Goings On

CAFE Reforms Could Address Long-Term Oil Consumption, RFF Scholars Testify Before House, Senate

As oil prices climbed throughout the spring and the public looked for relief at the pump as the summer travel season approached, RFF President Phil Sharp and Senior Fellow Billy Pizer were called before a May 3 House Energy and Commerce Committee hearing to testify on how reforming the Corporate Average Fuel Economy (CAFE) standards might affect the issue. The following week, Sharp appeared before the Senate Committee on Commerce, Science, and Transportation's Subcommittee on Surface Transportation and Merchant Marine to discuss the same subject.

"CAFE has been a very imperfect, but important, policy in dealing with fuel consumption," Sharp testified. "The [National Academy of Science's CAFE review panel] concluded, in 2002, that our oil imports would have been 2.8 million barrels a day higher had the policy not existed. That said, the academy report outlines possible reforms that could improve the standards."

Sharp was careful to note that while reforming CAFE standards could have many benefits, reducing gasoline prices is not among them.

"Action now by Congress on fuel economy standards obviously will have no immediate impact on gasoline prices. Indeed, it will take some years for changes in the policy to have any

impact at all," he said. "But action now on fuel economy standards can help the United States address important concerns over the longer term."

However, he noted that high gasoline prices and uncertainty about the future of the oil market have increased attention to fuel efficiency and alternative fuels. This presents Congress with a rare opportunity to act on a contentious issue. "After 20 years of stalemate on fuel economy issues," he said, "we finally have a moment where change is possible."

Pizer outlined for the committee opportunities to reform CAFE standards for passenger cars in light of recent reforms to the light truck standards.

"The light-truck rule provides a model for two improvements: differentiating manufacturers' standards based on their mix of large and small vehicles, and setting the overall level of the standards based on an explicit and careful cost-benefit analysis," he said.

"Further reforms include trading between the passenger-car and light-truck fleets, trading among manufacturers, unrestricted banking of CAFE credits earned by exceeding the standard, and a cost-limiting safety valve."

The hearings came as the National Highway Transportation and Safety Administration (NHTSA) called on Congress to grant it the authority to make changes to passenger-vehicle standards. Bills that would allow NHTSA to do so are pending in both the House and the Senate, and Pizer and Sharp both remarked that delegating target setting and redesign to NHTSA made sense.

"I find the complexity of the standard-setting process, as well as the need to regularly revisit the level of the standard, to be more suitable for agency rulemaking than Congressional action," Pizer stated. "Congress can instead reform the structure of CAFE to increase efficiency, continue to give NHTSA clear guidance on the key costs and benefits it should consider, and perhaps require greater transparency with regard to the cost modeling."

Sharp also noted that policymakers might want to look beyond CAFE for ways to reduce fuel consumption.

"Many experts believe that a more effective approach to reducing fuel consumption—and a more cost-effective approach for the U.S. economy—would be a stronger gasoline or oil tax, either as an alternative to CAFE or in conjunction with it," he said. "The impact would not only encourage consumers to purchase more efficient vehicles, but it would also encourage them to be more economical in their driving, a critical component that CAFE does nothing to address. Indeed, such a tax would have a more rapid impact on consumption than is possible through CAFE alone." ■

How Do International Crises Affect Trade in Oil?

Robert J. Weiner

Recurring oil crises in recent decades have sparked much of the concern and debate regarding energy policy among government and industry officials, the media, and the public. From the energy instabilities and oil embargo of the early 1970s through today's high oil prices and conflict in the Middle East, oil shocks have been a dramatic feature of the international economic landscape.

These shocks have been followed by recessions in the United States and other industrialized nations, as well as oil-importing developing countries. In his 2006 State of the Union Address, President Bush pronounced America "addicted to oil" and conceded that oil as an energy source is prone to volatility and supply disruptions.

One of the most significant oil shocks occurred after Iraq invaded Kuwait in 1990. The invasion touched off an economic, financial, diplomatic, and military crisis, triggering a tremendous spike in oil prices and recession in Organisation for Economic Co-operation and Development and oil-importing developing countries. But was the Gulf Crisis really a market disruption? Did it tear the fabric of trade in the world oil market?

To answer this question, I decided to study the changing role of international trade intermediaries—often referred to as trading companies—in the oil market during the Gulf War. My research shows that the crisis diminished the role that intermediaries played in petroleum sales—both during the crisis and after.

Intermediaries work as middlemen, connecting buyers and sellers in international trade and serving as the glue that holds many commodity markets together. Along with national oil companies, these intermediaries have come to complement (and in some cases replace) the so-called Seven

Sisters—the corporate energy giants that dominated international oil trade from the 1920s until the early 1970s. But although they have attracted harsh scrutiny from policymakers for their role in the United Nations' Iraqi Oil-for-Food Program, intermediaries have received limited attention in the research literature.

