

Testimony in the

United States House of Representatives

Committee on Commerce and Energy's

Subcommittee on Energy and Power:

“The Effects of Middle East Events on U.S. Energy Markets”

February 10, 2011

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Introduction:

Chairman Whitfield, Ranking Member Rush, distinguished Members of the Subcommittee on Energy and Power, my name is John Hofmeister, Founder and Chief Executive of the not-for-profit education foundation, Citizens for Affordable Energy, registered here in Washington, D.C. Thank you for the opportunity to be present today to share my assessment, perspectives and recommendations on current global instabilities and their impact on crude oil prices, the state of U.S. energy supplies and demand, and prospects, or solutions, to deliver U.S. citizens available, affordable and sustainable energy in the years and decades ahead.

I founded *Citizens for Affordable Energy* following my 2008 retirement as the President of Shell Oil Company for the sole purpose of educating every day, grass roots Americans about energy and environmental challenges and solutions.

Following multiple testimonies in both Houses of Congress during the high oil price period of 2006-2008, I determined that energy security for America would more likely come about with an informed electorate selecting its representatives on the basis of clear, well understood factual knowledge of energy and the environment. *Citizens for Affordable Energy* offers its members and followers, in

fact all Americans and Members of Congress, basic, practical and non-partisan energy, technology, environment and infrastructure information at no cost to them.

Additionally I have been privileged to serve as Chair of the Trustee Board of the National Urban League since May 2007. In this role I'm honored to work with my fellow Trustees and the Managerial staff of this century old institution serving the needs of urban Americans in over 100 U.S. cities. The timing of this

Subcommittee's meeting, in the face of rising prices for gasoline, is important.

Few Americans fully understand the pass through cost inflation that touches virtually every product we buy when crude oil prices rise or high crude prices are sustained. The most vulnerable Americans however feel the impact of such higher prices immediately and are the least able to afford inflated energy prices and the higher prices they pay for everything that energy costs touch, such as food, clothing and housing. Inner city urban Americans, where unemployment rates generally exceed national averages, are among those most vulnerable. Affordable energy is the lifeblood of the American way of life for all citizens, especially the most vulnerable.

Current Dilemma:

Americans once again face the out of pocket costs and anxieties of rapidly rising crude oil prices, which permeate and impact to our detriment the foundations of the

American economy, our lifestyles and national security. At the moment geopolitical uncertainty in the Middle East, once again, increases the political instability that oil production abhors. Companies that spend billions of dollars on long term oil exploration, production and infrastructure to supply the world with its daily demand of some 85 million barrels per day, 20 million in the U.S. alone, worry when its investments are threatened by the unpredictable politics of sovereign nations. Traders who buy and sell daily oil production by the millions of barrels seek to satisfy purchasers of that oil who worry more about the security of supply than the daily price. The anticipation of the consequences of purchasing insecurity creates a psychology among buyers that drives prices up or down, which directly impacts the volatility of prices on world markets. This price volatility plays havoc with national economies, especially those which depend upon predictable imports of global supplies for most or all of their oil consumption.

This brings us right to the point of dramatically increasing U.S. gasoline prices and the negative impacts on both consumers and companies across our country. The U.S. has unnecessarily forfeited its position as the primary direct supplier of the majority of its own oil supplies for domestic consumption. This forfeiture has taken place over the past several decades, especially since the 1980's when both Congressional and Presidential moratoria on the production of offshore oil began limiting access to domestic oil reserves by U.S. oil companies. While the 110th and

111th Congresses held many hearings on the issues of energy and the reasons and implications for high gasoline prices in the 2006-2008 timeframe, no legislative solutions to the proposition for increased domestic supplies were passed into law.

There is only one logical explanation for rapidly rising prices: demand is at or near surpassing supply, aggravated by geopolitical uncertainty. Even before the recent tensions and violence in Tunisia, Egypt and other nations in the Middle East, global crude prices through the Fall of 2010 and Winter of 2011 were on the rise. Increasing demand around the world, especially Asia, and a recovering U.S. economy were already pressuring available supplies. Winter in the northern hemisphere is generally a time of reduced demand for crude oil. However China's surging recovery and U.S. economic improvements, the two largest economies in the world, have raised overall demand back to roughly where it was before the collapse of oil prices in September-December, 2008.

