
Let's *Not* Be Energy Independent

BY DAVID R. HENDERSON

“Energy independence” is a term that sounds good but falls apart on closer examination. Although the United States could achieve energy independence, we could do so only at an enormous cost. Energy “dependence” is much cheaper and much more desirable.

Before considering the costs and benefits of energy independence, I should define my terms. What is energy independence? Various advocates and analysts have proposed various definitions, but two come up again and again. The first is that a country is energy independent if it is self-sufficient—that is, if it imports no energy from any other country. The second is that a country is energy independent if changes in world energy markets have no effect on that country’s price of energy. The first definition is more commonly used.

Although I could consider the issue of energy independence abstractly, it is more illuminating to examine it in the context of the actual U.S. economy. And I’ll focus on the major form of energy for which many Americans want independence: oil.

Currently, the United States uses about 20 million barrels per day (mbd) of oil and petroleum products and imports about 60 percent—or 12 mbd—of that. The most straightforward way to reduce imports to zero would be to ban imports or to impose a stiff tariff on oil designed to reduce imports to zero. With 12 mbd gone from the U.S. daily supply, there would be only eight mbd to serve consumers who were accustomed to

using 20. A substantial rise in price would result. As it rose, the amount demanded would fall and the amount supplied domestically would rise. The price would increase until the two were equal.

How high would the price have to go? The honest answer is that no one knows—even the most seasoned, informed energy economist. The reason is that to compute the new equilibrium price, one would have to know the elasticities of supply and demand—that is, the measures of sensitivity to price changes of the amount supplied and demanded. We have reasonable measures

of those elasticities for the range of prices of oil that we are used to. But the current price of oil (about \$125 per barrel at this writing) is, even adjusted for inflation, above that usual range, and so we know little about elasticities at that price or above.

Yet, even if the elasticities of supply and demand were each as high as 1 (they are generally thought to be much less than that)—so that a 1-

percent increase in price would lead to a 1-percent increase in quantity supplied and a 1-percent decrease in quantity demanded—it would still take a price increase of at least 40 percent to equate the amount

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supplied domestically to the amount demanded. That would imply a price of over \$180 per barrel. And few economists believe that the elasticities of demand and supply are as high as 1. The lower they are, the higher the price must go to equate the domestic amount supplied to the amount demanded. It would probably go to over \$200 per barrel.

This means that to be self-sufficient in oil, Americans would have to pay in excess of \$180 a barrel when, instead, they could be “dependent” on other countries’ supplies and pay the world market price of \$125. That’s not a good deal for Americans. To put it in terms that everyone who drives a car understands, a \$180-per-barrel price of oil would increase the price of gasoline by about \$1.20 a gallon (the \$50 increase in price divided by 42 gallons to the barrel).

Comparative Advantage and Dependence

Energy “dependence” is much cheaper. In fact, the case for being “dependent” on other countries for oil is the same as the case for being dependent on other countries for bananas or coffee. At some tariff-protected price, the United States could be self-sufficient in bananas or coffee. If the price were high enough, someone would grow bananas and coffee plants in greenhouses. But why would we want that? Why would we want

to pay more for coffee and bananas than we need to? Another way of saying that we would pay more is that we would give up more of our resources (capital, labor, and land) to have domestic bananas and coffee than we now give up by producing other things with these resources and using the proceeds to buy coffee and bananas more cheaply abroad. We would be poorer. The reasoning doesn’t change when the good is oil. By preventing people from importing oil, either with a ban on imports or a tariff on oil, the government would make us poorer.



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Or think of it another way. Do you ever take your shirts to the local cleaner to be washed? If so, you are “dependent” on the cleaner. You could wash your shirts yourself, but you don’t. The reason you don’t is that your time is more valuably used producing other things, some of which you sell, and using some of the proceeds to pay the cleaner.

Moreover, think about the word “dependence.” The image the word creates is of a poor, helpless waif. I picture Oliver Twist in the musical *Oliver*, who after eating a meager amount of food, says, “Please, sir, I want some more.” But U.S. consumers of oil are not poor, helpless waifs seeking the good will of oil-producing nations that are giving us oil out of kindness. Rather, they *sell* us the oil. We “need” the oil and they “need” the money. To the extent that dependence exists, it is

mutual. International trade in oil is just that: trade. Since both sides gain from trade, each is therefore “dependent” on the other. Producers of oil are dependent on the dollars, euros, and yen that buy the oil. This fact is commonly recognized when the topic is U.S. exports; many Americans worry that we don’t export enough because they want our exporters to earn money from people in other countries. In other words, they see that our exporters need the dollars, yen, and euros that they earn on their exports. But, somehow, they fail to see that this is true of foreign exporters too.

Exporters in the Middle East, Venezuela, and Canada need the income from exporting oil. “Dependence on foreign oil,” because it is so one-sidedly misleading, is a term that belongs in the dustbin of history.

But isn’t it important to avoid depending on oil when so much of it is produced in the politically unstable Middle East? It would be nice if the Middle East were less unstable. But whoever is in charge of the oil wants to produce it to make money. So, it matters little, from the viewpoint of oil supply, which particular tyrant runs which particular oil-producing country.

Dependence and Government Ownership

It is true, and troublesome, that the world oil industry is largely a government-run industry with all the problems that accompany government enterprise—high cost, slow reaction times, little innovation, and so on. And it would be nice if governments in Saudi Arabia, Iran, the United Arab Emirates, Venezuela, Britain, Norway, and Canada denationalized their oil supplies. But until that happens, it's still better to pay the lower price that producers in the world market charge rather than the higher price that would result from "independence."

