THE PRESIDENT'S OIL IMPORT FEE:

A Preliminary Analysis

The Congress of the United States
Congressional Budget Office

March 1980

BACKGROUND

President Carter has imposed fees of $4.62 per barrel on imported crude oil and $4.20 per barrel on imported gasoline, effective March 15. The fee on imported gasoline equals 10 cents per gallon, roughly equivalent to the crude oil import fee if it were passed entirely on to gasoline. 1/ Sixty days after the imposition, on May 15, the fees will raise the controlled ceiling on the wholesale price of a gallon of gasoline by approximately 10 cents. This lag results from using the entitlements mechanism, described below, which normally requires two months to reflect a change in petroleum prices. Retail prices should reflect the increase shortly thereafter.

Presidential authority to impose the import fee is derived from the Trade Expansion Act of 1962, which gives the President power to adjust the level of imports of any product bearing on national security. Such an adjustment can be made through the imposition of either an import fee or a quota. Through the Emergency Petroleum Allocation Act, which permits the President to regulate the petroleum market by setting entitlement fees, he is enabled to shift the crude oil fee onto gasoline.

Although complete details on the Administration's plan are not yet available, it appears to be designed to work as follows: Importers of crude oil pay the fee to the government and are reimbursed by the refiners of gasoline, who in turn are reimbursed by consumers through higher gasoline prices. The reimbursement of importers by refiners works through a mechanism similar to, but separate from, the present entitlement system. Refiners will be required to purchase an entitlement for each barrel of gasoline produced (whether from domestic or imported oil). The entitlements will be purchased from crude oil importers, who will thus be getting their money back. The refiners will in turn increase their prices to consumers. In short, consumers pay refiners, who pay importers, who pay the federal government. Because the importers are thus fully compensated, the price of domestic crude oil should not rise.

One possible difficulty in the Administration's plan is that the President's authority to set entitlements, though not to set import fees, may expire on September 30, 1981. (The Administration argues that the new

---

1/ Since more gasoline is refined than crude oil is imported (1.1 times, according to Administration estimates), gasoline refiners have only to pay $4.20 per barrel or 10 cents per gallon to reimburse importers the $4.62 fee—that is, $4.20 x 1.1 = $4.62.

separate entitlements program is part of the administrative structure of the import fee, allowable under the Trade Expansion Act, and, as such, does not expire with the other entitlements program.) If his authority were to lapse at that time and the import fees were extended past that date, he would no longer be able to shift the entire oil import fee onto gasoline. The price of domestic crude oil (and subsequently all petroleum products) would then rise to match the world price plus the import fee. These events should not occur, however, since the President has announced his intention of asking the Congress to impose an ad valorem tax on gasoline and diesel fuel. Initially set at 14 cents per gallon (the present 4 cents per gallon federal excise tax would be repealed), the amount of the tax would rise with the price of fuel. The proposed 14 cents per gallon tax would be roughly equivalent to the sum of the 10 cents per gallon import fee and the present 4 cents per gallon tax.

THE DEMAND FOR GASOLINE

If the oil and gasoline import fees are passed on solely to users of gasoline, the price of gasoline will rise by 9.7 cents per gallon in 1980. This price increase will cause a small reduction in the consumption of gasoline. Table 1 presents CBO's projection of motor fuel consumption after the tax increase, and the estimated petroleum savings attributable to the tax. CBO's estimates are based on the following assumption: that the import fee and entitlement program will continue in effect until the end of fiscal year 1981, at which time the President's proposed fuel tax will become effective. The savings are estimated at about 80,000 barrels of oil a day for 1980, increasing to 100,000 barrels a day in 1985.

The elasticity of fuel demand by automobiles and light trucks is assumed to be -0.150 in the short run and -0.200 in the long run. For trucks Class II and larger, the elasticities are -0.075 and -0.100. 2/ The long-run elasticity is assumed to take effect in 1982 and early 1983. The Administration estimates petroleum savings of 100,000 barrels per day in 1980 and 250,000 barrels a day in 1983, as compared with the CBO estimates of 80,000 and 90,000 barrels a day. The significantly higher Administration estimate for 1983—and presumably for other later years—appears to result from its assumption of a larger long-term price elasticity. The elasticity

---

2/ For further discussion of these elasticities, see Congressional Budget Office, "Preliminary Projections of Fuel Savings and Revenues Associated with Increased Taxes on Motor Fuels," Technical Note (December 1979).

