How to End our Dependence on Foreign Oil

Presented by Gary Wolfram at the Free Market Forum
As Part of Panel #2: "Free Markets, Government, and Energy Policy"
Dearborn Inn Marriott
Dearborn, Michigan
October 1, 2010

First, I am taking the contrarian position that we need not reduce our dependence on foreign oil. It is not at all clear that dependence upon foreign oil is in any sense a bad thing.

Adam Smith pointed out in 1776 in *An Inquiry Into the Nature and Causes of the Wealth of Nations* that society is better off when people are allowed to specialize, trading goods that are less expensive for them to produce for goods they find expensive to produce. He pointed out that it was possible to grow grapes in greenhouses in Scotland and produce wine, but it was a very expensive way to make wine. Scottish society would be better off making woolen coats and then trading them to the French for French wine. Then both the Scottish and the French would be better off.

Therefore, if it is less expensive to produce oil in Mexico or Canada then it is for us in the United States, then we should make financial services or some other goods or services and swap them for oil. To artificially limit our importation of oil from other countries would be as silly as requiring that we be self-sufficient in any other product.

The media and politicians give the impression that a major share of our oil comes from unstable countries, but by far the largest source of our imported oil is Canada, followed by Mexico. Canada surpassed Saudi Arabia as our largest source of imported oil in 2004. It has accounted for 40% of the growth in crude oil imports since 1990. In July of 2010 in millions of barrels per day, our largest imports were:

Canada 79
Mexico 40
Nigeria 36
Venezuela 34
Saudi Arabia 32.

Out of the 390 million barrels we imported in July of 2010, 162 million came from Canada, Mexico, the UK, and Saudi Arabia. That month the US had on hand one trillion barrels in reserves, with 726 million in the strategic oil reserve and the remainder is in storage tanks and pipelines.

Canada is a stable country with secure transmission lines to the US. The Athabasca oil sands in Alberta contains more than 175 billion barrels of oil that can be recovered with current technology and 315 billion that are recoverable with new technologies currently being developed. For comparison, the entire Middle East has about 685 billion barrels. Even if countries from whom we import are not friendly to the US, such as Venezuela, they depend upon us to earn the income that keeps the government in power.

The real issue is how we can develop a sustainable, stable, and efficient production of oil in the US. First, we must recognize that oil and gas usage is not going away. The US Energy Information

Administration estimates that world-wide demand for liquid fuels, primarily oil, will increase by 25% by 2030, with natural gas increasing 47% and coal by 49%.

Biofuels are not a viable source of meeting this increase in demand. Biofuels currently make up about 2% of world-wide liquid fuel production and there is not the capacity to increase this to any reasonable scale in the next two decades. Ethanol subsidies are great for increasing the demand for corn, but are a very inefficient mechanism to produce more gasoline. If corn-based ethanol were an efficient way to produce gasoline then we wouldn't have to subsidize if by 45 cents per gallon of refined ethanol blended in gasoline. If the ethanol program were really about substituting ethanol for gasoline then we would not be taxing ethanol from Brazilian sugar cane at 54 cents per gallon.

So we needn't artificially reduce our reliance on foreign oil, and government subsidization and taxation to create a biofuels industry not only wastes resources, making us poorer, but it distorts all sorts of markets that are related to corn, such as tortillas in Mexico.

We also shouldn't undertake policies to artificially reduce domestic production of oil. First, we shouldn't raise taxes on the oil industry as President Obama has been calling for. He has attempted to increase oil industry taxes by $80 billion in his budget. Taxing the oil industry must increase the cost of production, reducing the supply of domestic oil. This will lead to a reduction in production and employment an industry that makes up about 7% of GDP and employs 9.2 million workers. It will also have the unintended consequence of increasing prices and reducing output and employment in a myriad of industries, since oil enters the production process from many different angles.

The oil and gas industry already pays more in taxes than the rest of the S&P 500. As a percentage of earnings, oil and gas pays 48% while the rest of the S&P is 28%. Exxon Mobil alone paid more in taxes than it earned in the period 2004 to 2009.

We should reduce or end the restriction on shallow and deep water drilling. Five of the 33 oil rigs in the Gulf have already left for other countries. The Deepwater Horizon blowout was clearly a very large "negative externality" in economic terms, but proper liability laws and some state of the art technology requirements will be sufficient to address the problem. There are risks involved in any energy production, but the costs of not drilling in terms of lost US output are substantial.

While major oil spills are spectacular, 62% of the oil in the US water is from natural seepage, 33% from shipping, 4% from oil tankers and pipelines and 1% from drilling. The US Coast Guard estimates the average annual oil spill declined from 2.5 million gallons from the 1980-84 time period to 12 thousand gallons in the period 2000-2004.

We should eliminate the threat of cap and trade legislation. An artificial market in carbon credits will be very difficult to monitor for fraud as Europeans are finding out. It really is a tax on fossil fuels with all of the attendant increased costs of production that this involves.

In order to protect the environment we need to create certainty in taxation and regulation in order to allow for new technologies to protect the environment, the same way that markets develop improvements in any other good.

Advances in drilling technology and production technology will lead to greater oil reserves. For example, in North Dakota and Montana the USGS estimates the Bakken formation has between 3 and 4.3 billion

barrels of technologically recoverable oil, 25 times the 1995 estimate, and larger than the current assessment of the rest of the lower 48 states.

In summary, we should focus on increasing the efficiency of oil production rather than artificially limiting imports of foreign oil. We can do this by not increasing taxes on the oil industry, putting to rest the threat of cap and trade legislation, eliminating subsidies for ethanol production and refining, keeping regulation within economically efficient bounds, and creating certainty in the rules of the game so market innovation can lead to increased productivity and the economic growth that will allow us to afford a cleaner environment.