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We're in for a shock

Vaunted cap-and-trade bill does nothing about oil dependence

By Gal Luft *June 2, 2009*

Now, when the first signs of economic recovery may be in sight, it's time to ponder what kind of recovery we are likely to witness. Will it be the traditional V-shaped recovery in which economic growth bounces back from a slump, or will it be a W-shaped, double-dipped one in which one crisis follows the other for several years to come? Much of this depends on the price of oil.

Nearly a year ago, oil prices hit their near $150 peak. This price shock, according to some economists, contributed materially to the recession that a few months later caused prices to collapse by nearly $100 a barrel. The global recession shrank demand for crude. But all of this is going to change once growth resumes, and the oil market is far from ready to absorb the resurgence in demand. The International Energy Agency (IEA) recently concluded that even with the current recession, by 2030 global demand for oil could increase by 25 percent. The agency found that at expected rates of oilfield depletion, to meet future demand for oil, four new Saudi Arabias will have to be added to the global oil market between now and 2030. But the current economic conditions have thwarted the much-needed investment in new production. The IEA predicted that investment in oil and gas exploration will fall by 20 percent in 2009, and the Saudi oil minister is predicting a "catastrophic" shortfall in petroleum production.

For the U.S, such an oil shock would come at a terrible time as hundreds of billions of dollars of taxpayer-funded governmental stimulus and bailouts percolate into the economy, leading to inflationary pressure and devaluing the dollar. This would force OPEC members which conduct their oil transactions in dollars to keep prices high in order to ensure sufficient government revenues.

While the next oil crisis is staring us in the face, Congress prefers to lower its eyes. What seems to be the signature energy legislation of the 111th Congress, the American Clean Energy and Security Act, (also known as the Waxman-Markey cap and trade bill) does virtually nothing to shield the economy from the devastation the coming oil crisis would no doubt cause. The bill's renewable electricity mandate, which requires utilities to get 20 percent of their electricity from renewable sources by 2020, would discourage the use of coal and natural gas, but since only 2 percent of U.S. electricity is made from petroleum it will do nothing to address our oil dependence problem. The bill's "cash for clunkers" program may help drive stockpiles of unsold Detroit cars off the lots, but in terms of oil dependence it is equally meaningless. Even the provisions to encourage deployment of electric and plug-in hybrids, while important and useful, will not affect our near-term energy security, at least until battery costs are significantly reduced.

Sadly, the one provision that could have made a difference, an Open Fuel Standard to ensure 50 percent of new cars are flexible-fueled - capable of running on any blend of alcohol and gasoline - was watered down to meaninglessness by the House Energy and Commerce Committee. Such a standard, which adds less than $100 to the cost of a new car, could have enabled consumers to choose a fuel alternative at the pump if and when gasoline prices rise to $5 a gallon.

Devoid of any provision that could help strip oil of the strategic status derived from its virtual monopoly over transportation fuel, the Waxman-Markey bill is sowing the seeds for the next oil shock. A better course would include not only an Open Fuel Standard but the removal of trade barriers affecting alternative fuels, such as the 54-cent tariff on imported ethanol. With a significant portion of our fleet capable of running on alternative liquid fuels and with free trade in alternative fuels allowing scores of developing countries to export billions of gallons of sugarcane ethanol to the U.S., we could withstand the next oil crisis with relatively little pain. Congress and the Obama administration should ensure that any energy bill includes provisions that address not only the long-term implications of greenhouse gas emissions but the much nearer adversity coming to a gas station near you.

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