

March 30, 1983

WHY REAGAN SHOULD KEEP HIS WORD AND SHUT DOWN D.O.E.

INTRODUCTION

Every American voter knew what to expect of presidential candidate Ronald Reagan. During the 1980 election campaign, he often used the cry "Abolish the Department of Energy!" to symbolize his pledge to curb Washington's burgeoning bureaucracy. Time and again he scored DOE programs as signal examples of the sort of government interventionism and excess he felt were at the heart of America's economic ills. For good reason did voters expect that DOE's abolition would be a top priority during the opening days of the Reagan Administration. Initial indications seemed to confirm this view.

Soon after taking office, Reagan appointed James B. Edwards, a former South Carolina governor, as Secretary of Energy. At an early press conference, Edwards vowed he had come to Washington to "work myself out of a job." On another occasion he even stated that once he succeeded in eliminating the energy agency, he would "spread salt on the earth" to make sure it never rose again. Yet it soon became evident that abolishing DOE would be easier said than done. While the President continued to assert that the energy unit's demise remained a priority, suspicions grew within the energy industry that the effort to abolish DOE enjoyed only half-hearted support from the White House.

Some of the President's own appointees at DOE were openly hostile to the notion of closing the department. Though they opposed the agency's regulatory activities, they wanted the research and development activities maintained. Some even defended DOE's subsidies for the commercialization of energy technologies--a practice sharply at odds with the President's free market philosophy. As a result, a form of guerrilla warfare developed, with top-level DOE officials pitted against the Office of Management and Budget. Whenever OMB tried to cut a program, the officials fought the

cuts through appeals and leaks of information to congressional committee staffs hostile to the Reagan philosophy. The situation was aggravated by the White House's delay in filling key slots at the department. As a result, Secretary Edwards was, for a time, the only Reagan appointee at DOE and had to rely on bureaucrats--a group hardly committed to the agency's demise--for advice and information.

There even was opposition to dismantling DOE within the energy industry. Firms heavily involved in government contracts were loathe to see the federal spigot turned off. Other firms, benefiting from special advantage through DOE regulation, were anxious to maintain their privileged position. Still others, fearing a proliferation of state energy agencies and an accompanying morass of contradictory state rules and regulations, took a "better a devil you know than one you don't" attitude, and lobbied for continuation of DOE's regulatory regime.

The strongest opposition to abolishing the Department, however, came from the Congress. While the agency had existed for only four years when Reagan took office, it had managed to develop a powerful clique of congressional patrons. To no small degree, this was the product of pork barrel projects carefully distributed in the home states of key legislators. Synthetic fuels plants, alternate energy projects, and research and development facilities became powerful arguments on behalf of the agency's continued existence.

Even more important to the Congress, however, was the question of who would have jurisdiction over the department's programs if the department were to be abolished. A number of tasks would be performed by government (such as the maintenance of a Strategic Petroleum Reserve, or the production of nuclear weapons), whether or not a Department of Energy existed. Congress would continue to exercise a role in these areas through its appropriations and oversight functions. At present, the Energy and Commerce Committee in the House, and the Energy and Natural Resources Committee in the Senate, have primary jurisdiction over DOE. If DOE were eliminated, however, there would be no guarantee, particularly in the Senate, that these committees would retain jurisdiction over energy issues. Should jurisdictional boundaries change, some programs, their advocates fear, could be jeopardized.

This all has obscured the fact that the rationale for eliminating the Department of Energy remains as strong today as it was in 1980. As long as there is a Department of Energy, federal policymakers will continue to view energy issues in isolation and will continue to interfere in the market to the detriment of the nation's energy consumers. The urge to regulate where no regulation is warranted, to subsidize where no subsidy is needed, and to send false signals to the energy market is simply too strong to resist. This is history's sad lesson. The only way to ensure

that there are no DOE programs and bureaucracies destabilizing the energy economy is to ensure that there is no DOE.

THE INHERENT DEFECTS OF DOE

The Heritage Foundation's 1980 Mandate for Leadership energy task force report concluded that

...the central problem is not found in any specific deficiency of the agency, but rather in the concept that such an agency is needed in the first place. This concept has its basis in the contention that the government can and should play a major, if not dominant role in the management of the energy market; a contention we flatly reject....The major deficiency of the Department of Energy is found in the fact of its existence.

