To Combat Rising Energy Prices, Unleash American Production

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INTRODUCTION

In December 2021, the inflation rate as measured by the Consumer Price Index (CPI) reached 7.0 percent—a 40 year high—about 21 percent of which was due to rising energy prices.[1] Energy prices are most visible in the price that Americans pay at the pump—the average price for a gallon of gas rose by 50 percent in 2021, or approximately $1 per gallon—but these price increases are felt throughout the economy; increasing the cost of heating, electricity generation, travel, and anything that is shipped or trucked. High and rising energy prices place the greatest burden on America's lowest income families.

The sharp rise in oil, gas, and other petroleum product prices has primarily resulted from markets adjusting to pandemic-related disruptions and continued uncertainty in global energy markets. Government policies have likely exacerbated the problem by imposing new barriers to accessing American oil and gas reserves, and by discouraging investment in these historically reliable and inexpensive sources of energy.

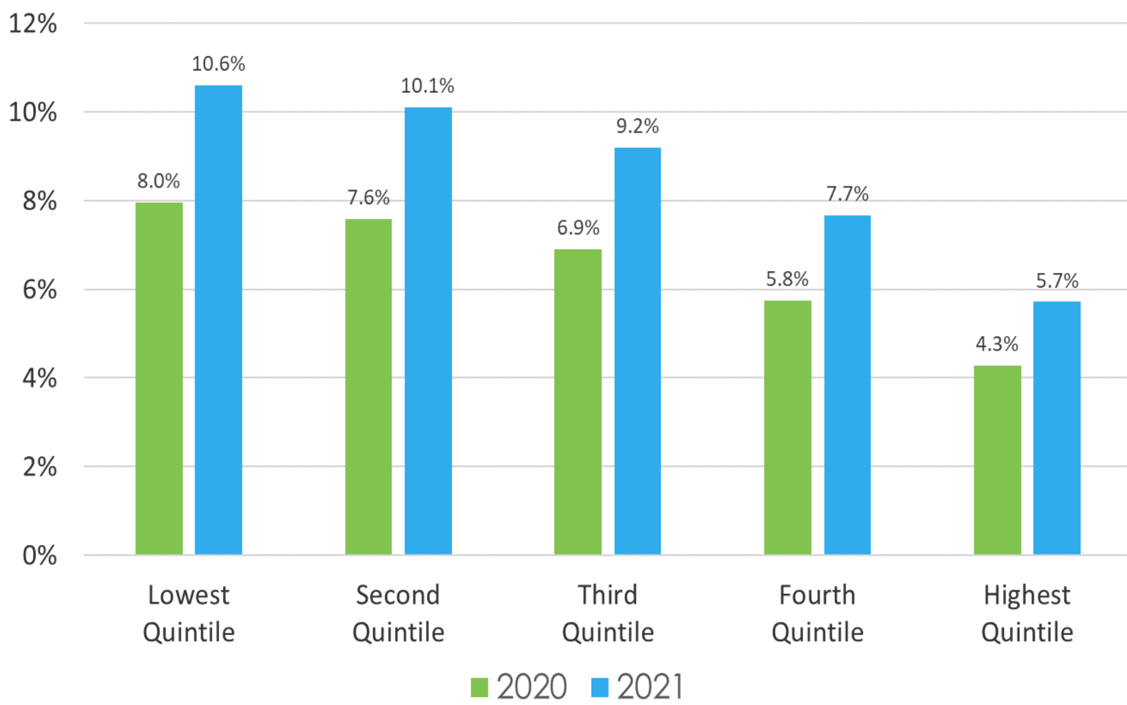
If policymakers want to prevent rising energy prices, they should focus on removing unnecessary barriers to domestic energy production and restoring American companies' confidence to make new investments in traditional energy infrastructure.

LOWEST INCOME AMERICANS WORST HIT BY SOARING ENERGY PRICES

In December 2021, the price of energy (the price paid by households for electricity generation, natural gas, motor fuels, and utility services, among other related functions) increased by 29 percent for the year. This represents the largest one-year increase since 2005. Measured from December 2019, before the pandemic disrupted global markets, energy prices are now 20 percent higher.

Due to these high energy prices, researchers with the Penn-Wharton Budget Model estimate that the average American household spent $1,200 more on energy costs alone in 2021, compared to the previous year.[2] Energy price increases impact the lowest income Americans the most, as they tend to spend a larger share of their incomes on essentials such as household heating and gas for transportation.[3] Rising energy prices increased the amount that households in the lowest income quintile paid by around $760 last year. Figure 1 shows that the lowest income Americans spent about 11 percent of their total expenditures on energy in 2021, up from 8 percent in 2020.

Figure 1: Expenditures on Energy as Percent of Total Expenditures, 2020-2021



Source: JEC analysis using data from the Consumer Expenditure Survey and Penn-Wharton Budget Model.[4]

These estimates understate the full impact of higher energy prices on consumers. Higher gas and electricity prices also increase the costs of most other goods and services, such as the cost of trucks driving produce to market.

Rising energy prices are a significant burden for all American families and hit the lowest income households the hardest.

