The Oil Drum
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

Obama's Energy Policy: Listening When We Disagree

Posted by Robert Rapier on November 12, 2008 - 9:42am
Topic: Policy/Politics
Tags: barack obama, energy policy, politics [list all tags]

Barack Obama has said that energy is going to be one of his top priorities. I believe he is completely sincere about this and that energy will get a lot of attention early on in his administration. I believe he is committed to moving the U.S. toward energy independence and a greener energy future. However, one can recognize energy as an important priority, yet sharply differ on the policy direction that is needed. For instance, some may have energy as a high priority because they feel that gasoline is too expensive. Their priority may be to keep gasoline prices low so people's budgets aren't adversely impacted by their fuel bills. Some can see energy as a top priority, and yet promote solutions like suing OPEC for more oil.

On the other hand, someone else may see energy as a top priority, but think low gasoline prices are not the solution, but instead a big part of the problem. This is the nature of my disagreement with some aspects of Obama's energy plans: We broadly agree on the big picture, but differ on how to get there. And since I recently heard him say “I may not agree, but I will listen”, here is my attempt to highlight what I feel are the flaws in his energy proposals.

Up front, let me state my assumptions. These will of course influence my opinion on his proposals. I believe that the present rate of fossil fuel usage in the U.S. is unsustainable. I believe that world oil production is very near a production peak, and an energy policy that is keenly aware of the potential for energy shortfalls - which will lead to severe oil price volatility - is paramount. I believe that even if oil production does not peak in the next five years, oil production will not be able to be expanded quickly enough to stay ahead of demand. Finally, I believe our current generation of liquid biofuels is too fossil-fuel dependent to enable them to make up for significant energy shortages, and that there are no obvious silver bullet technological fixes around the corner.

These key assumptions impact the direction that I believe energy policy should take. While I believe the evidence supports human-caused global warming, I don't think the world has the collective will to voluntarily reign in greenhouse gas emissions. I think this will ultimately only be accomplished by a combination of high prices and lack of availability. So the energy policy that I would propose would not focus on protocols and agreements for reducing greenhouse gases. Even though many countries signed on to the Kyoto Protocol, carbon dioxide continued to accumulate in our atmosphere - even from the signatories of the agreement. There will always be countries that will choose not to be a party to such protocols, thus I believe a greenhouse gas reduction will only come about as a *consequence* of a reduction in fossil fuel usage.

Thus I believe a sound energy policy should focus on 1). Minimizing per capita energy usage; 2). Finding sustainable, affordable alternatives; 3). Managing the down side of the production peak such that severe shortages are avoided. 4). Communicating to the public the nature of the

problem, and explaining why sacrifice is needed.

The Fossil Fuel Blind Spot

While I think many of Obama's proposals are spot on, and with a little tweaking he could have a great energy plan, I think he overestimates how easily alternatives can displace fossil fuels. Thus, he largely ignores the need to slow the decline of U.S. oil production. Late in the campaign, he started to pay some lip service to the need to (responsibly) drill, but not too many people are expecting him to put much emphasis on that aspect. That "responsibly" qualifier is usually a sign that 1). Someone thinks drilling is not presently responsible; 2). They are going to put hurdles in place that discourage drilling. In fact, one of the Obama proposals is

> **• A "Use it or Lose It" Approach to Existing Oil and Gas Leases.**
>
> Oil companies have access to 68 million acres of land, over 40 million offshore, which they are not drilling on. Drilling in open areas could significantly increase domestic oil and gas production. Barack Obama and Joe Biden will require oil companies to diligently develop these leases or turn them over so that another company can develop them.

That sounds great. Just one problem, though. There already is such a provision. To continue to beat this drum is either pandering, or demonstrates a fundamental misunderstanding of the oil and gas regulations in the U.S. The way these leases work is that companies bid on them competitively. They bid because they think there might be oil there. They then pay annual fees to the government over the course of the lease as they explore, and then if they find economically recoverable oil they begin to develop the lease. But the time between acquiring the lease and the beginning of production (should oil be found there) is several years. You don't acquire a lease and immediately start producing oil. Further, if an oil company did acquire a lease and didn't develop it (which would happen if they don't find any oil there) then it goes back to the government anyway. Oil companies can't keep leases tied up indefinitely without developing them.

The fact that these are the sorts of policies that are highlights of Obama's domestic exploration plan indicate to me that he doesn't look at domestic oil production as a big part of his overall energy plan. In fact, Geoffrey Styles recently noted the same in an essay that examined Obama's plans in detail:

> Senator Obama appears to consider the US tapped out for oil, and apparently expects his energy independence goals to be met without more help from that quarter. That assessment pervades his approach to the oil & gas industry, though recently he has described natural gas in more favorable terms. It is also consistent with his periodic citations of the "3% of reserves vs. 25% of consumption" soundbite, which drastically understates the remaining resource potential of the US. This may explain his 2006 vote against a modest expansion of the allowed drilling area in the Gulf of Mexico, and his restrained support for expanded access to oil & gas during this summer's Congressional debate on various drilling proposals.