TABLE 1. FORECAST OF FUEL CONSUMPTION AND ESTIMATED SAVINGS FROM IMPORT FEES AND PROPOSED TAX INCREASES (In thousands of barrels per day; by fiscal year)

	1980	1981	1982	1983	1984	1985
Automobiles and Light Trucks	6,180	6,140	6,080	6,020	5,990	5,950
Class II Trucks and Larger a/	1,670	1,730	1,790	1,840	1,910	1,980
Total Consumption	7,850	7,870	7,870	7,860	7,900	7,930
Estimated Fuel Savings Due to the Tax	80	70	75	90	90	100
Increased Tax at Start of Year (cents per gallon) b/	9.7	9.4	10.0	11.5	13.1	14.8
Net Estimated Revenues (billions of current dollars) b/	3.1	10.0	13.4	15.0	16.9	19.2

SOURCE: Congressional Budget Office.

a/ For 1980 and 1981, about one-half of the forecast represents diesel fuel that would not be subject to the import fee.

b/ Excludes existing 4 cents per gallon tax paid into Highway Trust Fund, which is assumed to be renewed in 1985.

estimates used by the Administration may include aid savings assumed to be achieved through higher standards set by the Energy Policy and Conservation Act (EPCA). Some estimates of gasoline price elasticity, including the estimate of long-term elasticity used by the Administration, are based on studies that ascribe most of the changes in consumption to changes in the price of gasoline. There are other factors that affect gasoline consumption, most notably the EPCA standards for new car fuel economy and concerns by consumers about the availability of fuel. After adjusting for these factors, the elasticity of price alone is relatively small.

REVENUES

The import fees on crude oil and gasoline will generate additional federal revenues of about $3.1 billion in fiscal year 1980 and about $10.0 billion in fiscal year 1981. The revenues for 1980 are affected by the time lag between when they go into effect and actual receipt by the Treasury. In 1982, the proposed 14 cents per gallon tax on gasoline and diesel fuel would generate revenues of about $13.4 billion above the revenues from the existing 4 cents per gallon tax. By the start of 1985, the tax will have increased to almost 19 cents per gallon with revenues of about $19.2 billion above the revenues that would have been collected by the 4 cent tax. This estimate does not include other potential impacts through corporate and personal income taxes.

The ad valorem nature of the proposed tax makes it quite different from the current federal fuel tax, which is on a unit basis. Since the price of fuel is expected to rise faster than inflation, the ad valorem tax would also grow faster than inflation. The projected annual rate of growth of the tax from 1982 to 1985 would exceed 10 percent. While at least 4 cents on each gallon would go to the Highway Trust Fund, this tax would generate an ever-increasing amount of new federal revenues, even though gasoline usage is projected to decline and diesel fuel usage to rise only slightly.

The first-year estimate assumes that the program will work as designed. There may, however, be some administrative and other unforseeable difficulties, often encountered in new programs, that could lower the revenues collected in the first months of the program.

MACROECONOMIC IMPLICATIONS

The gasoline price increase of 9.7 cents per gallon resulting from the oil import fee would have a direct impact on the Consumer Price Index (CPI)

of approximately 0.6 percentage point in 1980. In addition, since about 20 percent of gasoline is consumed by businesses, complete passthrough of these increased costs would result in another 0.1 percentage point impact on the CPI. Finally, the feedback of the higher CPI into wage increases which cause further price increases over the following several years would make the total CPI impact add to roughly a full percentage point. These estimates could be changed by any of the following possible circumstances:

- o If some of the increased cost of the fee is absorbed by reductions in dealers' margins or refiners' profits, the price impact could be slightly lower.

- o If, between now and May 15, inflation in general and gas prices in particular rise more rapidly than anticipated, the impact of the fee on inflation and gasoline consumption will be lower than the levels projected here.)

