

Costs and Consequences: America's Misguided Energy Policies

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Key Points

- This administration's energy policy is driven by considerations other than expanding our energy resources or creating more jobs.
- The administration targets fossil fuels in order to favor alternative energy, but the one certain result will be to make energy more expensive for America's working families.
- No alternative energy source produces nearly as much energy, nearly as reliably, nearly as cheaply, as fossil fuels.
- America needs a rational energy policy that protects our environment while allowing America's working families to benefit from the blessings of our natural resources.

Introduction

The Obama administration's rejection of the Keystone XL pipeline was obviously driven by considerations other than expanding our energy resources or creating more jobs.¹ Alas, that is true of this administration's energy policy across the board.

Indeed, the administration's energy policies often suppress job creation, and do so quite intentionally. This is because the administration targets fossil fuels in order to favor alternative energy. Its official energy plan, *Blueprint for America's Energy Future* (March 2011)² consists of the following major components: (1) envelope fossil fuel production in restrictive regulations; (2) impose highly expensive efficiency standards on homes and vehicles; and (3) favor the development of alternative energy.

Whatever its potential benefits, the one certain result will be to make energy more expensive. In times of economic hardship, high energy prices cut particularly deep. As the President himself said last spring:

One area of particular concern has been the cost and security of our energy. In an economy that relies on oil, rising prices at the pump affect everybody—workers and farmers; truck drivers and restaurant owners. Businesses see it hurt their bottom line. Families feel the pinch when they fill up their tank. For Americans already struggling to get by, it makes life that much harder.³

Alas, the administration seems to have conflicting policy objectives, such as saving the planet. On the night of his victory in the 2008 Iowa Cau-

ses, Senator Obama predicted that the night would be remembered as “the moment that the rise of the oceans began to slow, and the planet began to heal.” It is a cause to which many of his supporters are deeply committed, and in the name of which they justify their calls for major sacrifices on the part of the whole society. And more practical considerations motivate the administration to seek higher energy prices, despite their impact on the poor. As Secretary of Energy Stephen Chu said, before one congressional committee, “Somehow, we have to figure out how to boost the price of gasoline to the levels in Europe.” Why? In order to make alternative energy sources economically competitive.

This policy perspective examines the U.S. government's energy policy in light of its impact on the cost, availability, and reliability of our energy resources, as well as in light of its broader impact on the U.S. economy. Absent severe economic dislocation, there is no alternative to expanding the safe production of traditional energy sources. Energy policy should be shaped by a rational economic policy that seeks to reduce the burdens and uncertainties of the current regulatory and tax climate.

There Is No Alternative to Traditional Energy Sources

The “alternative energy” movement has an enormous obstacle to contend with, namely that none of the alternative energy sources produce nearly as much energy, nearly as reliably, nearly as cheaply, as fossil fuels. Sources such as wind and solar are inherently intermittent and unpredictable, even in ideal conditions. According to the *2011 Almanac of Environmental Trends*,

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wind power is three times as expensive as electricity derived from coal, while solar power is four times as expensive. Moreover, wind and solar are “parasitical” on traditional energy in electrical generation. Because wind and solar are intermittent and unpredictable, they must be backed up by other sources, typically natural gas.

As long as fossil fuels maintain such a large price advantage, the subsidies to alternative sources have to be huge, and therefore politically painful. The market will decide if these alternative energy sources will one day become primary energy sources, but until it is economically feasible to make a transition it would be foolish and unfair to force change upon the economy. If interventionist policies forced oil prices to rise to a point at which renewables could compete on price, the economic implications would be disastrous. When the price of energy rises, the price of everything rises: there could not be worse timing to push for such policies. Imagine the effect on something as essential as food, which uses fossil fuels in its production, its transportation and even its fertilizers. Moreover, electricity costs are a significant factor in production costs for almost all manufacturing industries. Texas suffered a significant downturn in industrial activity when natural gas prices spiked.

The president likes to target the “special subsidies” we give oil and gas companies. What he’s talking about is manufacturing tax deductions, expensing for intangible businesses costs, and depletion tax allowances. These tax-related provisions, which the president misleadingly characterizes as special perks for oil and gas companies, are generally available to all American manufacturers. Eliminating them would in fact single out the energy industry for punitive tax treatment. In his 2012 budget, Obama proposed eliminating 12 such tax-related provisions, generating \$46 billion over 10 years, all of which would go to his proposed \$148 billion in subsidies for green and renewable energy.

If adopted, this confiscatory scheme would transfer more than \$4 billion a year from the oil and gas sector to alternative energy—and consumers of oil and gasoline will pay for it. This is from the White House website:



The energy industry objects that oil and gas producers will have to cut back the money they spend on expanding capacity (e.g., exploration, exploratory drilling, production expansion) by about a third, eliminating or deferring hundreds and potentially thousands of jobs. And America’s working families will be paying higher prices for less fuel and electricity.

