

THE ENERGY CHALLENGE: PROGRESS AND PROCRASTINATION

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An Address

by

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Ladies and Gentlemen:

It's good to be "back home" in Toronto! Geraldine and I will always regard our years in Canada as among our happiest, and when we left four years ago we left part of ourselves here.

To be invited to speak to this distinguished audience for a third time is a high honor--which I deeply appreciate.

On both previous occasions on this platform, I tried to lay the cards on the table and "tell it like it is." You seemed to receive those presentations favorably. So I shall do my best to do the same today--even though in so doing I may have to say some things some of you would rather not hear.

When I was here in 1977, I enumerated five basic components of a sound energy policy, which in my judgement were (and are!) equally applicable in the United States and in Canada. These five ingredients: (1) conservation and improved energy efficiency; (2) realistic pricing; (3) accelerated development of oil and gas resources; (4) expanded use of coal and nuclear power; and (5) development of technology to make other alternate sources available.

Where do we stand today, three years later? I would submit, sadly, that the U.S. report card would have to read, "Some progress, much procrastination." The Canadian card would, I believe, read somewhat more favorably--especially with reference to accelerated development of oil and gas and development of alternate energy sources. The U.S. has outperformed Canada in only two of these areas--in conservation and movement of domestic prices toward world levels.

Canada has provided substantial leadership and inspiration for the United States and the rest of the world in its even-handed meeting of its energy challenges to date. Canada may well be the "energy envy" of the industrialized world. But even your great country has shown some recent signs of back-sliding which I'll discuss a little later.

First, though, I believe it would be useful to summarize briefly the energy situation as I see it on a world-wide basis, and then with respect to North America.

#### World Energy Situation

The world energy predicament is not so much a matter of quantity as location. Petroleum, which must continue to be the primary fuel of the industrialized world through the rest of this century, is just not where we would like it to be. This situation has resulted in unprecedented price increases, has permitted some supply interruptions and threats of others, and has contributed to economic difficulties around the world. Clearly, a shortage of oil can cause more problems in this world than a barrel of political ideologies.

About three-fourths of the oil reserves outside the Communist countries are in the Middle East and Africa. Two-thirds of the oil that moves by sea in international trade comes from five countries bordering the Persian Gulf--an area surrounded by not exactly friendly foreign powers. Yes, there is spare oil producing capacity in the Middle East, but that is irrelevant because OPEC apparently intends to keep supply just below demand and is willing to forego revenues to maintain a knife-edge, delicate balance.

Gulf's geologists and economists feel pretty certain that by the turn of the century crude oil production in the non-Communist world will reach a peak and start down. Even the discovery of another Middle East would delay that production peak by only 10 years.

The situation is grim. The problem is geo-political, and the solutions will be long-term and hard-won. A worried world knows that what is called an "energy problem" is really an economic and social problem. And history teaches no more frightening lesson: economic and social problems can lead to political and military chaos.

#### North American Energy Situation

Now let's look closer to home--to North America.

Few non-OPEC countries have the option of achieving a high degree of energy self-sufficiency in a relatively short time. The United States and Canada do have that happy opportunity. Both nations are energy-rich, but neither has the luxury of a lot of time to develop those energy resources. The job must be done with all possible speed.

The United States, for at least the next ten years, has but four solid ways it can increase its energy production: oil, natural gas, coal, and nuclear power. Those are the only significant choices, but what enviable choices they are when you look around the world. The United States could halt the decline in domestic oil production that began in 1970. It could maintain natural gas production at today's levels. It could more than double coal consumption and more than triple the amount of energy provided by nuclear power.

And while doing all this, the United States could also be getting the alternate energy sources ready, such as synthetic fuels from coal and shale, along with the renewables: solar, biomass, and nuclear fusion.

