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Dinner Address

THE BACKGROUND OF THE UNITED STATES SYNTHETIC
FUELS CORPORATION

by

The Honorable James A. McClure
Senator from Idaho

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It is indeed a pleasure to be in San Francisco tonight to address this conference on "Synthetic Fuels: Status and Directions." I can't think of a more appropriate time to address an audience such as yourselves, in light of the fact that approximately three months ago the President signed into law the Energy Security Act of 1980, which established the U.S. Synthetic Fuels Corporation. As you all know, under this Act, \$20 billion is initially made available for development of synthetic fuel projects. To intelligently, and more importantly, to successfully utilize these funds, the expertise and the talents of your industry must be effectively drawn upon. Indiscriminate use of funds of the magnitude just described could be counterproductive to the development of a U.S. synthetic fuels capability and capacity. On the other hand, we all trust that the wise use and application of these resources will minimize the financial risk which has been a major obstacle to synthetic fuel commercialization, thereby helping to bridge the gap between energy insecurity and energy freedom.

Although all of you are particularly interested in the role of synthetic fuels, I am sure that you appreciate the fact that synthetic fuels are but one source, albeit an important one, in the energy mix needed to meet the free world's increasing energy demand. In this regard, let me say at the outset that more emphasis has to be placed on the further development of the nuclear and direct coal combustion options, as well as to accelerate the decontrol of oil and natural gas. It is these fuel sources that will be the linchpin of any coherent national energy policy on both a near and midterm basis. I will return to this subject in a few minutes.

You all have undoubtedly been paying careful attention to the recent flurry of activity regarding the President's nominations for the SFC's Chairman and Board of Directors. With a position that could pay a salary of up to \$200,000, you would have expected the post of Chairman of the Synfuels Corporation to have been very attractive to a number of qualified executives. After all, the Chairman would be

appointed for a seven-year term, would have the ability to initiate a relatively new industry in this country, and would be insulated from political pressures while having sufficient unchecked latitude in day-to-day and long-term decision-making. Nevertheless, it has taken the Administration six months to nominate the Chairman, and this nomination was arrived at only after several other preferred choices declined. You might ask why such a situation would occur, given the uniqueness of the position being offered. I think the answer lies in the fact that there are inherent problems in the Synthetic Fuels Corporation concept, as enacted.

The first and perhaps the most obvious of these problems lies in the production goal targeted by the legislation--namely 500,000 B/D crude oil equivalent of synfuels by 1987 and 2 million B/D by 1992. According to an EPRI study, to meet this goal, considerable financial incentives beyond those provided by the U.S. Synthetic Fuels Corporation will be required. It is suggested that a business-as-usual approach, in the absence of legislation providing such additional incentives, would leave a shortfall of approximately 1.5 million barrels per day of crude oil equivalent. Some commentators have stated that it is irrelevant whether or not the Corporation achieves its statutorily mandated targets--that what is important is that the effort be undertaken with high goals. I disagree. I personally feel that the goals should have been realistic ones. If the SFC is unable to meet its objectives as stipulated by the legislation, it is possible that much harm could be done to the overall synfuels program. The Congress as well as the American public might become disillusioned with the industry and the people who administer the SFC--the end result being that a great deal of support would be lost for synfuels in general.

A second problem facing the Corporation is the multiple and rather distinct responsibilities that the Chairman and his limited staff of 300 are charged with performing. They are responsible for analyzing the merits of different technological proposals, determining the most suitable investment strategy for the corporation, and preparing the justification for the comprehensive production strategy which is to be submitted to Congress within four years.

It would seem, given the limited staff resources of the organization, that it may have a difficult time fulfilling these diverse responsibilities. In fact, it is quite conceivable that in order to fulfill its mission, the Corporation will have to rely extensively on DOE for assistance. If this situation occurs, a significant rationale for the creation of the Corporation will have been thwarted. As

you recall, one of the principal reasons for the idea of a separate entity such as the SFC was that Congress noted the lack of success DOE and its predecessor agencies have had in trying to bring just one commercial-size synthetic fuels demonstration project on line. Congress felt this was sufficient reason for them to set up the SFC. Its independence would assure that it would not be subjected to the bureaucratic red tape, policy and priority changes, and the vagaries of the budgetary process that DOE and other existing federal agencies succumb to.