The creation of a cabinet-level department with energy as its sole concern implies that government can manage energy resources more efficiently than the market can. History has shown this assumption to be fallacious. Recent experience with oil decontrol has demonstrated clearly that the market allocates energy resources far more efficiently than the government ever could and thereby maximizes benefits for energy consumers. DOE thus suffers from serious inherent defects.

Spiraling Intervention

DOE has a distorted view of the energy market. It sees energy issues in isolation, rather than as part of the economic whole. Problems thus tend to be exaggerated and there is a temptation to overreact. But because energy has such a pervasive effect throughout the economy, even small interventions have major consequences. As these become apparent, they are used to justify further "corrective" intervention, setting off an ever increasing regulatory spiral that never acknowledges that it was intervention and regulation that caused the problems in the first place.

Make-Work Regulation

The department seems to intervene in some cases merely to justify its own existence. This reflects the bureaucratic urge to tinker.

Typical was the department's response to the 1979 Iranian oil boycott. By coercing refiners into producing far more heating oil and diesel fuel than they would have otherwise, DOE caused a reduction in gasoline production just before the summer peak-driving season. This distortion in the production cycle, together with the gross misallocation of supplies caused by DOE rules, is widely recognized as the cause of the gasoline lines during summer 1979. The agency's policies magnified the nominal 5

percent loss of crude oil supplies into shortages of as much as 30 percent at the gasoline pump in some areas.

Had the market been allowed to function properly, supplies would have moved quickly to where they were needed, while refiners would have adjusted their product mix to meet customer demands. The market's efficiency was demonstrated in 1980, at the start of the war between Iraq and Iran, when a similar drop in world crude oil supplies was hardly noticed by consumers. The key difference was that during this "oil crisis" the market was allowed to function, free of panic buying inspired by regulation.

Distorting Research

The Department of Energy impedes the energy market by subsidizing some technologies while penalizing others. Since decisions to support one line of research rather than another stem from political rather than efficiency considerations, DOE's actions cause a further misallocation of resources.

In some instances, the agency's efforts even undermine the viability of those technologies that they seek to aid. In the case of alcohol fuels, for example, a DOE loan guarantee program, which carried with it a requirement that subsidized plants have an annual capacity of 5 million gallons or less, virtually ensured that the program would fail. Private firms engaged in power alcohol production had discovered already that a minimum annual capacity of 20 million gallons is necessary for efficient and profitable operation. But because DOE offered loan guarantees only to smaller plants, and investment bankers insisted on such guarantees before granting a loan, producers with viable projects were effectively barred from private capital markets by the very program intended to help them.

THE CASE FOR LIMITED FEDERAL INVOLVEMENT

Although government intervention in the energy market is unwarranted in most cases, there may be a need for the federal presence in two specific areas: energy emergency preparedness and long-term research and development (R&D). In both cases, the perceived need arises from what economists call "externalities." These are costs that must be accounted for, but that no individual, or group of individuals, can or will pay for. The classic example of an externality is national defense. No one individual or group has an incentive to assume responsibility for his share of defense, since the same total level of defense is needed, irrespective of what any individual chooses to pay. But it must be provided for somehow. It therefore falls on government to assume the chore and to assign costs to each taxpayer. To some extent, energy emergency preparedness, long-term R&D, and the nuclear fuel cycle carry external costs and benefits.

Energy Preparedness

In the case of energy security, the externalities arise from the government's broad duty to provide for national defense. To the general public and Congress, energy security has been synonymous with protection from the effects of an oil supply interruption. Consequently, most energy security programs aim at assuring adequate oil supplies, domestically and among the nations who have signed the International Energy Agency's shortage-sharing agreement.

Under the Carter Administration, the principal programs of energy preparedness included the expansion of the Strategic Petroleum Reserve (initiated in the Ford Administration), the development of a rationing plan for times of severe interruption of oil imports, creating the Synthetic Fuels Corporation, and the development of a plan, in close cooperation with the International Energy Agency, for the international allocation of crude oil supplies in the event of another oil embargo.

These measures ignored the supply side of the oil equation. Senior officials of the Carter Administration, it seems, did not believe that much new oil remained to be discovered. The only means of ensuring energy security therefore seemed to be to "share the shortage." To ensure that the burden of the anticipated shortfall was equitably distributed, it was necessary, from the Carter viewpoint, for the government to manage the burden. This rationale provided much of the justification for the creation of a Department of Energy.