The price has not fully recovered to prior levels for only two reasons: U.S. oil inventories remain robust and OPEC (Organization of Petroleum Exporting Countries) has several million barrels per day of so-called production overhang, i.e. shut-in production capacity. Both factors psychologically impact oil buyers and constrain price volatility somewhat. However this is winter and spring is coming, when demand in both major economies and the rest of the world is likely to further expand, demanding millions more barrels of oil production to sustain

economic growth. Everyone I know expects further price increases this spring and summer when seasonal demand increases. We are completely unprepared for it in the U.S. Cushing, Oklahoma inventories represent at today's record levels just two days of domestic demand. So no one should be comfortable thinking that such inventories provide energy security against rising U.S. demand. In addition OPEC is an international cartel beyond the reach of any sovereign nation's legal jurisdiction. Decisions to increase production to its rated capacity are the prerogative of the nations within the cartel. We have seen in the past that U.S. Presidents, the House Speaker, Cabinet Secretaries and other key U.S. influencers have little or no sway in impacting OPEC production decisions. In the current situation with the obvious hostility shown by the current Administration to the U.S. oil industry over a range of policy matters, it would be foolish to presume that OPEC leaders have any sympathy for the plight of American consumers. When their own government takes an active and decisive position against increased domestic oil production, favoring instead a regulatory regime that arbitrarily shuts down drilling at will and negates future legislatively prescribed Five Year Lease Plans by postponing such rounds, as announced by the Department of the Interior, from 2012 to 2017, Americans should not count on OPEC to rush to the rescue of high prices in America.

The current dilemma America faces with regard to rising crude oil prices is self-made, self-perpetrated and has been a sustained constant over decades, not years. While the U.S. is also the victim of geo-political instability, it further victimizes itself by refusing to produce its own oil. The U.S. previously produced more than 11 million barrels per day of its own domestic resources in the early 1970's and produced 10 million barrels per day well into the 1980's. It currently produces 7 million barrels per day; with the shut-in Gulf of Mexico, I predict it is on its way to 6 million barrels per day of production next year at a time of returning demand and record global consumption, especially driven by Asian growth. It might be visionary to project forward to a clean energy system in 2035 and to promote up to 1 million hybrid and electric cars on America's highways by 2015. But Mr. Chairman and Ranking Member Rush, and distinguished Members, there is a here and now reality where both more of our current energy sources are needed and future sources are needed as well. We live in a "both/and" world, not an "either/or world." Those who pretend that oil is an industry of the past and promote policies to suffocate domestic oil production through refusal to promote enabling regulation condemn their fellow Americans to prices beyond their means and guarantee the continued transfer of American hard earned wealth by additional hundreds of billions of dollars per year to countries from whom we buy imported oil. The risk of the current dilemma is high: we could impose a second recession on ourselves,

despite TARP, the economic stimulus, QE2 and all of the good faith investment taking place across the economy. High oil prices have sunk this nation into recession before; they could do so again.

Domestic Energy Supplies:

Citizens for Affordable Energy promotes the fact that the U.S. has more energy within its borders than our nation will ever, ever need. Whether it is during the current hydrocarbon era in which we find ourselves today or in a post-hydrocarbon era in the future, this nation is geologically and geographically positioned to always have more energy than we can use. We say this with an understanding that there are ten basic sources of energy that we can turn into useful power and fuels: coal, oil, natural gas, nuclear (uranium or thorium), bio-fuels, wind, solar, hydropower, hydrogen and geothermal energy. We utilize energy either as electrons for electrical power or liquid/gaseous fuels for stationary or motive power.

When it comes to the natural hydrocarbon resources in the ground, the Energy Information Agency, or the National Petroleum Council's 2007 report "Hard Truths: Facing the Hard Truths about Energy" contain as responsible and available an inventory as is currently available. Supplemented by research and university documentation as well as private industry's own knowledge and information, it is