I think the vast majority would agree for the need to move away from oil as our principal source of energy. But fossil fuels and nuclear power presently combine to provide more than 90% of

America's energy needs (Source: EIA). And I think there are too many people who fail to understand exactly *why* that is the case. As Geoffrey Styles put it so well in the afore-mentioned link "*it is counter-productive to pit solar, wind and biofuels against domestic oil & gas, which today contribute roughly 30 times as much net energy to the US economy, and could do more*."

Not understanding the problem can lead to unrealistic choices. A key question for me is whether Obama will sit down with the oil companies, explain his vision, but then also listen to these companies explain the view from their vantage point. After all, these are the companies that provide the vast majority of our energy today. They might know a thing or two about energy. On a personal level, I can't count the number of times that my perception of a situation has been changed by sitting and hearing the opposite viewpoint. Had I not kept myself open to that, I would have made many more mistakes in my life.

I believe that 10 years from now (the time frame we could reasonably expect today's exploration projects to start putting supply on the market) we are going to find ourselves falling into a deep supply hole, and while biofuels can help, they aren't going to fill the void. By adopting policies now that will encourage U.S. oil production, the supply void will shrink, and prices should be more stable (albeit still climbing). And as I have argued before, we can earmark the tax revenue from new production to fund alternative energy. The point here is not to keep us dependent on fossil fuels; it is to address what I see as a pending supply shortage in 10 years. Adopting policies that discourage U.S. production will exacerbate that supply shortage. If we are near an oil production peak - as I think we are - then those policies that discourage domestic production will put the country at great risk.

Yet there is a second proposal in Obama's plan that will discourage domestic production:

> • **Enact a Windfall Profits Tax to Provide a $1,000 Emergency Energy Rebate to American Families.**
>
> Obama and Biden will enact a windfall profits tax on excessive oil company profits to give American families an immediate $1,000 emergency energy rebate to help families pay rising bills. This relief would be a down payment on the Obama-Biden long-term plan to provide middle-class families with at least $1,000 per year in permanent tax relief.

I have had an internal debate on this one for quite a while. I favor higher gas taxes to reduce consumption. (And I give Obama high marks for resisting the calls by McCain and Clinton for a gas tax holiday over the summer). If a windfall profits tax is in place, I believe that this will discourage investment, and ultimately lead to higher prices as supply is constrained. Hence, the same objective is ultimately achieved - except the oil companies get blamed instead of the politicians. But the biggest difference is that gas taxes can be implemented or removed in short order. Taxes that discourage investment will have unpredictable results that last for many years.

Let's also be clear here. The oil industry does make big profits, but they are also already one of the most heavily taxed industries. And their tax payments to governments increase along with their profits. There has been a lot of coverage given to the record profits being made by the oil companies, but much less to the record windfalls in the form of taxes that governments have received over the past few years as a result.

And don't forget that we have experimented with a windfall profits tax before. It raised far less revenue than anticipated, and caused investment to fall. An article from the Cato Institute notes:

> We've actually been down this road before in the form of the Crude Oil Windfall Profit Tax of 1980. According to a study published by the Congressional Research Service, the tax discouraged investment in the domestic oil industry to such a degree that domestic oil production was 3 percent to 6 percent less as a result of that tax, and foreign oil imports grew accordingly by 8 percent to 16 percent. There isn't a single credentialed oil economist in the country who would argue that windfall profit taxes are good for consumers.

Geoffrey Styles also weighed in on this provision:

> If anything, [Obama] seems to regard the domestic oil industry not as a potential source of new supply, but as a source of new tax revenue. His short-term energy program leads off with one-time energy rebates--$1,000 per family or $500 per individual taxpayer--funded by a windfall profits tax on oil companies. He hasn't put a price tag on this, but assuming all taxpayers would be eligible, it would require on the order of $20 billion dollars per year in new taxes over the next five years. Although there are legitimate differences of opinion on the justification for such a tax, its consequences for future US oil output are unambiguous: what you tax more, you get less of.

I don't think there is any doubt that a windfall profits tax won't help add to supplies. And refunding it back to consumers sends the wrong message: If gas prices go up, the government will protect you by taking the money from the oil companies and giving it back to you. Where is the incentive for the consumer to conserve? For the oil companies themselves, the likely impact would be that foreign earnings wouldn't be repatriated back to the U.S., and would just be reinvested overseas. For that matter, a steep windfall profits tax would provide incentive for U.S. oil companies to simply relocate overseas.

The Ethanol Blind Spot

One reason Obama feels like he can shun the oil industry is that he comes from a 'corn state' and has ties to the ethanol industry. A recent Bloomberg story reported that he wants to bail out the financially strapped ethanol industry, keep the protective tariffs on Brazilian ethanol in place, and is "fully committed to it and sees tremendous value in the renewable fuels standard and continuing down this path."

Here we have a fundamental disagreement. I have written tens of thousands of words on my opposition to corn ethanol (a random sample here). I won't repeat all of my reasons here, but will highlight the key sticking point from my perspective. Sustainability and net energy are important, and large scale corn ethanol fails on both points. I think we should make every effort to make agriculture sustainable so we leave the soil in good condition for future generations. But the way we make corn ethanol encourages highly unsustainable agricultural practices.