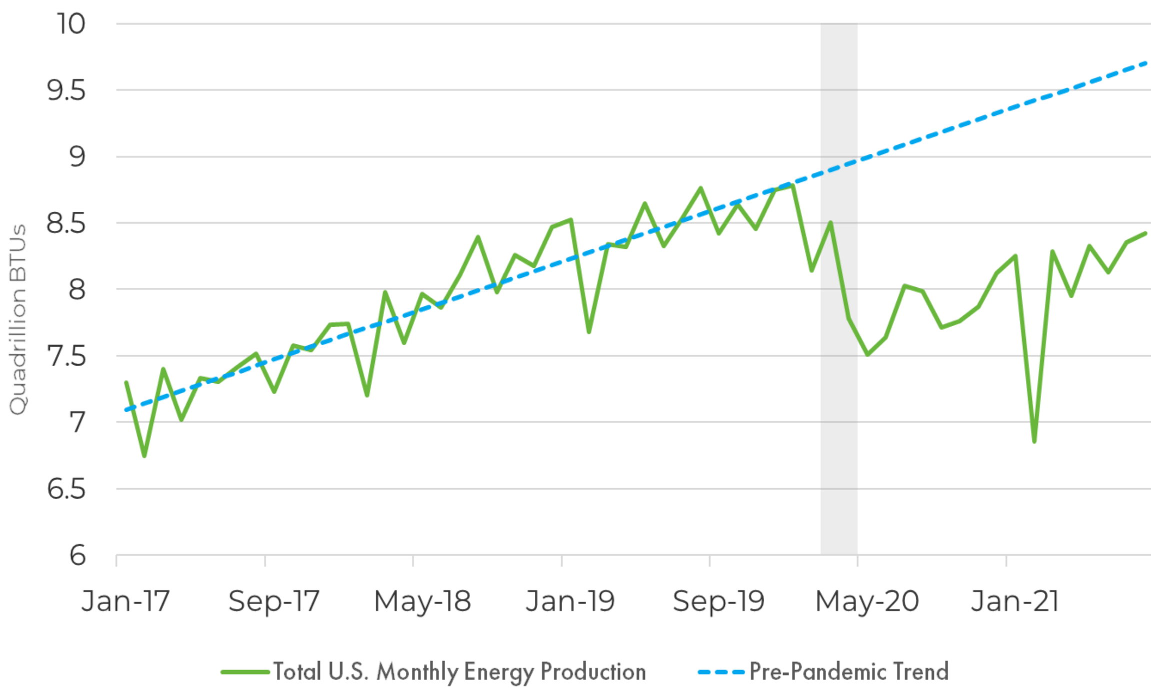
WHY ENERGY PRICES ARE RISING

Like price increases in other areas of the economy, the recent rise in energy prices is largely the result of elevated demand and restricted supply. A faster than expected recovery in demand was boosted even higher by heavy government spending and worsened by government-imposed impediments to increased domestic production.[5]

Domestic trends are reflected on the world stage. The gap between global oil consumption and production increased last year, with consumption outpacing oil production by 2.2 million barrels per day in the third quarter of 2021. The widening global gap between consumption and production has reduced world oil reserves by 342 million barrels over the past three quarters.[6]

Unusual market activity at the beginning of the pandemic helped set the stage for the current mismatch between energy production and consumption. In April 2020, one measure of the expected future price of crude oil turned negative for the first time ever.[7] Taken at face value, this means that producers would have to pay consumers to take oil reserves off their hands. While only a temporary blip in markets, it signaled unprecedented price uncertainty that led U.S. producers—and producers around the world—to shut down production and cancel new investments in expanded capacity. As a result, the number of active oil and gas wells in the U.S. fell to their lowest level on record in the summer of 2020.[8] Since then, demand has more than recovered but production capacity remains well below pre-pandemic levels. Figure 2 shows that U.S. energy production levels remain approximately 13 percent below the pre-pandemic trend.

Figure 2: Energy Production Trends 2017-2021



Source: JEC analysis of Energy Information Administration data.
Notes: Trendline is fitted based on Jan. 2017-Dec. 2019 data. This time period was selected to reflect the trend of recovery for energy production in the U.S. following the 2014-2016 energy crisis. Shaded region indicates a period of recession as defined by the National Bureau of Economic Research.[9]

Complicating matters further, the Organization of the Petroleum Exporting Countries (OPEC)—a cartel of oil-producing countries and its allies that hold approximately 80 percent of the world's known oil reserves—remains reluctant to increase production to pre-pandemic levels following large cuts to production in March 2020. Producers in the U.S. are particularly wary of OPEC's ability to undercut their prices because OPEC producers have some of the lowest marginal production costs in the world.[10] In Saudi Arabia, the average cost to produce and transport a barrel of oil or gas is approximately $9 a barrel, less than half the cost for U.S. producers.[11]

Energy prices are heavily influenced by complicated global dynamics and geopolitics. Producers and investors remain hesitant to quickly expand capacity while uncertainty remains surrounding the course of domestic policy, the possibility of future COVID variants, and the potential for OPEC to unilaterally increase production. Each of the above developments could make domestic investments unprofitable. As a result, energy supply has not kept pace with demand, contributing to rising energy prices.

