

## ARTICLES

### OIL IMPORTS AND NATIONAL SECURITY: THE LEGAL AND POLICY FRAMEWORK FOR ENSURING UNITED STATES ACCESS TO STRATEGIC RESOURCES\*

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## 1. INTRODUCTION

On January 3, 1989, in the last days of his Presidency, Ronald Reagan made a determination pursuant to Section 232 of the Trade Expansion Act of 1962, as amended,<sup>1</sup> that petroleum imports<sup>2</sup> threaten to impair U.S. national security and, on that basis, recommended that Congress take a series of legislative actions to address the problem.<sup>3</sup>

President Reagan's determination, which concluded a year-long investigation of oil imports directed by the Department of Commerce, is an important development in U.S. energy security policy. After years of cheap oil and relative complacency, the President's decision sends a clear signal that there are reasons again to be concerned over United States energy security; this dormant issue is likely to be of major importance for the United States and other oil-consuming nations in the 1990s. As economic and competitiveness considerations become more prominent factors in national security planning in the years ahead, U.S. access to secure, reasonably priced energy resources will become an increasingly important objective of national policy.

<sup>1</sup> 19 U.S.C. § 1862 (1988).

<sup>2</sup> As used herein, the terms "petroleum" and "oil" refer to both crude oil and refined oil products, both of which were subject to the recent Section 232 investigation.

<sup>3</sup> See Statement on the Effects of the Importation of Petroleum on the National Security, 25 WEEKLY COMP. PRES. DOC. 6 (Jan. 3, 1989). See also Memorandum on the Effects of the Importation of Petroleum on the National Security, 25 WEEKLY COMP. PRES. DOC. 7 (Jan. 3, 1989).

The Reagan determination under Section 232 highlights the emerging problem. While acknowledging that United States energy security has improved in a number of ways since the 1970s, the Commerce Department study on which the President's determination was based nevertheless points out a number of adverse trends with respect to energy security:

¶ Oil imports have grown significantly in recent years, both in absolute terms and as a percentage of U.S. oil consumption.

¶ U.S. dependence on imports from unreliable Persian Gulf suppliers, which tailed off in the mid-1980s, has risen substantially, and our reliance on these nations, which have most of the world's surplus capacity, will grow even further in the 1990s.

¶ As a consequence of rising and relatively low-priced oil imports, U.S. oil production has declined significantly and domestic exploration and drilling are at very low levels;

¶ U.S. energy consumption has begun to increase again in response to low oil prices; and

¶ Low-priced oil imports have impeded investment in alternative energy sources.<sup>4</sup>

On the basis of these recent trends and on an analysis of pertinent considerations, the Commerce Department found, and the President affirmed, that oil imports threaten to impair national security. In the months since the Reagan finding, these trends appear to have worsened. U.S. Crude oil production suffered the sharpest annual decline in history in 1989—553,000 barrels per day (bbl/d)—and oil imports consequently reached a ten-year high.<sup>5</sup>

As a consequence, President Bush today faces the significant challenge of shaping the appropriate mix of policies to respond to the growing U.S. dependence on imported oil and to the problems such dependence causes—both today and in the future—for U.S. national security, foreign policy and economic welfare.

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<sup>4</sup> See U.S. DEP'T OF COMMERCE, *THE EFFECT OF CRUDE OIL AND REFINED PETROLEUM IMPORTS ON THE NATIONAL SECURITY* (1989) [hereinafter *COMMERCE STUDY*]. The full declassified version of the report is available for public review and duplication in Room 4886, U.S. Department of Commerce, Washington, D.C. (202-377-2593). For the executive summary of the Commerce Study, see Presidential Decision; Petroleum Section 232 National Security Import Investigation, 54 Fed. Reg. 6556 (1989).

<sup>5</sup> See AMERICAN PETROLEUM INST., *13 MONTHLY STATISTICAL REPORT*, Dec. 1989, at 1.

This essay evaluates the recent Presidential determination under Section 232 and the relative utility of this statutory mechanism as a framework for shaping an effective energy security policy. It examines both the nature of the current and prospective threat of impairment to national security (i.e., the relationship between oil imports and national security and precisely how vulnerable we are) and the legal availability and efficacy of remedial measures to address this important issue in the 1990s.

Part 2 sets forth the legal, policy, and historical setting in which President Reagan rendered his Section 232 determination. Specifically, Section 232, the so-called national security clause, was developed as a response to the growing U.S. reliance on cheap oil imports in the mid-1950s and has become one of the principal legal mechanisms for evaluating, and responding to, energy security concerns. In the aftermath of both the 1973 OPEC crisis and the 1979 cutoff of Iranian oil, Presidents Ford and Carter invoked Section 232 to impose fees on imported oil. After 1979, however, import dependence declined gradually as demand decreased (due to conservation, increased energy efficiency, and an increased use of alternative energy sources) and supply increased (due to the substantial increase in drilling and exploration in the late 1970s and early 1980s). Hence, national security concerns gradually receded.

As the 1980s drew to a close, the situation again had changed significantly. Years of low-priced oil had resulted in decreased U.S. exploration and drilling, decreased U.S. production, and an increased reliance on oil imports. These circumstances caused the National Energy Security Coalition, an ad hoc coalition of independent oil companies, trade associations and individuals in the oil business, to file a petition under Section 232 in order to seek a Presidential finding that oil imports threaten to impair national security.

Part 3 addresses the relationship between oil imports and national security: What are the standards that ought to be considered by policymakers, and, under such standards, what is the nature and extent of the problem? Since its resource base is being depleted, the United States will always be an oil importer and can never achieve perfect security in terms of its oil needs. Thus, the basic policy issue is whether the existing and projected levels of risk are tolerable or whether they warrant some type of remedial action. From a national security standpoint, Section 232, which is broad in scope and focused on the future (i.e., the "threat" of impairment to national security), allows policymakers to focus on several appropriate considerations: (1) the prospect that the United States will face an oil shortfall in a conventional war or full

military mobilization; (2) the economic vulnerability of the United States to peacetime oil supply disruptions and substantial price increases; and (3) the implications of U.S. dependence on oil imports for U.S. foreign policy and the role of the United States as a global power.

The recent Commerce study under Section 232, which evaluated most of these considerations, highlights the growing importance of non-military considerations in national security planning. Although the President found no serious risk of an oil supply shortfall in wartime, he nevertheless made an affirmative finding based on other considerations, including the potential vulnerability of the United States to a peacetime supply disruption and the potential damage caused to the economic and foreign policy by virtue of high energy prices. The basic conclusion of the study was that the abundance of low priced oil imports today may result in significant energy insecurity in the future. This finding confirms the unique role of oil as a strategic resource—both in wartime and peacetime.

Finally, Part 4 identifies and assesses the basic policy options legally available to the President under Section 232 and other applicable federal laws to ensure continued access to secure and reasonably priced energy resources—both today and in the future. While Section 232 affords the President a broad range of authority to adjust imports, e.g., to impose tariffs and quotas, it does not by its terms authorize measures that do not have a “direct” or “initial” impact on imports. Nevertheless, the President can, and has, considered all available policy options available under other federal laws, as well as possible legislation that can be enacted by Congress. In his 1989 finding, President Reagan recommended a series of supply-side measures to Congress and agreed to further fill the United States Strategic Petroleum Reserve, but he decided not to take any actions to adjust imports, such as imposing an oil import fee or price floor. As discussed herein, however, President Bush can invoke President Reagan’s affirmative Section 232 finding, which is still in effect, as the basis for such remedial actions if he finds that further steps are warranted. Thus, the recent Presidential determination under Section 232 has not only signaled a need for increased attention to energy security concerns in the 1990s, but also can be the very vehicle through which energy security policies for the future are developed and implemented.

In selecting the appropriate mix of policy options to fulfill energy security objectives from a series of imperfect choices, policymakers should recognize the trade-offs that may need to be made between energy security objectives and other long-term and short-term economic, foreign policy, and national security objectives. In particular, there is a

need to balance short-term economic growth and efficiency considerations with longer term security concerns. While prevailing low oil prices facilitate short-term economic growth and encourage a sense of complacency, the failure to take tangible steps now could cause substantial insecurity in the future. Given the long lead times in oil exploration and the development of energy substitutes, the United States may need to take steps today, and incur current economic costs (or forgo economic benefits), to ensure access to reasonably priced energy in the future. The willingness of the current Administration and Congress to adopt such future-oriented policies today, and of the public to support such policies, may in large measure determine the degree of economic growth and energy insecurity we face in the 1990s.

Whatever choices the Bush Administration makes in this difficult area, the Administration should, at the very least, increase public awareness of the growing importance of the energy security problem. Enhanced public recognition of the issues will encourage debate and the possible development of a consensus among energy producers and consumers as to the need to shape an effective energy security policy today.

## 2. SECTION 232: AN ESTABLISHED VEHICLE FOR SHAPING ENERGY SECURITY POLICY

By its terms, Section 232 provides that the Secretary of Commerce shall, upon a petition from an interested party, the request of the head of another federal agency or department, or upon his or her own motion, "immediately initiate an appropriate investigation" as to whether an article "is being imported into the United States in such quantities or under such circumstances as to threaten to impair the national security."<sup>6</sup> Under the statute, the Commerce Department has 270 days to make its findings and recommendation "for action or inaction" to the President.<sup>7</sup> Thereafter, the President has 90 days in which to determine whether to concur in the Secretary's finding and to determine the nature and duration of the action, if any, that must be taken to adjust imports of the article and its derivatives so that national security is no

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<sup>6</sup> 19 U.S.C. § 1862(b) (1988).

<sup>7</sup> *Id.* The time limit for the Commerce study was shortened from 1 year to 270 days by the Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, § 1501(a), 102 Stat. 1107, 1257-58 (1988) (codified at 19 U.S.C. § 1862(b)(3)(A) (1988)) [hereinafter 1988 Trade Act]. Under the Act, the new deadline does not apply to investigations which were initiated prior to its date of enactment (i.e., August 23, 1988). 19 U.S.C. § 1862 note (1988). Hence, since the Commerce investigation of oil imports under Section 232 was initiated on December 23, 1987, Commerce had almost a year in which to conduct the investigation and in fact took the full time afforded it by law.

longer threatened.<sup>8</sup>

This relatively obscure statute, which was in large part adopted to address the oil import problem in the 1950s, has, in fact, served as a basic framework for formulating and implementing energy security policy ever since.<sup>9</sup> Although the statute has now been on the books for over thirty years, it has never been successfully invoked for any commodity other than oil.<sup>10</sup>

### 2.1. *The Early to Mid-1950s: Statutory Origins and Oil Imports*

Section 232 was in large part enacted in response to the substantial increase in oil imports in the 1950s. Although the United States was a net oil exporter at the end of World War II (with a positive net export balance 61,000 bbl/d in 1945),<sup>11</sup> imports of cheap oil increased gradually from 850,000 bbl/d in 1950 to 1,248,000 in 1955 and 1,815,000 in 1960.<sup>12</sup> In 1954, as a consequence of rising oil imports and growing industry concern over this trend, President Eisenhower empaneled the Advisory Committee on Energy Supplies and Resources Policy. After a full investigation, the Committee found in 1955 that:

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<sup>8</sup> The 90-day limit was added to the statute in 1988. See 19 U.S.C. § 1862(c)(1)(A) (1988). Prior to the enactment of this amendment, there was no deadline at all for Presidential action under the statute, and the President effectively was free to not make any findings at all based on a Commerce investigation under the statute. Although, as noted above, the recent Section 232 on imported oil was pending when the Act was enacted, the new time limit for Presidential action nevertheless was expressly made applicable by the 1988 Act. See 19 U.S.C. § 1862 note (1988) (making the new deadline applicable for Presidential actions to any case in which Commerce submitted its report to the President after the Act's date of enactment).

<sup>9</sup> Concerns over oil imports and U.S. security also were present in early periods. For a review of earlier Presidential actions in both the World War II period and thereafter, see generally R. GORALSKI & R.W. FREEBURG, *OIL AND WAR* (1987) (covering World War II period); *FACTORS AFFECTING U.S. OIL AND GAS OUTLOOK*, NATIONAL PETROLEUM COUNCIL ch. 2 *passim* (1987) [hereinafter NPC REPORT].

<sup>10</sup> In recent years, there have been negative findings under Section 232 with respect to, *inter alia*, ball bearings, 54 Fed. Reg. 1,974 (1989), and plastic injection molding devices, 53 Fed. Reg. 6,857 (1988). See also Knoll, *Section 232 of the Trade Expansion Act of 1962: Industrial Fasteners, Machine Tools and Beyond*, 10 MD. J. INT'L L. & TRADE 55, 69-85 (1986) (noting domestic industries that have unsuccessfully petitioned for relief from 1955 to 1981 and describing past Section 232 investigations involving machine tools and industrial fasteners). The President did, however, make an affirmative finding under Section 232 that imports of machine tools are threatening to impair national security. See 1986 PUB. PAPERS 661 (May 20, 1986). Although the President deferred formal action under Section 232, he did negotiate and enter into voluntary import limitations with certain supplier nations, including Japan and Taiwan, and agreed to monitor imports from other nations. See United States Machine Tool Industry, 22 WEEKLY COMP. PRES. DOC. 1654 (Dec. 16, 1986).

<sup>11</sup> AMERICAN PETROLEUM INST., *PETROLEUM FACTS AND FIGURES* 1-3 (9th ed.).

<sup>12</sup> AMERICAN PETROLEUM INST., 7 BASIC PETROLEUM DATA BOOK § 7, table 2 (Jan. 1987).

If the imports of crude and residual oils should exceed significantly the respective proportions that these imports of oils bore to the production of domestic crude oil in 1954, the domestic fuels situation could be so impaired as to endanger the orderly industrial growth which assures the military and civilian supplies and reserves that are necessary to the national defense. There would be an inadequate incentive for exploration and the discovery of new sources of supply.<sup>13</sup>

On this basis, the Committee recommended voluntary import restraints by oil importers as the appropriate means of keeping oil imports in balance and preserving domestic production incentives.

Given the growth in domestic demand, however, both domestic production and imports continued to grow, and the voluntary import controls proved ineffective. As a consequence of increased concern over petroleum and other strategic products, Congress considered a series of industry-specific measures in 1954-55 that would empower the President to impose mandatory restrictions; the petroleum, fluorspar, zinc, and lead industries had industry-specific proposals before Congress.<sup>14</sup> In lieu of these industry-specific proposals, however, Congress in 1955 adopted the national security clause,<sup>15</sup> which was designed to "provide a means for assistance to the various national defense industries which would have been affected by the individual amendments presented."<sup>16</sup> The statute, which was the precursor to Section 232, afforded the President the necessary authority to impose mandatory import restrictions in order to prevent over-dependence on imports of oil and other strategic resources, and ensure adequate domestic energy production.<sup>17</sup>

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<sup>13</sup> See S. REP. NO. 232, 84th Cong., 1st Sess. 4, *reprinted in* 1955 U.S. CODE CONG. & ADMIN. NEWS 2101, 2104.

<sup>14</sup> *Id.* at 2103. The House Report on Section 232 expresses concern over the need to protect "essential" industries "so that the Nation can quickly call upon them in time of emergency." See H.R. REP. NO. 50, 84th Cong., 1st Sess., *reprinted in* 1955 U.S. CODE CONG. & ADMIN. NEWS 2071, 2095. While the "[e]limination of certain industries because of their inability to match foreign competition appeals to the theorist on the ground that it is 'economically efficient[,]' [i]t does not appeal to us because it leaves the nation vulnerable to economic and military attack." *Id.* More specifically, as stated therein, "[P]reservation and expansion of domestic sources of essential raw materials are also vital to our Nation's security. Yet, our capacity to produce coal, oil, lead, zinc, tungsten, manganese, and a variety of other raw materials, has been damaged by imports." *Id.* at 2096.

<sup>15</sup> See Trade Agreements Extension Act of 1955, Pub. L. No. 84-86, ch. 169, § 7(b), *reprinted in* 1955 U.S. CODE CONG. & ADMIN. NEWS 182, 187, *amended by* Trade Agreements Extension Act of 1958, Pub. L. No. 85-686, § 8(a), 72 Stat. 673, 678 (1958), *reprinted in* 1958 U.S. CODE CONG. & ADMIN. NEWS 788, 795.

<sup>16</sup> S. REP. NO. 232, 84th Cong., 1st Sess. 4, *reprinted in* 1955 U.S. CODE CONG. & ADMIN. NEWS 2101, 2104.

<sup>17</sup> See, e.g., 101 CONG. REC. 5388-89 (1955) (statement of Sen. Carlson (R-



## 2.2. From 1955 to 1973: Section 232 and the Mandatory Import Program

Since 1955, Section 232 and its predecessor statute have been used on numerous occasions to address energy security concerns. Presidents Eisenhower, Kennedy, Johnson, Nixon, Ford, Carter and Reagan have all invoked Section 232 as a basis for restricting oil imports or for modifying existing restrictions thereon.

The very first investigation under the 1955 statute involved imported oil. On August 7, 1955, the Independent Petroleum Association of America filed a petition under Section 232 seeking a study of oil imports. In April 1957, the Director of the Office of Defense and Civilian Mobilization (ODCM) reported to the President that there was "reason to believe that crude oil was being imported in such quantities and under such circumstances as to threaten to impair the national security."<sup>18</sup> President Eisenhower concurred in this determination but urged the ODCM Director to further investigate the possibility of limiting imports effectively on a voluntary basis.

Subsequently, in the Trade Agreements Extension Act of 1958,<sup>19</sup> Congress strengthened and broadened the scope of the national security provision. Specifically, Congress afforded the President the authority to adjust imports not only of an article under investigation, but also of its "derivatives."<sup>20</sup> This amendment thus ensured that any import restrictions imposed under the statute are not circumvented by a shift in importation from the restricted product under investigation to a downstream derivative (e.g., from crude oil to refined oil products).<sup>21</sup> The

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Kan.)). In contrast to present law, which requires the Secretary of Commerce to investigate whether imports of the article in question threaten to impair national security, 19 U.S.C. § 1862(b), Section 7(b) of the 1955 Act required the Director of the Office of Defense Mobilization to conduct the initial investigation. See Trade Agreement Extension Act of 1955, Pub. L. No. 84-86, ch. 169, § 7(b), *reprinted in* 1955 U.S. CODE CONG. & ADMIN. NEWS 182, 187. The Trade Expansion Act of 1962, Pub. L. No. 87-794, § 232(b), 76 Stat. 872, 877 (1962) (codified as amended at 19 U.S.C. § 1862(b)(1982 & Supp. V. 1987)), transferred this fact-finding authority to the Office of Emergency Planning, which was abolished and its functions transferred to the Department of the Treasury in 1974. See Trade Act of 1974, Pub. L. No. 93-618, § 127(d), 88 Stat. 1978, 1993 (1974), *reprinted in* 1974 U.S. CODE CONG. & ADMIN. NEWS 2290, 2308. A 1979 reorganization subsequently transferred Section 232 investigation and fact-finding authority to the Secretary of Commerce. Reorg. Plan No. 3 of 1979, § 5(a)(1)(B), 44 Fed. Reg. 69,273 (1979).

<sup>18</sup> See COMMERCE STUDY, *supra* note 4, at II-2.

<sup>19</sup> Pub. L. No. 85-686, 72 Stat. 673 (1958), *reprinted in* 1958 U.S. CODE CONG. & ADMIN. NEWS 788.

<sup>20</sup> *Id.* § 8(a).

