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YOU, YOUR CAR AND ENERGY POLICY:
SUSTAINING CONSERVATION ON THE ROAD

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You, Your Car and Energy Policy

Americans are driving less. Official data for vehicle miles traveled (VMT) have declined by 2 percent since 2007, spring SUV sales were down 40 percent, and more Americans are using public transportation. This conscious effort at conservation on the part of many Americans, combined with shrinking economic activity, has resulted in a drop in U.S. oil demand of 8 percent from last year.

Lower oil demand is good for U.S. energy security, good for reducing the trade deficit and good for the environment — and policy makers must remain cognizant of this no matter how low oil prices may go. But the question is: Can we stay the course as gasoline prices fall?

The reality is that future world oil supply remains risky. Today, oil companies controlled by foreign governments, including Russia, Iran and Venezuela, hold nearly 80 percent of global oil reserves and dominate world production. Going forward, these government-controlled oil companies will be responsible for the lion's share of increased output and investment for future oil supplies. But questions remain whether these firms, especially in light of falling oil prices, will make the kind of new investments needed to meet rebounding demand when the global economy recovers.

These government-controlled oil companies are plagued by a multitude of problems, including heavy government interference, corruption, inefficiency and diversion of capital to pay for social welfare projects. In some countries, there is also a risk of civil unrest and social mobilization. All of this thwarts the ability of these state-owned firms to find and produce new resources.

At the same time, major multinational oil companies, including those in the United States, have been slow to respond with higher exploration spending, leaving open the possibility that we could be right back in the same oil supply crisis mode in three, five or ten years time, depending upon how long the current global economic slowdown persists.

The United States has been moving in the right direction in energy policy. Before we realized that economic recession would naturally reduce oil demand and, with it, oil prices, the U.S. Congress passed new corporate average fuel economy (CAFE) standards. According to a study

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by the James A. Baker III Institute for Public Policy, the new 35 miles-per-gallon fuel efficiency standard will shave 2.3 million barrels a day from U.S. oil demand by 2020.

Even as Detroit reels from an unprecedented downturn, we must not undo this regulation. Rather, we should make any government bailout of our car companies include an increase for this target to a more ambitious 50 miles to the gallon, saving the United States as much as 6 to 7 million barrels a day of imported oil.

The strategy of tying new efficiency technologies to government assistance to the car industry is not new. It has been done successfully in Japan. Targeted government subsidies and tax breaks were used to spur companies like Toyota, Honda and Nissan to develop and build vehicles with innovative hybrid and other efficiency improving features. The result was the emergence of a remade, stronger Japanese auto sector that provided steady export growth.

Conservation and efficiency are powerful tools for reducing demand. However, history indicates that Americans' choices are heavily influenced by the price at the pump. Thus, the easiest way and likely most effective way to continue the gains we have made in reducing oil demand in the United States would be to raise federal gasoline taxes.

Consumers would respond to the higher prices by increasing conservation and efficiency. We could certainly come up with constructive ways to use the added federal revenue. Some of it could be used to provide relief to low-income households in an effort to redress any regressivity of a higher gasoline tax. The added revenue from a higher gasoline tax could also be used to accelerate repairs of our aging bridges and roads, to enhance public transportation options, and to contribute to research in alternative energy technologies.

Promoting fuel efficiency is sound policy but long term, we need a grander, more comprehensive solution. With more research and development, electricity might become the medium of the future. Canada, France, Germany and the United States generate electricity from several different fuels, but generally without recourse to oil. By giving us a substitute to gasoline, hybrid plug-in cars would give consumers the flexibility to shift fuels when oil is expensive or in short supply,

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reducing the leverage of oil producers and enhancing energy security. Right now, the ability to plug in would save the first few electric car buyers a bundle. Three-dollar gasoline translates at today's average fuel efficiency to about 17 cents a mile, while plugging in at 9.5 cents per kilowatt-hour is about 2 cents a mile. Household electricity would have to rise to almost 50 cents per kwh before plugging in was the equivalent of a \$3gallon of gasoline.

The flexibility to shift to electrification of the transportation sector has many benefits. It gives U.S. consumers an alternative to gasoline during a supply crisis. The ability to shift among fuels to generate electricity could also lessen the negative macroeconomic effects, financial crises included, associated with high oil prices by further reducing the oil intensity of the U.S. economy. This has the desirable effect of reducing the leverage that oil-producing nations would have over the United States. Over time, as carbon dioxide is restricted, electricity could be generated with cleaner fuels such as nuclear, solar and wind or even coal with the carbon sequestered. Thus, "plugging in" could become a climate-friendly option as well.

No doubt, high oil prices and a slowing economy are behind the recent drop in U.S. oil demand. We have seen this story before. The 1970s oil price shocks contributed to a major global recession, lowering oil demand and helping to usher in a collapse in oil prices. Then, as now, we saw strong conservation efforts, but they proved short-lived because falling oil prices were taken as a sign that conservation policy was no longer needed. If our newly *re*-found conservation efforts and concrete energy policies again give way to old profligate energy habits when our economy recovers, we will have lost yet another opportunity to get out of the vicious cycle of repeated energy and financial crises.