The need for an effective policy to keep U.S. oil imports at the lowest feasible level is undisputed. The type of policy to achieve this aim is of course very much disputed. Essentially there are two approaches. In one the level of oil imports is determined by an integrated energy policy system; in the other the oil import level precedes and, hence, determines the energy policy system. The first approach treats oil imports as the required residual in balancing total energy supply and demand. It aims to maximize domestic production of oil and substitutable energy sources through the price mechanism and some forms of governmental assistance such as tax incentives and infant-industry aid to new types of energy; it uses the same measures plus certain mandatory constraints to maximize energy conservation over time. The resulting oil import level, assuming it is available, is a function of the progress in all these areas.

The other system starts out by setting an absolute ceiling on oil imports, independent of actual availability, thereby making the energy supply and demand balance a function of the imposed import limitation. Since the purpose of the limitation is to reduce import demand from what it would otherwise be, it creates in effect a supply shortage with attendant price increases. Thus, this system aims to raise the cost of oil above the world price and lower the flexibility of oil supplies as a means to reduce import requirements.
The first type of policy has been in existence on a very limited and timid scale for some time but is to be substantially expanded under announced government plans. The second type was in existence under very different circumstances from 1959 to 1973 and is now being revived by the President who announced in his energy message last July the establishment of a permanent fixed ceiling, or quota, on U.S. oil imports. Since the President did not address himself to the cost of the program nor its implementation, a critical examination of both these aspects of the quota system may therefore be in order.

The President has set the maximum permissible net volume of oil imports in any year at 8.5 million barrels per day, about equal to our net import level of 1977. For 1979 the President has ordered an actual ceiling of 8.2 million b/d and for 1980 he apparently also intends to hold imports below the 8.5 million ceiling.

This year's ceiling will not require enforcement regulations. The oil price increases over the last 8 months, the physical unavailability of gasoline during some of this time and the onset of the general business recession can be expected to keep net imports for the year below the imposed ceiling. Next year, imports will be slightly higher but the full impact of this year's price increases, the continued low economic activity in the first half and a modest increase in Alaskan production should keep the level well below the 8.5 million b/d ceiling. In 1981, with full economic recovery under way and oil demand on the rise, the ceiling might
be approached. After that unconstrained imports could well exceed it for some years since total domestic oil supplies are likely to continue to decline because none of the synthetic fuels, new production of heavy oil or enhanced recovery methods of old deposits will have a significant impact until after 1985. On the demand side the most optimistic assumption is no further increase after 1981. More likely, there will be a very modest increase in the early 1980's since the most massive and lasting form of energy conservation, the replacement of the nation's energy using capital stock--cars, houses, machines, etc.--by more energy efficient substitutes takes many years.

Accordingly, there will be a structural tendency for net imports to rise above 8.5 million b/d during the first half of the 1980's in the absence of the imposed import ceiling. Thus, from 1981 on the imposed import ceiling is bound to become increasingly onerous in terms of price and physical availability. Yet, foreign oil would continue to be available at a lower cost than the propped-up import quota price. But, of course, it could not be brought in under the quota system, thereby aggravating any oil price and supply problem attributable to OPEC. The President may find it difficult to explain the benefits of this self-induced incremental energy problem.

The emphatically inflexible annual import ceiling set by the President also does not allow for extraordinary short term demand fluctuations caused by such extraneous factors as weather changes, labor problems, cyclical economic changes, etc. In any given year each of these could cause required imports to fall below
or rise above the fixed ceiling. Since there is no provision for averaging, any extraneous event causing higher import requirements could lead to temporary physical shortages. In the reality of our political system the President may then be forced to raise the import level temporarily, if more foreign oil is available. But this would discredit his dramatic public declaration "never" to let imports rise above the 1977 level. Furthermore, given the bureaucracy's demonstrated inability to correctly gauge market factors, a small unmet incremental import requirement could lead to large temporary dislocations.

The implementation of the import ceiling would come through a quota system which the Administration apparently intends to introduce next January. There are two ways a quota can be used to distribute a commodity whose supply is fixed by decree: an auction system or an allocation system. Administration officials are currently examining both but are reportedly leaning towards the auction type.

Under this system all oil imports would have to be covered by import licenses which would be auctioned off by the government to the highest bidder. At first blush, this may sound like an uncomplicated system, easy to administer. It has been pre-sold as such by its advocates. In fact, it would be highly complex and difficult to administer. Its administrators would have to decide on the frequency of auctions to be held, on how many licenses to be offered at each auction, how to prevent any bidder from acquiring a disproportionate number of licenses at the expense of
some competitor, whether licenses can be sold or otherwise transferred and whether such transfers would raise the cost of the oil.

The economic and political considerations that will go into these decisions, together with the setting of the auction ceiling below unrestricted import demand, will make these auctions more a mechanism for bureaucratic market allocation than a forum for the interplay of market forces. Thus, the federal auction system for oil import licenses is unlikely to receive better grades in efficiency, equity, internal consistency and ability to ward off pressure from special interest groups than other forms of market allocation, such as the existing crude oil entitlement system or the mandatory oil import program of the last decade.