<sup>21</sup> See S. REP. NO. 1838, 85th Cong., 2d Sess. 12 (1958), *reprinted in* 1958 U.S. CODE CONG. & ADMIN. NEWS 3609, 3620 ("The need for such additional language is obvious, for a limitation of the materials alone would serve only to spur the importation

1958 amendments further expanded the scope of Section 232 investigations by requiring the Director of ODCM to consider whether the articles under investigation are being imported under such "circumstances," as well as in such quantities, as to constitute a threat to national security.<sup>22</sup> This amendment confirmed that the President could take actions not only in response to the level of imports, but also to other circumstances of imports that threaten to impair national security (e.g., very low energy prices).<sup>23</sup>

In February 1959, President Eisenhower, acting under the expanded national security clause, was advised by the Director of ODCM that "crude oil and the principal crude oil derivatives and products are being imported in such quantities and under such circumstances as to threaten to impair the national security . . ."<sup>24</sup> The finding came after further increases in imports of low-priced foreign oil in the late 1950s, principally from the Middle East. These increases, especially in petroleum products, indicated that President Eisenhower's voluntary program was being circumvented.<sup>25</sup> The Commerce Department found that although domestic demand grew by 216.8% from 1954 to 1958, domestic crude oil production rose only 5.8%. In the context of excess world supply and low prices, imports had actually increased during the voluntary program and threatened the capability of the domestic suppliers to meet the requirements of an expanding economy.

On the basis of this finding, President Eisenhower established the

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of the finished or semi-finished products which are, in the final analysis, the very items most essential to the defense of the country.").

<sup>22</sup> See Trade Agreement Extension Act of 1958, Pub. L. No. 85-686 72 Stat. 673, 678 (1958), reprinted in 1958 U.S. CODE CONG. & ADMIN. NEWS 788, 795.

<sup>23</sup> As noted in the Senate Report on the 1958 Amendment, "the amendments are designed to give the President *unquestioned authority to limit imports which threaten to impair defense-essential industries* . . . [T]he bill as reported grants to the President a potentially fast-moving vehicle for guarding our national security in this respect." S. REP. NO. 1838, 85th Cong., 2d Sess. (1958), reprinted in 1958 U.S. CODE CONG. & ADMIN. NEWS 3609, 3614 (emphasis added).

In the amendments, Congress also afforded interested private parties the right to petition the Director of ODCM to initiate a national security investigation; the amendments in fact require the Director to institute the investigation upon the request of an interested party. The amendment also required the President to consider the factors currently set out in Section 232 in making the determination as to whether a national security threat exists. See Pub. L. No. 85-686, § 8, 72 Stat. 673, 678 (1958). See also S. REP. NO. 1838, 85th Cong., 2d Sess. (1958), reprinted in 1958 U.S. CODE CONG. & ADMIN. NEWS 3609, 3619-20. These factors are further discussed in Part 3.1, *infra*. In 1962, Congress reenacted the national security provision, without material change, as Section 232(b) of the Trade Expansion Act of 1962. See Pub. L. No. 87-794, § 232(b), 76 Stat. 872, 877 (1962), reprinted in 1962 U.S. CODE CONG. & ADMIN. NEWS 1021, 1027.

<sup>24</sup> Proclamation No. 3279, 24 Fed. Reg. 1,781 (1959).

<sup>25</sup> See *Pancoastal Petroleum, Ltd. v. Udall*, 348 F.2d 805, 806 (D.C. Cir. 1965).

Mandatory Oil Import Program (MOIP), which imposed both quotas and import licenses in order to stimulate domestic oil exploration and to increase United States refining capacity.<sup>26</sup> Specifically, the President directed the Secretary of the Interior to set maximum levels of imports for each region of the country and to allocate those imports among various domestic refiners pursuant to an import licensing system. The Secretary allocated to refiners their share of the total amount of imported oil on the basis of their refinery "inputs" for the previous year.<sup>27</sup>

In September 1960, only a year and a half after the President's first actions to restrict oil imports, the Organization of Petroleum Exporting Countries (OPEC) was founded by Venezuela, Saudi Arabia, Kuwait, Iraq, and Iran. While ostensibly created to establish a joint mechanism for the members to maximize the exploitation of their resources and prevent a decline in oil prices, the creation of OPEC may have been a result of the President's action to restrict imports, which undoubtedly had an impact on world price levels. Thus, ironically enough, Presidential action under Section 232 to improve energy security may have inadvertently played a role in creating the organization that later posed the central threat to energy security.

Despite the establishment of MOIP, domestic consumption continued to grow faster than domestic production. Hence, oil imports continued to grow and rose from 1.61 million bbl/d in 1960 to 6.03 million bbl/d in 1973.<sup>28</sup> In response to this imbalance, Presidents Kennedy, Johnson, and Nixon, acting under Section 232, each increased quota levels.<sup>29</sup> Notwithstanding these adjustments, a Cabinet task force determined in 1970 that MOIP, as amended, was not fulfilling its objectives, in large part due to exceptions created for various domestic regional energy markets.<sup>30</sup> Accordingly, President Nixon, acting under Section

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<sup>26</sup> Proclamation No. 3279, 24 Fed. Reg. 1,781 (1959). For background on the MOIP program, *see generally* *Murphy Oil Corp. v. Hickel*, 439 F.2d 417 (8th Cir. 1971); *Gulf Oil Corp. v. Hickel*, 435 F.2d 440 (D.C. Cir. 1970); *Skelly Oil Co. v. Russell*, 436 F.2d 910, 913-15 (D.C. Cir. 1970); *Texas American Asphalt Corp. v. Walker*, 177 F. Supp. 315 (S.D. Tex. 1959).

<sup>27</sup> Refiners that imported oil pursuant to an allocation under the voluntary import restraint program in effect prior to 1959 also could elect to obtain their share of imports on the basis of a percentage of their last annual allocation under the voluntary program. *See* Proclamation No. 3279, 24 Fed. Reg. 1,781 (1959).

<sup>28</sup> *See* COMMERCE STUDY, *supra* note 4, at II-3.

<sup>29</sup> *See generally* *Federal Energy Admin. v. Algonquin SNG, Inc.*, 426 U.S. 548, 553 (1975). MOIP was amended numerous times during the 1960s and early 1970s. For a complete list of proclamations amending Proclamation No. 3279, *see* 19 U.S.C. § 1862 (1982 & Supp. V 1987).

<sup>30</sup> *See* CABINET TASK FORCE ON OIL IMPORT CONTROL, THE OIL IMPORT QUESTION 128 (1970).

232, modified the program radically in 1973.<sup>31</sup> Specifically, the President suspended existing tariffs on petroleum products, modified the existing quota system, and instituted a graduated schedule of licensing fees for importers of crude oil and most petroleum products. Although some oil imports were exempted initially from the fee requirements, the exemption levels were scheduled to decrease annually.<sup>32</sup>

### 2.3. *The 1970s Oil Price Shocks and Section 232*

#### 2.3.1. *The 1973 Arab Oil Embargo*

By the early 1970s, the domestic energy security situation had changed markedly. As a consequence of post-World War II economic expansion, U.S. consumption of oil had grown substantially—from 6.56 million bbl/d in 1950 to 17.3 million bbl/d in 1973.<sup>33</sup> Unfortunately, however, domestic crude production, which was 5.41 million bbl/d in 1950, peaked at 9.64 million bbl/d in 1970, and fell to 9.21 million bbl/d in 1973.<sup>34</sup> Hence, the growing gap between consumption and production had to be filled by imports, which grew from 1.8 million bbl/d in 1960 to 3.4 million bbl/d in 1970 and 6.3 million bbl/d in 1973. Not surprisingly, reliance on oil imports totalled 37% of domestic consumption at the time of the OPEC embargo.

At the same time, world supply was becoming tight. Member nations of OPEC, which controlled the bulk of the world's capacity, were operating at above 80% of capacity,<sup>35</sup> and non-OPEC nations had virtually no unused capacity. By 1973, OPEC members had assumed considerable ownership and control over oil production and, with it, the power to determine price and output. As a consequence of these changes over two decades, the Arab member states of OPEC were able to institute an embargo on exports of crude oil to the United States and its allies in retaliation for President Nixon's decision to support Israel during the 1973 Yom Kippur War. This action effectively denied the United States 2.4 million barrels of oil per day (or approximately 38% of domestic imports) during the embargo. In 1975, in the aftermath of the OPEC crisis, President Ford conducted a full-scale study of imported oil under Section 232. He found that dependence on reliable sources of imported oil was growing and threatened to impair the national security, foreign policy, military predominance, and economic

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<sup>31</sup> Proclamation No. 4210, 38 Fed. Reg. 9,645 (1973).

<sup>32</sup> *Id.* at 9,653.

<sup>33</sup> See 40 Fed. Reg. 4,459 (1975).

<sup>34</sup> ENERGY INFO. ADMIN., 1985 ANNUAL ENERGY REVIEW 101 (1986).

<sup>35</sup> NPC REPORT, *supra* note 9, at 7.

welfare of the United States.<sup>36</sup>

The major focus of the investigation was "the degree of risk of interruption of the supply of [oil] products from [foreign] countries" and "the impact on the economy and our national defense of an interruption of such supplies."<sup>37</sup> On the basis of a thorough analysis of supply and demand considerations, the Secretary of the Treasury found a significant risk of another supply disruption. The study projected continued growth of domestic dependence on oil imports, especially from the OPEC nations (which accounted for nearly 60 percent of United States imports at the time), the prospect of a continued decline in production in the United States, and reduced imports from Canada.<sup>38</sup> The analysis also highlighted the "limited" degree to which "other energy forms can in the short run be . . . substituted for oil," which at that time accounted for 46% of domestic energy consumption.<sup>39</sup> Thus, as the study concluded, "Although oil exporters vary in their specific national goals and from time to time make unilateral decisions in regard to oil policies, oil exporters have the potential to bring about concerted actions which can explicitly deny the U.S. needed imports through such actions as last year's embargo."<sup>40</sup> In short, the Secretary of the Treasury found that continued reliance on imports leaves the economy vulnerable to both a supply curtailment and an increase in price.<sup>41</sup>

The Treasury Department study further stated that another supply disruption "would have a prompt substantial impact upon our economic well-being, and, considering the close relation between this nation's economic welfare and our national security, would clearly threaten to impair our national security."<sup>42</sup> The analysis stressed that the OPEC embargo caused the price of oil imports to quadruple from approximately \$2.50 per barrel to more than \$10.00 per barrel<sup>43</sup> and had devastating effects on the overall economy, including a reduction in GNP by some \$10 to \$20 billion,<sup>44</sup> a 0.5% increase in the unemployment rate in just 6 months (i.e., approximately 500,000 people lost

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<sup>36</sup> Notice of Publication of 1975 Report on the Effects of Oil Imports on National Security, 40 Fed. Reg. 4,457 (1975) [hereinafter 1975 Notice].

<sup>37</sup> *Id.* at 4,458.

<sup>38</sup> *Id.* at 4,460.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> *Id.* at 4,457.

<sup>43</sup> *Id.*

<sup>44</sup> *Id.* at 4,459. The change in GNP reflected harm to all sectors of the economy, the study found, with the consumer durables sector and housing construction most heavily hit.

jobs),<sup>45</sup> and a significant increase in the Consumer Price Index.<sup>46</sup> The study also noted that the sharp price rise caused by the OPEC embargo substantially increased the total U.S. oil bill and, hence, significantly eroded the U.S. balance of payments.<sup>47</sup>

Finally, the Section 232 study also highlighted other ways in which import dependence was threatening national security. First, it concluded that

in the event of a worldwide political or military crisis, it is not improbable that a more complete interruption of the flow . . . would occur. In that event, the total U.S. production of about eleven million barrels per day might well be insufficient to supply adequately a war-time economy, even after mandatory conservation measures are imposed.<sup>48</sup>

In addition, the study found that the "massive payments outflow" resulting from high-price oil imports would cause an "inevitable" reduction in "the flexibility and viability of our foreign policy objectives."<sup>49</sup>

On the basis of the Treasury Secretary's findings, the President invoked Section 232 in an effort to strengthen the Nixon import fee program. Specifically, President Ford expedited the graduated increases in import license fees originally ordered by Nixon, imposed an additional, rapidly-increasing supplemental fee per barrel of imported oil, and reinstated tariffs suspended by the Nixon Proclamation in 1973.<sup>50</sup>

### 2.3.2. *The 1979 Iranian Supply Disruption*

Subsequent to the 1975 action, the situation worsened; domestic crude oil production declined and consumption continued to grow, with imports filling the gap. Indeed, from the time of the 1973 embargo to the election of President Carter in late 1977, dependence on foreign oil grew from 35% to 46% of consumption.<sup>51</sup> As the situation deteriorated in the mid-1970s, the government began to take a series of initiatives, including the establishment of the Strategic Petroleum Reserve (SPR),

<sup>45</sup> *Id.* The Department of Labor estimated that between 150,000 and 225,000 jobs were lost as a direct result of employers' inability to obtain petroleum supplies. As an indirect result of the supply disruption, another 310,000 jobs were lost in U.S. industries, including the auto industry, which made products or used processes that were subject to reduced demand because of the oil shortage. *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Id.* at 4,457.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> Proclamation No. 4341, 40 Fed. Reg. 3,965 (1975). See generally *Federal Energy Admin. v. Algonquin SNG, Inc.*, 426 U.S. 548, 553-555 (1975).

<sup>51</sup> NPC REPORT, *supra* note 9, at 49.

a crude oil reserve, a series of regulatory programs concerning oil pricing and allocation, and an entitlements program for small oil refiners. Unfortunately, this combination of extensive market interventions probably discouraged investment in oil production and refining and, by restraining prices artificially, may have fueled demand growth.<sup>52</sup> Thus, due to a combination of world market conditions, well-intended but apparently counterproductive policies, and unanticipated political developments, another supply disruption occurred only five years after the initial OPEC crisis.

In the aftermath of the Islamic revolution, Iran interrupted its oil imports to the United States—which, at that time totalled only about 5% of domestic consumption. Subsequently, the Treasury Secretary again conducted a Section 232 investigation and, not surprisingly, made an affirmative finding that oil imports continued to threaten national security.<sup>53</sup>

Specifically, the Secretary determined, on the basis of prevailing supply and demand factors, that the risk of a supply disruption had not decreased since 1975. Overall dependence on imports grew to 45%, as domestic production further declined to 8.55 million bbl/d in 1979. Also, United States dependence on OPEC rose significantly, from 17% of consumption in 1973 to more than 30% in 1979.<sup>54</sup> And OPEC's capacity utilization continued to be high, with more than 80% of capacity in use. In short, OPEC had even greater ability to control price and output than it did in 1973. As the Secretary determined, "In 1973, some of these countries demonstrated their willingness to use oil as a political weapon . . . . Despite the intervening years and strengthened relations with Middle Eastern nations, the United States cannot discount the possibility of another political disagreement with the nations on which it depends for its oil supplies."<sup>55</sup>

The study also highlighted other growing risks of supply interruption. These included the vulnerability of the Straits of Hormuz, through which the major Arab oil suppliers shipped their oil, and the likelihood that producing nations would face "a risk of terrorist action."<sup>56</sup> Also, the Iranian revolution "highlighted the potential for internal domestic upheavals to disrupt oil supplies."<sup>57</sup> The Secretary thus found that there were multiple types of supply disruptions which posed

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<sup>52</sup> See *id.* at 48-49.

<sup>53</sup> Notice of Publication of 1979 Report on the Effects of Oil Imports on National Security, 44 Fed. Reg. 18,819 (1979) [hereinafter 1979 Notice].

<sup>54</sup> *Energy Info. Admin., 1985 Annual Energy Review*, 101, 107 (1986).

<sup>55</sup> 1979 Notice, *supra* note 53, at 18,820.

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

a threat to national security. The study also found that excessive dependence on imported oil would impair the United States ability to achieve its foreign policy objectives and fulfill its international obligations, and could create doubts about the United States ability to sustain prolonged conflicts.<sup>58</sup>

In analyzing the potential consequences of a supply disruption, the Section 232 study concluded, from developments in Iran, that even the disruption of a small source of supply could have a substantial adverse impact on the U.S. economy.<sup>59</sup> Incredibly, as the Secretary of the Treasury noted:

Even though Iranian oil accounted for only 5 percent of U.S. oil consumption prior to December 1978, . . . the continued interruption of even this relatively less important U.S. supply source could require the U.S. to consider mandatory conservation measures. This . . . serves to emphasize . . . the vulnerability of the U.S. economy to supply disruption.<sup>60</sup>

The report concluded that such a disruption would have a potentially severe impact on the GNP, employment, and inflation.<sup>61</sup>

The study also highlighted the high cost of oil imports, which grew nearly thirty-fold from \$1.5 billion in 1979, to \$42 billion in 1978. Indeed, oil imports constituted 25% of total imports in 1978 and amounted to about one and one-quarter times the entire merchandise trade deficit. The report then found that excessive import dependence and increased inflationary pressures inhibited investment required for growth and impaired the U.S. ability to achieve its economic objectives. With lower dependence, the "U.S. economy could maintain appropriate levels of growth and grow faster with a lower inflation rate and a

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<sup>58</sup> *Id.* at 18,841.

<sup>59</sup> *See id.* at 18,820 (The "[d]isruption in *any* source of supply serves to concentrate U.S. reliance on the other supply sources, and, at a minimum, leads to unscheduled price increases, thereby increasing the nation's vulnerability.") (emphasis added).

<sup>60</sup> *Id.*

<sup>61</sup> *Id.* at 18,850. According to the NPC, the 1979 shock had even more severe effects than the 1973 embargo:

The simulated impact of the 1979 oil price shock is substantially greater than the 1973 shock. The 3.6% reduction in real GNP attributable to the oil price shock (through the fourth quarter of 1981) compares with actual growth of 1.2% over the same period. In other words, robust growth of 4.8% could have been expected had there been no shock. About 2 million jobs were lost, and the inflation rate was increased by nearly 3% for two years.



stronger dollar."<sup>62</sup> Significantly, the study also noted that:

Excessive and growing . . . dependence on oil imports increases the danger of reduced confidence in the dollar and makes the dollar more vulnerable to downward pressures in the foreign exchange market. If downward pressures on the dollar were to become so severe as to damage world confidence in the dollar, the national security of the United States would be impaired.<sup>63</sup>

Based on this Section 232 study, President Carter took a series of actions. First, in April 1979, in response to market shortages and high prices, President Carter eliminated all fees and tariffs on imported petroleum for a three-month period (from April 1, 1979 to June 30, 1979).<sup>64</sup> Subsequently, the Secretary of Energy extended this for a year. Then, on November 12, 1979, President Carter banned all imports of crude oil into the United States from Iran in response to the seizure of the U.S. Embassy in Teheran by Iranian students.<sup>65</sup> Further, on April 2, 1980, President Carter, on the basis of the 1979 Section 232 findings, found that "[t]he high level of the [n]ation's consumption of gasoline is the single most important cause of our dependence on foreign oil."<sup>66</sup> On the advice of the Secretaries of Energy and Treasury, the President established the Petroleum Import Adjustment Program (PIAP), which included a fee on oil and gasoline imports *and* a system for passing the cost of the fee to gasoline consumers.<sup>67</sup> On June 19, 1980, after the pass-through aspect of PIAP was held illegal by the federal courts,<sup>68</sup> President Carter rescinded the program and once again reinstated the MOIP program (but left the fees at \$0.00).<sup>69</sup>

The Carter Administration also took other steps outside of Section 232 to deal with the energy crisis, which was a central issue in the late 1970s. The appearance of gas lines throughout the nation in 1979 and panic buyings caused the Administration to adopt a series of conservation initiatives (many of which were not enacted by Congress) and to make government-financed investments in alternative energy programs (including the creation of the Synfuel Corporation to finance projects to

<sup>62</sup> 1979 Notice, *supra* note 53, at 18,822.