But what is the current status? The United States has not fully developed its conventional oil and gas, coal, and nuclear potentials. And it has delayed tapping its alternate energy resources because the artificially depressed prices of conventional oil and gas have made the economic development of these resources economically impossible. This failure and delay has placed the U.S. in an increasingly vulnerable strategic position. The United States is now importing more than eight million barrels of oil a day. Our economists project that under the most probable scenario, U.S. oil imports will increase to 10 million barrels a day by 1990. This is a doleful state of affairs. Oil imports cost the U.S. about \$57 billion last year. President Carter acknowledges that this year the tab may go over \$80 billion.

This means more inflation and a weaker dollar. It means the perpetuation of a vicious circle: more imports mean more inflation, more inflation means more OPEC increases, and more OPEC increases mean more inflation. The only answer, of course, is to reduce oil imports. And to do that the U.S. needs a national energy program that is clear, coherent, comprehensive, and consistent.

Canada is in a better position than the United States from the standpoint of domestic supply. The U.S. imports about 45 percent of its oil; Canada brought its imports down to 20 percent in 1979 due to increased natural gas substitution and all-out conventional oil production. Even with effective conservation measures and all possible efforts directed at new energy sources, the fact remains that until the end of this century two-thirds of the growing energy needs of Canada--as well as those of the U.S.--will still have to be met by crude oil and natural gas. Fortunately, it is possible to supply most of these requirements in both countries from domestic sources--provided we adopt and implement the necessary policies and actions.

#### Canadian Energy Policy

During the Seventies--to the great credit of all those responsible, one of whom was certainly my friend the Honorable Donald S. Macdonald--Canada conceived and put in place the beginnings of what I believe was an exemplary national energy policy. Others may describe it differently, but as I see it --and have described it to some of my colleagues and to appropriate people in the U.S. Government when I could get them to listen --the Canadian policy included four principal features:

First, it was recognized early on that it made no sense for the price of a glamorous premium fuel like natural gas to be a fraction of that of its more prosaic competitor, oil. So significant steps were taken toward the goal of equating the well-head prices of natural gas and oil on a Btu equivalent basis. The result was that a projected gas shortage has turned into a surplus.

Second, a program of definite, semi-annual increases in the price of domestic crude oil was announced to bring Canadian prices up to world levels in an orderly way over a period of several years. Canada recognized that by this means it could avoid the trauma of the OPEC "shocker" which dealt Japan, Europe, and other consuming countries such a heavy blow in 1973 and 74 and still achieve a realistic price structure in a reasonable time. The policy worked well prior to the accelerated OPEC price increases this past year.

Third, recognizing the enormous long-range potential of the Athabasca tar sands, Canada gave timely and effective support to the development of this important alternate energy source. This objective was accomplished:

- \* through the equity participation of the Federal Government of Canada, the Government of Alberta, and the Government of Ontario, as full-fledged partners with the private sector participants;

- \* by giving assurances that the product would have unfettered access to world market prices and would not be subject to whimsical changes in the tax regime, to unrealistic royalty demands, or to artificial volumetric limitations;
- \* and by providing certain necessary infra-structure amenities.

The three governments and the three private companies involved thus assured the construction and operation of the mammoth Syncrude tar sands plant in northern Alberta. All Canadians can be justly proud of the successful completion of that project. They can be proud, too, of the continued successful operation of the other commercial tar sands plant, the Great Canadian Oil Sands project. Two other potential commercial projects for tapping the tar sands and their "heavy oil" cousins are awaiting government approval. As a result, Canada leads its neighbor to the south by many miles in demonstrating the technical and commercial viability of its alternate energy resources--the ultimate answer to OPEC.

While I would not for a moment suggest that the Syncrude arrangement would be appropriate for all--or even any--other alternate energy development projects, I have often pointed to it as an example of what can be accomplished through genuine, realistic, effective government/industry cooperation.

