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HOW TO ENGINEER AN ENERGY CRISIS

by Gary North

And it came to pass after this, that Ben-hadad king of Syria gathered all his host, and went up, and besieged Samaria. And there was a great famine in Samaria: and, behold, they besieged it, until an ass's head was sold for fourscore pieces of silver, and the fourth part of a cab of dove's dung for five pieces of silver (II Kings 6:24-25).

Then Elisha said, Hear ye the word of the LORD; Thus saith the LORD, Tomorrow about this time shall a measure of fine flour be sold for a shekel, and two measures of barley for a shekel, in the gate of Samaria (II Kings 7:1).

The two-fold judgment of God against the Northern kingdom was a military siege and the resulting famine. The famine was the product of a war. Famine is basic to the siege plans of any general who conducts a siege. The siege cuts off the enemy's supply of food, driving the price of food too high for most people to buy it. This weakens the resolve of the people to fight. It brings pressure against the enemy to surrender. This is war, not business.

This strategy is very different from the plans of the monopolist. The monopolist wants to restrict output and therefore consumption, but he still wants to sell a portion of his product. He wants to sell it at a price higher than would have prevailed apart from the reduction of output. He wants a greater revenue from lowering output than from selling everything he can at a market price. In short, he seeks to make more money from the sale of a small quantity of goods than from a large quantity.

A military siege is notable by its high prices. So is a monopolist's market. There is this similarity: the cause in both cases is a reduction of supply. But there is this difference: the monopolist is not trying to destroy the market. He is trying only to restrict present supplies.

The Monopolist's Goal: Conservation

The monopolist is, economically speaking, a kind of conservationist: he attempts to reduce other people's consumption of goods. For this, he receives no praise from modern advocates of conservation, who also recommend that we all reduce our consumption, but without any capitalist's making a profit from the reduction of everyone else's consumption. They want us all to suffer, they tell us. No one should make a profit from the other person's pain. That this attitude reduces the supply of pain-killers never seems to occur to them.

When we face the tactics of the monopolist, what is the rational economic response? It is to seek ways to increase the supply of the monopolized good. How is this done? By allowing the price of the monopolized good to rise, thereby alerting the monopolist's competitors that there are profit possibilities available. If they enter the market to sell the monopolized good or a substitute, they can make a

profit. What they need is an incentive to break the monopolist's stranglehold over the market. The incentive is the presence of **above-average** selling prices. Anything that keeps prices down **artificially** is therefore a **disincentive** to the monopolist's competitors. What the consumer needs is an increase in the supply of the monopolized good, not a reduction in selling prices that is not the result of increased supplies.

The prophet Elisha **predicted** an end to the siege by predicting lower prices. That prediction came true, just as he said. But it could have come true another way. The king could have declared price controls on the named goods. He could have made it a crime to sell these goods above the prices that Elisha had predicted. Of course, there would have been few sellers of goods at those government-mandated prices. Those people with any food in reserve would have hoarded the existing supplies. This would not have solved the economic problem of the siege. But at least for a while, the prophecy would have come true. Economically speaking, this would have been a false fulfillment of prophecy. The prophet was predicting an end to the siege, not lower official prices.

The economic difference between these two possible outcomes of the prophecy was understood by the king of Israel. It was not understood by President Nixon in 1973.

A National Alert

President Nixon went on national television on November 7, 1973, to announce to the nation that we were in the midst of an energy crisis. He warned about the nation's heavy reliance on imported oil. He said that citizens and industry should be willing to work in 68-degree semi-comfort, thus cutting fuel use by 10 per cent. We should also drive no faster than 50 miles per hour, he said, thus increasing our gasoline mileage and reducing fuel consumption.

Six years later, President Carter went on national television to tell the nation that we were in the midst of an energy crisis. He warned us about the nation's heavy reliance on imported oil. He asked Americans to turn off their Christmas lights. The crisis was still with us.

Recently, United Nations military forces, mostly U.S. troops and equipment, fought a war in the Middle East. Another oil dictator was at it again. He was taking illegitimate actions, we were told, that threatened the crucial energy resource: oil. The threat of an energy crisis is with us still. We are still being warned by the experts that the U.S. imports far too much oil. But the solution – lower oil prices as a result of higher output of domestic oil – is not possible. Foreign producers can get it out of the ground far cheaper than U.S. producers can. This is a fact of geography. It cannot be solved by passing a law against imports, except in the economically perverse sense of raising

the price of foreign oil to American consumers, which includes American manufacturers. What we would be doing by raising the price of imported oil is to raise the costs of American business. This is not what most politicians have in mind when they proclaim the benefits of a tariff on imported oil.

What we need, then, are cheaper **substitutes for oil**. How can we get them? By making it clear to potential producers of these substitutes that there is a profit potential available. And how do we do this? By allowing oil prices to rise as high as the market will allow.

Freeways **Are** not Free

Since the mid-1950's, when the construction of Federal highway projects was seen as the eighth wonder of the world, we have come full circle. "Highways are bad, we have now been told; what we need is rapid transit in every city, meaning a gigantic system of tax-subsidized public transportation. Southern California, which once had a quite serviceable electric trolley car network – the Pacific Electric – was told by experts in Washington that it should spend billions of dollars of taxpayers' money in order to **achieve as good** a system as we had in 1950, before the days when government-financed "free-ways" were built. (The delightful movie, "Who Framed Roger Rabbit?", was based on this historical development.) The new trolley line from Long Beach to Los Angeles runs along the same route that the old PE trolley used. It takes about the same amount of time to make the run. And because of the heavy traffic on the freeways, it is just about as fast as driving.