<sup>63</sup> *Id.*

<sup>64</sup> Proclamation No. 4655, 44 Fed. Reg. 21,243 (1979).

<sup>65</sup> Proclamation No. 4702, 44 Fed. Reg. 65,581 (1979). See generally *Marathon Oil Co. v. Department of Energy*, 482 F. Supp. 651, 652 (D.D.C. 1979).

<sup>66</sup> Proclamation No. 4744, 45 Fed. Reg. 22,864 (1980).

<sup>67</sup> *Id.*

<sup>68</sup> See discussion, *infra*, at note 179.

<sup>69</sup> Proclamation No. 4766, 45 Fed. Reg. 41,899 (1980). See also Act of June 6, 1980, Pub. L. No. 96-264, 94 Stat. 439 (rescinding the PIAP program by statute).

develop synthetic fuels). Further, recognizing that the existing price and allocation controls were worsening the crisis, the Carter Administration decided to begin gradually to pass the true cost of oil onto consumers. Thus, President Carter began a phased decontrol of price and allocation requirements. At the same time, Congress enacted the wind-fall profits tax—essentially as a *quid pro quo* for decontrol.<sup>70</sup>

Subsequently, in 1982, President Reagan found that Libya was no longer a “reliable supplier of United States energy needs” and that “Libyan policy and action supported by revenues from the sale of oil imported into the United States are inimical to United States national security.”<sup>71</sup> Accordingly, in order “to eliminate the dependence of the United States on Libya as a source of crude oil,” the President, acting under Section 232, banned the importation of crude oil produced in Libya.<sup>72</sup> Soon thereafter, the President, again acting under Section 232, extended the ban to refined oil products from Libya.<sup>73</sup>

#### 2.4. *The 1980s: The Shift from Complacency to Concern*

During the early years of the Reagan Administration, vulnerability to supply disruptions declined significantly. The high energy prices of the 1970s, government-initiated conservation incentives and market-freeing measures resulted in a 15% decline in United States consumption from 1979 to 1985, from 18.5 million bbl/d in 1979 to 15.7 million bbl/d in 1985<sup>74</sup> (reflecting both conservation and energy efficiency gains). As a recent Commerce study noted, the economy had become less oil intensive, “the United States consumed only as much energy in 1987 as it did in 1973 even though the economy grew 40 percent over that period.”<sup>75</sup> In addition, there is greater flexibility for internal fuel switching now; numerous large oil users have the capability to substitute large volumes of national gas and oil for imported oil and gas.<sup>76</sup> At the same time, world oil supplies grew due to increased exploration,

<sup>70</sup> See NPC STUDY, *supra* note 9, at 53.

<sup>71</sup> Proclamation No. 4907, 47 Fed. Reg. 10,507 (1982).

<sup>72</sup> *Id.*

<sup>73</sup> Exec. Order No. 12,538, 50 Fed. Reg. 47,527 (1985) *reprinted in* 19 U.S.C. § 1862 app. at 80 (Supp. 1986). This Order also cited as authority Section 504 of the International Security and Development Cooperation Act of 1985, 22 U.S.C. § 2349aa-8 (1988), which permits the President to restrict imports from and exports to Libya. For a review of the President's actions against Libya, see J. Bialos & K. Juster, *The Libyan Sanctions: A Rational Response to State-Sponsored Terrorism?*, 26 VA. J. INT'L L. 799 (1986).

<sup>74</sup> ENERGY INFO. ADMIN., 1985 ANNUAL ENERGY REVIEW, *supra* note 34, at 65-66.

<sup>75</sup> COMMERCE STUDY, *supra* note 4, at III-2.

<sup>76</sup> *Id.*

drilling and the expansion of the world oil industry. Indeed, domestic drilling hit record levels in 1981, and domestic production increased from 8.6 million bbl/d to 9.0 million bbl/d between 1979 and 1985. Also, the sourcing of oil imports changed considerably. Specifically, Canada, Mexico, and the United Kingdom—more reliable non-OPEC suppliers—increased their shares of oil imports, while OPEC's share dropped from 70.5% of imports in 1979 to 36% in 1985. Not surprisingly, OPEC's level of capacity utilization also declined substantially, falling below 60% in 1985.<sup>77</sup>

In the United States, these welcome developments were aided by President Reagan's efforts, upon his inauguration in 1981, to deregulate the energy sector and let free market forces operate. The Reagan Administration accelerated President Carter's phase-out of oil controls and dismantled the oil import licensing system established originally by the 1959 Eisenhower Proclamation,<sup>78</sup> although Reagan retained all oil tariffs in effect.<sup>79</sup> Also, President Reagan steadily, albeit gradually, filled the SPR and proposed a series of steps to deregulate natural gas as prices declined. As energy prices gradually declined in the early 1980s, the Administration also abolished the Synfuels Corporation (and, at least initially, considered abolishing the Department of Energy).

In the mid-1980s, however, the situation began to change again, as increased exploration and drilling activities in the early 1980s began to translate into significantly increased world oil supplies. As the world oil market became glutted, Saudi Arabia played the role of a swing producer, gradually decreasing output in order to support falling prices. As a consequence, the level of crude oil imports from Saudi Arabia fell from 193 million barrels in 1982 to 48 million barrels in 1985. In late 1985, however, the Saudi Arabians decided to abandon this role and increase output so as to recapture lost market share and revenues. This new policy was articulated at the December 1985 OPEC meeting in Geneva, Switzerland, where the other OPEC members agreed with Saudi Arabian Oil Minister Sheik Ahmed Yamani that they had to regain a "fair market share" at the expense of non-OPEC producers by increasing OPEC production from 16 to 17.5 million bbl/d.<sup>80</sup> As Sheik Yamani put it in an interview, "[W]hen we defend our market share, this means the non-OPEC producers must give us part of their share in

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<sup>77</sup> NPC REPORT, *supra* note 9, at 7, fig. 3.

<sup>78</sup> Proclamation No. 3279, 24 Fed. Reg. 1,781 (1959).

<sup>79</sup> Proclamation No. 5141, 48 Fed. Reg. 56,929 (1983).

<sup>80</sup> Jenkins, *OPEC Agrees to Cut Production*, Wash. Post, Dec. 21, 1986, at A35, col. 4.

the market."<sup>81</sup>

Thus, Saudi Arabia, between August 1985 and August 1986, increased its oil output from approximately 2.3 million bbl/d to 6.4 million bbl/d in an effort to recapture its eroded market share. Also, Saudi Arabian exports of crude oil to the United States grew in one year's time to 225.2 million barrels—an increase of 369%—while domestic production plummeted.<sup>82</sup> As a consequence, oil prices fell sharply from about \$26 a barrel in January 1986 to \$9 to \$11 by mid-1986. Prices recovered partially by the end of 1986, and fluctuated in the \$14-to-\$18 range during 1987.<sup>83</sup> In short, Saudi Arabia, through its actions, successfully flooded the global oil market, which depressed world oil prices to levels that forced producers in the United States to go out of business, slowed down exploration efforts, cut production levels, and shut in high cost production. As a consequence, U.S. production levels fell markedly in 1986-1987, and imports began to rise significantly to fill the void.

In the United States, public concern over the precipitous oil price decrease and rising imports rose considerably, and numerous private organizations studied the problem and called for varying forms of government action.<sup>84</sup> The Administration's response to these developments was limited. It continued to fill the SPR and rely on market forces to maintain supply and demand balances. In order to enhance energy security and further deregulate energy markets, the Administration also pressed Congress to repeal the windfall profits tax (which was finally achieved in 1988) and to adopt a series of other supply-side measures,

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<sup>81</sup> *Yamani Singles Out UK to Start Contracts on Market Stabilization*, Platt's Oilgram News, Dec. 11, 1985, at 3. Another aspect of this low-pricing strategy is to simply stimulate demand for oil—demand at prices that more costly producers cannot afford to supply—in lieu of other, more costly energy sources or even at the expense of conservation measures. See G.H.M. SCHULER, *THE TREASURY DEPARTMENT'S VIEW OF OIL IMPORTS IN 1975, 1979, AND 1984: A STUDY IN CONTRASTS* 73 (Significant Issues Series Vol. 7, No. 5, 1985) ("The principal Arab exporters—Saudi Arabia, Kuwait, and the United Arab Emirates—have worked against a confrontational price policy in recent years because they have seen a convergence of economic, and other, interests, with the United States as the world's largest importer. They have agreed that lower prices will revive oil demand in the United States and other industrial countries."). Hence, these countries cannot only expand their share of the *existing* market for oil, but also increase the absolute size of the market itself, thereby increasing their leverage even further.

<sup>82</sup> ENERGY INFO. ADMIN., 1986 PETROLEUM SUPPLY ANNUAL (1987); 1985 PETROLEUM SUPPLY ANNUAL, at 8 (1986)

<sup>83</sup> COMMERCE STUDY, *supra* note 4, at III-5.

<sup>84</sup> See NPC REPORT, *supra* note 9; AMERICAN PETROLEUM INST., DOMESTIC PETROLEUM PRODUCTION AND NATIONAL SECURITY (1986). See also THE STRATEGIC CONSEQUENCES OF THE OIL PRICE COLLAPSE (G.H. Schuler ed.) (Significant Issues Series Vol. 9, No. 2, 1987).

not enacted by Congress, which President Reagan recommended again in his Section 232 finding in 1988. These included comprehensive legislation to deregulate natural gas; the opening of the Arctic National Wildlife Refuge in Alaska and the Outer Continental Shelf to oil production; an increase in the percentage depletion allowance used to calculate independent oil and gas producers' income tax; and the reform of nuclear power licensing.

Amidst rising concerns, the Administration also initiated a comprehensive study of energy security. The report, prepared by the Energy Department, concluded that lower world oil prices have had a positive impact on the economies of the developed world, but caused considerable adverse effects to the worldwide oil industry and could result in increased oil imports, especially from the Persian Gulf.<sup>85</sup> Specifically, the Report concluded the "[h]igher import dependence could increase the risk of major supply disruptions that are damaging to our economic well-being and energy security."<sup>86</sup> It also noted that this risk would affect national security, military preparedness, and foreign policy. Significantly, however, the report concluded that the Administration should not impose an oil tariff on floor price. It instead recommended the series of supply-side measures noted above.<sup>87</sup>

It was in this setting of falling oil prices, declining domestic production, increasing imports and the implementation of a government policy of reliance on market forces that an ad hoc coalition of trade associations, oil companies and individuals, decided to petition the Secretary of Commerce on December 1, 1988 to initiate an investigation of oil imports under Section 232.<sup>88</sup> For several weeks thereafter, the Administration took no action on the petition and resisted the initiation of a 232 investigation—even though this step was required by law.<sup>89</sup> The

<sup>85</sup> See U.S. DEP'T. OF ENERGY, *ENERGY SECURITY: A REPORT TO THE PRESIDENT OF THE UNITED STATES* 7 (1987) [hereinafter *ENERGY SECURITY*].

<sup>86</sup> *Id.* at 72-92.

<sup>87</sup> *Id.*

<sup>88</sup> See Petition under Section 232 of the Trade Expansion Act of 1962, as Amended, for Adjustments of Imports of Crude Oil and Petroleum Products (Dec. 1, 1987) (submitted by ENSERCH Corp. on behalf of the National Energy Security Committee and by the Texas Independent Producers and Royalty Owners Association).

<sup>89</sup> Section 232 affords interested parties the right to bring a petition requesting such an investigation, 19 U.S.C. § 1862(b) (1988), and both the statute and the Commerce Department regulations promulgated thereunder set forth with specificity the allegations that must be contained in the petition. See 15 C.F.R. § 359.5(c) (1988).

Once a petition that meets the Department's requirements has been filed, Section 232 mandates that "[u]pon application of an interested party, . . . the Secretary of the Commerce . . . shall immediately initiate an appropriate investigation to determine the effects on the national security of imports of the article which is the subject of such application . . ." 19 U.S.C. § 1862(b)(1)(A) (1988) (emphasis added). The legislative history of the statute confirms that the Commerce Department has no discretion to

Department of Commerce initiated the case on December 23, 1987,<sup>90</sup> only after counsel for petitioners sent a letter to the Secretary of Commerce which explained that the initiation of an investigation was not discretionary, but was mandated by law and that the petitioners would consider all appropriate steps necessary to ensure that the Department fulfilled its legal obligations under Section 232.<sup>91</sup> Once it initiated the investigation on December 29, 1987,<sup>92</sup> the Commerce Department then requested and received comments from interested parties<sup>93</sup> and began its year-long investigation of oil imports under Section 232.<sup>94</sup>

### 3. OIL IMPORTS AND NATIONAL SECURITY: UNDERSTANDING THE DYNAMIC RELATIONSHIP

The crucial inquiry under Section 232, of course, is whether petroleum is being imported in such quantities or circumstances of importation so as to threaten to impair national security.<sup>95</sup> The energy secur-

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decline an application to initiate an investigation. When Congress afforded private parties the right to request a Section 232 investigation, it stated in no uncertain terms that the Department "is *required* to institute an investigation upon the request of an interested party." S. REP. NO. 1838, 85th Cong., 2d Sess. 10, *reprinted in* 1958 U.S. CODE CONG. & ADMIN. NEWS 3609, 3619 (emphasis added). Thus, as a matter of law, Section 232 imposes a binding legal duty on the Department to initiate, and conduct, a Section 232 investigation and further mandates that such initiation must occur "immediately" upon the receipt of a petition. *See* 15 C.F.R. § 359.3 (1988) ("Upon . . . application of an interested party, . . . the Department shall immediately conduct an investigation to determine the effect on the national security of the imports of any article."). The Department is bound to follow its own regulations. *See* *United States v. Nixon*, 418 U.S. 683, 694-96 (1974); *Service v. Dulles*, 354 U.S. 363, 388-89 (1957); *United States ex. rel. Accardi v. Shaughnessy*, 347 U.S. 260, 268 (1954).

<sup>90</sup> 52 Fed. Reg. 49,059 (1987).

<sup>91</sup> *See* Letter from Weil, Gotshal & Manges to C. William Verity, Secretary of Commerce (Dec. 18, 1987) (on file in Department of Commerce Public Record Room).

<sup>92</sup> 52 Fed. Reg. 49,059 (1987).

<sup>93</sup> *Id.* Commerce received comments from over 60 parties, which are available in the public reading room at the U.S. Department of Commerce. Consistent with its past practice under Section 232, Commerce did not hold any hearings during the course of its investigation.

<sup>94</sup> In a Section 232 proceeding, the Commerce Department, which is required by law to consult with, and seek information from, the Defense Department and other appropriate parties, convenes an interagency panel for detailed consultations. For an overview of the 232 process, see Office of Industrial Resource Admin., *The Effects of Imports on the National Security* (July 1984) (Dep't of Commerce pamphlet). Other agencies generally participating in the study include: the National Security Council; the U.S. Commerce Department; the Department of the Interior; the Federal Emergency Management Agency; the U.S. Department of State; the U.S. Department of the Treasury; the Office of U.S. Trade Representative; the U.S. Department of Labor; and in cases involving oil, the U.S. Department of Energy.

<sup>95</sup> A threshold requirement under Section 232 is whether there are "circumstances" of importation that warrant investigation. In the recent oil case, the record was clear, and it was not disputed by Commerce, that Section 232's threshold requirement was met and the "circumstances" of importation—substantial increases in low-priced

ity debate often glosses over this important issue and simply equates growing dependence on cheap foreign oil with increased insecurity. As analysts have recognized, however, this is not necessarily the case.<sup>96</sup> If domestic oil imports were broadly and equally dispersed among many sources, or were mainly from reliable suppliers, high import *dependence* would not necessarily mean high *vulnerability*. Additionally, given the increased mix of energy sources that the United States now relies on, including natural gas, nuclear power, and coal, imported oil is only one element of the security picture. In all events, understanding the nature and degree of the security problem is critical to shaping appropriate policies to deal with it. Thus, it is important to consider how to evaluate the security risks in this area, and assess whether Section 232, long a focal point for government policy, focuses on the appropriate considerations.

The strategic significance of oil flows from one central premise: it is a vital interest of the United States to maintain a secure, and reasonably-priced supply, of adequate energy resources to meet civilian and military needs. As former Secretary of Defense Caspar Weinberger noted in the 1987 Annual Defense Department Report to Congress, a major objective of national security is to “[e]nsure U.S. access to critical resources . . . .”<sup>97</sup> At present, and for years to come, oil is, and will remain, the basic source of energy for the United States.<sup>98</sup> Domestic demand for oil, relative to other energy sources, at 54% in 1979,<sup>99</sup> was at 43% in 1987 and 1988, and 42% in 1989—despite two intervening oil crises and considerable efforts at developing alternative energy sources.<sup>100</sup> Furthermore, the continued availability of low priced oil is likely to enhance U.S. reliance on oil in the years ahead. U.S. consumption, which had declined in the 1981 to 1985 period, has grown and is projected to grow further in the early 1990s.

In the civilian sector, reliance on oil is still basic to the mobile American lifestyle. In this regard, 63% of oil consumed in 1985 went to

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oil imports—warranted close study.

<sup>96</sup> See, e.g., W. HOGAN & B. MOSSAVAR-RAHMANI, *ENERGY SECURITY REVISITED* 9-10 (1987).

<sup>97</sup> See also Wendt, *The Oil Market and U.S. Energy Security*, DEP'T OF STATE BULL., June 1986, at 51, 53 (“A fundamental objective of U.S. energy policy is to assure an adequate supply of energy at reasonable cost while avoiding undue dependence on any single fuel or supplier.”) (statement made before the Senate Committee on Energy and Natural Resources, Mar. 25, 1986).

<sup>98</sup> See *ENERGY SECURITY*, *supra* note 85, at 50.

<sup>99</sup> *Id.* at 38.

<sup>100</sup> *ENERGY INFORMATION ADMIN. MONTHLY ENERGY REVIEW*, Mar. 1987, at 59; *AMERICAN PETROLEUM INST.*, 13 *MONTHLY STATISTICAL REPORT*, Dec. 1989, at 2.

the transportation sector, and most other oil (25%) was consumed by industrial users.<sup>101</sup> While industrial users have greater capability to switch to alternative fuels, most transportation-related oil use is highly inelastic; even today, there is no readily available substitute for oil in most transportation uses.

Because of our reliance on oil, secure access of reasonably priced oil is central to economic growth. Periods of high inflation and low growth in the 1970s were fueled by high oil prices, and the sustained economic growth and low inflation in the Reagan years was significantly aided by low-priced oil.<sup>102</sup> As we have long recognized, national security is premised on a strong and giving economy. Hence, the economic component of security is directly linked to access to a secure supply of reasonably-priced oil.

Since the armed forces also are highly dependent on petroleum products (especially jet fuel, which accounts for over two-thirds of military demand for petroleum products), they too must be afforded access to sufficient supplies of secure oil to fulfill their deterrence function. It is central to deterrence that the United States be able to maintain ready forces that provide the nation with an "effective and credible response to any level of aggression."<sup>103</sup> Indeed, in the years to come, deterrence is likely to become more reliant on the capabilities and preparedness of conventional forces as a consequence of successful nuclear arms control efforts (such as the recent agreement on intermediate nuclear forces in Europe) and general improvements in United States-Soviet relationships. In such a changing world environment, ensuring military access to sufficient jet fuel, heavy bunker fuels, diesel fuels, and utility fuels will become increasingly important to the military component of security.

### *3.1. Assessing the National Security Risks: The Standards for Policymaking Under Section 232*

The question thus becomes what standard should be used by policy makers under Section 232 and, more generally, what security objectives are achieved by determining whether access to secure, reasonably priced, and adequate energy supplies is sufficient.

