will increase as oil imports increase.

Foreclosing offshore oil development, moreover, would deny the federal government a major source of revenue. From the inception of the offshore leasing program through 1983, the federal treasury has received \$68 billion in bonus payments, rentals, and royalties from offshore oil drilling operators. At a time when new revenue sources are at a premium, arbitrarily eliminating such a potentially lucrative one makes no sense.

In sum, there appears to be no line of argument--whether it concerns the environment, national security, industrial capability, or any thing else--raised in opposition to the five-year offshore leasing schedule that has any merit. To the contrary, the only action consistent with U.S. national interests is acceleration of the schedule. While the U.S. is enjoying a temporary respite from high oil prices and shortages, this favorable situation can be sustained only by steps to ensure that domestic resources are developed to their full potential. The Reagan Administration made a good start in that direction when it chose the path of area-wide leasing and an accelerated five-year schedule. It is a path the Administration should continue to follow.

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