- o If the tax is rebated in the form of reduced Social Security payroll taxes, these increases in the CPI could be offset somewhat.

If the revenues of the oil import fee were used to reduce Social Security payroll taxes, the inflation impact of the fee could be lessened. The actual level of reduction would depend on the specific terms of the rebate proposal. If the revenues were used entirely to reduce both the employers' and employees' share of the payroll taxes equally, then the oil import fee would result in an increase in the CPI of approximately three quarters of a percentage point as opposed to a full percentage point from the fee without a rebate. Such a rebate would not fully offset the effect of the fee on the CPI because most of the rebate would eventually go into increased after tax income, which is not in the CPI, rather than into lower prices, which are.

The impact of the fee and the tax on the automobile industry will be small, but noticeable. Previous research at CBO and elsewhere suggests that the elasticity of demand for cars with respect to the price of gasoline is -O.Z. Thus, the 9.7 cents per gallon increase in the price of gasoline could reduce the net demand for automobiles by 1.5 percent or 150,000 units in 1980.

Since the market share of small cars rises with increases in the price of gasoline, the reduction in demand for U.S.-built cars might be somewhat larger than 1.5 percent, reflecting a possible increase in the number of

imported automobiles. 3/ If present market trends persist, the oil import fee might result in a decline in the sales of U.S.-manufactured automobiles of 175,000 units in 1980. If U.S. car manufacturers increase their production of small cars, as they have stated they will, this figure would overestimate the decline in U.S. production.

The President stated in his March 14 speech that he wants to hold the revenues from the fees and tax in reserve or use them to reduce the national debt. The Congress, however, will consider a number of alternatives. These include continuing to use part of the existing fuel tax revenues for the Highway Trust Fund, placing the new revenues in the general fund to be spent through the normal authorization and appropriation process, and rolling back payroll taxes. The final decision will, of course, have an impact on the economy as a whole, including the rate of inflation.

Highway Trust Fund

In his proposal for the gasoline and diesel tax, President Carter suggested that the present motor fuels tax be repealed and replaced with at least an equivalent share of the new tax. Coming at a time when outlays from the Highway Trust Fund exceed its annual revenues, suggestions may be made to use this new tax as a way to increase Highway Trust Fund receipts. For example, the present 4 cents per gallon tax could be changed to an ad valorem tax.

General Revenues

The funds raised by the import fees, and later by the new fuel tax, could be allocated to general revenues. This option would have an advantage in terms of budget efficiency and overall planning. Should the Congress decide to use the proceeds to reduce the national debt, this could have an anti-inflationary impact. On the other hand, if the Congress spends the funds, it might add to inflationary pressures.

3/ For further discussion of the elasticity of market shares, see CBO, "Projected Composition of Sales of New Cars," Technical Note (March 1980).

Social Security

Social Security taxes are scheduled to increase by $11.4 billion in calendar year 1981 and by $21.2 billion in 1982. If the new revenues were used to reduce equally the employer and employee shares of the payroll taxes, the cost of labor to employers would be reduced while the after-tax real wages of labor would remain about the same. Such an action might reduce the pressure of inflation on wages and prices, and perhaps stimulate the supply (cost) side of the economy.

DISTRIBUTIONAL IMPACTS

The imposition of the import fees will cost the average family $46 in 1980 and $114 in 1981, in direct and indirect expenditures on gasoline and diesel fuel. (The difference between the two years is due, in the main, to the fact that the fee is being implemented in the middle of 1980). Families in the lowest income quintile would increase their expenditures by $18 in 1980 and $44 in 1981. These increments would represent 0.4 percent and 1 percent of the income of the average family in that lowest quintile. The families in the highest quintile would increase their expenditures by $70 and $176 for those years. Since the price of auto fuel is, as mentioned above, projected to rise more rapidly than prices in general, the tax burden as a percentage of family income should also rise (see Table 2). 4/

Many factors determine the level of gasoline consumption, but in general the absolute level of gasoline consumption rises with income. The percentage of income spent on gasoline consumption declines, however, with increases in income. Therefore, while families with large incomes will be paying more than other families absolutely, their relative burden will be less. Furthermore, families in the lowest quintile who own cars will, if previous expenditure patterns hold, pay a larger share of their income to purchase gasoline than that paid by low-income families in general. Low-income families who own automobiles will thus be the group most severely affected by the higher prices. Like the revenue estimates, these estimates do not include possible effects on corporate and personal income taxes. They also assume a complete passthrough of increased business costs.

