IS THE PRESIDENT'S PROPOSED OIL IMPORT QUOTA WORKABLE?

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In his energy address to the nation on July 15th President Carter announced an absolute ceiling on future oil imports and an undefined import quota system to implement this policy. He has reaffirmed these decisions on several occasions since then. And just recently his new Secretary of Energy, Mr. Duncan, stated that a quota system to enforce the import ceiling would be in place by the beginning of 1980. It is therefore timely to inquire into what the Administration's evolving import plan would do to oil consumers and producers as well as to the general economy.

The essence of the plan is a fixed ceiling on oil imports, independent of actual availability, thereby making energy demand a function of the permitted level of oil imports. Since the purpose of the import ceiling is to reduce import demand from what it would otherwise be, it creates in effect a supply shortage with attendant price increases. Thus, the plan is designed to raise the cost of oil above the world price as a means to reduce import requirements. Given the observed low demand response to oil price changes in the short run, even a small reduction from the unconstrained level of imports could require a substantial price increase to reduce oil demand to the available level of supply.

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 he 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 probably still well below the 8.5 million b/d ceiling. However, from 1981 or, at the latest, 1982 on, the ceiling will be exceeded if imports remain unconstrained. 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 in existing fields will have a significant impact before 1985. On the demand side the outlook is for a very modest increase in the first half of the 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.

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, thereby aggravating any oil price and supply problem attributable to OPEC. The President may find it difficult to convince the public of the benefits of this self-induced incremental energy shortage. It may also be difficult to convince OPEC not to raise its prices still further so as to appropriate for itself some of the price increase the U.S. Government considers necessary to balance oil supply and demand.
Besides the structural increase in import requirements, the emphatically inflexible annual import ceiling also does not allow for extraordinary short term demand increases 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.

The quota system through which the Administration intends to implement the import restriction can take the form of an auction, allocation or import fee system.

Under the auction system all oil imports would have to be covered by import licenses which would be auctioned off by the government. 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 political market allocation than a forum for the interplay of market forces. Thus, a federal auction system for oil import licenses is likely to prove as inefficient, inequitable, internally inconsistent and subject to pressure from special interest groups as the existing crude oil entitlement system or the mandatory oil import program of the 1960's.

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, uncontrolled 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 manufacturers would no longer be able to compete. Similarly, our exports of these products would decline. Probably, domestic manufacturers 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 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.

Another alternative under consideration is a fee on all crude and products imports. This would be much simpler to administer than an auction system. But it would be all but impossible to fine-tune the import fee so that it would exactly balance effective
demand with available supply. An import fee under conditions of a fixed import ceiling may therefore require a simultaneous import allocation program to make the system work. The fee system would also raise domestic crude prices above the world market level.

The two key features of all the proposed import quota systems are their 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 the actual availability and requirements of foreign oil and gives OPEC's skyhigh new prices a chance to do their work both on the supply and the demand side. An integrated energy system making full use of these prices and supporting them with imaginative tax and other legislation to stimulate more domestic energy product and restrain the growth in U.S. energy demand, while permitting oil to retain its role as the swing fuel, would be such an alternative. It would build and improve on the existing system (which we have never allowed to work without restraint) and accelerate positive trends that are already quite visible. It would also be more realistic than the President's quota program since it would tie our oil imports to our basic economic need for oil under prevailing world prices, rather than to an arbitrary historical level.