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Revisiting Energy Development in the Gulf of Mexico

Introduction

Americans continue to face higher than normal energy prices, with real financial consequences for individual consumers and business consumers alike. To address this, Congress is in the process of revisiting the issue of developing the known, valuable quantities of oil and natural gas under the deep waters of the Outer Continental Shelf (OCS).

Many of these OCS resources – including all of those located under the U.S. waters off of the East and West coasts – have been put off limits by Congressional moratoria or Presidential withdrawal dating back to as early as 1982. But one area not subject to moratoria is known as Lease Sale 181, located in the Gulf of Mexico.

This paper – the first of two on the subject – will examine the oil and natural gas supply available in Lease Sale 181 and how its development will aid U.S. consumers. The second paper will examine the risks of development in the Gulf of Mexico, fully evaluating the likelihood of an adverse event affecting tourism and marine life.

Brief Review of the U.S. Energy Situation: High Costs, Limited Supplies

Americans are facing high energy costs due to supply problems for both oil and natural gas, which are having an adverse effect on the nation's economy. Crude oil prices, for example, have hovered around $70 per barrel since April and have been above $50 per barrel nearly constantly since the beginning of 2005. As a result, American consumers have been faced with high gasoline prices, exceeding $2 per gallon for most of that time, and sometimes exceeding $3 per gallon.

As high as gasoline prices have been, the high price of natural gas may be having a greater impact on the economy. Throughout most of the 1980s and 1990s, the wholesale price (commonly referred to as the "city gate" price) of natural gas hovered around $3 per thousand cubic feet. By 2004, wholesale prices exceeded $6, and by the end of 2005, they exceeded $10.[1] Since then, the price has moderated somewhat, but it is still high at $6.19 per thousand cubic feet.[2]

In 2005, natural gas consumers spent $200 billion on natural gas, which is four times as much as was spent in 1999, the last time natural gas traded within its historic price band (the yearly average wholesale price during the 1980s and 1990s was between $2.78 and $3.95).[3]

The U.S. chemical industry, whose products are found in 96 percent of all U.S. manufactured goods, has been hit hard by high natural gas prices. The industry uses natural gas as both an energy input and as a key ingredient in its products (accounting for more than 10 percent of total U.S. consumption). It has been estimated that, from 2000 to 2005, the industry lost $50 billion in business to overseas competition, and reduced U.S. jobs by 100,000.[4] In the same time frame, the National Association of Manufacturers estimates that, overall, the United States lost 2.9 million manufacturing jobs, due in large part to high natural gas prices.[5]

In particular, the U.S. fertilizer industry has been devastated by the high cost of natural gas because natural gas is a key component in the production of nitrogen fertilizer, which represents the bulk of the industry's product offering. Sixteen production facilities have closed permanently and an additional five have been idled due to rising natural gas prices, representing a 35-percent decline in U.S. nitrogen fertilizer production.[6] In late 2005, three of the largest remaining producers announced that they are shutting or idling more facilities, which will reduce their combined production by at least 50 percent.[7]

Moratoria Renewed Despite Supply Potential

The OCS, as a whole, is estimated to contain approximately 60 percent of the remaining undiscovered oil in the U.S. and as much as half of the remaining undiscovered natural gas. However, for two decades, Congress has continued to renew the moratoria on energy exploration and development by annually prohibiting funds in Interior Appropriations bills or by authorizing legislation. These moratoria have affected areas off the coasts of New England, California, the Eastern Gulf of Mexico, the Mid-Atlantic, South Atlantic, Alaska's North Aleutian Basin, and the Pacific Northwest.

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[1]U.S. Energy Information Administration (EIA), Natural Gas Navigator – http://tonto.eia.doe.gov /dnav/ng/hist/n3050us3m.htm.

[2]EIA, *Natural Gas Weekly Update*, June 8, 2006. See also EIA chart at: http://tonto.eia.doe.gov/dnav/ng/hist/n9190us3m.htm.

[3]Jack N. Gerard, American Chemistry Council, Testimony before the Senate Subcommittee on Clean Air, Climate Change and Nuclear Safety, February 9, 2006.

