Sensible Energy Policy Does Not Include a Variable Import Fee

Lester B. Lave
Carnegie Mellon University

Follow this and additional works at: http://repository.cmu.edu/tepper
Part of the Economic Policy Commons, and the Industrial Organization Commons

Published In
Energy Systems and Policy, 12, 57-60.
Sensible Energy Policy Does Not Include a Variable Import Fee

LESTER B. LAVE
Carnegie-Mellon University
Schenley Park
Pittsburgh, PA 15123

Energy analysis has become unfashionable. The millions of dollars and professional hours devoted to fashioning solutions to the US energy problems in the late 1970s have disappeared with little trace. With world oil selling below $20 per barrel, there is little or no interest in alternatives to petroleum, or even in R&D on alternatives.

This has happened for two reasons. First because the conventional wisdom of the 1970s was dead wrong, and second because falling energy prices have lulled us into complacency. The fundamental tenant that was so mistaken was that there was a fixed ratio of energy to economic activity; without increases in energy supply, the economy was doomed to stagnation. The corollary was that we had to embark immediately on a Manhattan project to develop coal resources, nuclear power, synthetic fuels, fusion, and every other energy source. The nation spent billions of dollars “demonstrating” that the 1970s technologies for coal gasification and liquification aren’t competitive for oil prices at current or even substantially higher levels and that solar energy using 1970s technology is expensive and unreliable.

The price elasticity for energy was proved to be substantial; the USA and other advanced nations experienced substantial economic growth with little or no increase in energy use. The panic of the mid 1970s was built on little hard data. Since I was one of the people arguing for research, not demonstration, I still feel bitter at the political choices that were made and the ineffective, indeed anti-productive, way that political and economic resources were allocated.

Current apathy suggests that the USA is capable of only two modes of operation: Throw money at perceived crises, knowing it is being spent foolishly, or ignore any problem that ceases to be a perceived crises.

Energy policy seems to be thought of these days as bailing out the oil billionaires and the Texas banks and savings and loan institutions. When mature, consenting adults spend years trying to bring something about, one should allow them to enjoy the fruits of their labor—as long as it is within the law.

Thus, I assume that Singer’s proposal is not to be justified on the grounds of pulling these chestnuts out of the fire. Rather, Singer puts it forth on the grounds that it will contribute to sensible energy policy. Unfortunately, the variable import fee (VIF) is seriously flawed and the supporting arguments are contradictory or unsupported.

In order to evaluate a proposal such as Singer’s VIF, one has to be clear on
the objectives and time frame. He and I would agree that at any date, there is a
supply curve for domestic petroleum that rises with price. There are stripper wells,
secondary and tertiary recovery all waiting, and drillers willing to bring in new
wells; the higher the price, the more oil will flow from these sources.

There are limited oil deposits within US territory. What is pumped now will
not be available in a year or a decade. There may not be agreement on whether
the largest supplies of inexpensive petroleum have already been found with US
territory. But I believe it is unlikely that domestic drilling will uncover fields as
large as those exploited in the past at comparable delivered costs.

What Should be Our Policy Goals?

Thus, a basic US issue is at what rate do we want to use up the inexpensive US
resources. We could be totally independent of OPEC for a while by using domestic
resources first. Or we could choose to be totally dependent on foreign oil by
holding domestic reserves purely in reserve. I do not see that a "drain America
first" policy adds to the national security, at least not over a time horizon longer
than a few years.

The USA needs to protect itself from OPEC blackmail, but we still want to
buy the least expensive energy offered to us. If OPEC oil is the cheapest energy
resource, correcting for quality, the USA should be buying it. Failing to do so
puts the USA at a competitive disadvantage in world trade and lowers our standard
of living.

But OPEC is a cartel attempting to extract a monopoly price from buyers.
This is not a classic competitive market and the USA needs to account for how
our purchases will raise the world price of oil, our "monopsony" effect. Fur­
thermore, it makes no sense to give foreign producers the ability to raise havoc
in the US economy and standard of living by withholding oil.

