

BACON'S REBELLION

The Op/Ed Page for Virginia's New Economy

Coping with \$60-per-Barrel Oil

Sen. John Watkins wants to devise a long-term energy plan for Virginia. Let's hope that plan includes for free markets, micro-power, conservation and land use reforms.

By James A. Bacon

I'm not one of those self-flagellators who think Americans are "plundering" the planet because we, with only five percent of the world's population, consume 25 percent of the world's energy. I don't see anything *morally* wrong with being the energy fat boy on the global block. With oil selling at \$60 a barrel these days, our massive appetite for energy props up the economies of a lot of other countries. You want to see misery in the world? Just imagine what would happen if Americans suddenly stopped buying all that oil and natural gas from other countries!

My objection to our energy-extravagant ways are purely pragmatic. Energy dependence on foreign countries sucks a lot of wealth out of ours. Every barrel of oil we import represents \$60 shipped to Mexico, Venezuela or Saudi Arabia and not spent here at home. The Mexicans, Venezuelans and Saudis may be buying some American products and services in return, but they're not buying \$60 worth.

That's why I'm heartened to see that Virginia's state senate is thinking seriously about Virginia's energy future. Sen. John Watkins, R-Powhatan, has been appointed to lead the develop-

ment of a "long-term energy policy" for the General Assembly's consideration.

Virginia could benefit from the right kind of long-term energy policy. Virginians spend billions of dollars a year on oil, natural gas, electricity and other forms of energy. Helping keep energy prices stable and affordable will do more to protect our living



standards than most things that state and local government can do. However, the *wrong* kind of energy policy could well make difficult matters worse. There's a lot at stake.

Judging by an op-ed piece he published in the *Richmond Times-Dispatch* Sunday, Watkins is focusing on natural gas -- a legitimate area of concern. In 2004, he notes, Virginians consumed 272 billion cubic feet of natural gas. With the price of gas doubling over the past year, the spike in price will suck roughly \$1 billion a year out of our wallets.

By knocking out Gulf Coast gas wells and pipelines, Hurricane Katrina demonstrated Virginia's vulnerability to short-term supply disruptions. But the spike in natural gas prices reflects long-term imbalances between demand and supply that have been building for years, Watkins says.

Virginia has been expanding its electric generating capacity largely through the addition of midsized, gas-fired power plants, adding to the demand for natural gas faster than natural gas producers across the U.S. have been able to increase supply. Watkins recommends importing natural gas from abroad through Liquefied Natural Gas terminals, specialized facilities equipped to handle natural gas in liquid form.

Says Watkins: "The addition of a major LNG terminal ... would provide the Commonwealth with long-term energy stability and economic development resulting from a clean and reliable energy source. We would also gain natural gas supply diversity to provide price competition and serve as a cushion against future disruptions in the Gulf of Mexico."

Importing more natural gas is all fine and well: It's better to gain access to imported gas than not to have access any gas at all. But it's hard to work up enthusiasm for a policy that would increase Virginia's dependence upon foreign energy supplies. At the end of the day, we'd wind up siphoning more dollars from Virginia's economy to other countries.

Ideally, I would like to see a state energy policy that encouraged production of energy locally or, better yet, conservation of energy. Both approaches would provide income to local businesses and jobs to Virginians.

At the same time, I am very

aware how easy it is for government policy to go astray when it tries to influence economic activity. It is vital, I would suggest, that any energy policy follow the following principles.

- **Don't mess with prices.** The price mechanism is a remarkable thing: Rising prices encourage people to conserve energy or find substitutes, thus putting a damper on demand. Higher prices also send a signal to entrepreneurs, who will endeavor to find new supplies or new conservation techniques and it puts money in their pockets to fund those efforts. By short-circuiting price mechanisms, government generally succeeds only in creating more scarcity and causing more hardship.

- **Don't pick winners and losers.** The state should not get into the business of encouraging one competing fuel or technology over another. Different fuels and technologies develop constituencies that begin lobbying for support. Government winds up making decisions not on the basis of objective facts and analysis but upon who has the best team of lobbyists.

- **Don't grant subsidies, don't hand out tax incentives.** Fuels and technologies need to compete on their own merits. Subsidies and tax breaks come at the expense of the taxpayer. In other words, the government simply robs Peter to pay Paul. Inevitably, Paul is the guy with the better lobbyists and bigger Political Action Committees.

Biodiesel fuels are a case in point. In addressing the Virginia

Farm Bureau in September, gubernatorial candidate Tim Kaine noted that biodiesel fuel, which can be distilled from locally grown soy beans, is a renewable, environmentally friendly fuel that can substitute for as much as 20 percent of diesel fuel in the gas tank. Increased consumption of biodiesel fuel would increase incomes for Virginia soy bean farmers and create business opportunities for entrepreneurs to extract the fuel from the beans and distribute it.

It sounds like a win-win, especially for Virginia's hard-pressed agricultural sector. But there's no way that government can know for sure that it will be. If the economics are sound, the private sector will make it happen without tax incentives. If it turns out that biodiesel enthusiasts are hyping the potential and underestimating the obstacles, the state could get stuck with a tax credit that drains resources from the treasury. If there's one thing that's certain, it's that once a tax break is enacted, the farm lobby and the newly created soy bean-distillery lobby will move heaven and earth to protect their perk forever. The beneficiaries of a tax credit will always have more to gain by defending it than members of the general public will have to gain by getting rid of it.

