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OIL SHOCK: POLICY RESPONSE AND IMPLEMENTATION

A REPORT OF THE HARVARD ENERGY SECURITY PROGRAM

ALVIN J. ALM and ROBERT J. WEINER, eds.
Cambridge, Massachusetts: Ballinger. 1984. 239 pp. + xv. $28.00

This volume, the product of a conference held in Cambridge, Massachusetts, appears at a particularly opportune time, when the flow of oil from the Persian Gulf once again threatens to be interrupted. The major oil importing nations have achieved considerable progress since the first oil shock in 1973–74. Consumption has been reduced, supplies from non-OPEC sources increased, an international sharing agreement concluded, and large inventories accumulated. But one can have little confidence in our ability to cope the next time until the serious problems that remain can be resolved. To mention just two:

- the sharing agreement does not take effect until the shortage reaches 7 percent, yet the Iranian Revolution of 1979 caused serious shortages at a level well below that trigger;
- the United States has accumulated a large Strategic Petroleum Reserve, yet neither policies nor procedures for withdrawals are firmly in place.

The book addresses these, and related issues. Following a wide-ranging introduction by Alvin L. Alm, it covers three major topics: relevant aspects of the oil market, oil shocks and macroeconomic policy, and stockpiling policy. Each part contains three or four papers written by well qualified scholars and/or policy makers intimately acquainted with the issues. The result is a set of chapters that maintains the high standards set in the introduction throughout.

A brief review of 11 chapters by 14 authors (including co-authors) cannot cover the gamut of issues stemming from a sharp runup of oil prices. They range from the philosophy on which actions are based (free markets versus government intervention) to highly technical ones (e.g., alternative methods of financing stockpiles). There is agreement only that an ostrich policy would be folly. For the economy, these issues include such basics as inflation, income transfer (between nations, regions, and interest groups), levels of income and employment, and real hardships for lower income groups. All of these spill over into local, national, and international policymaking and politics. One difficulty is that no set of criteria, however well thought out, can serve as a definitive guide for policy decisions. Conflicts between different, equally desirable, objectives are unavoidable; tradeoffs and compromise are essential.

Take the old dilemma of efficiency versus equity, for instance. The Reagan Administration is committed to letting the market distribute oil supplies in a future disruption, and the President has vetoed congressional moves to give him standby allocation powers. Yet, in a crisis, public pressure is likely to lead to the institution of controls unless alternative measures have been enacted. Economists agree with the Administration that controls do more harm than good, which past experience seems to confirm. Chapter 7 by Michael C. Barth and Edwin Berk, and Chapter 8 by Steven Kelman address ways of avoiding the dilemma by permitting the market to operate freely and "recycling" funds to offset undesirable effects. The authors point out the difficulty in selecting among various possible implementation schemes. Not all desirable criteria (speed, coverage, low cost, etc.) can be met simultaneously. A combination of reduced personal income taxes plus unrestricted grants to the states (to take care of those not covered but likely to be particularly hard hit) may well be the best scheme that can be devised. But, as the authors point out, enacting any such measures takes time. Pre-emergency preparation would be of great help, yet neither the Administration nor Congress seems ready to tackle the subject (apart from hearings that were held some time ago).

The Strategic Petroleum Reserve, which is the subject of three chapters, is the major policy instrument on which the United States relies to counteract the effects of another supply disruption. Currently, it contains some 400 million barrels of crude oil, stored mainly in Salt Domes near the Gulf Coast. Even if one assumes no physical obstacles (transportation, processing, etc.) to the Reserve being available where needed, there remain numerous unresolved questions of when and precisely how to implement a drawdown. Some methods can cause perverse behavior by private companies which could nullify the beneficial effects of government action. Also, the behavior of other Western nations is critical; it could either counteract or reinforce our measures. Chapter 10 by S. Devarajan and R. G. Hubbard, and Chapter 11, by Hubbard and Weiner, analyze these issues in detail.

The authors and editors have tried to keep technical material to a minimum (e.g., by moving it to an appendix). But readers with limited knowledge of economic reasoning will find the volume rough going. In addition to conceptual discussions, many of the chapters present tests of hypotheses using econometric and other models. Yet students of oil policy, and decision makers as well, can scarcely ignore the issues with which the book deals. They are state of the art treatment.

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