not a stretch to say that our current hydrocarbon availability will serve this nation well into the 22nd century, if we need it. The billions and billions of barrels of crude oil available within the nation and in its offshore geologies from the east to the west coasts, the Alaska coasts, the vast tight natural gas formations in much of the country, the huge Bakken formation, and the prolific and untouched oil shale in the Piceance Basin and surrounding areas of Colorado, Wyoming and Utah, together with enhanced oil recovery of existing or decommissioned oil fields, represent oil and gas resources that if developed would sustain our energy demand, economy and national security well into the future, way beyond the lives of today's generations. Additional billions of tons of coal likewise secure the nation's energy future. Technology and innovation are the hallmarks of modern America. Pure and applied research have and will make advances into new forms of energy production from currently underutilized sources, such as wind, solar, biofuels, hydrogen, tidal power and geothermal energy. They will become commercial and productive in future decades. The future of alternative energy for America is robust and growing. But let's not celebrate or pretend we can rely upon future alternative energy supplies before they arrive. We have decades ahead of us where reliance on traditional coal, oil, natural gas and nuclear power, as well as existing hydropower, are essential to availability, affordability and sustainability of the world's largest energy system. Starving America of availability to its prolific

hydrocarbon base of energy makes no sense. It drives down America's cost competitiveness, weakens the purchasing power of the U.S. dollar, sends billions of U.S. dollars to foreign treasuries, destroys American jobs, frightens Americans who see their disposable income robbed from their wallets, and diminishes our national security and degrees of freedom over international influence. American genius, put to the test, can both develop our hydrocarbon base for our current and future energy needs while at the same time reducing the environmental effects of hydrocarbon production and use. Clean coal through gasification and carbon sequestration is not an oxymoron as critics suggest. Other countries are pursuing it; America can't even have a productive conversation about it. Cleaner fuels and cleaner use of fuels in transportation have been a journey of many successes, with more to come. Natural gas has yet to come into its own in this country because of the historic fear, no longer warranted, of inadequate supplies. Nuclear energy and waste management deserve a renaissance during the next half century.

America and its policymakers have to come to grips, especially with crude oil production in this country, if the U.S. is to maintain its rank as both a superpower and the world's largest economy. The notion that we can import oil at will and save ourselves the risks of producing hydrocarbons at home is at best misguided but more realistically simple nonsense. The world has no obligation to us. We put this great nation at the mercy of a few democratic friends for some of our imports,

but also then rely on autocrats, dictators and even criminals, who would as soon see our nation ruined as prosperous, for the crude oil we must have and the prices we pay to purchase it. We are reminded of this reality most recently due to turmoil in a country with whom we have a multi-decade partnership. We tempt fate daily with our dependence on foreign imports.

Policymakers should take note of recent actions by China to secure its future crude oil supplies in the face of inadequate domestic supplies. In addition to long term supply agreements in oil producing countries in return for building highways, stadiums, schools and universities, China has also loaned the following nations vast billions of dollars to aid their oil and gas production capacities, including the following: Brazil, \$10 billion; Kazakhstan, \$10 billion; Venezuela, \$20 billion; Ghana \$16 billion; DR Congo \$7 billion, Nigeria \$23 billion; and Russia, \$25 billion. In the case of Russia, this loan is to assist the conversion of Russia's supplies from 3% of current Chinese requirements to 30%. China is leaving no stone unturned to supporting its energy appetite, regardless of type of energy supply source. China's announcement in February 2010 of a \$60 billion supply agreement for coal from Australia is illustrative of the point and indicative that whatever commitment China is making to alternatives, first and foremost it will take care of economic development through the use of whatever energy it needs.

Over the coming decade while the U.S. continues on a path to reduce its oil (and coal) production, based on current policies, such as no new access to offshore leasing through at least 2017; the indeterminate shut-in of the deepwater western Gulf of Mexico; unclear, perhaps impossible to meet regulations, for future deepwater drilling; new mining regulations demanding water quality equal to or better than bottled *Evian* glacial waters; and drilling prohibitions on federal lands, the rest of the world watches in wonder and consternation. Not only does the U.S. refusal to produce more oil cost Americans higher prices at the pump, every nation on earth is negatively impacted by global price increases for oil, prompted not only by geopolitical instability and growing global demand, like everyone else, but by the continuing U.S. dependence on increased imports. Americans go abroad and come back with complaints that no one likes us out there. Is it any wonder when the U.S. demands more crude oil than any other country and refuses to produce its own very adequate supplies? No other nation shut down off-shore drilling after the traumatic, anomalous disaster at the *Macondo* well last April. They need oil. No nation exports its drilling risks like the U.S. They take the risks because they need the oil. No nation has established the type of adversarial relationship between government and hydrocarbon industry as inside the U.S. They work out their differences because they need oil. Continuing on its current path, Mr. Chairman, as I write in my recent book *Why We Hate the Oil Companies: Straight Talk from*

