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COMMENTS ON PROPOSALS TO LIMIT U.S. PETROLEUM IMPORTS

Statement before the

Subcommittee on Energy Regulation of the Committee
on Energy and Natural Resources

United States Senate

by

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Thank you for inviting me to present my views on the four Senate bills (S. 1417, S. 1205, S. 1134 and S. 1470) under discussion at this hearing, which provide for a variety of oil import constraints. You have also requested my comments on the oil import quota plan announced by the President in his energy message of July 16th.

I would like to begin my analysis with an examination of the President's plan, since it is the most widely discussed among these various proposals. Also, some of my comments on the plan are applicable to the four Senate bills.

We do not know by what mechanism the Administration intends to keep future imports from rising. We only know that the President has announced that net annual U.S. oil imports will never be permitted to exceed the 8.5 million b/d level of 1977 and that some form of oil import quota will be established to enforce this limitation. For 1980 no such limitation seems required, since unrestricted oil imports will probably not reach 8.5 million b/d because of depressed demand, the availability of some additional gas supplies and an increase in Alaskan oil production.

After 1980, much will depend on the world price level. Let us assume, for working purposes, that following the 65% increase (so far) in 1979, foreign oil price increases for the next several years will not substantially exceed the U.S. inflation rate and that U.S. domestic oil prices will have moved up to the world level by the end of 1981. In this case, U.S. oil demand can be expected to

Rationing would be very difficult to enforce in the absence of an actual emergency. It would create inequities, invite violations, and require a large bureaucracy for enforcement. Further, it would probably be widely resisted as long as additional volumes of imports are available at prices U.S. consumers are willing to pay and other major importing nations fail to take similar drastic measures. The Administration is apparently not actively considering the imposition of a rationing system at this time but is looking to the price mechanism to balance demand with its restricted supply level.

Leaving aside for the moment the question of who will be the ultimate recipient of the income from the required higher price--the suppliers or the government--the price increase itself creates certain problems. For one thing, given the observed low price elasticity of oil demand, even a relatively small mandated reduction in import requirements could cause a substantial increase in imported as well as domestic oil prices above the prevailing world level.

One possible consequence of this could be that the OPEC nations see this as evidence that their prices are still too low to curb the growth in demand for their oil. They may therefore attempt to transfer part of the required price increase to themselves in view of their stated positions that neither foreign companies nor foreign governments should earn unduly high revenues from OPEC oil.

Another problem is the domestic economic consequences of the required oil price increase. It would raise U.S. oil costs from below to above that of other industrial nations. In consequence, we may eventually import foreign oil indirectly in the form of certain energy intensive products, such as petrochemicals, with which domestic producers could no longer compete. For the same reason, our exports of these products would decline. In the domestic economy the regional impact of the oil price increase would vary with the share of oil in each region's energy consumption pattern. This means the Northeast would probably be more affected than other regions.

A third major problem is public support of such a program. The public may not see the logic in the Administration denouncing OPEC oil prices as unjustifiably high while at the same time raising prices even more for U.S. consumers so as to force them to buy less than is available at OPEC prices. I realize of course that there is a national security aspect to reducing our dependency on foreign oil and that national security has a price tag. But the public may see it simply as a self-inflicted and, hence, unnecessary further price increase for a commodity whose cost has already been rising at an excessive rate. Furthermore, there is a question whether the price increase resulting from the import restrictions is the most cost effective national security measure to deal with our oil import dependency.

Regarding the question of <u>who</u> the ultimate recipient of the income generated from the government-induced oil price increase should be, the intent is clearly for the government to collect the monies for itself. This may be done under an auction system. 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 would be offered at each auction, on how to prevent any bidder from acquiring a disproportionate number of licenses at the expense of some competitor, on whether licenses can be sold or otherwise transferred and on whether such transfers would raise the cost of the oil. The considerations that will go into these decisions are more likely to make the auctions a bureaucratic mechanism for a political (i.e. special interest) allocation system than a forum for the interplay of market forces.

As an alternative to an auction system the government might consider 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 enforceable

Both the auction and the fee system would have to deal with the fact that domestic crude prices would rise by the full amount of the auction value or the fee. Would this be acceptable? Would price controls be reimposed? Would the proposed "windfall profits" tax take care of the incremental income? Or would there be a differential tax for prices above the OPEC level? So far, we have no indication which option the Administration favors. Let me say I do not favor any of them, given the problems each will create.

As I pointed out earlier, my comments on the Administration's proposed import quota apply partly also to the four bills under consideration here. Thus, S. 1470 has an absolute import ceiling in any one year equal to "the aggregate number of barrels...imported into the U.S. during the calendar year 1978." Because 1978 imports were several hundred thousand b/d lower than the Administration's announced import ceiling, the import volume permitted in S. 1470 would require higher prices or an allocation method from early 1980 on.

The principal common feature of the three other bills is that under all of them the Administration would have to establish a separate agency, either within or outside of government, which would be the exclusive buyer of all crude oil and products imported into the U.S. The imported oil would then be channelled by various mechanisms to refiners, marketers and other users.

Proposals to transfer the right to import oil from private companies to a single government-controlled or appointed agency are not new. They have sprung up whenever foreign oil prices went up or foreign supplies went down. They reflect our frustration that as major buyers of this commodity we have so little influence over its price and supply determination. Yet, in my view, a single separate oil import purchasing agency would not improve this situation but could, in fact, have just the opposite effect.

For one thing, such an agency may not even be able to function in the technical sense, given the enormous complexity of the transactions of the several hundred U.S. crude and product importers. To keep every one of these companies supplied with the right quality and the right quantity of oil, at the right time and the right price is probably too big a job for any single agency, no matter how big its bureaucracy. (In this regard, the government's record in purchasing foreign oil for the Strategic Petroleum Reserve certainly does not inspire confidence.)

Furthermore, the import agency would not have the flexibility, or perhaps even the authority, to engage in the kind of complex global oil trading and swapping which is common practice in the international oil business and is necessary to minimize transportation and storage costs and maximize the value of the oil to the importer.

Another disadvantage of an import agency would be its inability to offer the kind of non-cash inducements which oil exporting countries increasingly want in return for long-term supply contracts. These may include investments in local refining or petrochemical plants, off-take agreements for products from these plants, and commitments to carry out exploration activities. A buyer with nothing to offer but cash and a need for 25% of the total volume of oil in international trade is likely to find it difficult to obtain all requirements at competitive prices.

Finally, and most importantly, OPEC members would probably view the import agency as a U.S. government attempt to weaken the group's cohesion. The emphasis on price secrecy of foreign bids in S. 1417 seems like an invitation to OPEC members to underbid each other under the protective privacy of a U.S. government agency. However, the secrecy provision is unlikely to prove attractive to OPEC or other oil exporters, for if they should want to grant confidential price reductions they can find eager takers among private oil companies who will have every reason to keep such a reduction a closely guarded trade secret.

But above all, OPEC is not just an oil export organization but a political power, sensitive to any real or perceived challenges to its position. Its members are therefore unlikely to give relatively better terms to a U.S. government purchasing agency which, according to these bills (S. 1134 and 1205) would be less acquiescent to price increases by "the foreign producers cartel" than the bills assume the private multinational corporations to be. It is quite possible that OPEC members will react to the creation of such an agency by a collective decision to offer less favorable terms to it than to private companies.

Finally, it seems clear that the world oil surplus, in terms of readily available additional supplies, which existed from April 1974 to November 1978 will not recur in the foreseeable future, except perhaps for brief atypical periods. This change in market conditions makes the argument for a government oil import agency even less convincing now than it was during the surplus period.