In short we should buy the cheapest energy, but take care that we have back
up supplies that would handle any economic or punitive threats from abroad.
This means a combination of a strategic petroleum reserve, an ability to bring
domestic oil into production, and an ability to utilize other domestic energy re­
sources such as coal to replace the petroleum. It is more than a theoretical pos­sibility that all of the current oil consumed in the USA could be produced abroad,
but still have the nation enjoy at least as much security as if all of it were produced
at home.

Basic Assumptions

The question before us is the extent to which the VIF accomplishes or at least
contributes to these objectives. To answer this question, some basic assumptions
need to be clarified.

I do not know and don't believe that anyone can know the precise, or even
the general profile of oil prices over the next twenty years. While they are likely
to be higher in 2008 than in 1988, during the period they may be up or down, but
almost certainly prices will be both higher and lower between now and then. I
do not know and don't think anyone can say with confidence what are the inten-
Sensible Energy Policy

Tions of OPEC and their ability to bring about these intentions, or the extent to which OPEC oil will earn monopoly rents or be used to undermine the security of the USA. No one should base our energy policy on assuming they know the answers to unanswerable questions. Thus, energy policy must be flexible and able to deter aggressive action by other nations, including monopoly pricing and undermining USA security.

It is foolish to regard OPEC as a single, profit maximizing entity. OPEC demonstrates that it cannot sustain short or long term profit maximizing prices. Aside from brief eras when other forces compel solidarity, OPEC has not been able to sustain high prices or fix production levels. As important as the economic dimension is the political one: OPEC could easily lose everything through civil war or conquest. The gulf states are unlikely to take actions that would provoke the developed nations or the have not nations.

While stabilizing oil prices sounds like a good policy objective, in fact it is a foolish one. In a highly unstable world, all parties could be made better if prices and supply were stable at the long run equilibrium price. However, this does not mean that fixing prices will make anyone better off. The inherent instability due to middle east politics, world economic growth, alternative energy resources, and improved energy technologies is real; we can set price but not do away with the instability. There have been many tries at stabilizing prices, from the coffee, rubber, and sugar cartels to setting the ratio of silver to gold in US coins, to domestic agricultural commodities. When political institutions are involved, there is an inherent temptation to stabilize at prices favorable to producers, which ruins the producers in the long term by driving buyers to find substitute commodities.

Singer argues that the VIF would not harm US exports since it could be refunded. Theoretically, refunding the VIF on exports is possible. However, calculating the oil content of an exported product with confidence is impossible. Approximate calculation would be challenged by nations that compete with us as violations of GATT.

A more substantial objection is that industrial design in the USA optimizes around domestic oil prices, since we are the largest market in the world. This would mean that products for export would have to be designed for export, missing out on the economies of scale in selling to our huge domestic market. Consider, for example, the low levels of auto exports to Europe and Japan in the 1950s and 1960s; their auto buyers didn’t want to buy gas guzzlers because of the high taxes on gasoline in these countries. Our automobiles simply weren’t designed for a market with high gasoline prices and could not be modified, short of completely redesigning them, to make them attractive to these markets. Having a higher oil (and energy more generally) price in the USA would extend this misdesign to all products.

Thus, Singer’s diagnosis is correct, but his remedy would simply make trouble. I predict that the VIF would be captured by domestic energy producers who would boost the target price to $25 or $35 per barrel in the name of holding price stable for decades. Rather than a VIF, what we need is a monopsony tariff that accounts for the USA effect on world prices through our purchases. We also need a program to increase the strategic petroleum reserve and otherwise increase standby supply and capacity in the USA. With such a program in place, OPEC would be foolish to try to manipulate the oil market since they could not succeed. Finally, we need
a sensible energy research program designed to enable the USA in particular and
the world more generally to supply itself with energy in case of a middle east war
or strife, world oil depletion, or social concern with the environmental or health
implications of one of the major energy sources. The VIF does not help get us
to these objectives.