4/ For a more complete discussion of the distributional impacts of increased fuel prices, see CBO, The Decontrol of Domestic Oil Prices; An Overview, Background Paper (May 1979).

TABLE 2. PROJECTED DIRECT AND INDIRECT GASOLINE AND DIESEL FUEL EXPENDITURES PER FAMILY RESULTING FROM THE IMPORT FEES AND PROPOSED TAX (In dollars)

	1980		1981		1982	
	Average annual expenditures	Percent of income	Average annual expenditures	Percent of income	Average annual expenditures	Percent of income
All Families	46	0.3	114	0.7	132	0.8
Ranked by Money Income						
Lowest Fifth	18	0.4	44	1.0	52	1.1
Second Fifth	32	0.4	80	0.8	93	0.9
Third Fifth	48	0.3	121	0.7	142	0.8
Fourth Fifth	57	0.3	142	0.6	167	0.6
Highest Fifth	70	0.2	176	0.4	207	0.5

SOURCE: Congressional Budget Office.

CBO estimates that, over the next two and a half years, the burden on families in the lowest income quintile because of the import fees and the projected tax will total $1.8 billion. While part of the tax will be offset thorough cost-of-living increases in Social Security and Supplemental Security Income, not all low-income families receive these indexed transfer payments. While the low-income energy assistance program is primarily designed to ease financial pressures on low-income families from increased home heating and cooling costs, part of this could be used to pay for the increased cost of gasoline. Since most aid would go to persons already receiving transfer payments, other families might be missed.

OPEC RESPONSE

The response of the Organization of Petroleum Exporting Countries (OPEC) to the President's initiative will be determined by political as well as economic considerations. While the OPEC response cannot be predicted, the implications of some possible responses can be indicated:

- The fee would slightly decrease the demand for oil. This might result in a slight lessening in the upward pressure on OPEC oil prices, which would slow the rate of inflation.

- OPEC might react negatively and raise the price of oil. The rate of inflation would then rise, and there would be downward pressure on the economy as whole.

EFFECT ON OTHER PRODUCT PRICES

The fee on imported oil may not be entirely passed through onto the price of gasoline, but there are two reasons to assume that most of it will:

- Supplies of diesel fuel, home heating fuel, and residual oil are currently in surplus, so that it would be difficult to increase their prices.

- The short-term demand for gasoline is generally more inelastic than that for most other petroleum products.

Essentially, the system would require refiners to pay 10 cents a gallon for each gallon of gasoline they sell, whether they import it directly or refine it. While most of this will likely be passed on to gasoline consumers,

it is possible that a small amount will come out of refinery margins or be passed on to other petroleum products. This is not likely to happen during the next several months. The demand for these products is quite seasonal, however, and market conditions could change over the next 18 months. To the extent that gasoline prices do not absorb the entire fee, and refiners lower their profit margins, the projected savings of gasoline will be lowered, as will the inflationary impact.

EFFECTS ON GASOHOL

The Administration also proposes to continue to exempt gasohol from the proposed ad valorem tax. Since gasohol is 10 percent alcohol, exempting it from the fuel tax is a subsidy to alcohol producers of ten times the amount of the tax. This proposed exemption would thus create an implicit subsidy of alcohol used for gasohol equivalent to $1.40 a gallon--a dollar a gallon increase over the current federal subsidy. Combined with state gasohol subsidies of as much as 50 or 60 cents a gallon in a number of states, and a gasoline price approaching $1.50, producers of alcohol could recover their costs even if they charged close to $4.00 a gallon. Such a price could encourage significant production of gasohol, with possible important effects on the revenue projections made here and even on the price of food.