As a starting point, it must be recognized that national security is a relative concept. It is impossible to quantify what level of risk is ac-

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<sup>101</sup> 40 Fed. Reg. 4,465 (1975).

<sup>102</sup> ENERGY SECURITY, *supra* note 85, at 57.

<sup>103</sup> C. Weinberger, Secretary of Defense, Annual Report to the Congress, Fiscal Year 1988, at 42 (1987).



ceptable. The fact that the United States has relied heavily on oil but has, for some time, been unable to meet its oil needs from its depleting domestic oil base, means that there necessarily has been, is, and always will be, a clear element of risk in this area—at least until a cheap, and non-depleting, alternative energy source is developed. Until such time, we therefore will necessarily be dependent on foreign oil suppliers. Moreover, since most of the world's oil reserves are in several countries in the Persian Gulf, we will necessarily be dependent on this volatile and inherently insecure region. This was true in the 1970s and is true again in 1990.

National security also is a dynamic concept. As the Soviet military threat recedes and United States-Soviet relations shift into a more cooperative framework, the military aspect of security may gradually become less significant. At the same time, the increasing focus on U.S. competitiveness in the global economy and the erosion of the U.S. industrial base has begun to make economic and trade considerations more prominent in national security planning. Whereas it has long been an assumption of U.S. national security policies that the United States is a technology leader in most sectors and would excel in world markets, this assumption can no longer be taken for granted. Our performance in world markets will directly affect our research and development efforts, investment levels, and, ultimately, the quality and technological level of U.S. industrial output (including both military goods and dual-use articles). Hence, for better or worse, security policies are now being shaped with these “economic security” considerations in mind.

The task for policymakers, in a Section 232 proceeding and generally, is to evaluate the degree of current and projected risk to national security in all of its aspects, and to evaluate whether the risk is tolerable or warrants some types of remedial actions. On close analysis, Section 232 sets forth a number of sound ground rules to be applied when making policy in this area.

### *3.1.1. United States Policy Should Be Future-Oriented*

First, a determination under Section 232 should be based on whether there is a future “threat” to national security by virtue of oil imports, not on present risk levels alone. This perspective is required by the express terms of the statute, which requires a determination as to whether there is a “threat” of impairment to national security. By framing the statute in this manner, Congress recognized that the President should not need to wait for national security to be actually impaired (e.g., for a supply disruption to occur) in order to take remedial

action. The statute thus is preventive in nature, and designed to allow actions today that will avoid such future damage to national security.

This prospective outlook also is supported by simple logic. In the energy sector, there are long lead times; investment decisions and exploration, development and research today will have their full effect felt only in the future. Exploration and development in the lower forty-eight states can take several years to result in production, and exploratory investments in regions like Alaska and offshore might not yield commercial production for much longer periods. Thus, the significant declines in United States exploration and development activities in 1986 to 1987 have resulted in a sharp decline in domestic oil production in 1989. It is therefore important that policy be driven by such future circumstances and the risks that they pose to national security.

Future policy also should not be based on "rosy" scenarios. Of course, predictions of the future in the world oil market are highly unreliable; nobody is right for long. Thus, from a national security standpoint, unless policymakers want to be risk takers, they should be cautious in making predictions. While it is important to evaluate all potential scenarios, policy should be based on less optimistic price and domestic production levels. Formulating policy in this area on the basis of a relatively low preference for risk is consistent with the continuing importance of oil to national security.<sup>104</sup>

### *3.1.2. Policy Should Be Based on a Broad Range of Security Considerations*

A second basic ground rule is that the inquiry into whether dependence on oil imports threatens national security should be broad in scope. The language, history, and administrative practice of Section 232 require that the Commerce Department, in conducting an investigation under the statute, study the effect of oil imports on *all* aspects of national security.

By its terms, Section 232 establishes a sweeping mandate, and requires that the Commerce Department, in investigating the threat to national security posed by imports,

shall . . . recognize the close relation of the economic welfare of the Nation to our national security, and shall take into consideration the impact of foreign competition on the economic welfare of individual domestic industries; and any

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<sup>104</sup> See also S. REP. NO. 232, 84th Cong., 1st Sess. 6, *reprinted in* 1955 U.S. CODE CONG. & ADMIN. NEWS 2071, 2106; S. REP. 1838, 85th Cong., 2d Sess. 11, *reprinted in* 1958 U.S. CODE CONG. & ADMIN. NEWS 3609, 3619-3620.

substantial unemployment, decrease in revenues of government, loss of skills or investment, or other serious effects resulting from the displacement of any domestic products by excessive imports shall be considered, without excluding other factors, in determining whether such weakening of our internal economy may impair the national security.<sup>105</sup>

The legislative history confirms that Section 232 embodies an all-encompassing concept of "national security." In this regard, the so-called Symington Amendment, a predecessor statute to Section 232, was far more limited in scope, and restricted the President's authority to reduce tariffs where "the President finds that such reduction would threaten domestic production needed for projected national defense requirements."<sup>106</sup> When it enacted the national security clause in 1955,<sup>107</sup> however, Congress adopted considerably broader language, which requires that the President investigate whether the article under investigation is being imported "in such quantities as to threaten to impair the national security."<sup>108</sup> As the Chairman of the House Ways and Means Committee declared in 1955, this broader language encompasses "our total national security in *all* its aspects . . ."<sup>109</sup> As he explained:

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<sup>105</sup> 19 U.S.C. § 1862(d) (1988). The Commerce Department regulations, which the Department is bound to follow (*see, e.g.*, *United States v. Nixon*, 418 U.S. 683, 694-96 (1974)), require that the Department, in conducting a Section 232 investigation, consider a nearly identical and similarly broad range of factors. *See* 15 C.F.R. § 705.4(b) (1989) (Recognizing "the close relation between the strength of our national economy and the capacity of the United States to meet national security requirements," the Commerce Department must consider: "(1) the impact of foreign competition on the economical welfare of any domestic industry essential to our national security; (2) the displacement of any domestic products causing substantial unemployment, decrease in the revenues of the government, loss of investment or specialized skills and productive capacity, or other serious effects; and (3) any other relevant factors that are causing or will cause weakening of our national economy.").

<sup>106</sup> *See* Trade Agreement Extension Act of 1954, Pub. L. No. 83-464, 68 Stat. 360, 1954 U.S. CODE CONG. & ADMIN. NEWS 421. This statute is still in effect today. *See* 19 U.S.C. § 1862(a) (1988).

<sup>107</sup> The 1955 version of Section 232 was promulgated as part of the Trade Agreement Extension Act of 1955. *See* Pub. L. No. 84-86, 69 Stat. 162, 1955 U.S. CODE CONG. & ADMIN. NEWS 182.

<sup>108</sup> Although the statute originally authorized an inquiry only where the quantity of imported articles threatened national security, it subsequently was amended to allow investigations into both the "quantities or . . . circumstances" of importation that threaten to impair national security. *See* Trade Agreement Extension Act of 1958, Pub. L. No. 85-686, 72 Stat. 673, 1958 U.S. CODE CONG. & ADMIN. NEWS 788, 795. This reaffirms the intent of Congress to require a broad investigation of the impact of the imported articles in question on U.S. security. *See* S. REP. NO. 1838, 85th Cong., 2d. Sess. 5-6 (1958), *reprinted in* 1958 U.S. CODE CONG. & ADMIN. NEWS 3609.

<sup>109</sup> 101 CONG. REC. H8161 (1955) (statement of Rep. Cooper (D-Tenn.)) (emphasis added).

The Symington Amendment referred to projected national-defense requirements. The [1955 statute] relates to a much broader concept of which the single facet of a projected [national defense] requirement is only one component among many others that must be considered. The President would, as he indeed must under the Constitution, consider our total national security in all its aspects and make his determination on the basis of all the factors bearing on our national security.<sup>110</sup>

As noted above, prevailing concepts of national security are now changing, with economic considerations and concerns over the state of the industrial base playing a more prominent role. Thus, Section 232, which requires a careful and thorough examination of all relevant factors, affords policymakers the discretion to take such emerging concerns into account.<sup>111</sup>

Within this broad framework, there are a number of considerations that warrant particularly close examination (and, indeed, have been a focus of past Section 232 investigations).<sup>112</sup>

<sup>110</sup> *Id.*

<sup>111</sup> Congress again affirmed the broad nature of the investigation required under Section 232 in 1958, when it added the broad range of factors that the President must consider in making a Section 232 determination. As noted by the Floor Manager of the Trade Agreement Extension Act of 1958, which included the amendment:

This language points out that the national security of the country is closely tied to its internal economic welfare and, therefore, that, without excluding other factors, consideration should be given to the impact of foreign competition on the . . . national security that might result from the displacement of domestic products by excessive imports . . . . It should be recognized that in this critical, complex and dynamic area of national policy it would be impossible to set forth in legislation all the factors, in their order of importance, which relate to the administration of the national security provision. By setting forth certain considerations . . . it was not intended . . . to exclude any other factors from being taken into account.

104 CONG. REC. H16,542 (1958) (statement of Rep. Mills (D-Ark.)). *Accord*, S. REP. NO. 1838, 85th Cong., 2d Sess. 5-6 (1958), *reprinted in* 1958 U.S. CODE CONG. & ADMIN. NEWS 3609, 3614 (noting that the amended language allows "possible action whenever danger to our national security results from a weakening of segments of the economy through injury to any industry, whether vital to the direct defense or a part of the economy providing employment and sustenance to individuals or localities" and requires consideration of "the dangers inherent in an economy suffering from unemployment, declining Government revenue, or loss of skills, and the investment because of excessive imports of one or more commodities").

<sup>112</sup> Past Section 232 proceedings, including cases involving oil imports, have been broad in scope, and focused on a wide range of relevant considerations, including: the current and projected health of affected domestic industries, Effects of Oil Imports on the National Security, 44 Fed. Reg. 18,817, 18,843 (Dep't of the Treasury 1979); production levels, production capacity, and the financial condition of firms in the industry, *id.* at 18,852; the risks of oil supply disruptions, and the possibility that such disrupt-

### 3.1.2.1. *The State of the Oil and Gas Industry*

First, as a threshold matter, the analysis should examine the current level of oil imports and their impact on the domestic oil industry.<sup>113</sup> This includes an analysis of the current oil production, exploration and drilling levels, and the impact of imports on the oil industry's basic infrastructure. Based on the current situation, projections then can be made concerning future domestic production levels and, hence, the level of imports that will be necessary to fill the void. Such considerations are essential to the required analysis under the statute, which was designed to ensure that the United States maintain sufficient domestic production of strategic resources to meet national security needs, e.g., during military emergencies or peacetime supply disruptions.<sup>114</sup>

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tions would "have a prompt substantial impact upon our economic well-being," Publication of Report of Investigation to Determine Effects on the National Security of Imports of Petroleum and Petroleum Products, 40 Fed. Reg. 4,457 (Dep't of the Treasury 1975); the impact of imports on the balance of payments and monetary policy, *id.*; the impact of imports on foreign policy and the economies of allies, *id.* at 4,461; the adverse effects on the ability of the United States to achieve its foreign policy objectives, *id.*; and the impact of imports on the development of alternative energy sources necessary to guard against further rises in oil prices. *Id.*

<sup>113</sup> An untested issue is whether Section 232 requires a showing of "causation" for an affirmative finding to be made under the statute—i.e., that the quantity or circumstances of importation are in some manner injuring the domestic industry producing the strategic resource in question. Express causation requirements appear in many international trade statutes, including the antidumping and countervailing duty laws, *see* 19 U.S.C. §§ 1673, 1671 (1988) (requiring a finding of material injury, or the threat thereof, to the domestic industry producing a like product by virtue of dumped or subsidized imports) and the escape clause, *see* 19 U.S.C. § 2251 (1988) (regarding a finding that increased imports are a substantial cause of serious injury, or a threat thereof, to the domestic industry producing a like or directly competitive product). However, since Section 232, by its terms, does not contain such an express requirement, a cogent argument can be made that no such requirement exists. Of course, it can be argued that such a requirement exists by implication because the quantities or circumstances of importation can only threaten the national security if such imports harm the domestic industry and the industry is unable to produce sufficient articles to meet national security needs in a conventional war or peacetime supply disruption. However, this argument ignores the fact that the United States can have a sufficient supply of a strategic resource where it has an active domestic industry but is heavily dependent on friendly, stable, foreign suppliers (e.g., Canada) and transportation methods can be protected from attack. Thus, it is possible that Section 232 could perhaps be invoked where a domestic industry has not been injured, but national security has nevertheless been threatened with impairment because sources of foreign supply have ceased to be reliable.

<sup>114</sup> Section 232, by its terms, requires an analysis of "the impact of foreign competition on economic welfare of individual domestic industries." 19 U.S.C. § 1862(d) (1988). *See also* S. REP. NO. 232, 84th Cong., 1st Sess. 4 (1955), *reprinted in* 1955 U.S. CODE CONG. & ADMIN. NEWS 2071, 2104 (noting the "importance of a strong domestic petroleum industry"). *See* 101 CONG. REC. 5390 (1955) (statement of Sen. Daniel (D-Tex.) and Sen. Carlson (R-Kan.)).

### *3.1.2.2. Military Emergencies*

In light of the current and projected domestic levels of oil production, the analysis then should focus on whether the United States has access to sufficient supplies of secure oil to meet its defense requirements in a period of a full military mobilization and conventional war. While this military-based evaluation should not be the only test of energy security, it certainly is one that should be considered. A key factor in this analysis is the ability of the United States to shift to alternative energy sources in wartime.

### *3.1.2.3. Peacetime Supply Disruptions and Price Increases*

It was in peacetime, not wartime, that we experienced the 1973 and 1979 oil crises, and the resulting damage to the economy which measured in the billions of dollars. These experiences dramatically highlight that an adequate supply of reasonably priced energy is necessary to ensure United States' economic growth, well-being, and the preservation of our citizens' mobile lifestyles. Thus, national security planning should focus on among other things, the vulnerability of the United States to future peacetime oil supply disruptions and significant price increases. A significant oil price rise, and the ensuing wealth transfer, could significantly hamper the competitiveness of key U.S. industries in the world economy.

### *3.1.2.4. Foreign Policy and Power Projection*

Finally, the impact of dependence oil imports on U.S. foreign policy and the U.S. ability to project power in global affairs is another major consideration. The degree to which increased dependence will constrain our freedom of action or result in other problems for U.S. foreign policy should be a major factor in formulating policy.

## *3.2. The Recent Commerce Study: The Nature and Degree of the Problem*

The recent Section 232 study conducted by the Reagan Administration evaluated a number of the considerations set forth above, and on this basis, made an affirmative finding that oil imports threaten to impair national security. An examination of the Commerce study reports, and their strengths and weaknesses, provides insight into the nature of the security problems we face today and in the years ahead in this area.

### 3.2.1. *Threshold Considerations: Oil Imports and Their Impact on the Domestic Oil Industry*

After reviewing prior government studies concerning energy security and discussing improvements in United States energy security since the 1970s, the Commerce study examines the recent trends in oil imports and their impact on the domestic crude oil industry.<sup>115</sup>

#### 3.2.1.1. *Import Trends*

The recent import trends noted by Commerce are troubling. Specifically, as a consequence of the 1986 decline in oil prices, “[n]et oil imports have risen again to 35 percent of domestic consumption in 1987 from a recent low of 27 percent in 1985.”<sup>116</sup> The situation became even worse in 1988 and 1989, with imports accounting for more than 46% of

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<sup>115</sup> The report also examines the United States oil refining industry and imports of refined oil products and, on the basis of a 1986 Department of Energy study entitled *Product Imports, Energy Security, and the Domestic Refining Industry*, properly concludes that “total U.S. refining capacity and the expected level of product imports pose no energy security threat to the United States.” *COMMERCE STUDY, supra* note 4, at III-4. Commerce noted that following the removal of crude oil price and allocation controls in 1981, small oil refineries lost their access to price-subsidized crude oil. Largely as a consequence of this action, 120 refineries, most of which had small capacities, closed. This increased the capacity utilization of the remaining refiners and resulted in improved financial success for U.S. refiners. *Id.* at III-2. Refiners have also made plant upgradings that allow them the flexibility to process various crude oil feedstocks and produce a mix of products. As a consequence, Commerce found that current refining capacity and non-OPEC surplus refining capacity “suggests strongly that capacity is available to carry out refining operations in the event of a disruption of product imports from Middle Eastern OPEC sources.” *Id.* at III-3.

Additionally, Commerce found no threat to domestic refining capacity by virtue of refined product imports. In this regard, there have not been significant increases in product imports, which were at 2,045 bbl/d in 1986, 1,901 bbl/d in 1987. *Id.* at Table III-4. Also, Commerce found no likelihood of massive product exports to the United States from OPEC nations because of rising internal requirements in these nations, the expense of transporting refined oil (which is higher than crude oil) and the closer proximity of product markets in Western Europe and Japan to OPEC refineries. Finally, Commerce noted that “some OPEC nations are purchasing refineries and marketing operations in consuming markets.” *Id.* at III-3. In the view of the Commerce Department, such downstream investments enhance national security because they provide OPEC producers with “an incentive not to take actions which will disrupt oil markets.” *Id.*

It should be noted, however, that the report does not expressly address (at least in the public version) a number of relevant variables: (1) whether U.S. and non-OPEC supply of jet fuel is adequate in a military emergency; (2) whether the location of refining capacity could create significant logistic problems in a military emergency (i.e., whether refining capacity is situated too far from potential conflict sites); and (3) the extent to which the United States could rely on non-OPEC refinery capability in South America or Canada in a military contingency or peacetime. Such considerations obviously bear on whether the United States has sufficient access to refined oil products to meet national security needs.

<sup>116</sup> *COMMERCE STUDY, supra* note 4, at III-4 & Table III-1.

domestic consumption in 1989. Indeed, at the time of the issuance of the report in January 1989, imports of oil (crude and refined) exceeded 8 million bbl/d for the first time since 1980, and crude oil imports increased in the first six months of 1989 by 11.5% over first-half 1988 levels.<sup>117</sup>

The mix of imports has also changed for the worse. Commerce notes that the domestic dependence on OPEC as a source of imports has increased from a low of 11.7% of domestic consumption in 1985 to 18.0% in 1987 to over 50% in May of 1989. Also, domestic reliance on Arab OPEC imports has grown from an average of 974 bbl/d in 1987 to 7,022 in the same period of 1989.<sup>118</sup> Thus, the import situation, long considered a crude benchmark of energy security, suggests that problems exist and are worsening.

### 3.2.1.2. *The Domestic Oil Industry: The Current Prognosis*

Not surprisingly, the Commerce report concluded that the major decline in oil prices in 1986 "has had a significant impact on the U.S. oil industry, reducing both production and exploration." The trends noted by Commerce are revealing:

¶ Crude oil production has declined, rapidly and substantially, to the lowest level in ten years. From a daily average of 8.97 million bbl/d in 1985, it fell to 8.35 million bbl/d in 1987.<sup>119</sup>

¶ The sharp production decline reflects closings of substantial numbers of stripper wells, which accounted for 1.3 million bbl/d of U.S. production in 1987.<sup>120</sup>

¶ The significant number of business failures in the industry—over 2,523 among oil and gas extraction companies from 1982 to 1986—means that substantial infrastructure has been lost.

¶ Employment is down substantially, from 692,100 in oil and gas extraction in 1981 to 425,200 in 1987.<sup>121</sup>

Commerce recognized that future industry prospects are troubling. Specifically:

<sup>117</sup> See ENERGY INFO. ADMIN., PETROLEUM SUPPLY MONTHLY, May 1989, at 3.