My research takes advantage of a unique database of individual sales transactions in the Brent market. Produced in the U.K. North Sea, Brent Blend is by far the most widely traded crude oil in the international market. The database is unusual in that it identifies the terms of each crude oil transaction, as well as the buyer and seller of each cargo traded, whereas terms of individual transactions are not typically available to researchers, despite their enormous size.

This database is generated by a daily trade-press survey of oil traders. Participants in the Brent market are diverse, with the largest traders falling into two categories. The first comprises oil companies, including the majors (Exxon, BP, Shell, etc.), other integrated petroleum companies, producers, refiners, and national oil companies. The second category comprises financial houses and trading companies—Wall Street banks, commodity traders, and Japanese general trading companies. This diversity provides an opportunity to test hypotheses regarding behavioral differences across types of companies before, during, and after the crisis.

The evidence makes it clear that the Gulf Crisis indeed affected patterns of oil trade. These patterns changed significantly during the crisis, with intermediaries playing a smaller role than before in serving as counterparties to the large oil companies that produce and refine the commodity. Moreover, although the crisis ended as abruptly as it had begun, and oil prices declined sharply to pre-crisis levels, the previous status quo was not restored. One possible explanation is that lightly capitalized trading companies were seen as less creditworthy after the crisis than before.

Intermediaries continue to be important in world oil trade, notwithstanding predictions of their demise as a result of improved information systems. Some intermediaries have entered upstream or downstream segments of the industry; the reason for others' survival is hard to pinpoint, given the paucity of data. The dominant role played by trading companies as purchasers of Iraq's oil exports during the UN Oil-for-Food Program suggests the usefulness of ongoing research into their role and behavior in international oil trade. ■

Adding a Public Voice to Investing the "Hot Air" Windfall

Ruth Greenspan Bell and Elena Safirova

One of the more controversial provisions of the Kyoto Protocol gives Russia, Ukraine, and countries in Central and Eastern Europe the right to sell or trade excess emissions credits, which were gained because the protocol set emissions targets at 1990 levels, after which many of these countries' economies (and emissions levels) collapsed.

These fortuitous credits, often referred to by critics as "hot air," are unlikely to have any salutary effect on greenhouse gas reductions because they are not associated with future reductions in emissions. They also represent an enormous windfall: the potential revenue from their sale could amount to billions of dollars.

This revenue presents a singular opportunity to bring about lasting change in Russia, Ukraine, and Central and Eastern European countries. Properly channeled, revenues from excess credits could provide direct support for projects such as curtailing energy consumption and switching to low- or non-carbon energy sources that reduce greenhouse gas emissions, as well as for other environmental efforts. Funding would also help build institutional and human capacity to administer such projects and assure their long-term success.

We are engaged in a joint effort to consider how two countries, Poland and Ukraine, which are holding large quantities of credits, can invest the proceeds in ways that will build their capacity to better manage their greenhouse gas emissions. Our partners are Poland's Institute for Sustainable Development, which is headed by Andrzej Kassenberg, and the Institute for Industrial Ecology, Kiev, Ukraine, with the active participation of Olga Gassan-zade.

Together, we have planned a combination of joint research, formulation of policy alternatives, and dissemination of those options into the policy arena in each country. What is innovative about this plan is the effort to add a public voice and independent policy analysis to ongoing discussions on how the proceeds from these sales might be used to advance environmental protection.

We believe that a public voice is essential to the eventual success of such plans, for at least two reasons. The first is that local experts can provide valuable insight into the institutional capacity and readiness to act in each of their countries. Moreover, local knowledge should be a part of any analysis of investment goals and how these are carried out, and in many cases can help evaluate the credibility of potential investments.

The second reason is that a public voice has value in all situations where potentially huge amounts of money might change hands. Much of the thinking about green investment has taken place within a relatively small community of climate scholars, activists, and government, but the implications are important for a broader swatch of society. A public voice helps assure a more transparent process and open procedures.

An "Expiring" Opportunity

Hot-air credits are technically slated to "expire" at the end of the first Kyoto commitment period, and various procedural issues have yet to be worked out before sales of credits can start. Today it is still unclear how high the demand will be. On the other hand, the credits are a temptation for countries having difficulty meeting their Kyoto targets, and many have expressed a preference for "greened" credits that would effectively link the purchase of credits with investments and activities that reduce greenhouse gas emissions.

Two other Kyoto Protocol flexible mechanisms, the Clean Development Mechanism (CDM) and Joint Implementation (JI), allow participating industrialized countries to invest in emissions-reducing projects in other countries in lieu of reducing their own emissions. However, CDM and JI projects are neither easy nor quick to develop; among other things, they must be certified by special commissions to allow the credits to be transferred.

Experts predict that sales of hot-air credits will pick up as 2012 nears and the pressure to meet Kyoto obligations escalates. If that happens, it will be critical that the countries in Eastern and Central Europe have effective green investment programs in place to make sure that their potential hot air does not vanish into thin air. ■