an Energy Insider (Palgrave Macmillan 2010), the U.S. will face inevitable brownouts, blackouts, and liquid fuel shortages within the decade. We cannot extend the 20th century infrastructure indefinitely and we have yet to embark upon the establishment of a rational, coherent 21st century energy infrastructure to replace it. We cannot sustain the path that we are on. We look to you and your colleagues in the Congress to provide leadership in the 21st century to secure available, affordable and sustainable energy for our nation. I'm happy to also share my thoughts on how to do just that.

Future Solutions:

First and foremost, what the U.S. needs most is a coherent, cohesive, practical energy plan for the future. We've never had one. Imagine all the billions of taxpayer dollars that the U.S. has spent on its energy needs and yet it has never spent the money according to a plan. We've made it up as we've gone along. No nation, company, institution or family can operate without a plan. Yet, here we are in the second decade of the 21st century, a nation with no energy plan in a world that competes every day for ever more energy.

Second, the nation's energy plan has to follow a logical and consistent time dimension over decades. Energy time, unlike political time which is calculated in two and four year intervals, extends over decades. Power plants, mines, oil

production, pipelines, refineries, storage sites, wind farms and dams, to name several sources of energy, require decades to plan, permit, engineer, build, operate and decommission. Therefore we need a U.S. energy plan that includes short, medium and long term planning, where short term is measured as now to 10 years out, medium term is 10 to 25 years from now, and long term is 25 to 50 years from now. Such a plan needs to be updated continuously, but not radically changed, short of reverting to where we are today: no plan and constant change in priorities.

Third, there is no question but that from now to as far into the future as any analyst can see over the next decade or two, perhaps three, the U.S. will need 20 million or more barrels of oil, or its equivalent, per day just to get through the day. That's 10,000 gallons per second, by the way. To pretend that oil demand is going to decrease is to defy reality. Increased gasoline mileage efficiency for vehicles, the production of biofuels to displace oil, the displacement of traditional internal combustion engine vehicles with hybrids, electric or hydrogen fuel cell vehicles are multiple decade impact initiatives. Meanwhile the population using current products is increasing, not only in the U.S. but around the world. In other words while we can set in motion initiatives to change the mix of fuels used and the technologies for mobility, it takes at least twenty years, or more, to change just what we're doing today. During these next twenty years we can't pretend we don't need more oil. We must have it or the economy and our lives, as we know them

today, shut down. It's dead wrong to call this an addiction. It is a choice we made as a society over the past 100 years. Because we made such choice we are the world's largest economy with the world's most envied lifestyle, the defender of freedom who won two world wars with our domestic oil. We don't reverse course with ideas or words. It takes action to change the direction we've been taking. Such action warrants a short, medium and long term plan. The 250 million cars and tens of millions of trucks, tens of thousands of aircraft, boats, millions of lawnmowers and tractors, and the entire petro-chemical industry that produces our fuels, lubricants, soaps, chemicals, fibers, make-up and pharmaceuticals all need oil from now until they don't. And no one should think Americans won't buy tens of millions of new products over the coming years and decades that rely on oil as well. We have a hydrocarbon economy now, and it's not going away in our lifetimes. So let's quit pretending we don't need more hydrocarbon development.

Fourth, let's set as a minimum a national objective to produce 10 million barrels per day by the end of this decade. Remember we use 20 million, we're on our way to producing 6 million. Depending on more imports to meet our demand is an economically debilitating and internationally frightening choice. Providing for and enabling increased domestic production at a time of increasing global demand amidst geopolitical instability should be a "no-brainer." Common sense alone says if you have the domestic resources, why depend on foreign sources? Economic

common sense says why invest American dollars to create oil producing jobs in other countries when we need jobs in our own country? But we've been insistent upon not using common sense for far too long. This proposal to commit to 10 million barrels per day realistically only gets us back to half of our domestic demand. This would down from 65% imports, where we were at the end of 2009, but it comes nowhere near to where we were at the time of the first Arab oil embargo of 1973, which was 30% import of supply.