<sup>118</sup> *Id.*

<sup>119</sup> COMMERCE STUDY, *supra* note 4, at Table III-8.

<sup>120</sup> *Id.* at III-5 (citing National Stripper Well Association estimate). Commerce noted that stripper wells generally produced on average less than 10 barrels per well per day. *Id.*

<sup>121</sup> *Id.* at Table III-7.



¶ There has been a significant decline in exploration and development activities. This is reflected by sharp decreases in the number of seismic crews engaged in exploration, the number of wildcat wells drilled, drilling permits, and total footage drilled. Also, the number of exploratory and development wells plummeted from 69,170 in 1985 to 33,320 in 1987.<sup>122</sup>

¶ Capital expenditures for oil exploration and developments have dropped significantly in recent years—from \$52.9 billion in 1982 to \$16.2 billion in 1987—and oil revenues have fallen substantially.

¶ Many companies postponed plans for secondary and tertiary recovery operations, which would have partially offset production declines from older fields.

Commerce also explains that there are several factors other than world oil prices that account for, and make inevitable, the declines in production. As it recognizes, "One of the chief factors affecting the outlook of the domestic oil industry is the oil resource base."<sup>123</sup> As stated in the Commerce study, "The United States has only modest reserves relative to current and projected future production because we have depleted much of our petroleum reserves that are currently known and are economic given current oil prices and development costs."<sup>124</sup> Indeed, domestic crude oil reserves dropped from 31.36 billion barrels in 1978 to 27.26 billion in 1987. In contrast, OPEC and Arab OPEC reserves have increased by 271 and 207 barrels, respectively, since 1986.

In short, the facts confirm that the United States, as the most heavily explored petroleum bearing region in the world (and for a long time, the leading producer), does not appear to have an ample supply of low-cost oil remaining to be discovered.<sup>125</sup> Commerce notes that while "[t]here remain some important prospects in North Alaska and in the Outer Continental Shelf which may help to stem the decline in U.S. reserves and production," they "are unlikely to reverse the trend."<sup>126</sup> Also, while improvements in drilling and recovery technology may help, the application of these new technologies will tend to be expensive

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<sup>122</sup> *Id.* at III-6 & Table III-7.

<sup>123</sup> *Id.* at III-7.

<sup>124</sup> *Id.*

<sup>125</sup> *Id.* at III 7-8. In support of this finding, Commerce notes that as the index of reserves to production decreased, U.S. finding rates have declined, and the exploration for new oil fields in the United States has not been very successful; over 80% of the additions to reserves over the last 20 years have come from revisions and extensions of old fields.

<sup>126</sup> *Id.* at III-7.

when compared to the large, low-cost reserves available outside the United States through lower cost extraction techniques.

Another related factor that operates to constrain domestic production is the high cost of domestic oil production as compared to the cost of foreign petroleum production.<sup>127</sup> The high costs reflect the fact that much of the "readily accessible [U.S.] oil resources have already been extracted."<sup>128</sup> Thus, increases in production will come largely through advanced recovery techniques, additions to old fields, and stripper production, but not through major finds. Accordingly, as Commerce points out, the rate of return on investment in domestic oil exploration and production is low compared to the rate of return on alternative U.S. and foreign investments. This situation is exacerbated by the fact that the fiscal and tax environment is now considered far less favorable for investors than that of many foreign producing countries.<sup>129</sup> Hence, it is not surprising that there is a relative scarcity of capital for domestic oil production and development. Larger, integrated firms are investing more capital abroad and smaller, less integrated firms are having trouble raising capital at all for oil exploration.

Further, the current natural gas regulations serve to constrain oil exploration; in exploring for new finds, it is difficult to predict whether oil or natural gas will be found. Because the regulations require some "old" or low cost gas to be held below market price levels, they create a disincentive to explore for gas and subsequently for oil. Similarly, the lack of open access to pipeline transportation has a depressing affect on market transactions, and creates a disincentive to explore.<sup>130</sup>

Finally, while not highlighted by Commerce, the depressed state of the oil field equipment and services industry also can constrain increased exploration and production. This industry, which provides the specialized manpower and equipment necessary to explore for and develop oil and gas reserves and to undertake advanced recovery methods, has been significantly weakened. While not fully examined by Commerce, it is clear that because of decreasing profits and the decrease in the number of companies due to bankruptcy and consolidation, the United States has suffered a significant loss in infrastructure in this sector. Manpower shrank from 480,800 production service workers in January 1982 to 22,600 in July 1987—a decline of more than fifty-

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<sup>127</sup> The Energy Department estimates that the cost of finding and producing a barrel of new petroleum in the United States is approximately \$13 (excluding taxes and royalties), compared to \$2.50 a barrel or less in the Middle East. *See id.* at III-8.

<sup>128</sup> *Id.*

<sup>129</sup> *See* U.S. CONGRESS, OFFICE OF TECHNOLOGY ASSESSMENT, U.S. OIL PRODUCTION: THE EFFECT OF LOW OIL PRICES - SPECIAL REPORT (Sept. 1987).

<sup>130</sup> COMMERCE STUDY, *supra* note 4, at III-9.

three percent. These developments could significantly impede any attempt to significantly "surge" production during a crisis. The fact that there is a smaller sector to service aging wells also means that advanced recovery techniques and marginal well production will become even more costly and, therefore, less attractive.

### 3.2.1.3. *Domestic Oil Production and Imports: Future Prospects*

While the future situation is difficult to predict, certain basic facts are uncontestable. First, because of significant declines in exploration today, future production declines appear unavoidable over the next three to five years—regardless of what action government takes today. The sharp U.S. production decline in 1989, following several years of exploration cutbacks, confirms this prospect. Also, as noted above, domestic consumption has again started to grow. The growing gap between consumption and production will have to be filled by additional imports.<sup>131</sup>

Further, as imports grow, their mix will undoubtedly become even more unfavorable. As Commerce found, there may be some increased diversification of imports and a shift from domestic exploration to non-OPEC sources. However, as Commerce concludes:

[E]ven if further diversification occurs, most of the increase in U.S. oil imports in the 1990s would probably come from Middle Eastern sources. Virtually all of the world's excess production capacity is located in OPEC countries; and over two thirds lies in the Persian Gulf States of Saudi Arabia, Iraq, Iran, Kuwait, Qatar, and the United Arab Emirates. Furthermore, about two thirds of the world's oil reserves are located in these Persian Gulf Countries.<sup>132</sup>

In short, the facts suggest that the evolving cycle of low-priced imports, declining production, and even more imports—especially from the unreliable Persian Gulf—will continue.

Significantly, the Commerce study's projections about both future domestic production and import levels may be optimistic. In this regard, Commerce relies principally on the relatively stale data and assumptions set forth in the 1987 *Energy Security* study which allows a more positive portrayal of the situation than more recent information would

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<sup>131</sup> The Oil and Gas Journal projects that annual crude oil production will decline by 10% between 1987 and 1991, while the DOE projects that, if prices remain between \$15-22 per barrel, domestic crude production in the lower 48 states could decline to between 5.3 and 6.0 million bbl/d in 1990 and to 4.1 to 5.3 million by 1995.

<sup>132</sup> COMMERCE STUDY, *supra* note 4, at III-10-11.

permit. The data for 1988 and the first five months of 1989 show a worsening situation, however, one that is, in fact, not very different from the worst case projections of the 1987 DOE Study.<sup>133</sup>

### 3.2.2. *The Conventional War Scenario: The Prospects of Oil Shortfalls in Military Exigencies*

The Commerce study then appropriately focused on the implications of increased oil imports and declining production for national security. As noted above, a principal basis for government policymaking in this area (in both Section 232 cases and generally) concerns the prospect that the United States will face an oil shortfall in a full military mobilization followed by a major conventional war.

The precise wartime scenario utilized for planning purposes was developed by the National Security Council, (NSC) in 1983, in order to develop an acquisition and disposal policy for the National Defense Stockpile of Strategic and Controlled materials.<sup>134</sup> The model, which is classified, apparently assumes a multi-front war of three years' duration and of significant dimensions which coincides with some type of disruption in oil supplies.<sup>135</sup> Planning on this conservative basis is consistent with the requirement that the United States maintain a sizeable conventional force capable of simultaneous operations in various parts of the world.

In the classified war scenario, the NSC model estimates the demand for oil during the emergency (which is likely to grow in the direct and indirect defense sectors),<sup>136</sup> the domestic oil supply (including domestic production and both civilian and military stockpiles) and available oil imports (which may be reduced due to wartime losses in transportation, sabotage, and military actions against oil fields and refineries, and the political unreliability of certain suppliers).<sup>137</sup> On the basis of this simulation model, the Commerce Department concluded in the recent Section 232 proceeding that "the United States will be able to meet direct and indirect military petroleum requirements during a major conventional war."<sup>138</sup>

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<sup>133</sup> See ENERGY SECURITY, *supra* note 85, Table B-2.

<sup>134</sup> COMMERCE STUDY, *supra* note 4, at IV-1.

<sup>135</sup> *Id.* ch. IV.

<sup>136</sup> *Id.*

<sup>137</sup> The NSC study estimates demand: (1) using macro economic models to estimate industry-output levels for a wartime exigency; and (2) converting these industry-output levels into demands for critical materials expressed in physical units. *Id.* at IV-2.

<sup>138</sup> *Id.* at IV-9.

### 3.2.2.1. *Assessing the Demand for Strategic Resource Needs in Military Contingencies*

In its study, the Department of Commerce assumes that there will be significant growth of military demand for petroleum products (nearly 75% of which is jet fuel) in wartime.<sup>139</sup> While Commerce has not publicly released its demand figures, a number of studies have shown that Defense Department demand for petroleum, which is approximately 500,000 bbl/d in peacetime (less than 3% of total U.S. demand), will increase during wartime by a factor of five.<sup>140</sup> Commerce also indicates that indirect defense demand during a war (i.e., oil needed to mobilize the economy in producing and transporting goods for the war effort) would increase during a war, with the size of the increase depending on “the length, scope, and character of the conflict.”<sup>141</sup>

### 3.2.2.2. *Wartime Supply-Side Considerations*

On the supply side, Commerce assumes that the current level of domestic oil production will be available during the war. In so doing, Commerce has concluded that the United States has no ability to “surge” production during the emergency because of: (1) the depleting resource basis, and (2) an inability to significantly increase production from existing wells even in response to substantial price increases and emergency conditions. Commerce also assumes oil will be available from domestic stocks, including the Strategic Petroleum Reserve (SPR), the Defense Department stockpile, and private stocks. It also assumes that oil will be available from reliable imports, although Commerce does not specify what imports it deems to be “reliable.”

On the basis of these supply and demand assumptions, Commerce concluded that direct and indirect defense demand for oil can be satisfied from domestic oil production, reliable petroleum imports, and the Strategic Petroleum Reserve. Commerce also concluded that sufficient free world refining capacity will be available to supplement domestic capacity and help meet offshore military requirements during a conflict.

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<sup>139</sup> *Id.* at IV-6, 7 & 9.

<sup>140</sup> See, e.g., INDUSTRIAL COLLEGE OF THE ARMED FORCES, PETROLEUM ALLOCATION AMONG MAJOR COMPETING NEEDS DURING TOTAL MOBILIZATION (1982). Commerce also noted that the Department of Defense has been increasing its wartime demand requirements since the *NSC Stockpile Study* was conducted (although it does not indicate the amount of the increase). COMMERCE STUDY, *supra* note 4, at IV-7. This increase is in large part a product of the increased size of the armed forces in a full mobilization.

<sup>141</sup> COMMERCE STUDY, *supra* note 4, at IV-7.

On this basis, Commerce has concluded that oil imports do not pose a threat to the defense effort in wartime.

Although much of the Commerce Department's analysis of oil supply and demand in a military emergency are classified and, therefore, difficult to evaluate, there are a number of aspects of the Commerce findings which merit further scrutiny.

First, as a threshold matter, the *NSC Stockpile Study* relied upon by Commerce was conducted in 1983 and postulates 1983 as the warning year (accompanied by a mobilization) with a war occurring in 1984 through 1986.<sup>142</sup> It is not clear, however, that the data used in the 1983 study have been fully updated to reflect recent developments in the world oil market, the domestic oil industry, and the structure of the armed forces and the economy.<sup>143</sup> Obviously, the developments since 1983 (including the significant decreases in oil prices and oil production) would have a significant impact on the outcome of the study.

Further, even assuming current data is utilized, there is a question as to whether Commerce carried the analysis forward into the future, as Section 232 requires, and evaluated whether the United States would face an oil shortfall in a future war three to five years hence (based on projections of future oil production and prices). The public version of the report does not indicate that this was done. Given the "threat" standard under Section 232 noted above, the long lead times in the energy sector and the need to plan today for future energy security needs, it is important to take such prospective analysis into account in shaping policy.

In such a future emergency, the United States is likely to face even greater problems. Significantly, the United States is likely to be forced to rely more heavily on imports in a *future* military crisis as a consequence of projected decreases in domestic oil production in 1989 through 1995. The projected increase in dependence on foreign oil would mean that there will be more oil travelling on the high seas and, hence, greater supply vulnerability during a conventional war fought in the early 1990s. Although there is more flexibility in oil transport modes out of the Middle East, this oil still must reach the United States or U.S.-controlled refining facilities. Thus, it may be reasonable to assume that a significant portion of oil moving on the high seas would be

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<sup>142</sup> *Id.* at IV-6.

<sup>143</sup> The *Commerce Study* is ambiguous. On the one hand, the charts on Tables IV-1 & IV-2 focus on the 1982-86 period. At the same time, the report notes that the conclusion "is based upon analysis contained in the *NSC Stockpile Study*, the U.S. Government actions discussed earlier, and the review of the current world oil market in Section III" (which, as noted above, also is based on data and assumptions from 1987).

lost during a conventional war due to attacks by enemy submarines, air attacks, and surface warships. Also, given decreases in production and losses in imports due to wartime, the United States may be forced to rely more on unreliable imports that are subject to political manipulation. The assumptions of the Department of Commerce concerning which suppliers are reliable and which are not thus warrant close scrutiny.

Commerce makes a number of other critical assumptions that require review. First, Commerce finds that wartime civilian demand could be met but assumes civilian demand would be substantially lower than peacetime levels. Commerce recognizes that "civilian austerity" would create "significant" personal hardships (although increased efficiencies, conservation, and interfuel substitution would reduce the level of civilian austerity required).<sup>144</sup> While not fully highlighted in the Section 232 study, such cutbacks would pose incredible costs on the population and would significantly alter American lifestyles. In particular, since transportation accounts for approximately 70% of consumption, and "[t]here are presently no substitutes for gasoline, diesel fuel, and jet fuel," significant cutbacks in civilian transportation would be required.<sup>145</sup> What Commerce may have overlooked is that these types of severe cutbacks, while possible on a short-term basis with rationing and other severe crisis measures, undoubtedly would be very difficult to sustain for a significant length of time and could gridlock the economy and the distribution system (especially in expansive western areas).

Also on the demand side, the study's assumptions about the ability to convert to alternative fuels require scrutiny. While not highlighted by Commerce, U.S. ability to substitute other energy forms in wartime and in other near-term exigencies is very limited. In wartime conditions, it is hard to see how military demand for jet fuel can be shifted appreciably (although perhaps some use of diesel fuel can be replaced by coal). In the civilian sector, oil can be conserved in some areas by rationing and limiting consumption in nonessential sectors, and shifting to coal and gas to some extent.<sup>146</sup> On balance, however, alternative en-

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<sup>144</sup> Commerce noted that petitioner's assumptions of civilian consumption of over 15 million bbl/d through the war years (or over 90% of 1987 peacetime consumption) is too high, and underestimates the amount of civilian austerity, fuel switching and conservation. Analyses undertaken by the Defense Department and the NSC indicate "significantly lower civilian sector oil consumption . . . ." *Id.* at IV-9.

<sup>145</sup> *Id.*

<sup>146</sup> Natural gas substitutes are greatest in stationary (non-transportation) uses, including industrial boilers, electric generators, and the like. Over time, gas can be substituted in the transportation sector as well through the use of natural gas vehicles. However, this would require a substantial investment in manufacturing facilities. For an analysis of the prospects of natural gas substitution, see M. COPULOS, *WILL THE FU-*

ergy sources cannot be relied upon for national security purposes— at least in the short-term. Indeed, the fact that most oil is consumed in the transportation sector will make conversion a long and difficult process.

Also, low oil prices have dampened market incentives to invest in, and develop, alternative energy sources (especially in renewable energy sources). And, as the DOE report explained, there also are a number of other impediments to large shifts toward other fuels, including regulatory restrictions, lack of infrastructure, safety concerns, and transportation problems. Further, the consumption trends in this area have not been salutary. Although use of natural gas has grown (due to lower oil prices and industrial conversions), the relative use of other energy types has not grown appreciably. Low oil prices, coupled with environmental and safety concerns, have led to decreased growth of reliance on nuclear power. The availability of low-priced oil is restraining a shift away from oil consumption and toward the use of substitute energy sources.

On the supply side, the Commerce Department assumption that domestic crude oil production would remain at current levels is also questionable. This view fails to recognize that some Alaskan oil must be assumed unreliable and, hence, unavailable for use in a war because a substantial amount would enter the continental United States through tankers and, hence, is vulnerable to attack from enemy submarines.<sup>147</sup>

In sum, there are a number of aspects of the Commerce analysis of wartime oil needs that warrant full scrutiny. To the extent Commerce did not take the considerations set forth above into account, it may have understated the nature and degree of the security problem. At the same time, however, it should be recognized that the scenario assumed a war of global proportions—a very unlikely event. Also, the public version of the study does not mention the possibility that if the United States did face a shortfall it could consider military actions to sustain a secure supply.

Thus, on balance, it is probably fair to conclude that in most smaller, and more likely, military scenarios (including single theatre regional conflicts), the United States probably can meet its oil needs. Accordingly, in the near term, energy security policy is unlikely to be driven by concerns over whether there is an adequate supply of oil for military needs in an exigency.

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TURE BE REFLECTED IN THE PAST? THE DOE "SECURITY REPORT" ONE YEAR LATER (National Defense Council Foundation 1988).

<sup>147</sup> Additionally, the Commerce assumption that free world refining capacity would be available is subject to question. In this regard, using World War II as an example, such refining sites would be major targets in wartime, and a significant portion of free world refining capacity could be lost through bombing or sabotage.



### 3.2.3. *United States Vulnerability to Peacetime Supply Disruptions and Substantial Price Increases: Is Complacency Warranted?*

As noted above, a central focus of national security planning also must be on whether the United States faces economic vulnerability because of its increased reliance on oil imports. In the aftermath of both the 1973 OPEC crisis and the Iranian supply disruption in 1979,<sup>148</sup> a finding of U.S. vulnerability formed the basis for Presidential determinations under Section 232 that oil imports were threatening to impair national security. Under these precedents, which serve as guideposts for national security planning, vulnerability to a supply disruption was essentially defined as a function of: (1) the risk of such disruptions; and (2) the potential damage that such disruptions could cause to the economy.

This analysis should not, however, be limited to the risk of supply disruptions; it also must focus on the possibility that some members of OPEC, either alone or in concert with non-OPEC producers, will be able to significantly raise prices in the 1990s. The prospect of such high oil prices, which also can have a significant impact on U.S. and world economic welfare, is an equally important national security concern.

