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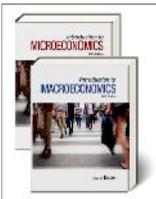


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Getting Energy Policy Wrong Around the World

Author: [Ed Dolan \(/blog/author/edolan\)](/blog/author/edolan) · March 20th, 2014 · [Comments \(2\)](#)

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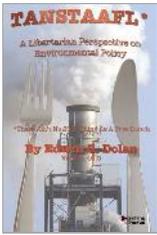
This interview by [James Stafford \(http://oilprice.com/contributors/James-Stafford?p=31\)](http://oilprice.com/contributors/James-Stafford?p=31) was first published by [Oilprice.com \(http://oilprice.com/Interviews/Energy-Getting-it-Wrong-Around-the-World-Interview-with-Ed-Dolan.html?p=31\)](http://oilprice.com/Interviews/Energy-Getting-it-Wrong-Around-the-World-Interview-with-Ed-Dolan.html?p=31) March 18, 2014

Smart energy policies seem to be elusive. The US policy disappoints environmentalists and industry alike; Europe's policy is economically disastrous but is getting people to change their habits; and developing-country subsidies aren't helping the people they're supposed to.

*At a point in time when even the Chinese are having second thoughts about the balance they have struck between pollution and growth, the United States should be concerned about how much it's willing to give up environmentally to remain competitive with energy. But there are ways to balance out this equation without further harming the environment or the economy, according to economist **Ed Dolan**.*

James Stafford:When it comes to talk of fossil fuel prices and carbon taxes, are we stuck in a place that makes us choose between protecting the environment and protecting the poor?

Ed Dolan: No, definitely not. As you know, I have long advocated using the language of the market—prices—to communicate the message that we need to strike a better balance between environmental policy and energy policy. So yes, I would like to see higher energy prices than we have now, and yes, other things being equal, that would pinch everyone in the budget, including the poor. But, as I explained [in a blog post](#)



**TANSTAAFL: A
Libertarian
Perspective on
Environmental
Policy from
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Finance**
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(<http://www.economonitor.com/dolanecon/2012/02/24/when-does-it-will-hurt-the-poor-outweigh-its-good-for-the-environment/>) a couple of years ago, there are persuasive reasons not to use energy policy to help the poor.

The biggest reason is that holding down energy prices is an inefficient way to help the poor. Most of the benefit of low energy prices goes to families with higher incomes. People in the lower half of the income distribution use only about 30% of total energy, and those truly in poverty only about 15%. If we try to use low energy prices as anti-poverty policy, 85 cents out of every dollar it costs us misses the target.

If we want to help the poor, we need to do something more targeted. My favorite policy would be a universal basic income

(<http://www.economonitor.com/dolanecon/2014/01/03/the-economic-case-for-a-universal-basic-income/>) of some kind. A UBI would provide a decent floor on a family's standard of living without taking away their incentive to work, as many of our current poverty programs do. Once you have the safety net in place, then it makes sense to use higher energy prices to give the poor, as well as the rich, an incentive to turn down their thermostats, take the bus when they can instead of driving, and so on.

James Stafford: How do fuel subsidies fit into this equation?

Ed Dolan: Fortunately, in the United States, we don't have much by way of absolute fuel subsidies. However, many emerging market countries, including Indonesia, Venezuela, Egypt and Iraq, spend huge amounts on fuel subsidies, nearly 10% of GDP in the case of Iraq. I wrote a piece (<http://www.economonitor.com/dolanecon/2013/08/12/how-fuel-subsidies-around-the-world-burden-the-rich-and-the-poor-alike-with-lessons-for-the-us-2/>) last year explaining why these subsidies don't help the poor much. The IMF calculates that for gasoline, some 60% of the benefit goes to families in the top 20% of the income distribution. Instead, they actually hurt the poor because the subsidies drain budgets of money that could otherwise be used for investments in education, public health, and infrastructure, which the poor need more of.

James Stafford: What is the best way to implement "pollution charges" on the energy industry in the US?

Ed Dolan: There is no one way that is ideal. Economics textbooks have diagrams that show the optimal level of a pollution charge in relation to the harm done by pollution and the cost of abatement; but in practice, no one can calculate the optimal value for each fuel and each use. But the fact that we can't calculate the exact optimum pollution charge does not mean we should leave the charge at zero, where it is now. Almost any kind of modest pollution charge would be a step in the right direction.

In my view, a simple carbon tax, beginning at a modest level of, say, \$10 per ton of CO2 equivalent, would be the right way to start. Carbon content isn't a perfect measure of the environmental damage done by various fuels, but it sets a rough hierarchy—gas is cleaner than coal, conventional oil is cleaner than bitumen from tar sands, and so on.