By establishing an objective to produce 10 million barrels per day we also commit to creating as many as 3 million new U.S. jobs within the decade! Currently 9.2 million people work in the nation's oil and gas industry to produce approximately 7 million barrels per day. In creating new jobs this proposal not only means new jobs in the oil and gas fields, onshore and offshore, new jobs for engineers and service company workers, it means so much more. There will be the education jobs to teach skills, math, science, technology to high school graduates in community colleges, four year colleges and universities. Oil and gas workers in the hundreds of thousands need cars, trucks, tools, equipment, clothes, and homes to live in. The expanded infrastructure for gas and oil needs rigs, pipes, valves, trucks, equipment, ships, construction workers, supporting service companies and products from the entire supply chain of materials from iron ore to steel, rubber and plastics, to food and fiber. These workers also need environmental protections

and safeguards because of the risks associated with any hydrocarbon activity and more jobs for the people who can provide it. The industry will need government enablers to provide the permitting and oversight necessary to produce natural resources and to protect our land, water and air as we go about increasing our production by one third. The objective to increase domestic drilling to produce 10 million barrels per day is a rising tide that can lift all ships. The economic value creation will be paid for by private, not taxpayer, investment. The revenues generated both by the economic expansion of wages and salaries, the royalties of increased oil and gas production and the multiplier of goods and services purchased across the spectrum of the supply chain produce new revenues for local, state and federal governments.

Fifth, specific, concrete, measureable plans to develop the supply side of the nation's energy industry across the entire ten sources of energy would enable the same job-creating dynamic as the plan to produce 3 million more barrels of oil per day. We have affordable energy in this country when the supply slightly exceeds the demand. That is the lesson of the 20th century, at least up to the 1980's when we began exporting oil jobs by importing more crude oil than we produced.

Utilities across the country have been shelving new power plants by the dozens because of regulatory uncertainty. Coal plants now average almost 40 years in operation. Nuclear plants average over 30 years. Both types of plants have a

natural permitted life-cycle. Rather than extending old plants longer, living with higher risks, increasing inefficiencies and outdated technology, why wouldn't we build new plants with newer technology? Do we want the 20th century energy system to last forever? Well, it won't. So rather than pretend we can extend, why not set in motion the enablers to promote private investment capital to pay for replacing existing old infrastructure with new? More jobs, more value creation and more government revenues are the result.

Sixth, protect our land, water and air with manageable environmental laws and regulations. Mr. Chairman, I've never met the American who argues for dirtier water and air and wasteful land use. To the contrary I know no one who doesn't want better for themselves and their children than what they've experienced.

There is no question but that as a nation we have learned lessons in the 20th century regarding environmental protections that we need to apply in the 21st century. The manner by which we go about protecting ourselves has up to now been exceedingly controversial, in part because of the American tendency to do everything at once. We are a society that prioritizes "now." But when it comes to technology, investment and existing infrastructure, we are where we are. We need a practical plan to tackle over the coming years and decades what improvements we need so that government, businesses and operators can adjust to improvements in a way that supports ongoing business and future investments. Again, the nation

should follow a “both/and” approach to environmental improvements, not “either/or.” What we knew then is less than what we know now. But getting from then to when, in the future, should be graduated and incremental in the broader interests of jobs, people, and the biosphere.

Finally, Mr. Chairman, the Congress would best serve the energy requirements of the American people if it could enshrine three fundamental concepts in every energy law: energy must be available, affordable and sustainable. The nation’s security, economy and lifestyles are precious to every American who has experienced the use of energy during their lives. The nation is the envy of the rest of the world because of all three. We became a great nation because we harnessed the energy we knew and learned as quickly as we could how to do the same with the energy we discovered. That formula works. We don’t need to change it. What we need to do instead is to cease politicizing energy into “good” and “bad” energy sources, where we play favoritism with the current “good” energy providers and punish the “bad” energy providers. The electrons in our lights, computers, machines and transmission lines don’t know “good” from “bad.” They just know they have a job to do and that is to keep our nation running. The fuels in our vehicles don’t know where they came from either, except they have a job to do. In the same manner as we enjoy the benefits from all energy, especially knowing that there is more where that came from, we can provide future generations with more

and more. Our domestic energy sources are ample, available and producible, provided, Mr. Chairman, that they are accessible. Thank you again for inviting me to testify. I would be pleased to respond to any questions you or the Members of the Subcommittee might have.