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ENERGY POLICY IN PERSPECTIVE

The jump in oil and gasoline prices between February and early April and the threatened 30-day oil cutoff by Iraq have given new impetus to the energy policy debate in the Congress. Energy security concerns have taken center stage. There is concern that the energy price increase could derail the economic recovery. President Bush has proposed opening up to drilling the one-hundredth of one percent of the Arctic National Wildlife Refuge (ANWR) needed to extract its major reserves. He has also called for a number of conservation and alternative fuel initiatives. The House has passed an energy bill that is generally consistent with the President's objectives, including ANWR. The Senate, where opposition to drilling in ANWR is stronger, is now considering the measure. Senate opponents favor more conservation measures and tighter corporate fuel economy (CAFE) standards.

A bit of perspective is in order. Energy policy should make economic sense for the long term. It should not be based on transitory concerns or events. We should drill in ANWR, but only because it makes economic sense. We should not

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waste money on bizarre alternative energy schemes and forced conservation, because they do not make economic sense, whether recommended by the President or his opponents.

It is true that crude oil and gasoline prices have moved up sharply in recent weeks. However, they are barely back to the levels paid this time last year, and are below the levels of last summer. The increase is due only in part to concerns about the conflict in the Middle East. There have been other factors at work, including the advent of the summer driving season and the rebounding economy, both of which increase demand for oil. The economic rebound has also affected other raw material prices. Price hikes that are the *result* of a strengthening economy should not be confused with exogenous supply shocks that might be the *cause* of economic difficulties.

Of course, it would be even better to have more plentiful oil at lower prices. In fact, industry analysts regard the oil market fundamentals as pointing to a price in the low to mid \$20's per barrel, and view the current price in excess of \$26 a barrel as temporary.

But what about the Iraqi embargo? Iraq, under U.N. sanctions, has only been producing about 1.5 million barrels a day. It has stopped its oil exports for 30 days, and has urged other oil producing states to do the same. This is not a serious threat. Other nations, pressed for cash, are ready to increase production to take advantage of the selling opportunity. Kuwait, Saudi Arabia, Russia, and Norway are all capable of and inclined toward additional output. In fact, of more consequence is the general strike in Venezuela that has cut off its oil exports, which run about 2.5 million barrels a day. But the Venezuelan

shipments will resume as soon as the political situation in that country is resolved.

What if a few oil producers stopped selling to the United States, as Iran has suggested but not done, while continuing to market their production to the rest of the world? That would be even less of a problem. Oil is fungible. We would simply shift our purchases to other sources.

Yes, if several Middle East producers actually cut their output, there would be a price spike, but such a policy could not last. Oil products are a small part of what we consume, constituting about 3% of the CPI, and oil is a much smaller component of the U.S. gross domestic product today than it was 25 years ago when earlier embargoes were attempted. By contrast, oil revenues constitute a huge portion of the producing nations' incomes and government budgets. They have to keep producing. If the Iraqis and their neighbors stop pumping oil, we will carpool, they will starve.

What has this to do with ANWR? ANWR is expected to produce a million barrels of oil a day. Critics complain that this is only about 4 percent of U.S. daily needs, and will not eliminate our dependence on foreign oil. Quite true. We will never again be completely self-sufficient. On the other hand, Iraq only produces about 1.5 million barrels a day, so ANWR doesn't seem that piddling by comparison.

In fact, domestic sourcing is really not the issue. We should not strain for energy independence. Again, oil is fungible. It doesn't matter whether an extra million barrels a day comes from Alaska, the Gulf of Mexico, Russia, Africa,

Indonesia, or the Persian Gulf. Every barrel of production capacity adds to the world supply. Every barrel of capacity does its bit to hold down the world price, and to weaken the power of any one producer to disrupt the market and blackmail consumers. A million extra barrels from ANWR are no less valuable in that regard than a million existing barrels from Texas, and no more valuable than a million additional barrels from Russia.

Why, then, should we open ANWR to exploration? We should let companies drill in ANWR because it pays to do so. If oil is selling for \$26 on the world market, and if private firms are willing to bet that they can extract oil for less than that in the ANWR, even after taking extra care of the environment, they should be allowed to try. We should not do this because the oil is sited in the U.S., but because it is economical. By the same reasoning, we should not pay \$30 to \$90 a barrel-equivalent, including subsidies, to produce energy from exotic alternative sources, such as domestic corn, shale, or windmills. We should not be paying drivers thousands of dollars to buy electric cars. We should not force them to spend lives and limbs in addition to what they pay for gasoline to "conserve" oil by hiking CAFE standards that force people into lightweight cars that they don't want and that kill and maim thousands of people each year by being less survivable in a collision.

Open ANWR. Shut down the subsidies. Close the CAFE. Let the market work.

Stephen J. Entin
President and Executive Director

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