The recent Commerce study acknowledges concern over this issue, concluding in its executive summary that “[d]ependence on a small number of suppliers located largely in a volatile region could make the United States and the OECD countries increasingly vulnerable to oil supply disruptions or cartel manipulation of production and price.”<sup>149</sup> Notwithstanding this important conclusion, the public version of the Commerce study nowhere fully evaluates the prospect of a peacetime supply disruption in light of recent developments in the worldwide oil supply and demand. Plainly, this is an issue that warrants considerable attention. Given the increasing importance of economic considerations in national security planning and the apparent U.S. ability to meet its petroleum needs in wartime emergencies, the implications of import reliance for economic health and competitiveness may very well become the focal point for energy security planning for the 1990s.

#### 3.2.3.1. *The Disruption Risk*

Commerce views the short-term risk of a peacetime oil supply disruption or price rise as relatively low. In so doing, the study points out

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<sup>148</sup> See 40 Fed. Reg. 4,457 (1975); 44 Fed. Reg. 18,819 (1979). For a full analysis of these decisions, see *THE STRATEGIC CONSEQUENCES OF THE OIL PRICE COLLAPSE* (G.H. Schuler ed. 1987).

<sup>149</sup> *COMMERCE STUDY*, *supra* note 4, at ES-3.

the ways in which the security position today has improved since the 1970s<sup>150</sup> and the likelihood that the world oil market is likely to be soft in the near future because of: "(1) the availability of excess crude oil supplies; (2) limited growth in Free World oil demand . . . ; (3) fairly high . . . oil stocks of 5 billion barrels; and (4) the inability of OPEC to maintain discipline regarding the production and pricing policies of the members."<sup>151</sup>

However, Commerce views the risk of a disruption as growing more significantly after 1990 due to increased demand, U.S. production declines, and increased imports from, and reliance on, the Persian Gulf region. Thus, sometime between 1990 and 1995, Commerce apparently anticipates a somewhat tighter oil market that can pose appreciably increased supply disruption risks.

For a number of reasons, the Commerce Department prognosis may be overly optimistic and understate the degree and certainty of the risk. The real issue is not whether the world oil market will tighten, but *when* this will occur and, hence, result in heightened United States vulnerability. While the risk of a disruption today is still being restrained by the substantial production of non-OPEC oil, the danger signs—both economic and political—are present.

First and foremost, on the supply side of the equation, the distribution of global oil reserves is, and will always be, a problem; the Persian Gulf continues to hold most of the proved world reserves of crude oil. Further, capacity utilization of OPEC is increasing—approaching the levels that prevailed during the 1970s. And, OPEC controls virtually all of the non-communist world's excess of spare capacity, with Arab members of OPEC controlling more than 53%. As world consumption grows and high cost production declines in coming years, OPEC's capacity utilization can be expected to tighten further.

Second, complacency is in large part based on today's oil surplus. Yet, at current and projected price levels, this surplus is likely to shrink considerably in the years ahead due to exploration and production de-

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<sup>150</sup> *Id.*, at III-2. Specifically, in response to high energy prices in the 1970s, the United States adopted conservation efficiency measures that resulted in declines in U.S. consumption. Also, 1970s oil prices fueled increased exploration and production outside of OPEC, which have in turn led to substantial excess world oil capacity. *Id.* at III-1. As a consequence, dependence on imported oil decreased significantly, from 43.2% of consumption in 1979 to 27.3% in 1985. Moreover, the mix of imports shifted in favor of more reliable suppliers like Canada, Mexico, and the United Kingdom. The expansion of oil stocks (including the SPR), the decontrol of U.S. oil prices, and improvements in petroleum transportation flexibility (including the construction of new oil pipelines that reduced the delivery of oil through the straits of Hormuz) also contributed to improved security. *Id.* at III-1, 2.

<sup>151</sup> *Id.* at III-10.

creases and demand increases. As noted above, the significant cutbacks in exploration in recent years are now being translated into lower production. And lower prices have led to increased energy consumption. Thus, the only issue is an intertemporal one: how fast will the oil surplus—what some consider the security margin—erode?<sup>152</sup>

Continued complacency over the oil import problem is in large measure based on the growth of non-OPEC suppliers — which has served as an important restraint on world oil prices and the market power of OPEC. While this variable is a matter of some uncertainty, there is a real likelihood that production outside of OPEC will decline in the coming years.<sup>153</sup> There is little or no excess capacity in these nations, which are producing all they can in order to earn revenues. Moreover, given the recent declines in exploration and development levels, it can be expected that the production levels of these higher cost producers will decline unless world prices increase appreciably; they will deplete oil reserves at a rate faster than they are replacing it.<sup>154</sup> Ironically enough, one can make the case that if non-OPEC countries do manage to maintain or increase production levels and restrain attempts by OPEC to limit supply or maintain prices for the next few years, the glut of low-priced oil will only further weaken the U.S. industry, decrease domestic production, and thereby exacerbate our security situation in the future. This could put us in an even worse position when non-OPEC sources do eventually decline and world supply tightens in the 1990s. Thus, the question is not if non-OPEC oil production will decline, but how fast and when; this bears only on whether the world oil market will tighten in 1990 or 1995.

Further, while there is a tendency to only think of Persian Gulf oil as unreliable and subject to manipulation, this view is not necessarily warranted. While not acknowledged by Commerce, imports from non-OPEC suppliers also can be disrupted or manipulated for political purposes during a supply disruption. Indeed, nations now considered reliable may not be so several years hence. In this connection, the lesson of Iran, once a longtime stable supplier, should be borne in mind. Less than two years after President Carter toasted Iran as “an island of stability in one of the more troubled areas of the world,”<sup>155</sup> the United States lost virtually all Iranian oil imports. In short, the point is that oil now imported from non-OPEC nations should not be assumed to be

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<sup>152</sup> See Yergin, *Energy Security in the 1990s*, FOREIGN AFFAIRS, Fall 1988, at 121.

<sup>153</sup> See NPC REPORT, *supra* note 9, at 161-62.

<sup>154</sup> ENERGY SECURITY, *supra* note 85, at 22, 23.

<sup>155</sup> R. SHERRILL, *THE OIL FOLLIES OF 1970-1980* 411 (1983).

automatically available during a supply crisis. Thus, for national security planning purposes, a significant portion of non-OPEC oil should be deemed unreliable and, therefore, not counted on during a supply disruption or war. In all events, the issue of non-OPEC production is a wild card in the equation that the United States has little ability to influence.

Recent events indicate that non-OPEC nations could be willing to join with OPEC members to jointly limit production in order to increase prices.<sup>156</sup> The apparent decision of the Soviet Union, the world's largest oil producer, and other non-OPEC suppliers to restrain output has apparently been a major reason for the recent stability in world oil pricing. Thus, the development of a working consensus by OPEC and key non-OPEC suppliers to continue to decrease output, coupled with increased demand and declines in high cost production, could possibly result in significant and rapid price increases.

The demand side of the equation also is of concern. Domestic energy consumption has increased as oil prices have fallen and can be expected to increase even further in response to continued low prices. And, as noted above, with domestic production declining, imports are filling the gap. Moreover, imports from unreliable suppliers have recaptured their lost shares of the U.S. market. During 1988, the United States received approximately 47% of its crude oil imports from OPEC nations. And, since mid-August 1987, Saudi Arabia has again become our largest single source of oil imports—for the first time since 1981.<sup>157</sup>

In short, these basic economic conditions mean that OPEC, and its members, will likely have the ability to exercise significant control over price and output again sometime in the early 1990s—with the timing dependent to a large degree on the rate of demand growth and the timing of non-OPEC production declines. The ability of OPEC members (or Persian Gulf suppliers) to impose discipline on price or output may also increase as a result of the end of the Iran-Iraq war. Further, OPEC's power will increase faster and be greater if OPEC members, or a group thereof, act in concert with non-OPEC suppliers.

Finally, wholly apart from the economics of the situation, the members of OPEC, especially Arab producing nations, may again develop the political will to use oil as a weapon (either for political or economic reasons). While there are areas of common interest, there also are broad areas of political disagreement between the United States and Persian Gulf states that could potentially prompt such actions.

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<sup>156</sup> See *N.Y. Times*, Apr. 11, 1988, at D1.

<sup>157</sup> ENERGY INFO. ADMIN., MONTHLY ENERGY REVIEW, Sept. 1987, at 46-47.

### 3.2.3.2. *The Costs of Supply Disruptions*

The possible consequences of supply disruptions or substantial price increases for the economy, which are not addressed in the *Commerce Study*, also must be fully considered. A supply disruption several years hence—when domestic production has declined further and the world oil supply tightens—could very likely have significant consequences.

As the Commerce Department study acknowledges, we have no real ability to predict with any certainty the potential price implications of an oil supply disruption in the 1990s. Changes in world markets since the 1970s render prior models based on the 1973 and 1979 disruptions largely irrelevant. Thus, we lack historical reference points by which to gauge the potential economic impact of a 1990s-era disruption or substantial price rise.<sup>158</sup>

From what we do know, however, changes in the structure of the world oil market since the last crisis could very well exacerbate the impact of even a small disruption. In recent years, the oil market has become a commodities market, with over 100 million barrels of crude oil being traded a day (as distinct from a million to two at the time of the last crisis). The new reliance on the spot market and the trading of oil futures on the New York Mercantile Exchange has led to increased price volatility and more rapid responses to any slight supply, demand, or political developments. Thus, a disruption, no matter how small or short-lived, could potentially cause an immediate and sharp price rise—a price shock—that could be highly damaging to GNP, employment, and the like. Indeed, given the speed with which our financial markets now react to global political and economic developments, the impact of a substantial oil price hike could be immediate and significant. The outflow of capital to pay for oil would erode our trade position further, devalue an already weak dollar, and increase our indebtedness further. The price rise could substantially affect stock values in sectors of the economy heavily dependent on oil, and perhaps could impact financial institutions that hold substantial indebtedness from such sectors. The effect on inflation of a small increase in fuel prices this winter also confirms the strong relationship between oil prices and economic growth.

Even if SPR could be rapidly used as a cushion, the damage from the price spike would already have been done. As one analyst recently noted:

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<sup>158</sup> COMMERCE STUDY, *supra* note 4, at IV-4.

The first thing that's going to happen in a crisis is that these markets are going to move, and move rapidly—much more rapidly than they did in the Seventies, when oil moved at official prices. The liquidity of the futures market will be gone. There'll be plenty of buyers, but no sellers. Prices will rise rapidly. Costs and prices are now tied to the spot market, so that retail prices will go up the full amount of the increase in the spot market. The economic damage could be completely transmitted to the economy long before the first International Energy Agency emergency meeting is held.<sup>159</sup>

Hence, such changes in the structure of the oil market and financial markets, which warrant close study, very well may have enhanced our vulnerability to a supply disruption. Accordingly, the traditional analysis which correlated the degree of the price impact to the size and duration of the disruption, may no longer hold true. In a rapidly moving market, even small disruptions may, in a day's time, be translated into significantly increased world oil prices and resulting economic costs for oil consuming nations.

### 3.2.4. *Foreign Policy and Military Power Projection Concerns*

Finally, as in past Section 232 investigations, the Commerce Department properly considered the consequences of our dependence on insecure oil supplies for foreign policy and the projection of military power abroad. While not explicitly stated by Commerce, increased dependence could significantly erode the global influence of the United States. Since the end of World War II, national security policy has assumed, as a necessary predicate, a healthy and growing economy. Such a strong economy is necessary to the basic strategy of containment of the Soviet Union and the maintenance of U.S. collective security arrangements. A strong and world competitive U.S. economy also fueled perceptions of power and prestige, and made it easier for the United States to achieve its foreign policy objectives in the post-war era.

Unfortunately, however, a number of circumstances have increased concern over U.S. economic prowess—a basic underpinning of our national security policy. While the United States is still internationally competitive in many sectors, recent studies show that the United States no longer is the dominant leader in a number of key industries.<sup>160</sup>

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<sup>159</sup> See Cook, *The Third Oil Crisis*, FORBES, Dec. 14, 1987, at 40.

<sup>160</sup> U.S. DEP'T OF DEFENSE, *SOVIET MILITARY POWER: PROSPECTS FOR CHANGE 134-37* (1989); *Bolstering Defense Industrial Competitiveness* (Report to the Secretary of Defense by the Undersecretary of Defense (Acquisition)) (July 1988); *see*,

Leadership (in both technology and production) has passed to Japan, West Germany and other countries in such important industrial sectors as semiconductors and consumer electronics. Our declining competitiveness in world markets is also affecting our research and development expenditures and our future ability to be at the cutting edge technologically. Also, the combination of high budget deficits, low savings rates, and a high trade deficit, have altered perceptions of U.S. prestige and power. In these circumstances, a tightened world oil supply and high oil prices plainly could exacerbate our economic problems and even further diminish perceptions of U.S. economic power. Certainly, such circumstances would increase the energy costs of U.S. industry, potentially making the United States even less competitive in world markets (with higher transport costs encouraging more local production and purchasing).<sup>161</sup>

In short, since perceptions matter in international affairs, the role of the United States as a world power may be substantially affected by increased oil prices. Indeed, the matter goes beyond mere prestige. A significant transfer of wealth to oil-producing countries may potentially leave the United States with the need to consider modifying its collective security commitments and its support for various regional initiatives.

In a more tangible sense, the U.S. ability to project military power also may be constrained by the oil situation. As the Commerce Department noted:

[T]he dependence on potentially insecure oil supplies by our friends and allies on whom we rely for base access in military emergencies can affect their willingness to provide base access and overflight rights for U.S. military forces in certain situations. This perception about their vulnerability to potential oil supply manipulations, if they were to cooperate with the U.S. military efforts, can constrain U.S. military power projection capabilities and flexibility.<sup>162</sup>

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*e.g.*, A Strategic Industry at Risk (Report to the President and Congress from the National Advisory Committee on Semiconductors) (Nov. 1, 1989).

<sup>161</sup> Of course, Japan, Germany and other major trading partners may also be adversely affected by high oil prices. These nations have little or no domestic oil production and, hence, higher dependence on oil imports. On the other hand, they have small territories and less reliance on oil in the transportation sector. Also, they have come to rely to a greater extent on nuclear power (especially Japan and France). Finally, Japan and Germany may be able to better compensate for increased transport costs in reaching foreign markets (through increased investments in local manufacturing abroad, for example). Thus, they may be less adversely affected by a tightened supply and higher oil prices than the United States.

<sup>162</sup> COMMERCE STUDY, *supra* note 4, at IV-10.

Thus, the perceptions of declining U.S. power, and the decreased U.S. capability to project power, could significantly impair global interests. It could affect how adversaries perceive our resolve, and how allies perceive the U.S. commitment to their defense. In this sense, the U.S. commitment to NATO could become less meaningful to our European allies, which may more frequently have to take actions contrary to U.S. interests in order to promote their own national energy policies and other vital interests.

Declining U.S. influence in Europe in an era of tight oil markets and increased oil imports also could result in an increase in Soviet influence (especially since the Soviet Union is the world's largest oil and gas producer).<sup>163</sup> Also, given recent developments in Europe and the prospects of a reunified Germany, a declining U.S. presence could jeopardize stability and security there, undermine the continuation of NATO and our efforts to keep Germany with NATO, and increase concerns over the integrity of territorial borders.<sup>164</sup> In the changing European situation, our presence is salutary in nature, and it can help keep the peace until new structures for security are developed.

Rising dependence on unreliable oil imports also is likely to significantly constrain U.S. freedom of action in foreign affairs generally. Unfortunately, unless the world energy outlook changes considerably, there is little we can do to prevent this cost from being incurred. Our increased import reliance and a tightening world market in the 1990s undoubtedly will require the United States to take actions, for energy security reasons, that are detrimental to other U.S. interests.

As the Commerce study notes:

The United States and its allies may find themselves constrained from pursuing either unilateral or multilateral foreign policy actions for fear of provoking producer countries

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<sup>163</sup> The U.S.S.R. also could reap other benefits from high oil prices or a supply disruption; such situations could provide hard currency earnings from oil sales that the Soviet Union could use to finance increased military expenditures, intervention, or aid to third-world revolutionary movements.

<sup>164</sup> The adverse impact of oil imports on these alliances was highlighted in past Section 232 investigations. As the Defense Department stated in its 1979 study:

The substantial dependence of the United States on imported oil may strain security arrangements with allies and may make productive relations with uncommitted nations about defense matters more difficult. Included here is the perception on the part of a foreign government that the United States may be unable to meet its international defense commitments.

44 Fed. Reg., 18,828 (1979); *see also* 40 Fed. Reg. 4,461 (1975) (noting that rapid increases in world oil prices in 1973-1974 "posed serious threats to the economic and military viability of NATO and other friendly nations, as well as the United States").



into actions that would result in the manipulation of oil supplies and increased prices for consumer countries. Further, the lack of flexibility could also impair allied cooperation to avoid the bidding-up of world oil prices in the aftermath of an interruption of oil supplies (*e.g.*, the Iranian Revolution).<sup>165</sup>

While it is difficult to assess, at this juncture, the precise ways in which foreign policy will be constrained, one obvious area concerns policy toward the Middle East. In particular, the recent dialogue with the Palestinian Liberation Organization (PLO) has created an opening for potential diplomatic initiatives in an effort to negotiate a comprehensive settlement including the West Bank. Obviously, the task before the United States is a difficult one, fraught with uncertainties and problems. Yet, there is at least some opportunity for the United States to exercise its influence in an effort to resolve the situation. Increased vulnerability to oil supply disruptions will make this task even more difficult, and will likely diminish the ability of the United States to influence both Israel and the PLO and its backers. Indeed, in a tight world oil market, Persian Gulf suppliers that support the PLO will be in a far better bargaining position *vis-à-vis* the United States than today and, hence, may prove far less flexible. Thus, given projected world changes in oil market conditions, the United States may have a very narrow window of opportunity in which to work to resolve the situation in a manner consistent with U.S. interests.

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In sum, the Commerce study confirms the inherently strategic nature of oil for the United States and the increasing importance of non-military considerations in national security planning. Even though Commerce found that the United States could meet its oil needs in a military emergency, it nevertheless determined that oil imports threatened to impair national security because of the increased risk of a supply disruption and the consequences of such a disruption for the economy, foreign policy, and "military power projection capabilities even in peacetime."<sup>166</sup>

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<sup>165</sup> COMMERCE STUDY, *supra* note 4, at IV-10.

<sup>166</sup> *Id.* at ES-4.

#### 4. COPING WITH GROWING UNITED STATES DEPENDENCE: THE POLICY CHOICES

The final question to be discussed regarding Section 232 is what mix of policy options the United States should adopt in order to mitigate the national security concerns posed by rising dependence on foreign oil.

##### 4.1. *Presidential Authority Under Section 232*

A preliminary matter is the scope of Presidential authority to take remedial actions under Section 232. As noted at the outset, President Reagan, on the basis of his affirmative finding, proposed a series of legislative initiatives, but decided not to take any actions to adjust imports. Thus, the legal issues are: (1) can President Bush now take additional actions pursuant to the affirmative finding made by President Reagan without initiating and conducting a new Section 232 investigation; and (2) if so, what is the scope of the President's authority to adopt remedial measures under the statute?

##### 4.1.1. *The Continuing Validity of the Reagan Finding*

President Bush can, in all probability, take authorized actions to adjust imports on the basis of President Reagan's affirmative finding under Section 232—*without* conducting a new investigation. This issue was addressed in an opinion rendered by the Attorney General in response to a question raised by the Secretary of the Treasury.<sup>167</sup> Specifically, the Secretary sought advice as to whether the 1959 affirmative finding made under the predecessor statute to Section 232 could serve as the basis for 1975 modifications to the oil import restrictions imposed under that finding "in light of the drastic change from the factual situation which provided the basis of the 1959 finding."<sup>168</sup> At the time of the 1959 finding, there was global overproduction and low oil prices that discouraged domestic exploration and production. In contrast, by 1975, "the world [was] faced with high prices and threatened cutbacks in production . . ."<sup>169</sup>

In these circumstances, the Attorney General found that Section 232, which provides that the President "shall take such action, and for such time, as he deems necessary to adjust the imports of such article and its derivatives," authorizes "not a single act but rather a continuing

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<sup>167</sup> Restriction of Oil Imports, 43 Op. Att'y. Gen. No. 3 (Jan. 14, 1975).

