Should We Confront Our Oil Addiction?

By: Andrew Brod

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Article:

In his State of the Union address last month, President Bush announced that "America is addicted to oil." To some this was a remarkable statement given the president's experience and connections to the oil industry. To others it signaled the start of a new era in which the U.S. will reduce its dependence on oil.

The president outlined a program that he claimed will end the addiction, focusing mostly on government subsidies of new fuel technologies. As I noted a few weeks ago on this page, such measures are unlikely to end our oil addiction any time soon, because new technologies don't grow on trees. Of course we should invest in research and development, but the results can be unpredictable and far in the future. (Never mind that non-military R&D has actually fared poorly under this president.)

The president invoked the concept of addiction because it causes a visceral and negative reaction in most Americans. Addiction is bad, isn't it? But perhaps we should pause a moment before rushing to heed the president's clarion call to action. Ending an addiction sounds good, but *should* we end our oil addiction? Or put differently, should we do anything about it? And if we should, do we want a quick transition, as the president's urgent language suggests?

To get a handle on this, let's think briefly about addiction. In economics, an addictive good is one that is believed by its consumers to have very few substitutes. To a smoker, there's little that can replace a good cigarette. Similarly, my unwillingness to eat any dessert that doesn't involve chocolate comes close to an addiction, though it's a relatively harmless one. In effect, the lack of viable substitutes for oil indicates that the American economy is addicted to it.

However, not even addiction is immune to the influence of price. Studies have shown that smokers and other addicts respond to price changes. When the price of an addictive good rises, even an addict looks to find substitutes and reduce consumption. The reduction is smaller than for a non-addict, but there's still a reduction. If this applies to tobacco-addicted smokers, it applies to an oil-addicted economy.

So rising oil prices can be instrumental in ending our oil addiction. But let's return to the question of whether we should be acting to end it. One way to think about this is to ask whether oil is more like chocolate or tobacco. If oil is more like tobacco, then our consumption of it is a dependency whose harm to us will be direct and identifiable. Such a dependency is best ended quickly. But if it's more like chocolate, then the situation is somewhat less ominous and will eventually disappear as the price of oil continues to rise.

Most oil-is-like-tobacco arguments (such as the State of the Union speech) rest on the fact that many international oil suppliers are based in unstable parts of the world, and a few of them appear not to like us. But addicted or not, we're actually in better shape than most of the big oil producers, whose economies are nearly one-dimensional. In other words, Saudi Arabia is more addicted to the sale of oil than we are to the purchase of it.

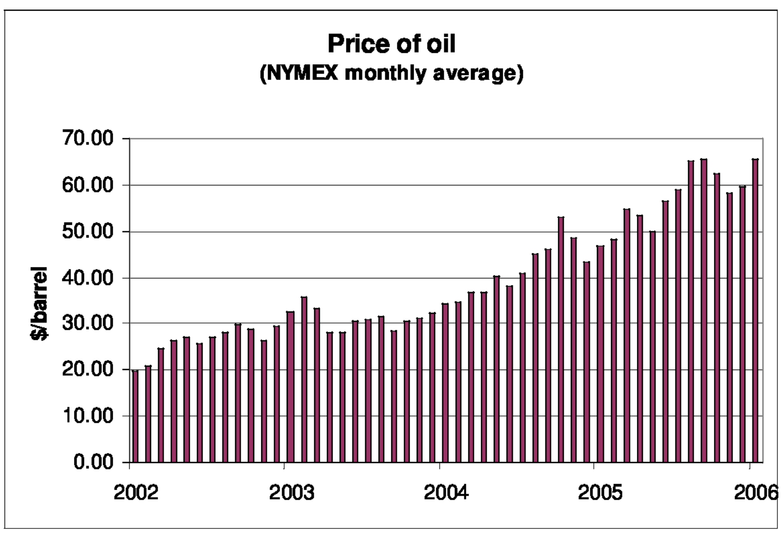
Moreover, just like money flowing out of the state's Highway Trust Fund, international oil is a fungible commodity. Suppose our friends in Venezuela or Iran were to embargo their shipments to us. Oil and gasoline prices would rise and people would be spooked. But other suppliers would be more than happy to step in, and the crisis would be weathered.

Of course, if huge swaths of productive capacity were wiped out by war or some other calamity in the Middle East, then the overall supply of oil would fall. Even then, however, the economic impact is unlikely to be so calamitous. Since 1981, when the U.S. deregulated oil prices, the American economy has shown great flexibility in the face of changing prices (more than you'd expect from an addict!). In case you've forgotten, gasoline and other fuel prices shot through the roof just last fall, and yet the economy barely skipped a beat. We didn't like what we saw at the gas pump, but for the most part we continued on our merry economic way.

So if you ask me, oil is more like chocolate than tobacco. Oil is a relatively (but not completely) benign habit that the American economy is perhaps now overdoing. Yes, the U.S. consumes a quarter of the world's oil production while accounting for less than 5 percent of its population. But that isn't because of moral bankruptcy or a lack of willpower. It's because of the American economy's strength and oil's relative cheapness.

However, the era of cheap oil is probably over. As the accompanying diagram shows, oil prices have risen steadily since the end of 2001, caused primarily by the increasing thirst for oil by emerging economies like China and India. Their emergence is not going to reverse itself, so while prices in the future may not rise as fast as in the last four years, they're unlikely to fall.

Not only will rising prices eventually end our oil addiction, but their steady and gradual nature means they won't inflict the sharp pain that would result from an abrupt increase in the tax on oil (which is what many commentators are recommending). For good or ill, cheap oil led us to the technologies we now employ, from our SUVs to our power plants. We need time to adjust to the new era of fuel prices, and the gradual increases allow that.



Not everyone is applauding high prices. Some commentators, such as *New York Times* columnist Thomas Friedman, are concerned about geopolitical implications. In particular they fear that $60 oil will embolden rogue states like Iran to make mischief. And a nuclear Iran is indeed a scary thought. But Iran should be more frightened of $60 oil than we are. The longer oil remains expensive, the more likely we are to innovate and substitute, and in the long run that's bad news for Iran.

So if we want to end our oil addiction *and* avoid sending the economy into a tailspin, let's... do nothing. Let the price system work. Some tax breaks might make sense, but many (including the massive ethanol subsidies) are boondoggles. And can we finally stop subsidizing SUVs so much?

I don’t want the government to retreat from this issue. It has an important role to play in promoting research in new fuel technologies, but it’s a role that can be overplayed. In a world of rising oil prices, businesses and consumers already have an incentive to find alternative fuels. They don’t need the government to do it for them any more than they need the government to find them a substitute for chocolate.