The Congress wanted the Synthetic Fuels Corporation to be primarily a banking organization, not staffed with bureaucrats but with hard-nosed businessmen trained in high finance and possessed with the expertise to make the synthetic fuels program a reality. We wanted the SFC to be an entity that would instill confidence in the private sector as to its continuity of purpose and its ability to deliver on what it contracted to do. In other words, we wanted it to be everything that DOE is not. Nevertheless, in light of the complex and different responsibilities delegated to the SFC, it is now quite possible that DOE will play an important role in establishing synfuel policy. DOE already has the authority to initiate cooperative agreements and feasibility studies in the period prior to the formal start-up of the SFC.

A third issue which the Corporation is going to have to deal with involves the proprietary nature of many of the most promising candidates for demonstration and initial commercialization. Many of the technologies that are now ready for or close to large-scale demonstration or initial commercial deployment have been developed largely with private sector financing. As a result, the promoters of these technologies have significant proprietary positions which, from a business standpoint, they must maintain. It is quite conceivable that a large number of these companies will not seek SFC funds because of the disclosure and reporting requirements placed upon them by the Corporation. The effect of this may be that the government will fund some of the least attractive processes, both technically and economically, thus retarding commercialization.

Finally, the last major problem that I perceive confronting the SFC is the lack of power that it has with respect to the expediting, licensing, and permitting of synthetic fuel plants. An integral part of the total synfuel effort, as proposed by the Administration a year ago, was the Energy Mobilization Board. During the course of its legislative gestation, the EMB effort was so weakened through political compromise that it ultimately died in labor. As you remember, the EMB was to be an independent and complementary agency to the SFC, charged with the duties of

speeding up the environmental licensing process for nationally designated non-nuclear energy priority projects. The EMB however, is dead in its tracks for this Congress and its absence leaves the Synthetic Fuels Corporation in a weakened posture vis-a-vis federal, state, and local environmental regulations. It has been estimated that more than 100 permits are required for constructing a commercial synfuel facility. It is evident, therefore, that some expediting process is needed.

This fact is more clearly understood when viewed in the context that a 50,000 barrel per day synfuel plant will cost somewhere between \$1.5-\$2 billion 1980 dollars. Thus, many potential investors, already frightened by the high financial risk facing them, could be further inhibited from investing by the uncertain permitting and licensing requirements which exacerbate their financial risk. In view of all of these problems, it is understandable why the Administration had such a difficult time locating a chairman. Nevertheless, they did find one in Mr. John Sawhill.

On September 25, the Senate Energy and Natural Resources Committee acted on Mr. Sawhill's nomination and the five Board of Director nominees. The Republican members of the Committee offered a compromise proposal to allow confirmation of four members of the Board, a working majority on the seven-member panel. The compromise would allow John Sawhill to be confirmed as Chairman. Three other nominees would be chosen by President Carter to fill the one-year, two-year, and three-year positions of the Board. In exchange, the Republican proposal called for one of the three nominees to be a Republican. The White House rejected the proposal and it was subsequently defeated on a party-line vote of 7-11 that morning in the Committee.

Majority Leader Robert Byrd brought the nominations to the Senate floor on October 1, under the threat of a Republican filibuster. As you can imagine, there was a great deal of resentment to the way in which the nominations were being railroaded through the Senate. In the words of Senator Mark Hatfield, ranking minority member of the Senate Energy Committee, "Republicans are anxious to get the U.S. Synthetic Fuels Corporation on track. The war between Iran and Iraq serves only to remind us of our growing national dependency on unstable sources of oil. Any continuing effort by the White House and the Democratic leadership to ram nominees down the throats of (the) Republican leadership is a destructive example of election-year politics at its worst."

Because the Senate was scheduled to adjourn in the next few days, and in light of the considerable Republican opposition to the handling of the nominations, Senator Byrd decided that it was wiser to end debate on the nominations and take them up again after the November election.

In spite of the foregoing, on October 3 the President appointed on an interim basis Mr. Sawhill and the other five nominees to the Board of Directors, instead of accepting the Republican proposal of establishing a more permanent working majority on the Board. I would anticipate that Mr. Sawhill would be confirmed in the event that President Carter is re-elected. If Governor Reagan becomes President, I would imagine that he would submit new names to the Senate. In any event, the SFC is presently operational and functioning under the leadership of Mr. Sawhill and had its first organizational meeting on October 8.