The principal economic impact of an auction system would be to raise the price of imported oil immediately above the world level by the value of the import license. In turn, domestic oil prices would rise by the same amount, as oil price controls are being phased out. Uncontrolled gas prices as well as coal prices would directionally track the higher oil prices so that over a period of time our national energy cost may move from below to above that of other industrial nations. In consequence, we may eventually import energy indirectly in the form of energy intensive products with which domestic producers would no longer be able to compete. Similarly, our exports of these products
would decline. Probably, domestic producers would then strongly push for exemption from the import license system. So would the North East which would be more adversely affected than other regions because of the relatively high share of oil in its energy supply pattern. If the exemptions are granted they could undermine the integrity of the auction system and invite requests for more exemptions. If they are not granted our economy would suffer.

The principal beneficiary of the whole scheme would be the U.S. Treasury which would receive not only the full auction value of the import licenses but also a windfall profit tax (assuming such a tax is passed) on the price increase of domestic crude induced by the auction. On a rough calculation, each dollar of import license could increase annual federal revenue by about 4 billion.

An import allocation system would initially probably be less costly than an auction system, since the licenses would be allocated on some equitable basis. However, once potential import requirements at prevailing world prices exceed the Administration's ceiling, oil demand would either have to be rationed all the way to the end user or importers would have to be allowed to raise prices sufficiently to depress demand to the imposed fixed level of supplies. Domestic oil and other energy prices would then follow the same upward path as under the auction system. The allocation system would also have to face the problem of newcomers attracted to the import trade solely by the assured value of an allocation.
The two key features of the proposed import quota system are its intended rigidity and the assumption that current and prospective OPEC prices are still not high enough to curb our need for more foreign oil.

An alternate approach would be a flexible one which takes account of actual oil availability and requirements and gives OPEC's skyhigh new prices a chance to do their work both on the supply and the demand side before effectively considering them as still too low. An integrated energy system making full use of these prices and supporting them with imaginative legislation to stimulate more domestic energy production and conservation would provide such an alternative. It would build and improve on the existing system (which we have never allowed to work without restraint) and accelerate trends that are already visible. It would also be far less inflationary and economically restrictive than the President's quota program. Finally, it would be more logical since it would tie our oil imports to our basic economic need for oil under prevailing world prices, rather than to an arbitrary historic level.
The need for an effective policy to keep U.S. oil imports at the lowest feasible level is undisputed. The type of policy to achieve this aim is of course very much disputed. Essentially there are two approaches. In one the level of oil imports is determined by an integrated energy policy system; in the other the oil import level precedes and, hence, determines the energy policy system. The first approach treats oil imports as the required residual in balancing total energy supply and demand. It aims to maximize domestic production of oil and substitutable energy sources through the price mechanism and some forms of governmental assistance such as tax incentives and infant-industry aid to new types of energy; it uses the same measures plus certain mandatory constraints to maximize energy conservation over time. The resulting oil import level, assuming it is available, is a function of the progress in both these policy areas.

The other system starts out by setting an absolute ceiling on oil imports, independent of actual availability, thereby making the energy supply and demand balance a function of the imposed import limitation. Since the purpose of the limitation is to reduce import demand from what it would otherwise be, it creates in effect a supply shock with attendant price increases. Thus, this system aims to raise the cost of imported oil, thereby reducing the flexibility of oil supplies as a means to reduce import requirements.
being revised by the President who announced in his energy message last July a permanent fixed ceiling on U.S. oil imports and a quota system to distribute the permitted volume among oil importers.

Thus, we now have two systems at work— one in which oil imports are the outcome of our energy policy and one in which they are the starting point. Much thought has been given to the first type of policy but very little to the second. A critical examination of the practicability and consequences of an import ceiling and quota system may therefore be in order at this time.

In his energy message the President set the maximum net volume of imports ever permitted in any year at 8.5 million b/d, about equal to our net import level of 1977.

For 1979 the President has ordered an actual ceiling of 8.2 million b/d and for 1980 he also intends to hold imports below the 8.5 million ceiling.

This year's ceiling will cause no problem and require no quota regulations. The oil price increases over the last 8 months, the physical unavailability of gasoline during some of this time and the onset of the general business recession can be expected to keep net imports below the 8 million b/d ceiling. Next year, imports will be slightly higher but the full impact of this year's price increases, the continued low economic activity in the first half and a modest increase in Alaskan production should keep the level well below 8.5 million b/d ceiling. In 1981, with full economic recovery under way and oil demand on the rise the ceiling might be approached. After that unconstrained
imports could well exceed it for some years. The reason is that some of the synthetic fuels, new production of heavy oil or enhanced recovery methods of old deposits will have a significant impact until after 1985, so that during the first half of the 1980's total domestic oil supplies are likely to continue to decline. On the demand side the most optimistic assumption is no further increase after 1981. More likely, there will be a very modest increase in the early 1980's since the most recent massive and lasting form of energy conservation, the replacement of the nation's energy using capital stock--cars, houses, machines, etc.--by more energy efficient substitutes takes many years. Accordingly, there will be a structural tendency for net imports to rise above 8.5 million b/d during the first half of the 1980's in the absence of the imposed import ceiling.

