5. Current Status of the Domestic Oil Industry

Petition: Low oil prices and the uncertainty concerning future price drops were forcing small producers to abandon many fields prematurely. The possible loss of these reserves and production would result in increased dependence on foreign oil.

DOC Analysis and Conclusion: The Department found that, as world crude oil prices declined since 1986, the relatively smaller U.S. oil fields with higher cost production became uneconomical and the operators shut-in or abandoned some wells. The impact of low prices has been especially severe on small producers operating stripper wells with average production of 15 barrels per day or less. If small producers continue to shut-in production because of low oil prices, this could result in reduced cash flow to reinvest in exploration and increased dependence on lower-cost foreign oil.

6. Oil Import Dependence

Petition: U.S. national security worsened because oil imports have increased since 1988 both in absolute terms and as a percentage of U.S. oil consumption and our dependence on imported oil will continue.

DOC Analysis and Conclusion: The Department found that net U.S. imports have grown from 5.9 MB/D in 1987 to 7.5 MB/D in 1993. Imports currently account for 44 percent of domestic consumption compared to 37 percent in 1987. Imports from Persian Gulf countries increased from 1.07 MB/D in 1987 to 1.64 MB/D in 1993.

U.S. demand for imported oil is expected to continue growing because of declining production and increased economic growth. The Energy Information Administration of the U.S. Department of Energy (EIA/DOE) projects that net imports will increase to 11 MB/D by 2000 and account for approximately 51.5 percent of domestic consumption.

To the extent the United States and other countries import more oil in the future, EIA/DOE projects that they will turn increasingly to OPEC countries located in the Persian Gulf which has the largest amount of known low-cost reserves and surplus production capacity. The Persian Gulf producers will account for approximately 55

2000.

7. Vulnerability to a Supply Disruption

percent of world crude oil exports by

Petition: Increased reliance on lowpriced oil imports will leave the United States subject to a supply disruption and resulting costs to the economy. DOC Analysis and Conclusion: The Department found that political and economic problems in the Persian Gulf region make supply disruptions a possibility in the near-term. Disruptions are possible in other regions, but the risks to the U.S. and other importing countries are lower because oil production facilities elsewhere are not as concentrated as they are in the Persian Gulf.

The United States and the OECD countries have limited prospects to offset a major oil supply disruption because: (1) there is little surplus production outside the Persian Gulf; (2) U.S. and OECD government oil stocks today provide less protection from an interruption than was the case in 1988; and, (3) there is currently no substitute for liquid transportation fuels which account for approximately two-thirds of all oil consumption in the United States. During a major oil supply disruption, there could be substantial economic austerity as a result of the decreased availability of oil. This, in turn, could pose hardships for the U.S. economy.

8. Foreign Policy Flexibility

Petition: The petitioner did not raise this issue.

DOC Analysis and Conclusion: The Department found that our allies' and trading partners' dependence on potentially insecure sources of oil may affect their willingness to cooperate with the United States during a major oil supply disruption.

9. U.S. Military Requirements

Petition: Low oil prices are weakening the domestic petroleum industry to such an extent that it will not be able to support U.S. security needs in the event of a global conventional war.

DOC Analysis and Conclusion: The Department of Defense advised that the military requirements for petroleum fuels could be satisfied under current planning scenarios.

10. Other Factors

The Department evaluated several factors that served to improve the security of U.S. oil supplies since the 1988 investigation. Foremost among these factors are the following:

Status of OPEC: Low oil prices are in large part a symptom of the apparent disarray within OPEC. The ability of OPEC to manipulate prices has been impaired because its members have been unable to coordinate production levels among themselves.

Transparency of Oil Markets: The growth of the futures market into a full-fledged commodity market has made crude oil prices more transparent and

less subject to manipulation. Computerized trading, options, and forward contracts have connected refined products and crude oil markets more closely than was the case in 1988.

Demise of the Soviet Union: The end of the Cold War and the breakup of the Soviet Union removed the risk of Middle East oil becoming a pawn in East-West competition. The demise of the Soviet Union also has reduced the probability of a conventional war that could jeopardize Western Europe's and Japan's access to Middle East oil.

Finding

Since the previous Section 232 petroleum finding in 1988, there have been some improvements in U.S. energy security. The breakup of the Soviet Union and the apparent disarray within OPEC have enhanced U.S. energy security. Lower oil prices on balance benefitted the U.S. economy. However, the reduction in exploration, dwindling reserves, falling production, and the relatively high cost of U.S. production all point toward a contraction of the U.S. petroleum industry and increasing imports from OPEC sources. Growing import dependence, in turn, increases U.S. vulnerability to a supply disruption because non-OPEC sources lack surge production capacity; and there are at present no substitutes for oil-based transportation fuels. Given the above factors, the Department finds that petroleum imports threaten to impair the national security.

Recommendation

The Department does *not* recommend that the President use his authority under Section 232 to adjust imports. The Clinton Administration's other efforts to improve U.S. energy security are more appropriate than an import adjustment.

Section 232 requires the Secretary of Commerce and the President to recognize the close relationship between the economic welfare of the nation and U.S. national security. As energy security effects the economic welfare of the U.S., energy security must be considered in determining the effects on the national security of petroleum imports

The Department concurs with the conclusions of the 1988 study that, on balance, the costs to the national security of an oil import adjustment outweigh the potential benefits. For example, an oil import adjustment such as a tariff would likely have an inflationary effect on the economy and would result in the loss of significant jobs in the non-petroleum sectors. This, in turn, would reduce real Gross