Fourth, the risky, long-payout exploration of Canada's vast and prospective frontier areas has been stimulated through "super-depletion" and other incentives. The results so far are the exciting discoveries in the Arctic Islands, in the Beaufort Sea, and most recently in the Atlantic Ocean offshore Newfoundland. While I share the view that it is premature to extrapolate these discoveries into commercial reality . . . and while we all need to be conscious of the enormous capital, physical, and time requirements involved in their development--assuming their commercial extent is confirmed . . . these discoveries do provide a basis for the hope that Canada can once again approach petroleum self-sufficiency in the foreseeable future.

But now I must return to the observation that, regrettably, in the recent past there has been some back-sliding with respect to these noble objectives. The price of natural gas has not been allowed to rise as much or as rapidly as was planned and there have been indications that the price may be further restrained in the future, purportedly to encourage its preferential use in Eastern Canada. There have been delays and cancellations of some of the scheduled increases in domestic crude prices to the point where the gap between Canadian prices and world prices has widened. Another concern is the government's apparent determination to cause a larger percentage of the incremental revenues to flow into the public treasuries rather than allow them to go to work to provide future energy resources.

I understand that a few months ago there were rumblings, fortunately later denied, that the Federal Government was considering altering unilaterally some of the fundamental understandings on which the Syncrude project was predicated. This of course would have dealt a body-blow not only to that project, but even more importantly, to future such undertakings. Perhaps most distressing is that the imaginative and courageous incentives for frontier exploration known as "super-depletion" are scheduled to expire today . . . just when they are beginning to pay off in terms of significant new Canadian reserves.

I trust the new Government will take immediate steps to put Canada back on the high road to a sound and sensible national energy policy. Canada has a genuine opportunity to become energy self-sufficient in the next 20 years and to lead the world in responsible, effective energy management.

#### Obstacles to Energy Progress

This brings me back to the United States and to what I see as the five major obstacles to solving our energy problems.

Obstacle Number 1: Capital Formation. If the United States is to hold imported oil to the 1978 level of 8.5 million barrels per day over the next decade . . . as agreed at the Tokyo conference . . . approximately 6.2 billion barrels of domestic crude oil and natural gas equivalents must be found each year. This requirement is more than one and a half times what the industry has been able to find in recent years. To do this, it is estimated that the industry's capital expenditures for conventional oil and gas exploration and production must double by 1990 to more than \$40 billion a year in 1978 dollars.

To provide the industry with some of the capital needed, the Carter Administration last year began a program to gradually decontrol the price of domestic crude oil. But it followed that sensible move, with a counterproductive measure inaccurately called the "windfall profits" tax . . . really an excise tax . . . which in this decade will divert about \$227 billion of oil revenues into a variety of government-supported programs. The result in Gulf's case is that the government will get about 85 percent of the additional revenues expected from decontrol. In an election year, it is politically appealing to return the bulk of the excise tax to constituents . . . but it is draining off badly needed capital, and the national interest will suffer.

Gulf, by the way, last year invested \$2.5 billion on world-wide capital and exploration projects. With the stronger earnings generated last year we are undertaking an even greater effort in 1980--\$3 billion, the first step in a \$16 billion, five-year program.

Last week, as you may have noted, Gulf announced a secondary offering of approximately two million of its 29 million shares of Gulf Canada stock. The reason for this planned sale is simple: we need the money. Our aggressive \$3 billion capital and exploration program in 1980 will exceed our projected cash flow, and we have concluded that under present circumstances the most prudent way to finance the shortfall is through this redeployment of some of our assets. This proposed sale in no way means we are disenchanted with Gulf Canada, the Canadian

energy scene, or anything in Canada. Gulf's interest in Gulf Canada will be decreased by this transaction to 60 percent from the present 65 percent, but considering the projected growth of Gulf Canada, we expect to have a larger investment in Canada in the future than we have now. Even though we will have a slightly smaller slice of the pie, the pie itself will be larger.