There are still other problems with the emphatically inflexible annual import ceiling set by the President. It does not allow for extraordinary short term demand fluctuations caused by such extraneous factors as weather changes, labor problems, cyclical economic changes, etc. In any given year each of these could cause required imports to fall below or rise above the fixed ceiling. Since there is no provision for averaging, any extraneous event causing higher import requirements could lead to temporary physical shortages. In the reality of our political system the President may then be forced to raise the import level temporarily. But this would discredit (if additional supplies are available) his
aggravating any oil price and supply problem attributable to OPEC. The president may find it difficult to explain the benefits of this self-induced incremental energy problem.
dramatic public declaration "never" to let imports rise above the 1977 level. Furthermore, given the bureaucracy's demonstrated inability to correctly gauge market factors, a small/incremental import requirement could lead to large temporary dislocations.

The implementation of the import ceiling would come through a quota system which the Administration apparently intends to introduce next January. There are two ways a quota can be used to distribute a commodity whose supply is fixed by decree: an auction system or an allocation system. Administration officials are currently examining both but are reportedly leaning towards the auction type.

Under this system all oil imports would have to be covered by import licenses which would be auctioned off by the government on a bidder-bid basis. At first blush, this may sound like an uncomplicated system easy to administer. It has been pre-sold as much by its advocates. In fact, it would be highly complex and difficult to administer. Its administrators would have to decide on the number of auctions to be held, on how many licenses to be offered at each auction, how to prevent any bidder from acquiring a disproportionate number of licenses at the expense of some smaller competitor, whether licenses can be sold or otherwise transferred and whether such transfers could raise the cost of the oil. Given the fixed volume of

The economic and political uncertainties that will go into these decisions, together with the setting of the auction ceiling below uncontrolled market demand, will...
with the setting of the auction ceiling below unrestricted import demand, will make these auctions more a mechanism for bureaucratic market allocation than a forum for the interplay of market forces.

Given these conditions, it is unlikely that a federal auction system would receive better grades in efficiency, equity, internal consistency and ability to ward off pressure from special interest groups such as the existing market allocation, such as the existing mandatory oil import system or the mandatory oil import program of the last decade.
different systems would have to be devised for crude and products imports. In short, an auction system could end up as unwieldy, unmanageable, pressures internally inconsistent and subject to special interest as the current crude oil entitlement system.

The principal economic impact of an auction system would of course be to raise the price of foreign oil immediately above the world level by the value of the import license. In turn, domestic oil prices would rise by the same amount, since oil price controls are being phased out. Uncontrolled gas prices as well as coal prices could track the higher oil prices so that within a few years our national energy cost may move from below to above that of other industrial nations. In consequence, we may eventually import energy indirectly in the form of energy intensive products with which domestic producers would no longer be able to compete. Probably, before that these producers strongly push for exemption from the import license system. So would the North East which would be more adversely affected than other regions because of the relatively high share of oil in its energy supply pattern. If the exemptions are granted they would undermine the integrity of the auction system and invite requests for more exemptions.

The principal beneficiary of the whole scheme would be the U.S. Treasury which would receive not only the full auction value of the import licenses but also a windfall profit tax (assuming such a tax is passed) on the price increase of domestic crude induced by the auction. On a rough calculation, each dollar of import license could increase annual federal revenue by $4.5-5.0 billion.
An import allocation system would initially probably be less costly than an auction system, since the licenses would be allocated on some equitable basis. However, once potential import requirements at prevailing world prices exceed the Administration's ceiling, oil demand would either have to be rationed all the way to the end user or importers would have to be allowed to raise prices and, hence, profits sufficiently to depress demand to the imposed fixed level of supplies. Domestic oil and other energy prices would then follow the same upward path as under the auction system. The allocation system would also have to face the problem of newcomers attracted to the import trade solely by the assured value of an allocation.

The two key features of the proposed import quota system are its intended rigidity and the assumption that current and prospective OPEC prices are still not high enough to curb our need for more foreign oil.

An alternate approach would be a flexible one which takes account of actual oil availability and requirements and gives OPEC's sky-high new prices a chance to do their work both on the supply and the demand side before reselling them at still
It would build on existing efforts to make full use of these prices and supporting them with imaginative legislation to stimulate more domestic energy production and conservation would provide such an alternative. It would also be far less inflationary and economically restrictive than the President’s quota program. Finally, it would also be more logical, since it would tie our oil imports to our economic need for oil to fuel energy policy rather than tie it to an arbitrary historic level.