Where do we pay the price for strip-mining the soil? Who is going to get the bill for degraded soils and depleted aquifers? Our children will. If we are consuming natural resources and taking them

away from future generations, there needs to be a really extraordinary reason, like a crisis that threatens our existence. Yet we are depleting our soil to keep our cars running on a fuel that delivers a very small energy return. Most of the energy in ethanol is derived from the fossil fuels used to produce it. If we put higher carbon taxes in place, not only would it encourage conservation, but it would directly discourage 'alternative' energy that relies heavily on fossil fuels. A cap and trade system, or a system in which the EPA has to quantify greenhouse gas savings - will quickly degrade to a lobbying effort if the ethanol industry finds itself at a disadvantage as a result of the rules (see this example).

The "benefit" of corn ethanol - unless you happen to be a corn farmer or ethanol lobbyist - is questionable. The negative consequences need to be a part of the analysis when determining whether to continue pursuing ethanol policies. At present the environment would be better off if - instead of using natural gas to produce fertilizer and steam for the ethanol plant - the natural gas was just burned directly in CNG vehicles. (To his credit, Obama does favor increased use of CNG).

However, I think we have put an ethanol infrastructure in place that can't be easily dismantled without severe consequences on Midwestern communities. I would not advocate pulling the support out from under the corn ethanol industry, but I would be looking for an exit strategy. Instead, Obama wants to expand the program. What I wish he would do - instead of making *a priori* assumptions about the value of ethanol for our energy policy - is put a task force together consisting of opponents and proponents - and let them document the pros and cons around all of the sticking points. Some, like the long-term consequences of aquifer depletion - don't even seem to be on Obama's radar. Yet our present policy calls for sending that bill to our children.

The Nuclear Blind Spot

Nuclear power gets a bad rap. While it is true that there have been some very serious incidents involving the nuclear industry, the truth is that all of our energy options involve difficult tradeoffs. It is also true that countries like France derive almost 90% of their electricity from nuclear power. While the majority in France supports nuclear power, in the U.S. we have attached a particularly strong stigma toward the topic. Personally, I would rather see the U.S. use more nuclear power and less coal (particulate pollution kills thousands every year).

As is the case with fossil fuels, nuclear gets only a passing mention in Obama's energy plan. The reasoning is clear: He thinks we are better off with 'clean coal' technology and a mix of renewables. In my opinion, if we discourage nuclear we will ultimately ensure that coal continues to play a dominant role in producing our electricity. While I would be the first in line for 100% solar, wind, and geothermal electricity, the EIA projects that by 2030 renewable energy will only provide 12.5% of our electricity. The EIA has a spotty prediction record, but they do a good job laying out the obstacles that renewable energy has traditionally faced:

> **Renewable Energy is Expensive and Capital-Intensive**: Renewable energy plants are generally more expensive to build and to operate than coal and natural gas plants. Recently, however, some wind-generating plants have proven to be economically feasible in areas with good wind resources, compared with other conventional technologies, when coupled with the Renewable Electricity Production Tax Credit (described below).
>
> **Renewable Resources Are Often Geographically Remote**: The best renewable resources are often available only in remote areas, so building transmission lines to

> deliver power to large metropolitan areas is expensive.

I personally believe we are going to exceed the EIA's projections, but I also believe that fossil fuel depletion is going to put pressure on all sources of energy. Thus, I don't believe we can afford not to encourage further development of the nuclear industry.

What I Like in Obama's Plan

As I stated, there is much that I like about Obama's plan. I have suggested my own plan in the past, and there are several areas of overlap. We agree on the need to push plug-in hybrid cars and to incentivize the purchase of these vehicles. We agree on the need to invest in a green energy future, but we differ on the details. I like his proposal to weatherize a million new homes a year, and I think incentivizing the solar, wind, and geothermal industries will pay big dividends. (I just don't know how some of this stuff is going to be paid for). I certainly agree with the need to take our energy security out of the hands of foreign powers, but we have some fundamental disagreements on how to get there.

Also, I like the aggressive targets, but I think the most realistic way of achieving them is via a pricing lever. This is one reason I haven't been overly enthusiastic about the efficacy of raising CAFE standards: We already make fuel efficient vehicles. What we need is the incentive to purchase them, which will be incentive to the auto industry to continue making and improving them.

Conclusions

While I think Senator Obama has great potential in front of him, and like a lot of his ideas, I can't fully embrace his energy policy proposals. I think there are many positive elements, but in my opinion there are glaring blind spots that could lead to energy shortages. I recognize that he is going to have factions trying to pull him in many directions, and this often leads to compromise in favor of the politically expedient over the technically best solutions. As he prepares to govern, he has to be very careful that some of the politically expedient solutions don't carve out a huge energy shortfall.

Additional Reading

Obama's Plan: New Energy for America
Geoffrey Styles on the Obama Plan
The Outline of My Energy Plan
CNN: Putting Obama's energy plan to the test
Energize America