<sup>168</sup> *Id.* at 2.

<sup>169</sup> *Id.*

course of action, with respect to which the initial investigation and finding would satisfy the statutory requirement."<sup>170</sup> In the view of the Attorney General, this construction of Section 232 was confirmed by its legislative history, "which clearly contemplates a continuing process of monitoring and modifying the import restrictions, as their limitations become apparent and their effects change."<sup>171</sup> In short, the Attorney General has made it clear that Section 232 calls for continued monitoring of "the factual situation and the effectiveness of [the President's measures] in meeting it," and that the President can make changes in remedies without conducting another formal investigation.<sup>172</sup>

As noted above, in the recent Section 232 finding, President Reagan sought legislative action by Congress. If, upon monitoring the situation, however, President Bush finds that such needed legislation has not been enacted or that the import situation has worsened and additional measures are necessary, Section 232 empowers him to select among other remedies available under the statute in order to mitigate the national security threat.

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<sup>170</sup> *Id.*

<sup>171</sup> *Id.* See 101 CONG. REC. 8160-61 (1955) (remarks of Rep. Cooper) ("The President would not only retain flexibility as to the particular measure which he deems appropriate to take, but, having taken an action, he would retain flexibility with respect to the continuation, modification, or suspension of any decision that had been made."); H.R. REP. NO. 745, 84th Cong., 1st Sess. 7, reprinted in 1955 U.S. CODE CONG. & ADMIN. NEWS 2071, 2140 ("[I]t is . . . the understanding of all the conferees that the authority granted to the President under this provision is a continuing authority and that prior action taken under this provision may be modified, suspended, or terminated in light of changed circumstances.").

<sup>172</sup> Congress eliminated the phrase "such action, and for such time" when it amended Section 232 in 1988. See 19 U.S.C. § 1862(c) (1988). However, it did not thereby remove the Presidential authority to take continuing actions under Section 232. This rewriting only was done in order to add the statutory deadline for initial Presidential action under Section 232. See H.R. REP. 576, 100th Cong., 2d Sess. 711-712. There is no evidence of any intent to otherwise change the established meaning of the statute.

Indeed, the statute still broadly affords the President the authority to "determine the nature and duration of the action that, in the judgment of the President, must be taken to adjust the imports of the article and its derivatives so that such imports will not threaten to impair the national security." *Id.* The breadth of the language and the statutory reference to "duration" plainly indicate that the President has continuing authority under the statute. The continuation of authority is further confirmed by the addition of a provision requiring that where the President seeks to enter into an agreement to restrict imports under the statute, and such an agreement has not been reached within 180 days after the President's initial determination or is not being effectively carried out, the President shall take such actions as he deems necessary to adjust imports. See 19 U.S.C. § 1862(c)(3)(A) (1988). This power to take necessary actions confirms that the statute contemplates continual monitoring and adjustment of remedies in response to the national security threat caused by imports.

#### 4.1.2. *The Scope of Presidential Authority under Section 232*

The question thus arises: what options are legally available to President Bush under Section 232?<sup>173</sup> By its terms, Section 232 is broad in scope, and affords the President authority to "determine the nature and duration of the action that, in the judgment of the President, must be taken to adjust the imports of the article and its derivatives so that such imports will not threaten to impair the national security."<sup>174</sup> The statute, as interpreted by the courts, allows the President to take any actions that have an "initial" and "direct" impact on imports.<sup>175</sup> Hence, the President can impose import quotas or import fees, set a price floor on imported oil, promulgate license requirements, establish trigger price mechanisms, or choose from a range of other measures that have an initial and direct impact on imports (even though such actions may have other effects outside the import sphere).<sup>176</sup>

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<sup>173</sup> It also should be recognized that Presidential actions to adjust imports under Section 232 are consistent with international law, including U.S. obligations under the General Agreement on Tariffs and Trade (GATT). See General Agreement on Tariffs and Trade, Oct. 30, 1947, art. 21, T.I.A.S. No. 1700, 55 U.N.T.S. 1974 (as amended) ("Nothing in this Agreement shall be construed . . . to prevent any contracting party from taking any action which it considers necessary for the protection of its external security interests . . . taken in time of war or other emergency in international relations.").

<sup>174</sup> 19 U.S.C. § 1862 (c)(a)(A) (1988). The legislative history of Section 232 confirms the breadth of presidential authority to take actions to restrict imports. See, e.g., 101 CONG. REC. 5299 (1955) (statement of Sen. Millikin) (describing the presidential authority "to take whatever action . . . necessary to adjust imports if they should threaten to impair the national security, [including] tariffs, quotas, import taxes, or other methods of import restriction"); 101 CONG. REC. 5293 (1955) (statement of Sen. Byrd) ("the President, if he finds a threat to the national security exists, shall take whatever action is necessary to adjust imports to a level that will not threaten to impair the national security"); 101 CONG. REC. 5298 (1955) (statement of Sen. Barkley) (noting that "[i]f the President finds [that a commodity is essential to the national defense], he can impose such quotas or take such other steps as he may believe to be desirable in order to maintain the national security").

<sup>175</sup> See *Federal Energy Administration v. Algonquin SNG, Inc.*, 426 U.S. 548, 571 (1975). See also *Pancoastal Petroleum, Ltd. v. Udall*, 348 F.2d 805, 807 (D.C. Cir. 1965) (holding that Section 232 "confers discretion on the President in the broadest terms").

<sup>176</sup> In *Algonquin*, the leading case under the statute, the Supreme Court unanimously held that Section 232 affords the President the authority to "control . . . imports by imposing on them a system of monetary exactions in the form of license fees," and does not only authorize quotas. 426 U.S. at 552.

At issue was the legality of President Nixon's oil import program, established by proclamation in 1973, and amended in 1975, which provided for the gradual removal of the then-existing system of quotas on oil imports and its replacement by a system of gradually increasing fees applicable to certain oil imports. Although the District Court upheld the fees, the Court of Appeals for the D.C. Circuit reversed, and ruled that Section 232 did not authorize the President to impose a license fee as a means of adjusting imports. The Supreme Court reversed, holding that Section 232 grants the Presi-

Similarly, other, more creative actions which directly adjust the circumstances under which oil is imported are also sanctioned. For example, the President could require that for every specified number of barrels of oil that a party imports into the United States, that party must provide a certain quantity of oil to the United States government, as a contribution to the Strategic Petroleum Reserve. Significantly, the statute also authorizes the President to take action to restrict imported "derivatives" of the article under investigation. Hence, any action taken can apply to imports of refined petroleum products as well as to crude oil (even where, as here, the President's finding principally relates to imports of crude oil).<sup>177</sup>

At the other end of the continuum are actions that have no impact or only a "remote" impact on imports; these are not within the President's authority under Section 232.<sup>178</sup> Thus, the President plainly cannot, under Section 232, nationalize the oil industry. The governing principles also indicate that pure demand-side measures—such as a tax on gasoline consumption or rationing—are not within the scope of the

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dent "a measure of discretion in determining the method to be used to adjust imports." 426 U.S. at 561. The statutory authority to "adjust" imports cannot, on its face, "be read to encompass only quantitative methods—i.e., quotas—as opposed to monetary methods—i.e., license fees—to effect such adjustments," the Court concluded.

The Court further reasoned that limiting the available relief to the imposition of quantitative restraints would be "inconsistent with the range of factors that can trigger the President's authority" under Section 232. In this regard, the President's ability to "adjust" imports is triggered by a finding by the Secretary of Commerce that the article under investigation is being imported in "such quantities or *under such circumstances* as to threaten to impair the national security." *Id.* (emphasis added). As noted by the Court, this "language reflects Congress' judgment that 'not only the quantity of imports . . . but also the circumstances under which they are coming in: their use, their availability, their character' could endanger the national security and hence should be a potential basis for Presidential action." *Id.* (quoting 104 CONG. REC. 10,542-10,543 (1958) (remarks of Rep. Mills)). Furthermore, as the Court succinctly stated, "It is most unlikely that Congress would have provided that dangers posed by factors other than the strict quantitative level of imports can justify Presidential action, but that action must be confined to the imposition of quotas." 426 U.S. at 561. Finally, the Court took the pragmatic view that quotas and license fees both operate to "adjust" imports. As stated by the Court, "a license fee as much as a quota has its *initial and direct impact* on imports, albeit on their price as opposed to their quantity." *Id.* at 571 (emphasis added).

<sup>177</sup> The authority to restrict "derivatives" of the investigated article was added by Congress in 1958 in order to protect against circumvention of Section 232 remedies. See S. REP. NO. 1838, 85th Cong., 2d Sess. 12, reprinted in 1958 U.S. CODE CONG. & ADMIN. NEWS 3609, 3620 ("The need for such additional language is obvious, for a limitation of the materials alone would serve only to spur the importation of the finished or semifinished products which are, in the final analysis, the very items most essential to the defense of the country.").

<sup>178</sup> *Algonquin*, 426 U.S. at 571 (noting in dictum that it would be wrong to conclude from its ruling that "any action the President might take, as long as it has even a remote impact on imports, is . . . authorized" under the statute) (emphasis added).

President's authority under Section 232 where they do not discriminate against, or have a direct impact on, imports.<sup>179</sup>

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<sup>179</sup> *Independent Gasoline Marketers Council v. Duncan*, 492 F. Supp. 614 (D.D.C. 1980), establishes the outer boundaries of Presidential authority under the statute. In *Duncan*, plaintiffs challenged the Petroleum Import Adjustment Program (PIAP) established by President Carter in 1980. See Proclamation No. 4744, 45 Fed. Reg. 22,864 (1980). Promulgated in the midst of the 1980 energy crisis, the PIAP sought to adjust crude oil and gasoline imports by imposing a license fee on imported oil that would be paid by importers. The PIAP further provided, however, for a system of gasoline "entitlements," under which the domestic refiners would purchase entitlements to the oil from the importers; the mechanism thus allowed importers to be reimbursed for the import license fees by domestic refiners. PIAP further provided that all costs of the import fee could be passed on through the chain of distribution to consumers through a conservation fee. As recognized by the court, the "imposition of the [conservation] fee [on consumers] would not put imported oil at a competitive disadvantage with domestic oil, and the demand for imported oil would not decrease proportionally to domestic oil." 492 F. Supp. at 617.

Under the court's analysis, the import fee component of the PIAP, standing alone, would have been within the scope of the President's authority under Section 232, because it would have had an "initial and direct" effect on the price of imported oil. Yet, the court concluded that "[i]n the context of the PIAP mechanism as a whole . . . the import fee has no 'initial and direct impact on imports' similar to that of the fee approved in *Algonquin*." *Id.* at 618. The "purpose and effect of the entitlement component of the PIAP mechanism . . . neutralize[d] the 'initial and direct' impact that the fee standing alone would have on oil imports." *Id.* As recognized by the court, "[a]ny impact on imports will be indirect and will result from the general gasoline conservation fee, not from the initial import fee." *Id.*

The court then focused on the remaining, and most difficult, issue: whether the general conservation fee imposed on retail gasoline sales under PIAP was within the scope of the President's authority under Section 232. The government asserted that this demand-side disincentive was sanctioned by the statute because it operated to lower imports. In rejecting this argument, the court ruled that:

Section 232 does not authorize the President to impose general controls on domestically produced goods either through a monetary mechanism or through a quantitative device. The statute provides for regulation of imports. A regulation on imports may incidentally regulate domestic goods. The regulation of domestic oil contemplated by PIAP, however, is not incidental to regulation of imported oil. Rather, it is a primary purpose of the program, and is essential to the goal of reducing demand for all gasoline regardless of its source . . . . *Any possible benefits of the PIAP on levels of oil imports are far too remote and indirect for [Section 232] alone to support the program.*

*Id.* (emphasis added).

Finally, the court also rejected the argument that the President could invoke his inherent foreign affairs authority under the Constitution as the basis for such an action. In this regard, Article I of the Constitution affords Congress the authority to make laws, and Article II affords the President the authority to see that they are executed faithfully. Thus, as stated by the court in *Duncan*, "[i]t is clear that Congress, not the President, must decide whether the imposition of a gasoline fee is good policy." 492 F. Supp. at 620. See also *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579 (1952) (prohibiting the President from issuing orders, based generally on all powers vested in him and his specific powers as Commander-in-Chief, directing the Secretary of Commerce to seize and operate most of the nation's steel mills in order to avert a nationwide strike of steelworkers).

In the middle of the continuum is a "gray area" between clearly permissible actions that directly affect imports, and clearly impermissible actions which primarily affect domestic demand and have little or no effect on imports. Such intermediate measures include a range of combined Presidential actions that have some effect on imports, but also may "incidentally regulate domestic goods."<sup>180</sup> Because the President's authority under such foreign commerce/foreign policy statutes as Section 232 is typically construed broadly,<sup>181</sup> especially in exigent circumstances such as a supply disruption,<sup>182</sup> the President has some flexibil-

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<sup>180</sup> *Duncan*, 492 F. Supp. at 618.

<sup>181</sup> Section 232 is one of a number of international trade statutes that "pool" the plenary power of Congress to regulate foreign commerce (*see* U.S. CONST., art. I, § 8, cl.3) with the inherent authority of the President to conduct foreign relations. *See, e.g.*, *Chicago & Southern Air Lines, Inc. v. Waterman Steamship Corp.*, 333 U.S. 103, 109-10 (1948) ("Congress may of course delegate very large grants of its power over foreign commerce to the President . . . . The President also possesses in his own right certain powers conferred by the Constitution on him as Commander-in-Chief as the nation's organ in foreign affairs . . . . Legislative and Executive powers are pooled obviously to the end that commercial strategic and diplomatic interests of the country may be coordinated and advanced without collision or deadlock between agencies."); L. TRIBE, *AMERICAN CONSTITUTIONAL LAW* § 4-2, at 210-13 (2d. ed. 1988).

By enacting Section 232, Congress has delegated to the President part of its exclusive power over foreign commerce (i.e., the authority to "adjust" imports on national security grounds). At the same time, the statute prescribes procedures for the President to follow in exercising his inherent foreign affairs authority to evaluate and define whether a threat to national security exists because of imports, and determine what actions, if any, to take. *See, e.g.*, *United States v. Yoshida Int'l, Inc.*, 526 F.2d 560, 582 (C.C.P.A. 1975) (Although Congress "remains the ultimate decisionmaker and the fundamental reservoir of power to regulate commerce," its statutory grants concerning foreign commerce are enhanced by the President's foreign affairs authority.); *American Ass'n of Exporters & Importers v. United States*, 751 F.2d 1239, 1248 (Fed. Cir. 1985) (Legislation conferring upon the President discretion to regulate foreign commerce "invokes, and is reinforced and augmented by, the President's constitutional power to oversee the political side of foreign affairs.").

Consistent with the pooled authority of Congress and the President reflected in Section 232, it is well-established that such statutory delegations of power to the President in the sphere of foreign commerce and foreign affairs must be broadly construed. As the Court of Appeals for the Federal Circuit declared in *Florsheim Shoe Co. v. United States*, 744 F.2d 787, 793 (Fed. Cir. 1984) (quoting *South Puerto Rico Sugar Co. Trading Corp. v. United States*, 334 F.2d 622, 632 (Ct. Cl. 1964)), the President's discretion under such statutes "'should not be hemmed in or 'cabined, cribbed, confined' by anxious judicial blinders.'" *Accord Yoshida*, 526 F.2d at 574 (declaring that power under § 5(b) of the Trading With the Enemy Act "be given generous scope to accomplish its purpose"); *Sacilor, Acieries et Laminaires de Lorraine v. United States*, 613 F. Supp. 364, 369 (Ct. Int'l Trade 1985) ("Where foreign affairs and domestic matters are mixed, Congressional delegation must be broadly construed"); *Mast Industries, Inc. v. Regan*, 596 F. Supp. 1567, 1575 (Ct. Int'l Trade 1984) ("Where Congress has given the President discretion . . . in international trade, the courts have uniformly sustained action against a claim that it has exceeded the delegated authority.").

<sup>182</sup> *See Dames & Moore v. Regan*, 453 U.S. 654 (1981) (upholding inherent power of President to settle claims "as a necessary incident to the resolution of a major foreign policy dispute" in circumstances where Congress had acquiesced in such action). *See also United States v. Yoshida Int'l, Inc.*, 526 F.2d 560, 581 (C.C.P.A. 1975).

ity to take actions which primarily affect imports, but which also may have some impact outside the import sphere.<sup>183</sup> Whether a particular measure is lawful will be decided on a case-by-case basis by the federal courts.<sup>184</sup>

Finally, in considering the available options, the President need

<sup>183</sup> *Duncan*, 492 F. Supp. at 615.

<sup>184</sup> The authority of the President under Section 232 is constrained by the availability of judicial review of any regulatory actions taken thereunder. Under longstanding precedent, executive branch decisions under such discretionary international trade statutes are subject to limited judicial review to determine whether the President's action: (1) is subject to some constitutional infirmity; (2) falls within the scope of the statutory authority (i.e., is not *ultra vires*); (3) adheres to procedural requirements set forth in the statutes and any applicable regulations; and (4) "bears a reasonable relationship" to the power delegated and the national security threat "giving rise to the action." See *Federal Energy Admin. v. Algonquin SNG, Inc.*, 426 U.S. 548 (1975) (reviewing whether Presidential action under Section 232 is an unconstitutional delegation of power by Congress and exceeds the scope of statutory authority); see also *Florsheim Shoe Co. v. United States*, 744 F.2d 787, 795 (Fed. Cir. 1984); *United States v. George S. Bush & Co.*, 310 U.S. 371, 379-80 (1940); *United States v. Cane Sugar Refiners' Ass'n v. Block*, 683 F.2d 399, 409 (C.C.P.A. 1982); *Sneaker Circus, Inc. v. Carter*, 566 F.2d 396, 402 (2d Cir. 1977); *Aimcee Wholesale Corp. v. United States*, 468 F.2d 202, 206 (C.C.P.A. 1972). See also *United States v. Yoshida Int'l, Inc.*, 526 F.2d 560, 578-79 (C.C.P.A. 1975) ("[T]he nature of the power determines *what* may be done and the nature of the emergency restricts the *how* of its doing, i.e., the means of its execution") (emphasis in original).