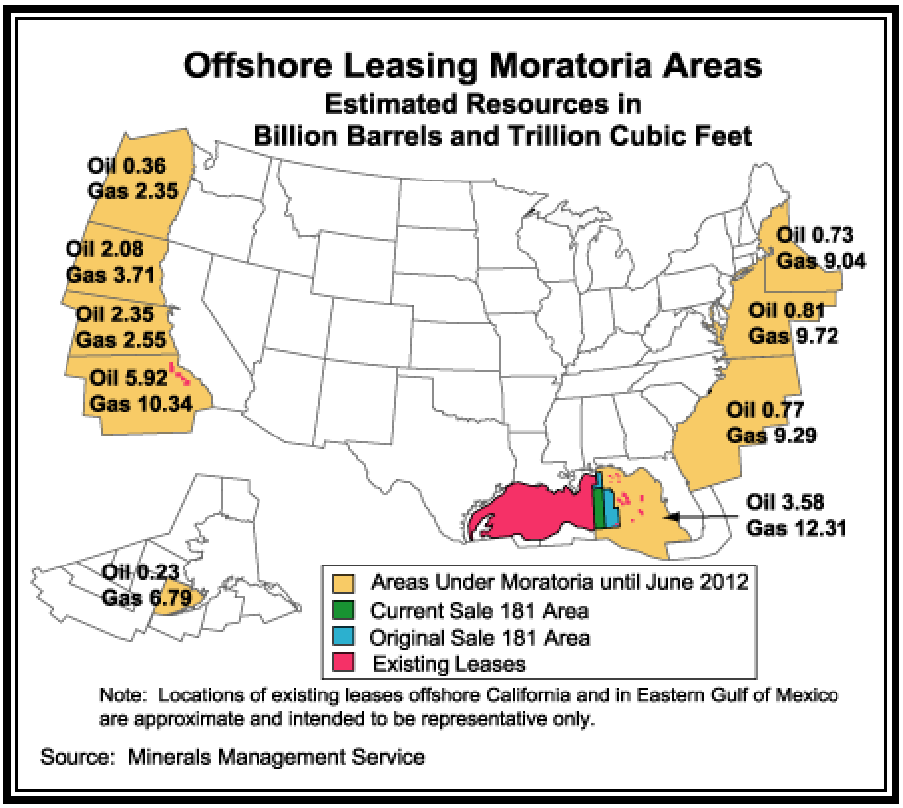
[4]Jack N. Gerard, February 9, 2006.

[5]Jack N. Gerard, February 9, 2006.

[6]Ford B. West, Fertilizer Institute, Testimony before the Senate Appropriations Subcommittee on Interior and Related Agencies, October 25, 2005.

[7]Ford B. West, October 25, 2005.

Additionally, Presidents Bush (41st) and Clinton have used their executive authority to keep areas from being developed. In 1990, President George H.W. Bush issued an Executive Order prohibiting lease sales off the East and West coasts for 10 years. In 1998, President Clinton, in a memorandum to the Secretary of the Interior, withdrew from leasing through June 30, 2012, those areas of the OCS put under Congressional moratoria in the Department of the Interior and Related Agencies Appropriations Act of 1998, which included the areas put under moratoria by President Bush, as well as the North Aleutian Basin, the eastern Gulf of Mexico (minus the 181 area), and the Mid-Atlantic and South Atlantic.[8]



Note: Map created by the American Petroleum Institute from MMS data

Bipartisan Bill Opens to Leasing Another Portion of the Gulf of Mexico

In April, the Senate Energy Committee reported S. 2253, a bipartisan bill cosponsored by Chairman Domenici and Ranking Member Bingaman, by a vote of 16-5 (with 1 "present" vote). It requires the Secretary of the Interior to offer for oil and gas leasing, within a year of enactment, a specified area within the deep waters of the Gulf of Mexico that is not subject to any moratoria or Presidential withdrawal. This known mineral-rich region is far off the coast and encompasses a large portion of a region that was originally approved for development under

[8]U.S. Department of the Interior, Minerals Management Service, *Leasing Oil and Natural Gas Resources: Outer Continental Shelf*, February 13, 2006.

the Clinton Administration (a 5.9-million acre tract region commonly referred to as "Original Lease Sale 181"). The main difference in the boundaries between S. 2253 and the original lease sale areas is that S. 2253 is significantly scaled back to address opponents' concerns of drilling activities closer to the coastlines. As can be seen from the above map, the entire portion of the Gulf of Mexico to the west of Original Lease Sale 181 (the portion in red), is already under production. Opening the 181 area would incrementally increase the available leasing area within the Gulf for exploration and production.