Whether the Synfuels Corporation succeeds or fails, only time will tell. International events and domestic policies will play an important role in this decision. The bottom line with all these problems that I have raised is that the SFC has not developed a track record. It is not possible to judge all its strengths and weaknesses from its actual performance. Yet the problems I mentioned suggest opportunities for future legislation.

Personally, I voted with reservation to establish the Synthetic Fuels Corporation. I believe that Federal intrusion in the energy marketplace should be minimized. Under the Energy Security Act the notion of price guarantees or purchase agreements, loan guarantees, loans, and joint ventures as administered by a major new federal bureaucracy will not constitute the most dynamic means of motivating U.S. corporations having the technical expertise in synthetic fuel development to move forward in an aggressive manner consistent with the objective of this legislation.

I believe that the objective of the Congress and the Executive Branch should be to tailor any Federal support for synthetic fuels so that such assistance is minimized but sufficient to induce the desired amount of synthetic fuels investment by the private sector. There are other methods available to the Congress to accomplish this goal such as changing the tax laws to allow industry to expense capital investment during the construction period or establishing new production tax credits. The measures would result in low-cost synthetic fuels and would require a minimum direct capital outlay from the Federal Government. Such action however, did not appear as politically acceptable as establishing a major federal bureaucracy such as the Energy Security Corporation.

There is no doubt in my mind that the Republican National Convention Platform is right when it said, "Proven American values of individual enterprise can solve our energy problems. A decontrol of oil and natural gas prices will eliminate any need for government support for a synthetic fuels industry, except possibly for limited demonstration projects." I am convinced that only by a return to truly free market principles can we be sure that the right decisions will be made to develop energy resources at the lowest costs to the American people.

To have energy independence, however, is going to require considerably more than what the SFC can possibly hope to accomplish. As I previously mentioned, the best near- and intermediate-term solutions to America's energy needs lie in the rapid production and development of coal, oil, gas, and nuclear fission.

In the area of coal, putting aside coal-derived fuels, a great deal of promise exists, for this is one of our most abundant natural resources. The electric utility industry, of which many of you are members, projects the addition of 164,000 MW of coal-fired capacity between 1978 and 1987, requiring an additional 430 million tons of coal over the 1977 consumption of 470 million tons. Because of the very large increases in oil prices and the uncertainty about oil supply, coal has been selected to fuel these plants.

In spite of this recognition on the part of utilities of the perceived economic advantages of coal and in spite of Federal policy advocating increased use of coal, there have been significant difficulties in putting this generating capacity in place. First, environmental standards have not reflected a balance between health and ecological concerns versus the need for adequate electrical supply. Secondly, environmental standards and safety regulations have repeatedly changed in the absence of well-documented need for such change. And finally, there have been unfortunate delays in the siting of power plants and transmission lines with the effect that consumers' rates have unnecessarily increased.

I strongly believe in the increased use of coal, and I believe this can be achieved while maintaining an effective environmental program. We can ensure a constancy in environmental standards and regulations and make certain they are enforced fairly and predictably. Furthermore, we must reform regulatory procedures so as to expedite licensing and permitting. All these things are achievable and will be implemented in a Republican Administration. As the Republican platform states, "We strongly affirm that environmental protection must not become a cover for a "no-growth" policy and a shrinking economy." Ladies and gentlemen,

our economy can and will grow in an acceptable environment--an environment which envisions an expanded use of coal.

As to nuclear power, there is no doubt that it will be required in increasing quantity to relieve the economic and national security burden of short-term and long-term oil supply problems. Further, although there are abundant coal and oil shale reserves in the United States, there are limits to the rate at which they can be developed. Nuclear power will be necessary to provide the increment of energy between future demand and what these domestic fossil fuel resources can be expected to produce.

Unfortunately, in the past few years the role of nuclear power has been uncertain because of regulatory and licensing delays, reactor safety problems, and the lack of sound plans for nuclear waste disposal. Further, it has been the Administration's position that the breeder reactor option should not be deployed until the year 2020. In addition, the Administration has opposed reprocessing. The net effect of these decisions is to both destroy our technical credibility in these areas, as well as to lose our ability to benefit and to influence other nations that are pursuing similar programs.