New taxes are always a hard sell, but a carbon tax can be more acceptable if we present it as part of a broad, revenue-neutral tax reform. The carbon tax could replace other taxes that people like even less, like the payroll tax or the corporate income tax.

The cap-and-trade approach has its fans, but after the failure of the [Waxman-Markey bill](http://dolanecon.blogspot.com/2010/07/postmortem-on-waxman-markey-politics-of.html) (<http://dolanecon.blogspot.com/2010/07/postmortem-on-waxman-markey-politics-of.html>) in the U.S. Congress a few years ago, and after the difficulties encountered by the European Emissions Trading System, I think that approach poses even more political problems than a tax.

James Stafford: Will we ever see a cap-and-trade system or some form of specific energy taxes as long as cheap energy is giving the US a clear advantage?

Ed Dolan: We have to be careful about what we mean by “cheap energy” or “affordable energy.” (<http://oilprice.com/Interviews/The-Myth-of-Affordable-Energy-Interview-with-Ed-Dolan.html?p=31>)” If we mean energy that is artificially cheap, because we allow users and producers to shift part of their costs to others by not paying for the harm done by pollution, then cheap energy is an illusion. On the other hand, if production costs are low, then energy is cheap in a more meaningful sense.

Right now in the US, both conditions apply, so energy is doubly cheap. Even if we implemented a moderate pollution charge, lower production costs would still hold the price of energy to end users below those in Europe and in many other trading partners. That is especially true of natural gas, where transportation costs are relatively high. So a modest pollution charge would not completely annul the competitive advantage of our energy intensive industries.

Still, the longer US energy prices stay relatively low, the more those energy intensive industries will expand and the harder they will lobby against pollution charges. Even though pollution charges make economic sense, they would become less and less attractive politically as time goes by.

Many environmentalists worry about a global “race to the bottom” in which the countries that do the least to control pollution gain a competitive advantage at the expense of the global environment. Do we really want to challenge China in that race? Even the Chinese are having second thoughts about the balance they have struck between pollution and growth.

James Stafford: What would happen to the economy if energy taxes were imposed right now?

Ed Dolan: Partly, that depends on whether we imposed them in an intelligent way or not. An intelligent way would mean, first, using the revenue to reduce rates on other taxes that are a drag on the economy—payroll taxes, corporate taxes, or whatever taxes you think are most harmful. Second, it would mean phasing out regulations like [CAFE standards](http://www.economonitor.com/dolanecon/2011/07/15/is-a-56-2-mpg-fuel-economy-standard-really-a-good-idea/) (<http://www.economonitor.com/dolanecon/2011/07/15/is-a-56-2-mpg-fuel-economy-standard-really-a-good-idea/>) and ethanol mandates, which are burdensome without really doing

much, if anything, to cut pollution or encourage energy conservation. Third, it would mean phasing out direct subsidies for wind and solar, and letting higher prices provide the incentive to shift toward low carbon and renewable sources of energy.

If we did all of those things together as a package, then we could introduce pollution taxes in a way that increased the effectiveness of our environmental and energy policies as a whole without increasing their burden, maybe even reducing it.

If we introduced energy taxes in a less intelligent way—introduced them on top of all the taxes, subsidies, and regulations we have now—they would still provide beneficial incentives to reduce pollution and shift toward cleaner sources of energy, but the cost to the economy would be greater relative to the environmental benefit.

James Stafford: How industry-unfriendly are Europe's policies, and how is this affecting supply for European countries right now?

Ed Dolan: Europeans have tied themselves in knots over energy policy. Their policies are almost the opposite of what I just described as intelligent.

The centerpiece cap-and-trade element, the European Emissions Trading System, looked like a good idea at the time, but it has not worked out well. Too many sectors are exempted. Too many permits have been issued. The international trading element has been the victim of scams and gaming. So it has not really accomplished as much as supporters hoped it would.

Then, on top of that, individual countries have their own regulatory regimes. Germany's huge effort to ramp up solar and wind capacity is an example. Many of the projects it has encouraged have been extremely high cost. Then, because the costs are so high, there are special schemes to shelter large, energy hungry industries from the high cost of renewable energy. That just introduces further distortions.

The one thing European policy has shown is that high consumer energy prices do encourage conservation. Some people in the US still don't believe that prices affect behavior—they think the demand curve for energy is completely inelastic. Not so. Although European energy policy has not always been cost effective, it has made European economies much more energy efficient than the US.

James Stafford: Is the Obama administration's energy policy "smart"?