The key chapter in the story of Lease Sale 181 essentially begins with action taken in November 1996, when President Clinton's Secretary of the Interior, Bruce Babbitt, adopted a five-year leasing program (1997-2002) to start the multi-step process to allow for eventual energy exploration and development in the Original Lease Sale 181 area. The Secretary's decision was made after extensive consultations by the federal government with coastal states, including the State of Florida (which, among the Gulf Coast states, has traditionally offered the strongest opposition to energy activities off its coasts).[9] In June 2001, after President George W. Bush came into office, a Final Environmental Impact Statement was completed for the full area, giving the lease owners the green light to begin development activities. However, within weeks, Rep. Jim Davis (D-Fla.) introduced to the U.S. House of Representatives an amendment to the FY02 Interior Appropriations bill (H.R. 2217) to prevent the use of funds to execute a final lease agreement.[10] The amendment passed by a vote of 247-164. The amendment was eventually stripped out in conference, but the strong opposition from the Florida congressional delegation, the Governor of the state of Florida, and some environmental groups induced Interior Secretary Gale Norton to offer a compromise proposal to adjust the lease sale area from 5.9 million acres to 1.5 million, such that every point of the proposed area would be at least 100 miles from the coast of Florida.[11]

S. 2253 seeks to expand supply by opening to exploration and production a 3.6 million-acre area, while still maintaining the 100-mile buffer from the coast of Florida. The lease area proposed in the bill is estimated by the Minerals Management Service (MMS) to contain 930 million barrels of undiscovered recoverable oil and 6.03 trillion cubic feet of undiscovered recoverable natural gas, an amount which would yield up to about 1 billion cubic feet of gas per day.

The bill also provides that an additional area may become available for exploration and production if the Secretary of Defense authorizes exploration and production activities east of a longitudinal line in the Gulf off the coast of Florida, known as the Military Mission Line. The Defense Department has a say in activities in this section of the Gulf because of military exercises conducted there. This additional 700,000-acre tract contains an estimated 130 million

