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Are Low Energy Prices a Reasonable Target of Public Policy?

In the battles over energy policy, the environmental community's mantra has tended to be "clean, secure, and affordable" energy. What they have in mind are large quantities of low priced energy efficiency improvements and renewable energy supplies, such as wind and solar.

The price of fossil fuels has been rising daily: We are close to \$100 per barrel oil and \$3 to \$4 per gallon of gasoline; homes that heat with fuel oil expect their bills to increase by 50 percent this winter. The howl is mounting for the federal government to do something to cap these high prices.

I hate to say it, but we need these higher prices and, actually, we need them to go much higher. Higher prices are the motivating force, the incentive, within our economy to change and adapt. We need higher energy prices to motivate the development of new, cleaner, and more sustainable energy supplies on a massive scale. We need higher energy prices to force all of us to change our energy-using behaviors and invest in energy efficiency improvements. Those higher prices will also provide the incentives necessary for our innovators and entrepreneurs to hunt for the most effective ways of both squeezing the most out of the reduced amounts of fossil fuels we use, develop new renewable fuels, and reduce the greenhouse gas emissions associated with our energy use.

This may sound hard-hearted because it ignores the impact that very high energy prices will have on households, especially those in the middle and at the low end, who

struggle to provide for their families. But it is important to keep in mind that what matters to the household budget is not just the price of energy but also the amount of energy that we have to use. If the higher energy prices bring forth technologies that dramatically increase the efficiency with which we satisfy our needs and desires and go about the ordinary tasks of daily living using much less energy, the higher energy price may be significantly offset by our lower energy usage.

We could try to avoid using rising energy prices to motivate the transformation of how we produce and use energy by relying instead on government mandates that we all adopt certain technologies or government subsidies for those new technologies. But that requires the governments to get into the business of picking and choosing what are the best technologies and the superior alternative sources of energy. The government has a mixed record on that, successfully motivating the development of wind energy and mandating improvements in the efficiency of energy intensive appliances but also the wasteful development of ethanol energy from corn and the promotion of dirty coal and nuclear technologies under a phony veil of “clean energy.”

One advantage of higher energy prices is that they provide incentives throughout the economy to search for alternatives, adaptations, and substitutions. “Let a thousand or hundreds of thousands of flowers bloom.” The market can then test and sort among the various new technologies and find those that best balance low emissions, sustainability, convenience, safety, and cost. We should not count on the government to be the primary innovator and technology gatekeeper.

Environmentalists should not be promising to keep energy prices low. Instead, they should be focused on the fact that there are alternative energy supplies and

technologies available that will help us dodge much of the impact of the higher energy prices, allowing us to keep the total cost we pay for energy from rising anywhere near as much as energy prices will have to rise. But if we do not let energy prices rise and turn instead primarily to government mandates and subsidies, we will tap into only a tiny fraction of the adaptive adjustments that are possible and will almost certainly head off in some unproductive, even destructive, directions.

That is the reason for the current push in Congress for a “cap-and-trade” approach to carbon control that focuses government regulation on establishing and enforcing the annual limit on total carbon emissions and then slowly but systematically ratcheting those limits downward so that we stand some chance of heading off the worst impacts of global warming.

The government can also play an important role in reducing the impact of higher energy prices on the budgets of low and middle-income households. If a significant portion of the permits to emit carbon into the atmosphere are auctioned off, it will create a substantial flow of revenue to the government that can be used to reduce payroll taxes, expand the earned income tax credit, provide tax credits for energy saving investments in people’s homes and vehicles, and otherwise help protect household budgets as energy prices rise.

There are vast potentials to reduce our consumption of energy without impoverishing our families or strangling our economy: Amory Lovins and his colleagues have been working on the 100 mile per gallon hyper car for many decades now. Instead of making biofuels from food crops we should be focused on cellulosic crops grown on previously abandoned farmland or on forest lands or ultimately from algae fed by the

carbon dioxide emissions of industrial facilities. We should move from incandescent lights to compact fluorescents and soon to LED lights or some other extremely low energy light source. With ongoing technological change, for some time to come, we can turn to living off what had been our wasted energy and our waste in general. At this point that waste is an almost unlimited reservoir of alternative energy.

To trigger that innovative and adaptive explosion of entrepreneurial energy, we need those energy prices to keep rising. They still don't come near to reflecting the full cost of our capturing, processing, and consuming those fossil fuels, including our wars around the world and the damage we are doing to our atmosphere and almost all living systems on this planet.