If the state shouldn't pick winners or losers, shouldn't grant subsidies and shouldn't hand out tax incentives, what *can* it do? Here are some appropriate roles. The state can act as:

- **Information broker and catalyst.** The state can take the lead in publicizing new opportunities, organizing conferences, and bringing together private-sector players in the hope of igniting something worthwhile.

- **Early adopter.** If the state wants to encourage, say, the production of biodiesel fuels, it can legitimately, in one of Tim Kaine's better ideas, begin buying the fuel for its own automobile fleet. As an early adopter, the state can demonstrate the value of the fuel and take out a lot of the risk for private sector consumers.

- **Regulation buster.** If Virginia wants to host a LNG facility, it can take the lead in identifying a potential site for the facility, clearing regulatory hurdles and soliciting potential investors. More broadly, energy requires a large infrastructure to support it -- oil and gas pipelines, storage tanks, power plants, electric transmission lines and so on. These facilities require lengthy permitting processes and, typically, public hearings. The state can help by streamlining those processes, shortening the lead time and ameliorating some of the risk for investors.

Another example: Dominion has indicated an interest in some day expanding adding more nuclear units to its power-generating facilities at Surry and South Anna. If the state chooses to encourage the production of more nuclear energy, it should convene with Dominion to identify all potential regulatory hurdles that the power company must go through, and then begin diligently crunching through the necessary permits and reviews. If there are concerns about the storage and disposal of nuclear waste, the state can act aggressively to address them -- perhaps even proactively drafting new laws and regulations that will satisfy safety and environmental inter-

ests.

At the other end of the spectrum from massive, multi-billion dollar nuclear plants, there is growing interest in micro power sources -- solar power, windmills, biomass and micro-turbines operating at the level of individual farms, businesses and households. There are many advantages to promoting small-scale production capacity. Solar energy and micro-turbines running on waste heat are green -- they don't pollute. Furthermore, advocates argue, an energy system built on widely distributed but small energy sources, is less vulnerable to power outages from failure at a single point. Remember the blackouts a few summers ago?

Any long-term energy policy in Virginia should explore how to encourage the spread of these micro-energy sources -- short of subsidies or tax credits. Among the critical issues: how to tie these mini power sources into the larger power grid. One big step that could improve the economics of micro-power is empowering households and small businesses to sell excess capacity to the electric power distributor. Power companies are less than eager to deal with a multitude of little guys, who may or may not prove to be reliable energy sources over the long run. Without regulatory clarity, this energy option will never take off. Providing that clarity is a legitimate role of the state.

Finally, a long-term state energy policy needs to consider conservation. Economically, a BTU saved through conservation is as worthwhile as a BTU generated. From an environmental perspective, a BTU saved is better -- a BTU saved does not pollute.

A no-brainer for the state is to

accelerate the adoption of conservation measures at its own buildings and facilities. Private sector businesses typically show a three to four year payback on investment in automated building systems that fine-tune the performance of HVAC systems and lights. As part of the ongoing management of its own office properties, the Commonwealth needs to look for opportunities to hold down its utility costs through such conservation measures.

The most spectacular opportunity for conservation, however, will require major institutional change: the scattered, disconnected and low-density pattern of land use. Over the past 50 years, state and local policies have colluded to create an auto-centric society in which every citizen needs an automobile to participate. Furthermore, the increasing scatteration of housing, offices and stores means that people must drive farther -- and consume more gasoline. On average, Virginians were driving 70 percent more miles per year in 2001 than they were in 1980. Over the years, Virginians have become more vulnerable, not less, to surges in the price of gasoline.

Mr. Watkins' energy task force can't do much to influence the supply of gasoline in Virginia, but it can certainly influence the *demand* for gasoline by initiating fundamental change in human settlement patterns. While preserving the freedom of people to live where they want -- as long as they pay the full cost of providing government services to those locations -- Virginia's state and local governments need to rethink their zoning codes, comprehensive plans and allocation of highway construction dollars. Virginia needs to evolve to a pattern of development that (1) emphasizes in-fill and redevelop-

ment over extending development farther into the rural hinterlands, (2) permits jobs, housing and retail to reside in closer physical proximity to each other, thus cutting down on the length of trips, and (3) incorporates urban design standards that create inviting places for people to walk, ride bikes or avail themselves of mass transit.

According to the Department of Motor Vehicles, Virginians consumed more than 5 billion gallons of gasoline in 2003, the most recent year for which figures are available. At today's prices, we're paying more than \$12 billion a year at the gas pump, and shipping maybe half that sum to foreign oil producers. Conserving energy through more rational human settlement patterns could save Virginia consumers literally billions of dollars a year -- and keep billions of dollars circulating in the local economy.

That, I would submit, is a goal every bit as worthy as Sen. Watkins' plan to diversify our natural gas supply. Let us hope that the good senator takes a broad-minded view of what constitutes energy policy.

— **October 31, 2005**

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