The White House Targets Oil, Gas, Coal, and Nuclear

At the time of the administration’s moratorium on offshore drilling after the Gulf spill in 2010, the president explained that the moratorium was needed to protect the Gulf from another spill until we could make sure the drilling could be done safely. In retrospect the explanation seems little more than a pretext. It was quickly repudiated by the experts whom the administration claimed to have consulted with.⁴

In fact, the administration’s explanation didn’t make any sense at all. An accident like what happened April 2010 cannot occur until the very final days of drilling and preparing the well for production—in particular, the few days when you’re cementing the well and need to counteract the pressure in the reservoir, without knowing exactly what that pressure is. In the months of drilling before the pipe reaches the reservoir you’re drilling into sheer rock the whole time (virtually no risk of a spill).

There was absolutely no justification for halting all drilling in a blanket moratorium, without any case-by-case inquiry into the progress or risks of any particular drilling operation, as the law plainly requires.

It was for this reason that the moratorium was tossed out of federal court multiple times.⁵ A federal district court in Louisiana tossed the original moratorium out as arbitrary and capricious. Its ruling was affirmed by the 5th Circuit Court of Appeals. The administration then revised its original moratorium to alter the definition for the drilling projects to which it would apply, and in so doing expanded its scope. The Louisiana district court then tossed out the revised moratorium.

But these court orders didn't make any difference.⁶ The administration has achieved its objectives largely through tools that are beyond the reach of federal courts: regulatory uncertainty and administrative inaction. As of June, 10 of the 33 drilling rigs present in the Gulf before the spill had left to other countries, and another eight that were destined for the Gulf had been detoured.⁷ According to one recent study, 60,000 jobs were lost along the Gulf coast in 2010 alone, as a result of Obama's deep-water drilling moratorium and slow-walking of shallow water permits. Gov. Bobby Jindal justly called Obama's policies a "second Katrina."

Those job losses were not a collateral result of Obama's policy objective—they were the policy's objective. The moratorium was part of an overall strategy of constricting domestic oil production, the purpose of which (if the Secretary of Energy is to be believed) is to increase oil prices. Huge new finds in the deepest U.S. waters in the Gulf have drawn some of the remaining drilling rigs, but according to another recent report, the slow-down in permitting could drive most of the remaining deep water drilling rigs out of the Gulf in coming months.⁸ According to one expert, the current number of rigs is "unsustainable" at current rates of permitting.⁹

The administration's effort to constrict domestic oil production has been across-the-board. Obama has cancelled leases and made new ones more expensive; slowed permit approvals for exploration plans down by 85 percent;¹⁰ proposed to impose new taxes and taken away deductions; and has now unleashed the EPA against the industry, with a number of inordinately expensive new rules. More than 80 percent of the nation's recoverable oil reserves are off limits. The U.S. Chamber of Commerce estimates that some 351 energy projects

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stalled for one regulatory reason or another would create 2 million jobs and add \$1.1 trillion to GDP.¹¹

According to the Department of Energy, the oil production from Alaska and the waters of the Gulf of Mexico is expected to drop by almost 700,000 barrels per day by the end of 2012—well over 10 percent of total national production of 5.5 million barrels.¹² Increased production on private land (where the federal government cannot readily block production) chiefly from North Dakota and Texas is making up the shortfall, but any increase in domestic demand may have to be filled largely by foreign sources of oil, at least in the short term. Meanwhile, the data analysis firm IHS Global Insight estimates that because of the slowdown in permit approvals for drilling in the Gulf, along with onerous new regulations, the U.S. will defer the creation of 230,000 jobs in 2012 and more than \$44 billion in economic activity.¹³

Leases to drill on federal land (mostly in the western United States) have also been severely constricted. In Utah alone, the Bureau of Land Management (BLM) arbitrarily withdrew 77 leases sold to private investors in 2008.¹⁴ BLM has also made that approval process more complicated, imposing year-plus delays on leases where companies (most of them small independents) have already invested millions in exploration.

On July 28, 2011, the United States Environmental Protection Agency (EPA) issued a proposed rule that will dramatically expand the regulation of emissions from oil and natural gas exploration, production, transmission, and storage facilities, in the form of a New Source Performance Standard (NSPS) to be finalized by February 2012. This is the first time EPA has moved to regulate emissions from oil and gas sources on private or state land, and the first time the federal govern-

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ment has sought to assert direct control of private/state land oil production at all. This NSPS will apply not only to natural gas processing plants, but also to oil and natural gas exploration and production operations, and related transmission and storage systems. The NSPS will require the use of “reduced emissions completion” technology or flaring for all new and recompleted natural gas wells that are hydraulically fractured—the so-called “green completion” rule.

