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Energy Policy: Let's Not Repeat the Mistakes of the '70s

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America is currently facing energy challenges reminiscent of the 1970s. Unfortunately, rising gas prices have policymakers repeating the mistakes from that decade—mistakes that took a bad situation and made it worse.[1]

Then, as now, good energy policy is easy to distinguish from bad energy policy: Good policy leads to more supplies of affordable energy; bad policy leads to less. Chief among the good policies is expansion of domestic oil production, and chief among the bad are windfall profits taxes, price controls, and federal subsidies and mandates for alternative energy sources. These bad ideas were tried before and backfired, and they will do no better this time around.

Bad Idea #1: Windfall Profits Tax. Criticizing big oil companies and their big profits is very popular in Congress right now. But experience has shown that hurting big oil is not the way to help consumers, and ideas like the windfall profits tax (WPT) that have failed before should not be given a second chance.

The WPT is an excise tax on oil when its price exceeds some predetermined level. For example, Senator Byron Dorgan (D–ND) introduced the Windfall Profits Rebate Act of 2005 (S. 1631) that would have imposed a 50 percent tax on the price of oil above $40 per barrel. Given that the price of a barrel of oil is about $125 today, Senator Dorgan's bill would have increased the price to $187.50.

Of course, there is a considerable populist appeal to taking more in taxes from big oil at a time when they can most easily afford it and giving the proceeds to taxpayers when they are straining to pay high energy costs. But the last time it was tried, the WPT backfired badly. It discouraged expansion of domestic energy supplies and led to increased oil imports. According to a 1990 Congressional Research Service study, the WPT in place from 1980 to 1988 "reduced domestic oil production from between 3 and 6 percent, and increased oil imports from between 8 and 16 percent."[2] These unintended consequences were among the reasons why the WPT was repealed in 1988 and why similar bills should not be introduced today.

Bad Idea #2: Price Controls. The market price of gasoline is the price at which supply and demand are balanced. Currently, that price is uncomfortably high, largely due to inflated crude oil prices in the face of strong U.S. and global demand for gasoline.

Price controls were tried before by the federal government in the 1970s, and the consequences were disastrous. The experience showed that attempts to force gasoline prices below market levels invariably result in shortages. Expensive gas gets replaced by scarce gas.

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Indeed, federal price controls would artificially lower the price of gas. Yet, those old enough to remember waiting in long gas lines—and stations sometimes running out before your turn—will get a real feeling of déjà vu if policymakers introduce similar measures. Gasoline price gouging legislation introduced by Congress would have the same effect as price controls, as would efforts to crack down on oil speculation. Both seek to ignore the tight supply-demand situation and instead punish market actors over current prices. Neither tries to deal with the underlying problem of inadequate supplies by expanding those supplies.

Bad Idea #3: Picking Winners and Losers Among Alternatives. During the 1970s and early 1980s there were many attempts by the federal government to pick winners and losers among emerging energy alternatives—synthetic fuels, solar, ethanol and others—and tilt the playing field in their favor. Virtually all turned out to be big disappointments.

Several recent bills would either subsidize or mandate alternative fuels and/or vehicles. However, the 30-plus-year history of federal attempts to encourage such alternatives includes numerous failures and few, if any, successes.

Indeed, many of the recipients of tax breaks and incentives in the bill have been subsidized for decades—ethanol since 1978, for example—originally with the promise that they would become viable within a few years and then go off the dole and compete in the marketplace. But this has never happened. Instead, Congress just passed a huge expansion of the ethanol mandate, essentially forcing Americans to use more of it even as it continues to be heavily subsidized. Wind and solar are doing no better competing without government help.

Even after decades of special tax breaks, alternative energy still provides only a small fraction of America's energy needs. For example, wind and solar energy account for less than 3 percent of America's electricity because of their high costs and unreliability.[3] Further, the overall percentage of electricity attributable to renewable sources is not expected to increase by 2030, according to the Energy Information Administration.[4]

After all these years, Washington has failed to grasp the serious economic and technological shortcomings of these energy alternatives, which is why they needed special treatment in the first place. Federal efforts to pick winners and losers among energy sources—and to lavish mandates and subsidies on the perceived winners—have a dismal track record relative to allowing market forces to decide the direction of energy innovation.

What Government Should Do. Those who don't know energy policy history are condemned to repeat it. There are many energy bills currently pending before Congress, and they fall into two general categories: (1) those that seek to increase domestic energy supplies, and (2) those that seek scapegoats and diversions instead. Policymakers should recognize the failures of past energy policies that led to some of the most dismal and frustrating years for American consumers and instead focus on ways to increase the supply of energy domestically.

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1. See Ben Lieberman, "Crisis! What Crisis?: America's Response to the Energy Crisis," in James Jay Carafano and Richard Weitz, *Mismanaging Mayhem: How Washington Responds to Crisis* (Praeger Security International, 2008), pp. 113–129.
2. Salvatore Lazzari, "The Windfall Profit Tax on Crude Oil: Overview of the Issues," Congressional Research Service, September 12, 1990.
3. U.S. Department of Energy, Energy Information Administration, "Renewable Energy Consumption and Electricity Preliminary 2006 Statistics," August 2007, Table 4, at *http://tonto.eia.doe.gov/FTPROOT/renewables/pretrends.pdf* (July 25, 2008).
4. U.S. Department of Energy, Energy Information Administration, "Annual Energy Outlook 2007," p. 82.