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ECONOMIC VIEWPOINT

By Gary S. Becker

Let's Make Gasoline Prices Even Higher

We must cut consumption and expand oil reserves. A new gas tax would help

The recent attacks on oil facilities in Saudi Arabia and Iraq are fresh evidence that terrorist destruction of oil output poses a huge threat to the world's recovery from its 2001-03 slowdown. But it is not too late to implement policies that would greatly reduce the world's economic vulnerability to disruption of oil production in the Middle East.

The sharp rise in oil prices during the past year, to more than \$40 a barrel, has been partly caused by fear of terrorist attacks and political instability in Saudi Arabia and other large producers. The booming Chinese economy, solid growth in the U.S., and a slower-than-expected rise in Iraqi production also contributed to the price jump. So far industrial nations have absorbed these increases without much damage because, even at \$40, oil is cheaper in real terms than it was during the price shocks of the 1970s and early '80s. Moreover, most countries have since economized on usage through higher taxes on gasoline, more fuel-efficient cars and planes, and power plants that use natural gas and coal, and to a lesser extent a shift in emphasis to nuclear power. As a result, spending on oil relative to gross domestic product in the U.S., and especially in Europe and Japan, is much less than it was 20 to 30 years ago.

Yet suicide bombings and other terror attacks against oil facilities, if successful, could temporarily spike the price to \$70 to \$80 or more. That would derail the world's economy. So major consumers need to further reduce their dependency.

GASOLINE AND DIESEL FUEL account for about half of all oil consumed in the U.S. and other advanced nations. Gasoline consumption could be cut immediately by imposing a federal "terrorist protection tax" on gasoline of about 50 cents a gallon. The current federal gas tax is only 18.4 cents, while state taxes average about 23 cents a gallon. This added tax would boost the American retail price of low-octane gasoline, now about \$2 a gallon, to \$2.50 a gallon, still well below prices in Europe and Japan. Studies indicate that such a price hike would cut the amount of gasoline used by Americans by about 10%.

Instead of going into general tax revenues, proceeds from this terrorism tax should be used to expand gasoline and oil reserves. These could partly enhance federal reserves that would be available for military and related purposes when oil supplies were disrupted. The proceeds should also help subsidize a buildup of special privately held gasoline reserves that could be used only when an emergency is declared.

Other ways to reduce dependence on oil take much longer to implement, but a long view is necessary since the terrorism threat will last into the foreseeable future. The federal government has been trying to develop a cleaner substitute for gasoline by subsidizing production of ethanol, made primarily from corn. This program has essentially been a flop: Ethanol is still too expensive, and ethanol factories create pollution consisting of nitrogen dioxides and other gases. The ethanol subsidy of about 50 cents a gallon is just another way to subsidize corn growers, not a serious attempt to find efficient ways to reduce dependence on gasoline.

A good substitute for the internal combustion engine would be of enormous value. The most promising approach seems to be the hydrogen fuel cells that power cars and buses. London has an experimental fleet of buses powered by these cells, but they are much too expensive for use on a large scale. While any major transition to hydrogen fuel cells would require construction of thousands of refueling centers to replace gas stations, General Motors Corp. ([GM](#)) and others believe they can make hydrogen fuel cells competitive with gasoline engines within 5 to 10 years. To help speed the process, the federal ethanol subsidy should be reallocated toward this cleaner and more promising technology.

Other technologies are also worth pursuing, including more use of wind power for energy and renewed construction of nuclear power plants. Neither is a panacea, but both reduce pollution and cut demand for oil and other fossil fuels.

Industrial nations have good reason to be concerned about terrorism in the Mideast. The long-run priority is to find a substitute for the gasoline engine. Higher gas taxes would immediately cut oil consumption, and the tax proceeds could subsidize larger gasoline inventories to be used in an emergency. This would eliminate a potentially damaging avenue for terrorist strikes at industrial economies.

Gary S. Becker, the 1992 Nobel laureate, teaches at the University of Chicago and is a Fellow of the Hoover Institution.

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