It should be recognized, however, that the President's factual judgments concerning whether imports threaten to impair national security and his selection of particular remedies are, in all probability, not subject to judicial review. The statute, by its terms, commits these discretionary determinations to the President, who is empowered to accept or reject the Commerce Department's findings and "determine the nature and donation of the action that, *in the judgment of the President*, must be taken to adjust . . . imports . . ." 19 U.S.C. § 1862(c)(1)(A) (1988) (emphasis added). In such circumstances, under the political question doctrine, the judiciary normally will not adjudicate claims that require an inquiry into the validity of discretionary Presidential determinations in foreign policy matters because, under the Constitution, these matters fall exclusively within the purview of the executive and legislative branches. See *Baker v. Carr*, 369 U.S. 186 (1962); *Greeham Women Against Cruise Missiles v. Reagan*, 591 F. Supp. 1332, 1335 (S.D.N.Y. 1984) (the legality of the stationing of cruise missiles in Britain held to be a non-judiciable political question). Consistent with the political question doctrine, courts have refused to inquire into the validity of factual determinations committed by statute to the executive branch in the areas of foreign policy and international trade. See, e.g., *United States v. George S. Bush & Co.*, 310 U.S. 371, 379 (1940) (refusing to review executive branch decisions regarding tariff rates); *Martin v. Mott*, 25 U.S. (12 Wheat.) 19, 30-32 (1827) (President's decision on matters of national defense not to be reviewed by the courts); *Florsheim Shoe Co. v. United States*, 744 F.2d 787, 796 (Fed. Cir. 1984) (Executive branch decisions in the sphere of international trade "are reviewable only to determine whether the President's action falls within his delegated authority, whether the statutory language has been properly construed, and whether the President's action conforms with the relevant procedural requirements"); *United States Cane Sugar Refiners' Ass'n v. Block*, 683 F.2d 399, 404 (C.C.P.A. 1982) (if the President's actions are authorized by statute, the bases for his decision are immune from judicial scrutiny); *United States v. Yoshida Int'l, Inc.*, 526 F.2d 560, 579 (C.C.P.A. 1975) ("[C]ourts will not normally review the essentially political questions surrounding the declaration or continuance of a national emergency.").



not, even in the context of a Section 232 proceeding, look only to his specific authority under Section 232. He can also consider and invoke his authority under other laws and, if necessary, seek the enactment of new laws (as President Reagan did in this instance).

#### *4.2. Evaluating the Policy Choices*

The remaining and most difficult question concerns which of the available policy choices the Administration should adopt in order to mitigate the risks to national security resulting from rising oil imports.

##### *4.2.1. Defining United States Policy Objectives*

As a starting point, on the basis of the security risks discussed above, it is important to identify the specific policy objectives the United States needs to pursue over time in order to ensure access to a secure supply of reasonably priced energy resources in both wartime and peacetime. In identifying these objectives, intertemporal considerations are important. In the short-term, the impracticality of fuel switching and the time needed for the technological development of renewable energy sources limit the range of possible choices. In the long term, the gradual depletion of world oil reserves shape our energy security objectives. The benefits, costs, and risks of available policy options should be assessed in light of these time-sensitive policy goals.

##### *4.2.1.1. Short-Term Goals*

In the short term, since the United States is unable to shift away from its significant dependence on oil, it is necessary to maintain a secure and reasonably priced supply of petroleum to protect against potential supply disruptions and price increases. In these circumstances, the following should be the basic United States short-term energy security goals:

¶ Strengthen the domestic oil and gas industry and maintain secure domestic production as a protection against the risk of wartime shortfalls and peacetime disruptions.

¶ Slow the growth of oil imports and diversify the sources as much as possible (relying, to the extent feasible, on more secure suppliers).

¶ We should seek to secure Persian Gulf imports against risk. In light of the global distribution of oil and the relative costs of production of oil, the United States inevitably will need to rely on the Persian Gulf for a significant portion of

our oil imports.

¶ Given the short-term constraints on increasing secure oil supplies, it is important to moderate consumption and take steps towards improved energy efficiency.

#### 4.2.1.2. *Medium-Term Goals*

For the medium term, the United States still will be very reliant on oil and, hence, will need to maintain a secure and adequate supply of oil. Over a period of years, however, policies should be adopted which would create incentives which would maximize the nation's shift toward alternative energy sources to which the nation can readily convert in case of emergency. Such alternatives include abundant sources of natural gas and coal. While such sources are not as helpful in military exigencies, they can displace a good portion of the existing civilian demand for oil.

#### 4.2.1.3. *The Long Term*

Finally, in the long term, the domestic petroleum base (which only contains about four percent of proved world reserves) and global oil reserves gradually will decline, leaving the United States even more vulnerable to energy shortfalls. Hence, the basic objective of long-term energy security policy should be to develop and effect major shifts toward alternative energy forms. This policy inevitably will require a greater use of safe and environmentally sound nuclear power as well as an eventual shift to renewable energy sources.

#### 4.2.2. *The Policy Alternatives*

What makes the energy security issue difficult is that no single option can possibly fulfill these objectives. Thus, within the framework of Section 232 and other applicable laws, President Bush should shape the best "mix" of initiatives which would ensure that the United States will have secure access to adequate energy resources at reasonable prices in the future. Unfortunately, the available policy choices are all imperfect, and they present difficult trade-offs between energy security goals and other foreign policy, economic, environmental and national security objectives. Some of the most important trade-offs policymakers must identify and weigh are intergenerational in nature. United States energy policy should not only focus on the short term (where the risks are lowest), but it should be future-oriented. Given the long lead times in developing energy resources and technologies, the nation may need to

sacrifice some short-term economic benefits (and incur some costs today) in order to provide for future security. Hence, in selecting among the available options, the benefits, costs, and risks of each option should be evaluated in the context of both short-term, medium-term, and long-term objectives.

Finally, whatever steps he selects, the President should give increased public visibility to the energy security issue and begin to lay the groundwork for future actions. Increased public consciousness of this issue can lay the groundwork for developing the necessary consensus between consumer and producer interests for future government actions.

#### 4.2.2.1. *Demand-Side Measures*

On the demand side, in an era of low prices and increasing energy consumption, efforts can be made to structure additional incentives for conservation, energy efficiency, and fuel conversion. A variety of fiscal incentives can be developed, including tax credits for taking certain energy efficiency measures or for converting from oil to gas use. However, a substantial shift toward energy substitutes will require significant and long-term changes in transport modalities, which are principally dependent on oil today. Such a change, which will require greater reliance on mass transit, necessitates substantial expenditures (principally by the federal, state, and local governments).

Perhaps the major demand-side issue is whether the United States should follow the lead of other western nations and impose a gasoline tax in order to limit the growth of consumption and, hence, the growing reliance on imports. From a security standpoint, this approach appears to have mixed merits. Although the tax can be set at a level that reduces consumption growth, such a tax might depress prices even further, resulting in undesirable declines in domestic exploration and development. However, since oil prices are global in nature, this price-depressing effect will probably be limited. Thus, this type of measure, which also will raise revenue and help the budget situation, merits careful consideration.

#### 4.2.2.2. *Supply-Side Measures*

The remaining array of choices are on the supply side of the oil import equation.

*Diversifying Imports.* With respect to the further diversification of oil imports, the available options unfortunately are limited. Notwithstanding the growth of non-OPEC oil sources, this oil is less abundant

and higher in cost than Persian Gulf oil; only twenty-four percent of world reserves and virtually none of the world's excess capacity are owned by non-OPEC nations.<sup>185</sup> Also, while the fiscal climate may be better in these nations for oil exploration than in the United States, such investments still may have low return rates relative to non-oil investments. Thus, it is inevitable that the United States will be more and more reliant on the Persian Gulf for its oil imports.

Recently, there has been a trend among larger oil companies toward allocating a greater amount of their budget to increased investment in non-OPEC nations.<sup>186</sup> The United States can perhaps structure tax and other financial incentives for its oil companies to invest in exploration and development in non-OPEC nations. Yet, since this investment comes to some extent at the expense of already declining investments in domestic exploration, the idea of adopting further policy measures in this direction is open to some question from a security standpoint, especially because basic economics is driving larger oil companies to offshore investments outside OPEC in any event.

In light of developments in U.S.-Soviet relations, one interesting possibility to consider is a barter arrangement whereby the United States purchases oil from the Soviet Union in exchange for technology, technical skills, or capital; recent developments now allow us to rethink the reliability of Soviet oil supplies.

*Securing Persian Gulf Resources.* There are a number of incremental steps that could be considered in order to protect our access to, and the security of, Persian Gulf oil supplies against a range of potential threats, which include, among others, possible Soviet military intervention, terrorist actions against pipelines and other facilities, civil wars and revolutions.

First, following on the Carter doctrine, the United States needs to continue to make clear to the Soviet Union its vital interest in the Persian Gulf region, and confirm its willingness to defend its Gulf interests. While a sufficient military presence is necessary to deter adverse Soviet action, this presence also should be nonprovocative in nature and sensitive to the fact that the Soviet Union borders on the Gulf region. In light of recent developments, however, the Soviet threat in the Persian Gulf has declined. The nature of the U.S. presence in the area should thus be driven, at least in part, by other potential risks. In this connection, our military capabilities there should include highly trained and quickly mobilized forces which can, if necessary, secure oil fields

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<sup>185</sup> See ENERGY SECURITY, *supra* note 85, at 18.

<sup>186</sup> U.S. CONGRESS, OFFICE OF TECHNOLOGY ASSESSMENT, U.S. OIL PRODUCTION: THE EFFECT OF LOW OIL PRICES, SPECIAL REPORT 89 (1987).

and major oil facilities in case of a revolt or similar internal problems in Saudi Arabia or other Gulf supplier states.

Second, in the coming years, the United States must continue to work to improve bilateral relations with key supplier states in the Gulf and to maintain the stability of such allied governments through arms sales, economic aid, and the like. In taking such steps, the government may, on a case-by-case basis, have to make trade-offs between other foreign policy objectives and energy security objectives. Hence, as noted above, energy security concerns undoubtedly will constrain freedom of choice in foreign affairs and require us to take some steps vis-à-vis these nations for energy security reasons that we otherwise would not undertake.

Third, the U.S. government should ensure that its intelligence resources in the region are adequate. The United States cannot afford another Iran in Saudi Arabia—especially in a tight oil market.

Finally, we should continue to work to ensure more secure transport modes for Persian Gulf oil.

*Slowing the Growth of Imports and Maintaining a Secure Supply of Domestic Oil and Gas.* With the ability to diversify imports low and the need to rely on imports from the Gulf high, it is important for the United States to maintain both an adequate reserve supply and domestic oil production in order to protect against short-term and medium-term energy security vulnerabilities.

*The Strategic Petroleum Reserve (SPR).* One important element of United States policy is the SPR, which the Reagan Administration relied on as the linchpin of its approach for emergencies. Despite its initial reluctance to fill the SPR, the Administration nevertheless increased it substantially (and is working toward the stated goal of 750 million barrels).

Plainly, the availability of the SPR as a cushion against supply disruptions is a salutary development. However, this policy tool does have limitations and, in all events, should only be one element in a mix of policies for emergency situations. First, the oil now in the SPR can only be drawn down and distributed at a rate of approximately 2.3 million bbl/d for 120 days—which will curtail its effectiveness in reducing the price increase resulting from a supply disruption.<sup>187</sup> Further, as noted above, the world oil market has changed substantially since the SPR's creation, with prices reacting much more quickly—potentially in a matter of minutes or hours—to market developments. Thus, it is questionable whether the SPR could dampen an

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<sup>187</sup> ENERGY SECURITY, *supra* note 85, at 215.

immediate and sharp price spike resulting from a supply disruption—which is more apt to occur given the current oil market. Speculators may be able to run up the price to an extent unimagined in the 1970s.

Also, how planners would use the SPR is, at best, unclear. While some believe that the U.S. government would, in such circumstances, immediately announce its intention to put substantial amounts of SPR reserves on the market, this is highly doubtful. In the early days of a crisis of uncertain duration, it would be imprudent for the United States to release a substantial portion of its SPR reserves. Moreover, the Administration's willingness to rely on market forces suggests that it would not use the SPR in this manner, but would instead choose to let the market operate to dampen the price hike. Thus, given the SPR's limitations and uncertainty over its effectiveness, it should not be the only United States real policy instrument for oil emergencies.

The Administration also should evaluate measures to enhance the effectiveness of the SPR, including the possibility of a substantial increase in SPR levels and the possible development of a stock of refined oil (to deal with immediate consumer hoarding and gasoline shortages that could occur in a crisis). Finally, the United States should encourage its allies to build up their government stocks, and to develop coordinated policies for stock drawdown measures in an emergency. There is a need for coordinated multilateral policies and actions on all aspects of energy emergencies, and substantial efforts should be made in this direction.

*Steps to Strengthen the United States Oil and Gas Base.* Given the limits on the SPR, other actions to strengthen the domestic oil and gas sector need to be considered. Admittedly, the costs of finding and extracting domestic oil are high, and allocating more resources in this direction may be contrary to principles of comparative advantage. Also, the current base is small and declining. Yet, the simple fact is that, as a security matter, a stable domestic industry is needed at least for the immediate future. Stripper well production and oil extracted through advance recovery techniques—which current prices do not support—may prove important to our ability to cope with high oil prices and possible disruptions in the 1990s—a period when alternate energy sources are unlikely to be able to replace oil as our primary fuel.

*Exploration and Development Incentives.* One set of choices is to improve existing incentives to domestic exploration and development through tax and fiscal measures.<sup>188</sup> Since oil and gas drilling go hand-

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<sup>188</sup> The Reagan Administration favored: (1) increasing the net income limitation

in-hand, these approaches also may encourage natural gas development as well. In light of the prevailing price levels and state of the industry, however these incentives probably will be of only limited use. They can, at best, increase exploration and development today in less risky projects, but probably will not appreciably slow the closing in of higher cost domestic production. As prices increase, however, these incentives may help to create a favorable environment for more oil and gas exploration.

*Maintaining Stripper Production.* The United States may want to consider more aggressive measures to maintain stripper well production, including a possible program of purchasing stripper oil for the SPR at above-market prices that will keep such wells operating. From a security standpoint, it may prove more beneficial to have this oil in reserve than to potentially lose it forever.

*Exploring Frontier Regions: ANWAR and the Outer Continental Shelf.* Like the Reagan Administration, the Bush Administration favors opening the Arctic National Wildlife Refuge to drilling and reestablishing the five-year Outer Continental Shelf leasing program. While drilling in these hostile regions is expensive, requires long lead times and is risky, these are the areas with the greatest potential for yielding oil discoveries. Yet, in practice, it has proven difficult to gain Congressional approval for these options. Moreover, given the recent Exxon oil spill off Alaska and rising environmental concerns, it may prove difficult in the future to develop a strong public consensus for these choices.

*Fees and Floors.* Another more controversial set of approaches for enhancing domestic production involves the setting of a price floor or fee on oil imports.

The Reagan Administration's focus was on decontrolling oil and gas prices, and allowing the market to allocate energy resources. Toward this end, it sought further deregulation in the natural gas area in order to allow gas to reach its full potential as a substitute. Plainly, the elimination of market distortions has promoted efficiency in energy markets and removed artificial constraints on energy transport systems and development. Moreover, in an era of a tight world oil market, the removal of the pre-existing regulatory regime allowed consumers to bear the true cost of oil and, hence, encouraged both efficiency and conservation.

In an era of low oil prices, however, the lack of any government action in oil markets can be debated. An argument can be made that

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on the percentage depletion allowance from 50% to 100% per property, and (2) repealing the transfer rule to permit use of percentage depletion for properties that have changed hands. COMMERCE STUDY, *supra* note 4, at ES-6.

some form of government action is appropriate in the oil market, which drives prices in the other energy markets as well, in order to avoid the "boom and bust" cycle of the past. Plainly, oil pricing is the driving force behind future production levels; the relationship between the rig count (an accepted measure of exploration activity) and price has been well-established. Yet, because of long lead times in the energy sector, the responses to price signals in a period of low prices (i.e., less exploration) can overcompensate and result in under-production and possible shortages in a later period of high prices and a tight oil market.

This "boom and bust" cycle has been the historic pattern in the oil industry, and could present problems again in the years ahead. Years of low prices and ensuing low levels of exploration will likely cause significant problems in the future when the oil market tightens; these low prices in 1986 have already resulted in a dramatic U.S. production decline in 1989. Significantly, new exploration to expand supply (especially in frontier areas) would take years to reap results. Thus, while today's low oil prices clearly facilitate short-term economic growth, the cost of this may be long-term energy insecurity. In other words, allowing the economy to benefit from the cheap oil today and taking no tangible steps concerning future oil production may not sufficiently take long-term security interests into account.

Moreover, the reality is that the world oil market is not an unrestrained market, but is regulated by the actions of foreign producers which manipulate output and global price levels. Their actions are causing market distortions and, through low price levels, are sending signals for less exploration and production that will undoubtedly cause problems later. Thus, to some extent, the issue is not *whether* governments should set prices, but *which* governments will do so.

Admittedly, the establishment of a price floor on imported oil or an import fee is not the choice of first resort; insulating the United States from world oil markets will create its own distortions (as past history attests). Also, a price floor may not result in any significant increases in production levels (and at best may lessen the decline in production to some degree). Further, such a proposal would have current economic costs. Yet, in light of current global and domestic oil market conditions, the troubling prospects of continued declines in domestic production and increases in imports, and the absence of other effective policy instruments, it is a choice that the United States should at least consider.

One approach which warrants full evaluation is the establishment of a floor price—in effect, a safety net—on the price of oil imports



(including both refined and crude oil).<sup>189</sup> This eliminates the risk that the bottom will fall out of the price, which currently operates to deter domestic exploration. This approach would create some increased incentives for exploration and keeping oil wells open (although the precise effect on production levels is hard to predict). Additionally, the price floor on oil creates some incentive for movement toward alternatives like natural gas. As exploration for oil and gas go hand in hand, more exploration for oil necessarily means more exploration for gas. Such price stability is unlikely to significantly increase research and development in other alternative energy sources, however; alternatives such as synfuels, etc., are only economic at much higher oil price levels.

At the same time, concerns raised by the critics of the price floor concept also warrant serious attention. Plainly, the proposal does have costs. Yet, the issue is whether these costs are: (1) as high as critics suggest; and (2) justified in an effort to mitigate the national security risks. It is clear that a price floor would result in costs to consumers and the economy as a whole. There would be some price increases, and some costs in terms of short-term economic growth. These costs could, however, be mitigated if the price floor was set near current price levels.

Yet, the fact that the floor will create economic costs, and winners and losers, is not dispositive. The question is whether it provides overall net security benefits to the United States. In this regard, one point to consider is that every barrel of low-priced oil imported into the United States has a security cost—measured in terms of lower domestic exploration, less secure oil available to meet national needs, and greater vulnerabilities in future peacetime and wartime exigencies. At present, individual importers and consumers are not bearing this cost, which is societal in nature.<sup>190</sup> Thus, the price floor arguably allows importers and consumers to bear the true cost of oil, in effect removing part of the subsidy they are incurring by obtaining oil at less than its true cost to the nation.

*Alternative Energy Sources.* As noted above, low oil prices also have created disincentives for investment in, and the development of, alternative energy sources. Here too, the market is sending the wrong signals—allocating resources away from alternative energy sources at a

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<sup>189</sup> The floor price for crude oil could vary in accordance with the gravity of the oil. Refined oil products should be set at a level above crude oil, also in accordance with the properties of the various products. Historic pricing trends and relationships could be used to set the various price floors for refined products.

<sup>190</sup> For a full economic analysis of the social costs of low-priced oil imports, see W. HOGAN & B. MOSSAVAR-RAHMANI, *ENERGY SECURITY REVISITED* (1987).

time when the nation should be moving in that direction. Accordingly, an appropriate role for government would be to directly finance or create tax and other incentives for research and development in renewable energy sources. Additionally, the removal of regulatory obstacles to natural gas development would be helpful and could encourage further oil exploration as well. While these efforts may not have tangible short-term benefits, they may prove significant to future energy security.<sup>191</sup>

## 5. CONCLUSION

In sum, President Reagan's finding under Section 232 demonstrates that the abundance of low-priced oil imports today should not lead to complacency about the future. Today's oil surplus and low prices means increased vulnerability for the United States in the future (as measured by the enhanced risk of high oil prices and peacetime supply disruptions). For these reasons, the President should carefully consider and adopt a mix of policy measures that best ensures access to reasonably priced energy resources—both today *and* in the future.

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<sup>191</sup> For a review of these alternatives, see AMERICAN PETROLEUM INST., ENERGY SECURITY WHITE PAPER: U.S. DECISIONS AND GLOBAL TRENDS (1988).