Obstacle Number 2: The Regulatory Quagmire. Time won't permit me today to go into detail about the maze of over-regulation which is strangling the oil industry and other industries in the U.S. these days. Suffice it for now to quote Thomas Jefferson, who once said, "Were we directed from Washington when to sow and when to reap, we should soon want for bread." We are being told in such detail "when to sow and when to reap" that the American Petroleum Institute estimates that oil companies employ the equivalent of 10,000 people full time just to comply with the regulations of the Department of Energy. This effort costs about \$500 million a year--enough to drill more than 3,000 new on-shore wells. We simply must find a way in the U.S. to simplify this part of our life, and I certainly hope Canada will be able to continue to out-fox the devil and avoid this kind of bureaucratic affliction.

Obstacle Number 3: Access to Federal Lands. The U.S. government controls about one-third of all the land in the U.S. and access to all the Outer Continental Shelf beyond the limit of state jurisdiction. Under these lands lie the most promising prospects for new supplies of energy. Less

than five percent of the Outer Continental Shelf of the U.S. has been leased for oil and gas exploration. And only one-third of all the onshore public lands have been opened for energy development. Obviously, to cut imports, accelerated leasing programs are essential in order to increase domestic production.

Obstacle Number 4: The Government-Industry Adversary Relationship. A certain degree of "creative tension" may be necessary and even healthy, but I think the government-industry relationship too often in the U.S. and, sometimes in Canada, has gotten out of hand. In the U.S. particularly, we must devise better ways for industry and government to work together. The tasks of loosening the grip of OPEC on our economies, of finding and producing our hydrocarbon reserves, and of developing the advanced technologies for synthetic fuels are just too big and the risks too great for either industry or government to even try to handle alone.

I like to keep repeating that the petroleum industry's most important message to government is simply this: Tell us what you want done, but don't tell us how to do it. Tell us the destination we're seeking, but don't tell us how to get there. Leave the doing of the job to the ingenuity of the industry!

Obstacle Number 5: Recognizing International Interdependency.

The fifth and final obstacle to energy progress that I would mention today is the unwillingness or inability of the producing countries and the consuming countries to engage in meaningful dialogue to accommodate their respective needs and aspirations to the benefit of the entire world. I think it is imperative that such talks begin in earnest and at the earliest possible time. Since we are engaged in a very real and crucial economic war, such a negotiation could well be termed an "economic peace conference."

When it comes to energy, all nations are interdependent--be they producing, consuming, developed, developing, Third World, OPEC, OECD, North, South, or whatever. An orderly, mutually agreed upon arrangement for establishing world oil prices, assuring reliable production rates, and settling other related areas of difference is greatly to be preferred over the unilateral, unpredictable, and sometimes irresponsible behavior that seems to characterize the international crude oil scene today.

I deplore actions that would involve more government intervention in the marketplace when we already have much too much government intervention. But this may be the price we have to pay in the short term to achieve a semblance of order in the world oil market-place.

To summarize, here's what I think ought to be done right now in the United States:

- \* Permit the formation of sufficient private capital to support the needed investments in conventional and alternate energy sources.
- \* Rationalize the present regulatory quagmire, retaining adequate safeguards of the public interest but eliminating unnecessary governmental controls and unjustified obstructionism.
- \* Provide access to geologically prospective areas, both onshore and offshore, with realistic environmental protection.
- \* Encourage and promote more genuine cooperation between government and industry in the national interest.
- \* Convene a meaningful negotiation between the principal oil-producing nations and the principal oil-consuming nations of the world leading toward binding agreements regarding oil prices, production rates, and related matters.

Far be it for me to recommend what Canada should do, because obviously what is in Canada's national interest is for Canadians to determine. But I would respectfully suggest that this course of action may have some applicability in Canada as well.

Now that I've said what I wanted to say, I would like to close with one more thought. It's the same thought I closed on the last time I was here, and I restate it because it is even more applicable now than then. What we have been talking about here today is in a very real sense the survival of North American society as we know it.

Thank you.

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