Some people worry that a government in a major oil-producing country—Saudi Arabia, for example—might get upset at the U.S. government and take it out on Americans by refusing to sell us oil. But such a selective embargo is bound to fail. Imagine that Saudi Arabia cuts oil exports to the United States, but maintains total exports. Then it must sell these suddenly freed-up oil supplies somewhere else. Let's say that it ships the additional oil to buyers in China. Then those buyers will want to buy that much less oil from their old suppliers. Presto! The American buyers' problems are solved because they can get this oil.

In short, when the government of one country tries to selectively target people in another country, but still wishes to maintain output, it cannot succeed. The selective "oil weapon" is a dud. It's like a game of musical chairs with the same number of chairs as players. The game would be awfully boring, which is why it is not played that way. But in the case of international trade, boring is good.

Of course, the Saudis could hurt the United States by cutting exports in total. But then the Saudis would hurt all oil-importing countries, not just Americans. This is in fact what happened in 1973, when the Saudis embargoed the United States and the Netherlands over those two countries' governments' support of Israel. The countries were hurt by the new, much-higher

price of oil. But so was every other oil-importing country. So it is true that a government of an oil-producing country can occasionally get nasty, cut the world supply of oil, and raise the world price. It's also true that if the U.S. government insulated the country from the world oil market by ending imports, it could avoid these occasional price spikes. But the irony is that it would avoid the occasional spike by replacing it with a permanent "spike." Imagine that haircutters unionized and had the occasional strike and that during such strikes the price of a haircut rose to \$30 from its normal \$20. You could avoid the high price by resolving always to cut your own hair, even when the price is \$20. Would that be a good idea?

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Subsidizing Alternative Fuels

Many supporters of "energy independence," instead of arguing for a ban or prohibitive tariffs on oil imports, advocate government subsidies for alternative fuels or for conservation. They seem to think that such policies can create energy independence at a low cost. They are mistaken.

The cost of using these alternatives, if successful in driving oil imports to zero, would actually be quite high. What makes these other policies politically attractive is not that they cost little, but that they hide the cost. A tariff on oil is a tax, and people can see the result of the tax in the price of oil. A subsidy to alternative fuels or to conservation, however, comes from the government's treasury or from some other source and therefore is not visible to more than a small percent of the population. Economist David Loughran and engineer Jonathan Kulick studied the effect of state public utility commissions' policies requiring electric utilities to subsidize their customers' investments in conservation. The subsidies came not from tax revenue, but mainly from higher prices to other customers. Loughran and Kulick found that the cost of the conservation was between 14 and 22 cents per kilowatt-hour. This was a whopping two to three times as expensive as

the energy conserved. (David Loughran and Jonathan Kulick, "Demand Side Management and Energy Efficiency in the United States," *Energy Journal* 25, no. 1 [2004], cited in Jerry Taylor and Peter Van Doren, "Energy," in David R. Henderson, ed., *The Concise Encyclopedia of Economics*.)

"Energy independence" is a bad idea. Every individual understands that it is far better to depend on others for most of what we want rather than trying to do everything for ourselves. This is true whether we're

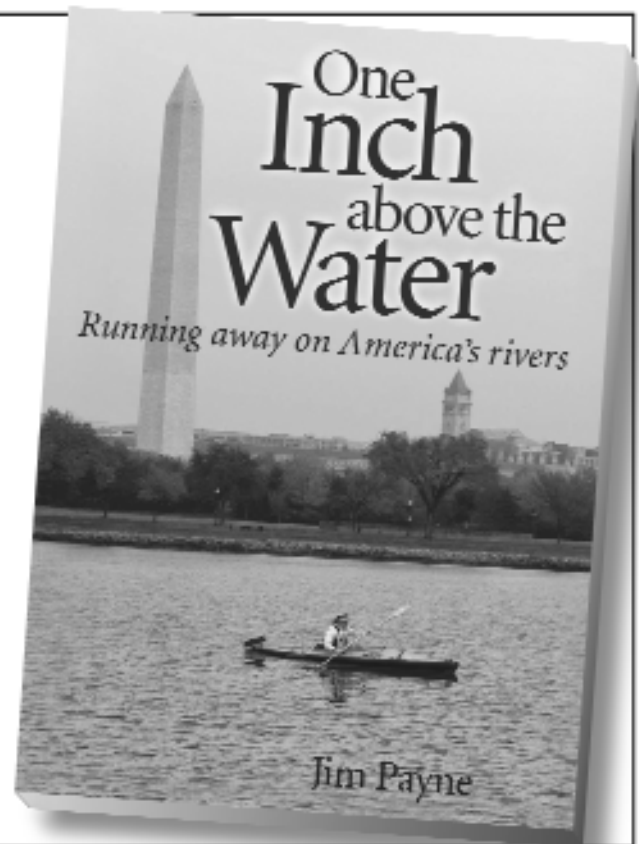
buying oil or haircuts. The principle applies to groups of individuals living in large geographical areas called countries. Moreover, the dependence is mutual. In 1776, Adam Smith wrote in *The Wealth of Nations*, "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner but from their regard for their own self-interest." We can comfortably depend on foreigners for much of our oil because the world's oil suppliers want to make money. 

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