We in Congress who support the nuclear option are taking steps necessary to make nuclear power available for both short- and long-term use. The Administration, in its FY81 budget for nuclear fission research and development, asked Congress not only to kill the Clinch River Breeder Reactor Demonstration Plant, but also to make deep cuts in the base program for the liquid metal fast breeder reactor. Although the Senate and House Appropriations Committees reduced funding for the LMFBR base program for FY81, the Appropriations Act does provide that core breeder personnel be kept on the payroll. And the Clinch River project has been kept alive for this year with the passage of a continuing appropriations resolution a few weeks ago.

On July 30, the Senate moved to alleviate concerns about waste disposal by passing SB2189, the Nuclear Waste Storage Bill. The bill emphasizes temporary storage in order to reflect the desire of the Senate to provide the nuclear industry with a demonstration that there are solutions to the waste disposal dilemma. The bill requires federal construction of one or more away-from-reactor facilities to store spent fuel, as well as requiring the Secretary of Energy to send to Congress within one year of enactment a plan for a system of long-term civilian and military waste disposal facilities. The legislation also gives the states a significant role in waste disposal decisions.

SB2189 is a step in the right direction. Money has been made available for its implementation in FY81. Hopefully the momentum we have achieved by the passage of the bill in the Senate will not be lost as a result of a lack of commitment by the House of Representatives to resolve this issue in the post-election session of Congress.

With respect to oil and gas production, I have always advocated immediate decontrol of price at the well head for these fuels. It is my firm belief that with deregulation, domestic energy production would increase. Presently, we are seeing a phase in decontrol of oil and natural gas. I suspect, however, that if the Administration had its way, there would still be a permanent lid on oil and gas prices, as unrealistic as this might seem. Then again, President Carter has never been known for his decisiveness in the area of energy pricing.

In this regard, I cannot help but remember the natural gas debate of 1977-78 in which I was intimately involved as a conferee. As you probably recall, when he was running for election in 1976, President Carter promised total decontrol of natural gas. Then, six months later in his first national energy plan (NEPI), he advocated total control. Finally, a year and a half after NEPI, President Carter had become a believer of phased decontrol for natural gas. In a period of less than two years, he had undergone three major philosophical changes regarding natural gas pricing. I would like to attribute these to the fact that President Carter is an open-minded person. But you are probably the best judge of that.

Coupled to the phased decontrol of oil, President Carter signed his windfall profits tax bill into law last April. I believe this legislation to be one of the major impediments to increased domestic oil production that has been passed by a recent Congress.

This so-called windfall profits tax is neither a windfall to the oil companies--it is a windfall to the government--nor a profits tax. It is an excise tax on production that will encourage people to produce overseas and have the further result of depressing the investment in production in this country.

The bottom line of this is that each individual citizen/consumer is the loser. We will all be paying realistic, but painful, prices for our domestic oil, but we will be doing it in such a way that we will continue to be at the mercy of OPEC's pricing decisions and more vulnerable to future supply shortages.

The revenues to be raised under this new taxation, which the American consumer will pay, are greater than the revenue to the federal government from all sources from 1879 through the end of World War II. And that is the revenue projected over the next 10-year period from this tax and this tax alone.

It is evident that drastic regulatory changes are going to have to occur before an increase in the development and production of oil, gas, coal, and nuclear fission takes place. Significant regulatory change has already occurred in the area of synthetic fuels, as reflected by the new legislation.

Whether or not the new Synthetic Fuels Corporation will play a significant role in our national energy policy in the 1990s, however, is debatable. The SFC will be subject to conflicting expectations as its performance in Phase I is evaluated by Congress. From all of this uncertainty, however, one unmistakable fact arises and that is that abundant sources of inexpensive energy are no longer available. We must pursue all realistic energy options. Synthetic fuels is but one of these, albeit one of the more controversial. Nevertheless, the U.S. has decided to move aggressively on synthetic fuels development. Our failure to do so could prove to be quite distressing for our country in the future.

Thank you for allowing me to present my thoughts on these subjects. I am now ready to answer questions from the audience.