Such thinking was repudiated by incoming Reagan officials. For them, long-term energy security was to be achieved, in the words of Interior Secretary James Watt, by "conserve and conserve, and produce and produce." This was the role of the market. In their view, the Department of Energy was a barrier to this.

DOE's conservation programs had achieved few real energy savings. Worse still, the department's controls on crude oil prices encouraged overconsumption. Although major strides in energy conservation had been achieved, noted Reagan Administration officials, such progress could be attributed mainly to market forces--that operated in spite of, rather than because of, DOE's regulations.

International agreements to share shortages on the world oil market, moreover, were of little value since experience indicated that few nations would abide by them, should an embargo occur. Real security lay therefore in developing domestic energy resources--which only the private sector, through the market system, could accomplish. Until domestic resources were developed, the Strategic Petroleum Reserve would furnish ample protection against a catastrophic shortfall.

Energy security thus is no reason for a Department of Energy. Though the federal government might be needed to maintain the Strategic Petroleum Reserve, existing agencies, such as the Interior Department, could do this.

Research and Development

There is relatively widespread support for the argument that the government can play a useful role in sponsoring scientific research. "Pure" scientific research will ultimately yield significant benefits to society, even though it is impossible at the outset to determine just what those benefits will be or to whom they will accrue. Perhaps the most familiar example of this process is the space program, which gave society products ranging from Tang Breakfast Drink and Teflon to the sophisticated cardiac monitors now used in hospital intensive care units.

In addition to so-called pure research, however, many Americans accept the notion that there is value in federal sponsorship of "applied" research, that undertaken toward a specific end. Unlike pure research, applied research leaves little doubt as to its beneficiaries' identities and this often raises the question: "Why should they not bear the costs?"

In answer to such questions, advocates of a federal role in applied research argue that, in today's economy, such projects constitute part of the "infrastructure of commerce." As such, the support of applied science, as of ports and highways, is said to be within the legitimate scope of government.

While it is true that technology lies at the heart of the modern economy, even if some federal involvement is therefore appropriate, the degree of that involvement must be justified and the limits clearly set. The danger that federal research will become politicized, as has happened so often in the past, would suggest that the direct federal role be minimized to the greatest extent possible. Where should these limits be placed?

Recently, the notion has gained currency that direct federal research and development projects should be restricted to those that can be categorized as "high risk, high potential payoff." The basis of this is the assumption that a private firm would be hesitant to undertake projects of this kind because they lack near-term commercial potential--even though their long-term prospects might be significant. Fusion energy is an example of this. While promising virtually limitless energy, the most optimistic time frame for fusion still puts commercial plants well into the next century. Given the billions of dollars needed to conduct the experiments, no private sector firm would likely proceed on its own. But the potential benefits to society may well be enormous. Like national defense, fusion research is characterized by significant "externalities."

Only under extraordinary circumstances, however, can externalities provide justification for government involvement. The crucial factors are their magnitude and how they relate to other factors in the economy.

At the other end of the spectrum are so-called commercial demonstration projects. Popular during the Carter Administration, these projects are most often aimed at building "first of a kind" plants to test the commercial feasibility of a new process. The synthetic fuels projects proposed under Carter's Energy Security Act, and possibly the Clinch River Breeder Reactor, fall into this category.

In these cases, the rationale for federal involvement is weak at best. It is based on a faulty notion that the government can demonstrate commercial feasibility of a technology. Yet, a technology is commercially feasible only when the market provides it. If government subsidies are necessary for a technology to compete, then it clearly is not commercially feasible. Attempts to force a technology into the market prematurely are destined to fail, no matter how large its federal subsidy.

On rare occasions, however, national security reasons or similar purposes require the development of technologies even though they may not yet be economically viable. This can usually be accomplished through the construction of small bench-scale or prototype plants. Although the construction of an intermediate sized plant (as proponents of the Clinch River Breeder Reactor claim their project to be) may be required in some cases, it would never be necessary to construct a full-size commercial plant.

The Nuclear-Fuel Cycle

In one area of energy, the government unquestionably has a role: the nuclear fuel cycle. The term "fuel cycle" refers to the process whereby uranium or some other fissionable material is mined and enriched to make it suitable as a fuel, burned in a reactor, and finally processed to dispose of the radioactive wastes.

The main reason for a federal role here is the concern over nuclear proliferation. The U.S. government is the only body with the stability and longevity needed to oversee the long-term management of nuclear waste facilities, where several centuries may be needed to effect disposal. The federal presence has been dominant in the field ever since nuclear power emerged as a viable energy source. That presence will not diminish in the future. Nuclear weapons production will remain the sole responsibility of the federal government, as will uranium enrichment, the control of nuclear exports, and a host of other nuclear related matters.