SUPPLY IS KEY

For energy prices to fall, oil and gas supply must rise to meet global demand. While U.S. oil and gas production are tied to the global market, Congress and the Biden Administration can still take important steps to ease barriers for domestic producers and ensure policy is not adding additional uncertainty and inefficiencies to the energy sector. Some of the Biden Administration's recent actions communicate a desire to increase the supply of oil to meet demand and relieve price pressures. However, a more comprehensive policy agenda by the Biden Administration is simultaneously working to undermine domestic oil and gas production.

The Biden Administration announced in November 2021 that the United States would release 50 million barrels of crude oil from the Strategic Petroleum Reserve (SPR) in coordination with similar actions by other major nations in an attempt to help alleviate supply shortages.[12] The barrels of crude oil released by the U.S. represent only one half of one day's global oil consumption.[13] The move does not address underlying supply issues and was already largely priced in to global markets, with crude oil prices actually rising 3 percent immediately following the announcement.[14]

In addition to the SPR release, the Biden Administration issued an unsuccessful request to OPEC to increase production and submitted a letter to the Federal Trade Commission (FTC) alleging oil and gas companies are purposefully restricting supply to drive up prices.[15] Each of these actions is inadequate. For example, the FTC allegation attempts to blame domestic producers for a price increase driven primarily by global markets.

The Biden Administration has also announced various green energy initiatives, intended to accelerate America's shift to zero-emission energy sources.[16] While these initiatives, if successful, may reduce the impacts of global oil market volatility on domestic energy prices in the long term, policies to accelerate the development of new technologies and adoption of clean energy are unlikely to have a significant effect on energy prices in the near term, and will come at a significant cost.[17] The Biden Administration has focused on increasing alternative sources of energy production while aggressively acting to phase out traditional forms of energy production—at the peril of doing so faster than the new politically preferred sources of energy are able to come online. Traditional fossil fuels accounted for approximately 70 percent of primary energy consumption in the U.S. in 2020. By contrast, nuclear energy production, the single largest source of zero-carbon-emissions energy, remains at about 10 percent of primary energy consumption.[18]

While the Biden Administration seeks to offer preferential treatment to solar, hydrogen, and wind, these and other forms of energy generation are not yet able to serve as an affordable primary source of energy. Instead of passing subsidies and mandates for politically preferred energy sources, policymakers should remove existing regulatory impediments to all sources of energy generation and allow consumer preferences to drive specific energy markets. One example of this type of reform is Senator Mike Lee's UNSHACKLE Act, which streamlines the lengthy environmental review process to ensure the U.S. can continue to develop and maintain critical energy infrastructure, including for renewable energy sources.[19]

BIDEN POLICIES ARE INFLATING PRICES BY HOLDING BACK PRODUCTION

The rest of the Biden Administration's actions seem designed to reduce domestic energy production rather than increase it. One week into his presidency, President Biden issued an executive order establishing a moratorium on leasing federal lands for oil and gas production.[20] President Biden has since called for the re-implementation of an Obama-era rule to require oil and gas producers, processers, and refiners to install expensive technology to detect methane leaks, and in a counterproductive attempt to protect the environment, has begun rolling back any reforms from the Trump Administration that lower costs for energy producers.[21]

The Biden Administration also revoked permits for the Keystone XL Pipeline—a pipeline that would have transported 830,000 barrels of oil a day—proposed fee hikes on domestic energy producers leasing government land, and faces internal pressure to reinstate a misguided ban on oil exports.[22] These and other federal actions would directly and indirectly halt new investments that are critical to expanding domestic supply.

Investors and business leaders make business decisions based on policy actions as well as the political discussion that often precedes policy. The perceived political climate can directly influence forward-looking investment decisions, especially in heavily regulated industries. The Biden Administration has consistently threatened oil and gas producers with new taxes, regulation, and reporting requirements that raise costs for domestic producers. Similarly, Congressional Democrats have gone so far as to propose legislation that bans banks from financing fossil fuel production, to name just one of many similarly targeted proposals.[23]

Washington is sending conflicting messages. Policymakers seem simultaneously concerned about high prices reflecting the weak supply of oil and gas, while aggressively pursuing an agenda designed to entirely phase-out oil and gas from domestic energy production.[24] High levels of policy uncertainty at home can only lead to producers hedging against both global macro uncertainty and unfavorable policy conditions domestically.

New government-imposed costs combined with pandemic-related uncertainty and the threat of OPEC unilaterally increasing production have fostered hesitancy among oil and gas producers that is stalling production.

TO LOWER PRICES, PRIORITIZE AMERICAN ENERGY PRODUCTION

Global energy markets are complex, and prices reflect a multitude of dynamics that are often outside the control of U.S. policymakers. However, without addressing the current barriers imposed by government policies on oil and gas production and maintaining an all-of-the-above approach to addressing America's energy needs, energy prices will remain higher than they would be otherwise. At least on the margin, domestic policy has contributed to the inflationary pressures that are increasing prices and making life more expensive for all Americans. To address the ongoing energy crisis, policymakers should prioritize restoring American energy production.

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ENDNOTES

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