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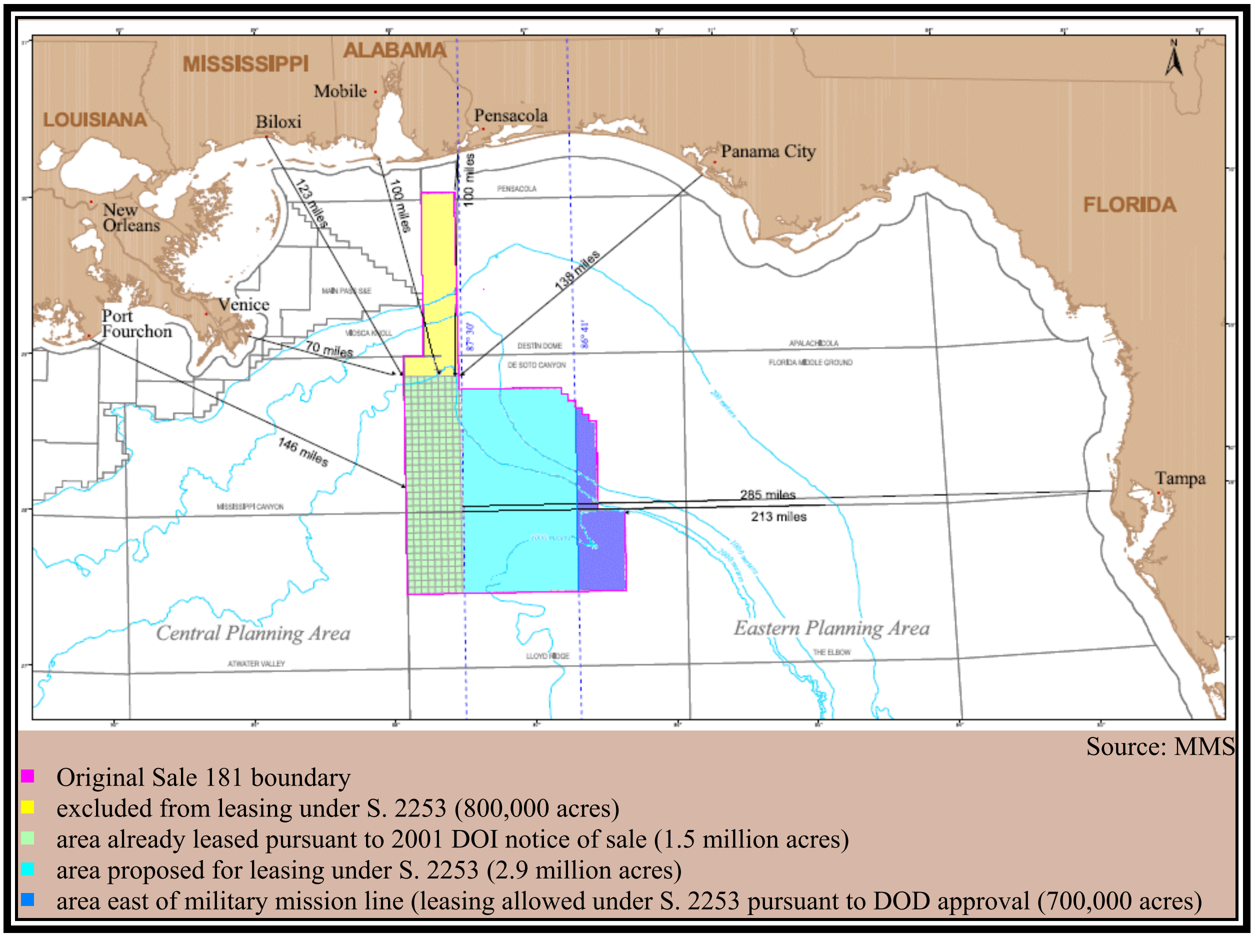
[9] U.S. Senate Committee on Energy and Natural Resources, Report (109-240), April 7, 2006.

[10] National Ocean Industries Association, *Background on Lease Sale 181*, http://www.bipac.net/page.asp?content=sale181&g=NOIA.

[11] U.S. Senate Committee on Energy and Natural Resources, Report (109-240) to Accompany S. 2253, *Oil and Gas Leasing in the 181 Area of the Gulf of Mexico*, filed April 7, 2006.

barrels of undiscovered recoverable oil and 1.17 trillion cubic feet of undiscovered recoverable natural gas.[12] The following map shows the position of the various portions of lease sale 181.



While the bill promises to increase supplies of both oil and natural gas, the larger effect, at least in terms of prices for consumers, would come from natural gas production. Since oil is a global commodity, the effect of developing the oil resources in the area provided by in the bill would be to slightly increase world supplies, and so slightly reduce the world price of crude oil. Natural gas, on the other hand, is a regional commodity, and development of that domestic resource would have a direct and more substantial effect on natural gas prices in the United States. Also, given that these resources are located in the Gulf of Mexico near major oil and natural gas transport terminals and pipelines, these resources would be easily shipped to market.

[12] Senate Committee on Energy and Natural Resources, *Background for Tomorrow's Energy Independence Hearing*, March 6, 2006 – http://energy.senate.gov/public/index.cfm?FuseAction = PressReleases.Detail&PressRelease_Id=234889.

Conclusion

The increased utilization of even a small amount of the known resources of oil and natural gas in the Gulf of Mexico would help alleviate the price of gasoline, electricity, and other utilities, thus offering financial relief to millions of American families, businesses, and farmers. The outstanding question is this: what are the risks? The second paper will address this question.