This is insufficient, however, to justify the existence of a cabinet-level agency.

DISMANTLING THE ENERGY DEPARTMENT

There is no convincing rationale for the existence of a federal energy agency. Where the federal government should or might play an energy role, the functions could easily be assigned to other cabinet departments or performed by a lesser agency. More important, the orderly dispersal of the government's legitimate energy related functions could lead to a more realistic view of how energy issues relate to the greater economic whole, and a more rational policymaking environment.

Three options have been suggested for abolition of the Department of Energy. These are:

- * Outright abolition
- * Merger
- * Downsizing.

Each has its own advantages and disadvantages, but each must be considered in terms of its political feasibility. Indeed, political considerations, more than any other factor, must determine which option should be employed.

Outright Abolition

Outright abolition would mean the total elimination of the Department of Energy and the transfer of its legitimate functions to other cabinet agencies. Management of the Strategic Petroleum Reserve, for example, may be assigned to the Interior Department and the nuclear weapons program to the Department of Defense, while the Federal Energy Regulatory Commission again could become independent. In the early days of the Administration, outright abolition was the option given the closest consideration. Outright abolition, however, appears politically infeasible. It ignites jurisdictional concerns within the Senate. And abolition would eliminate the focus for energy programs which Congress seems to want.

A Merger

Another approach is merging DOE's continuing functions with another cabinet department. There would seem to be two candidates: the Department of the Interior and the Department of Commerce. The course of U.S. energy policy would be quite different under each agency. If the merger were with the Department of the Interior, DOE's programs would likely focus on resource management and development. If Commerce were selected, trade and technological development undoubtedly would dominate.

Some proponents of a merger have suggested that DOE's functions be divided more or less equally between Commerce and Interior. Functions most concerned with resource management, such as coal leasing and maintenance of the Strategic Petroleum Reserve, plus fossil fuel research would go to Interior; the nuclear, solar, conservation, and international functions would be transferred to Commerce. Most of DOE's statistical programs also would go to Commerce.

Merger could save money by eliminating redundant programs. For example, the Energy Information Agency currently collects a wide variety of statistics on oil imports. But these data are largely duplicated by statistics collected by the Customs Service. Such information gathering could be unified easily at Commerce, with the Customs Service providing the data and Commerce providing the computer capability and statistical analysis.

Merger also would lead to the better coordination of policies. For example, although responsibility for promoting U.S. coal exports rests with the Department of Commerce, the Department of Energy sets coal targets and is responsible for coal research. The Interior Department, on the other hand, oversees coal leasing. While the Reagan Administration's use of a Cabinet Council on Energy and Natural Resources has improved coordination to a degree, there still is considerable bureaucratic inefficiency. Most important, a merger with one or more agencies would allow energy issues to be considered within a broader context.

Downsizing

This final option would eliminate most of DOE's regulatory functions, while retaining research and development, plus some statistical capability, within the department. The new agency, which would be below cabinet rank, would be much like the Veteran's Administration or NASA and resemble the Energy Research and Development Administration (ERDA) of the Ford years. This would reduce unnecessary personnel and could realize real savings to the taxpayer. There is still the danger that it would become a vehicle for pork barrel projects. It is less attractive, therefore, than the merger option, but still politically feasible.

CONCLUSION

No option for dismantling DOE, no matter how sensible or carefully constructed, will succeed if the political will to make it succeed is lacking. It is not clear that Congress or the White House has summoned that will. During the early days of the Reagan Administration, when officials were asked about abolishing DOE, the answer was always "after the budget and tax bills." Reagan Administration officials now admit privately that "abolition is not a priority."

For the energy industry too, eliminating the Department of Energy is not a priority. The fear of a proliferation of state energy agencies remains strong, and Reagan inspired reforms of regulatory programs have eliminated many of DOE's points of conflict with energy companies. With the general slowdown of economic activity, some of the same firms that were criticizing DOE's largesse a few years ago are now eagerly competing for their share of the federal pie.

Yet the original reasons for the agency's termination remain as valid today as they were two years ago. The DOE still promotes a distorted picture of energy issues. It still hinders the ability of the market to function. It still sends false and confusing signals through the economy. In short, it still has no reason to exist.

Milton R. Copulos
Policy Analyst