Ed Dolan: It is hard to say that the Obama administration has any coherent energy policy. It has taken a piecemeal approach. It has disappointed environmentalists with a relatively permissive policy toward fracking (<http://www.economonitor.com/dolanecon/2012/05/04/fracking-and-the-environment-an-economic-perspective/>) and by leaning toward approval of the Keystone XL pipeline (<http://www.economonitor.com/dolanecon/2011/12/22/linking-keystone-xl-to-the-payroll-tax-only-shows-why-we-need-a-real-energy-policy/>). It has disappointed industry by condoning the EPA's efforts to regulate CO2

as a pollutant. It has disappointed economists by backing command-and-control measures like CAFE standards and renewable energy subsidies while eschewing price-based measures like emissions trading or pollution taxes.

I was encouraged when Obama appointed Steven Chu as Secretary of Energy. Chu had previously spoken out in favor of higher energy prices as a conservation measure. But then the administration made him recant his views (<http://www.economonitor.com/dolanecon/2012/03/16/please-secretary-chu-retract-your-retraction-high-gas-prices-are-good-you-were-right-the-first-time/>), just like Galileo! The result is a policy muddle that does less than it could to reduce pollution and promote energy efficiency, and at the same time places a greater economic burden on both consumers and producers than it needs to.

James Stafford: The ban on most US crude exports in place since the Arab oil embargo of 1973 is now being challenged by lobbyists, with media opining that this could be the biggest energy debate of the year in the US. How do you foresee this debate shaping up by the end of this year?

Ed Dolan: I favor liberalization of the export regime, although I think the effects are sometimes exaggerated. In the oil market, the gap between the price of Brent and WTI crude is already narrowing. We could interpret that as meaning that export liberalization would make less difference now than it would have when the gap was wider, or perhaps as meaning that the gap is narrowing in anticipation of export liberalization. I'm not sure it makes much difference. In the natural gas market, the gap between US and world prices is wider, but even with export liberalization, it would remain wider than for oil because of high transportation costs.

On a geopolitical plane, I sympathize with the wish that we could rescue Europe from its foolish dependence on Russian gas (<http://oilprice.com/Interviews/Russian-Aggression-Paves-Way-for-Ukrainian-Energy-Coup-Interview-with-Yuri-Boyk.html?p=31>), especially now during the Crimean crisis. Still, as many people have pointed out, liberalization of export rules will have little practical effect until the export facilities themselves are up and running.

James Stafford: Is the EPA proposed new carbon emissions standards for power plants, which would make it impossible for new coal-fired plants to be built without the implementation of carbon capture and sequestration (CCS) technology, a viable one?

Ed Dolan: I am not really qualified to render a judgment on the technological viability of CCS, although the accounts I have read make me skeptical. From an economic perspective, though, that is beside the point. A comprehensive carbon tax would resolve the issue.

Right now, under the regulatory approach, the industry has an incentive to put all its engineers to work proving that CCS is not viable. If they can prove that, then Congress, or the courts, will find a way to block the EPA initiative. If a carbon tax were in place, industry executives would call those same engineers into a room and say, "Find a way to make it work, damn it!" Maybe there is no way to make it work, but why should policymakers try to make technological judgments in advance? Put the right incentives in place and see what the engineers come up with.

James Stafford: We are also watching the EPA backtrack on its ethanol mandate, with growing bipartisan ranks ganging up against it. How has the mandate affected various sectors of the economy?

Ed Dolan: I think economists are closer to universal agreement about the stupidity of ethanol mandates than about any other aspect of energy policy. I have [blogged about ethanol](http://www.economonitor.com/dolanecon/2012/08/15/repeal-and-replace-the-ethanol-mandate/) (<http://www.economonitor.com/dolanecon/2012/08/15/repeal-and-replace-the-ethanol-mandate/>) repeatedly in the past, but I have not done so recently because it seemed like it would be beating a dead horse. Unfortunately, the horse doesn't die. Maybe if the EPA and a bipartisan Congressional coalition all gang up, we can euthanize the beast once and for all.

See our previous interview with Ed here. (<http://oilprice.com/Interviews/The-Myth-of-Affordable-Energy-Interview-with-Ed-Dolan.html?p=31>)

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[ThomasGrennes](http://intensedebate.com/people/ThomasGrennes) (<http://intensedebate.com/people/ThomasGrennes>) 61p

Ukraine's persistent policy of subsidizing the use of energy has contributed to economic problems, debt problems, and political problems.

1 reply (javascript: collapseThread(807952585);) · active 16 weeks ago



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75p ·

16 weeks ago (#IDComment808015134)
I think we are all waiting nervously to see whether Ukraine's old, corrupt, political elite dominate the new government or whether there are changes. A smooth end to gas subsidies would be part of the picture. IMF has written some good stuff on right way and wrong way to end such subsidies, discussed in the link given above