The purpose of the rule is to capture or flare natural gas before it enters the atmosphere, which will increase operational costs. EPA also proposes to amend and make more stringent its existing standards for pollutants that apply to oil and natural gas exploration, production, transmission, and storage. As usual, EPA contends that the new rules will result in a net cost savings to industry due to the amount of natural gas that will be required to be captured and can then be sold.¹⁵ However, according to Lee Fuller, of the Independent Petroleum Association of America, EPA appears to have significantly overestimated the amount of natural gas that will actually be captured, while significantly underestimating the costs of complying with the “green completion” and storage requirements of the proposed rule.¹⁶

Then there is the U.S. Fish and Wildlife Service, which enforces the Endangered Species Act. In order to protect the habitat of the spotted owl, the Clinton administration put an end to most of the large-scale logging in the Pacific Northwest, killing nearly 20,000 jobs in the industry alone. A similar number of agricultural jobs were sacrificed to protect the habitat of the California Delta Smelt.

Could a similar fate soon befall large swathes of Texas? The U.S. Fish and Wildlife Service wants to make the 3-inch long dunes sagebrush lizard (*Sceloporus arenicolu*) an endangered species. In the affected counties (mostly Permian Basin), among the most productive oil-and-gas regions in Texas, significant new costs could be imposed on drilling activity, road construction, and even on the new electrical lines necessary for transporting electricity from the subsidized wind farms in west Texas to the cities in the east.¹⁷ The spot-tailed earless lizard (*Holbrookia lacerata*) could impose similar costs on producers in the Eagle Ford shale in south Texas. That lizard is currently the subject of a 12-month review of a petition for listing as an endangered species. In both cases, the regulatory uncertainty alone could chill commercial development. And on the horizon looms the deadline for federal compliance with a recent consent decree requiring the Fish and Wildlife Service either to list scores of new species as endangered or designate “critical habitats” for them, imposing further costs on industry.

The emergence of technological advances in horizontal drilling and hydraulic fracturing has revolutionized the future of the oil and natural gas industry. In the past year, the U.S. Energy Information Administration has doubled its estimate of commercially recoverable natural gas in the U.S. The U.S. is now estimated to have enough natural gas for at least 100 years; and the Department of Commerce recently issued its first ever natural gas *export* license to a U.S. company. But, responding to pressure from environmentalist groups, the EPA is currently studying the environmental impact of hydraulic fracturing used in extracting natural gas.¹⁸ Preliminary results will be released in 2012, but if EPA’s general pattern of regulatory behavior in recent years is any guide, American businesses and working families alike have reason to worry.

The Cross-State Air Pollution Rule, which imposes drastic emission limits on power plants and other coal-burning facilities in 28 states could lead to the retirement of as much as 10 percent of the Texas’ electrical generation capacity. Luminant has announced the closure of several coal mines and power plants in Texas, eliminating 500 jobs in the Lone Star State alone. American Electric Power has announced far more sweeping plant closures in at least six Midwestern states. The rule, which was supposed to be effective January 2012, was stayed by a federal court because of apparent violations of the Administrative Procedures Act.

The CSAPR is just one of an avalanche of new EPA rules affecting the economy—one of 10 major new EPA rules, and one of four aimed directly at power plants, impacting electrical reliability. The Obama administration is increasingly using authorities under the Clean Air Act and other federal environmental laws to drive its energy policies, in order to suppress fossil fuels and facilitate a rapid transition to alternative energy use.

The cumulative costs of Obama's energy-constriction policies are devastating—and fall primarily on the poor. Low-income families have to spend a much larger share of household income on gasoline, electricity, and food—the major variable price component of which is energy. For a family with an income of \$50,000 per year, the percentage of income spent on gasoline has averaged around 5.7 percent in the last decade. So far this year, the percentage is up to nearly 8 percent. Only twice before have Americans spent this much of their income on gas. In 1981, after the last oil crisis, Americans spent 8.8 percent of household income on gas. In July 2008, when oil prices spiked, they spent 10.2 percent.

The EPA's regulatory avalanche of at least 10 major rules coming into effect in just a few years threatens national calamity. Besides the coal plants that will be shuttered, eliminating

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perhaps 8 percent of electrical generation capacity,¹⁹ the increased shift to natural gas will increase the price of natural gas.²⁰ Average electricity prices will increase by as much as 12 percent nationally, and much higher in places. Some estimates are as high as 60 percent.²¹ Job losses could be in the hundreds of thousands.²²

During the 2008 campaign, then Senator Obama admitted in one interview that saving the planet would hit American families hard. "Under my plan ... electricity rates would necessarily skyrocket." So have gasoline prices, unemployment, and lost opportunity. ★

Endnotes

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²² See note 17.

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