The Political Implications of America's Oil & Gas Boom, Part 1

As we begin a new year, we wanted to take a look at the current energy landscape, and see what the future holds for the global economy, America's oil and gas boom, whether renewables will continue to be a favorite amongst investors, and whether we should be focusing more attention on conservation and energy efficiency rather than our continuous effort to increase supply.

To help us look at these issues and more, we managed to speak with the well-known economist James Kwak. Kwak is an associate professor at the University of Connecticut School of Law. He blogs at The Baseline Scenario [1], which he co-founded with Simon Johnson. Simon and Kwak have also written two books: 13 Bankers [2] and, more recently, White House Burning: The Founding Fathers, Our National Debt, and Why It Matters To You [3]. In a previous career, Kwak worked as a management consultant and co-founded a successful software company. You can follow him at @JamesYKwak [4].

James Stafford: What changes do you see happening to the domestic energy landscape in Obama's second term?

James Kwak: The biggest trend is obviously the domestic boom in shale gas and oil, and hence the biggest question is what will happen to it. Frankly, I don't see anything happening to change the current trend. Plentiful fossil fuels do have obvious short-term economic benefits that the Obama administration is not blind to. Insofar as the administration wants to reduce fossil fuel consumption — and it's not clear that they do want to — there is enough opposition, both in Congress and in the courts, to justify a policy of doing nothing.

James Stafford: What are your thoughts on America's oil and gas boom?

James Kwak: There are some obvious benefits. Lower dependence on politically unstable parts of the world is clearly good. Shifting electricity production from coal to natural gas is also good. One can also come up with a plausible scenario in which plentiful natural gas buys us the time necessary to shift toward greater usage of renewable energy sources.

On the downside, I worry about the political implications of the boom. Increased

domestic production will encourage politicians to declare victory on the energy front without doing anything about the big, long-term problem: climate change. Before, fears of rising energy prices and dependence on the Middle East were encouraging political investment in renewables and conservation. Now the message from ExxonMobil and its allies will be that we don't need to do anything because we are a (net) energy exporter and energy is cheap. That will further reduce the chances that we do anything meaningful about climate change.

James Stafford: What do you see happening to the U.S. and global economies in 2013?

James Kwak: I'm modestly positive about the U.S., but that's not because of any particular insight. It's because I read *Calculated Risk*, and because the housing market is turning around.

James Stafford: Obama has made clear his desires to cut the $4 billion a year tax breaks given to oil companies. What affect do you believe this would have on the U.S. economy and the U.S. oil industry?

James Kwak: I find it hard to imagine this would have a big impact on anything. $4 billion is simply not a lot of money for the energy industry (something like a few weeks' operating profit for ExxonMobil), and even assuming they pass it on to businesses and consumers, that's not a lot of money for the U.S. economy. At the same time, it won't do much to cut the deficit. But it's still a good idea simply to get rid of economic distortions.

James Stafford: What is the relationship between energy and the economy? Is cheap energy vital for economic growth?

James Kwak: I don't see why, as a logical matter, you need cheap energy to have economic growth. My background is in software, for example, and energy inputs were just not an important part of our cost structure. We sold software to insurance companies, and their ability to pay for our software was not constrained by higher energy prices, since they weren't a big part of their cost structure either. Cheap energy can certainly change the type of economic growth you have, and maybe it can increase growth, all other things being equal, but I don't think it's a prerequisite.

James Stafford: At this moment in time, natural gas extraction is cheap — which is leading people to say coal is finished. Is it too soon to predict this — as natural gas prices can't stay depressed forever?

James Kwak: I think it's always too soon to make this kind of prediction. People thought wood was finished in England sometime in the eighteenth century, and now other people are talking about biomass (which hopefully won't make a comeback, but does have its supporters). Coal may not be economically viable now, but as energy prices rise in the future, it could become viable again, and maybe someone will figure out a way to use it "cleanly."

James Stafford: Advances in renewable energy technology are slow and expensive. Do you see renewables making a meaningful contribution to global energy production? And if so, over what time period?

James Kwak: Renewables can and must make a meaningful contribution to global energy production, or else much of our coastline will be under water in a century. But I think we're talking about a few decades here, not a few years. The problem is that, behaviorally, we find it very difficult to make choices that seem painful today, and whose benefits are both uncertain in magnitude and far off in the future. Having a dysfunctional political system in the United States and not much better ones in Europe doesn't help. (I'm not saying that China has a good political system, but as an autocracy it is more able to dictate a national energy strategy, whether or not it's the right one.)

James Stafford: With cheap oil running out, do you see Americans changing their driving and energy consumption habits?

James Kwak: Unfortunately, I think Americans' energy consumption habits will shift relatively slowly in response to increases in the price of oil. There are many factors that lock us into our current driving patterns, most notably the physical layout of our cities, suburbs and exurbs. The stickiness of people's living and working arrangements means that we will always be slow to respond to changes in prices.

In addition, there are cultural factors at work here. I imagine many people will continue driving long distances either because they take pleasure in it or because they refuse to change their habits as a matter of pride, despite the economic disincentives.

James Stafford: Peak oil has been finding itself in the press a great deal recently with peak oilers taking quite a bit of flak over the shale boom. What are your thoughts on peak oil?

James Kwak: Peak oil is inherently difficult to predict because it is an economic, not a scientific concept. The rate of oil production will always depend on at least three factors: difficulty of extracting the marginal barrel of oil, difficulty of producing the marginal unit of the alternatives and demand for energy. The more difficult is to produce alternatives and the higher the growth of the overall world economy, the more worthwhile it is to extract the next barrel of oil. These days we should know not to bet against technological progress when there is enough of an economic incentive for it, so peak oil will depend on that incentive.

James Stafford: Economic growth goes hand in hand with carbon emissions. This means that China and India, whose economies are growing quickly, are also the largest polluters. In our global battle against climate change, is it fair to limit the economic growth of developing countries by demanding they keep their emissions below a certain level?

James Kwak: This is a complicated question that ultimately depends on your moral philosophy. The simplest and perhaps most sensible answer is that it doesn't make

sense to deprive people in developing countries of the lifestyle that we enjoy in the United States because of our high energy consumption, and therefore, emissions limits should be roughly the same, per capita, worldwide.

However, you could come up with an alternative argument on utilitarian grounds. If we were to mandate equal emissions levels for everyone, the disutility that Americans would suffer in having to radically change our lifestyles is probably far greater than the utility that people in developing countries would gain, because they would presumably be able to consume more energy than they do today.

The other thing to look at is that it is the people in developing countries who are going to suffer the most from climate change (and are suffering already), whether from coastal flooding or because their agricultural systems are the most vulnerable to climate change. Arguably, they have the most to benefit from global emissions limits, and therefore, should be willing to accept lower limits on energy consumption than in the United States. A deal like that would be "fair" when measured against the likely alternative, but "unfair" in an absolute sense.

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