We have well-engineered highways in this nation – safe at 70 miles per hour on some stretches, safe at 65 virtually everywhere. But in 1973, we were told that we should only drive 50. The government then compromised: a national 55 mph speed limit. This was not for safety's sake, we were assured, but for gasoline economy's sake. This led to the classic Texas bumper sticker: Drive 70 and Freeze a Yankee! Then the law was changed again in the 1960's: 65 mph in some designated areas. But it had all been nonsense from the beginning. During the urban rush hours, when most of our driving is done, no one really worries about driving 55; if you are very lucky, you will average 25.

United States Department of Transportation data indicated in Nixon's day that only about 42 per cent of the driving was done at speeds of over 50 – and that was before the really serious traffic jams began. So, the Federal government's speed restrictions, when imposed in all states, even when obeyed by drivers who were used to 70 miles per hour driving, and even when enforced by the state highway patrols, saved the nation at most 45 million barrels of crude oil annually, or about two and a half days' **worth** of national consumption. Terrific!

Freeways, being "free" to any motorist at all hours of the day, provide little economic incentive to drive at less crowded hours of the day. But you can always drive 65 miles per hour during the hours when you and your peers are not actually on the highway. As I said, we have the best highways tax money can buy. They are just priced irrationally.

One Mess After Another

Then, of course, there was the effect the new speed limits had on the trucking industry. Shipments of goods were delayed, since truckers were not legally able to drive at the higher speeds. This was the tail end of the era of extensive transport regulation. (The beginning of transport deregulation came in the Carter era.) Government regulations over rail transport, coupled with near-monopoly status of the "favored" railroads, then offered us another prob-

lem: reduced supplies of other goods. Government regulations are like stones tossed into pools of water; they create ripple effects that not even the most sophisticated computer predictions can foresee. Government agencies toss in great handfuls daily.

We now return to the first half of the proposed crisis cure: restrictions, voluntarily imposed, on energy use. We were to turn off all neon signs, for example, as had already been done in Oregon by the time that Nixon gave his speech. A spokesman for the Outdoor Advertising Association of America informed us that this at best would have saved about 1 percent of all electricity used in the country. Neon signs are energy efficient.

With all gasoline station neon signs off in the evening, it was a good thing that our faithful motorist was holding his speed to a fuel-conserving 55; he needed those extra miles for his search for an open gas station. Most stations were not open anyway, since the gasoline shortage encouraged them to shut down after 6 p.m. But without brightly lighted signs, motorists were hard-pressed to tell the open from the closed stations. This no doubt encouraged some people to do their driving before evening, thus clogging the "freeways" even more during the peak hours.

Washington's response? Another handful of stones.

Voluntary Restraints

What about voluntary restraints on heating homes and businesses? Perhaps it was healthier. It may have encouraged slightly lower energy use for a brief period, but not for long. Why should a firm or a housewife keep the temperature down? By their own demonstrated preference, people like warmer conditions in the winter, but cooler in the summer. Each voluntary conservationist always has this nagging doubt: "I'm living less comfortably, but what about everyone else? What good does one uncomfortable family (or work crew) count in a nation of millions?"

Indeed, the energy conservation problem is very much like the smog problem or the traffic jam problem. How much pollution or how much used-up space will one additional automobile cause? An infinitesimal quantity, obviously – literally unmeasurable by macro-economic tools. Each family or each driver or each business concludes that his presence or his use of power won't make that much difference. Each skeptic is absolutely correct; It will not make much difference. But the combined effects of all these micro decisions will make a big difference. The macro crisis will remain.

All these micro decisions produce macro crises in today's world. Why? In other areas of our lives, our micro decisions do not produce macro crises. The newspaper agent fails to deliver a paper one day. This is an inconvenience, but not a disaster. You can call up the local distributor, and someone will send out the paper. If this happens too often, there is an economic incentive for you to take a different newspaper. The newspaper managers know this, so they take care to organize their staffs so that the paper does get delivered most of the time. It pays them to have built-in self-correction devices that operate against micro-economic errors.

A person can take an unannounced day off from work once in a while. This is a bad policy morally – a person is not fulfilling the terms of his contract. But if the practice continues, the company will impose counter-pressures. The public's position as consumers is protected by internal company policies. Service becomes more constant and more predictable, which is what the public expects and pays for. There is an economic incentive for companies to see to it that micro failures do not become macro failures. They have a reliable indicator to remind them of their task: the profit-and-loss statement. This indicator works for as long

as there is the right to exchange property (including labor) on a market of freely changing prices.

There are micro failures in business. They must be solved in order to meet customer expectations. Businesses must take steps to limit these micro failures. Those firms that do reduce them prosper. The best example of this is the success of the many Japanese firms that in the 1950's and 1960's adopted the previously ignored techniques of the American efficiency expert, Edwards Deming.

"Make Mine Pepperoni!"

But what about micro decisions that should not be, in and of themselves, detrimental? Suppose pizza-eaters who have for years ordered their pizzas with mushrooms should decide to order them with pepperoni? All of a sudden, pizza shops have to order more pepperonis and fewer mushrooms. As always, customers set prices. Their increased demand for pepperonis increases the price of the presently available supplies of pepperonis, for the customers are bidding (as always) against each other.

Meanwhile, the price of mushrooms tends to drop, since fewer customers want to consume the available supplies of mushrooms. In a long chain of economic reactions, the costs associated with pepperoni production rise (labor, machinery, the costs of breeding more and more little pepperonis, and so on). Next, entrepreneurs will concentrate their attention on increasing the supply of pepperonis more efficiently – more inexpensively – in order to reap profits. Up goes the supply of pepperonis, which is precisely what the public has demanded, while the mushroom producers are forced to cut production, freeing economic resources (such as capital) for more important uses. No "crisis" emerges – no television speeches by the President, no Congressional hearings, no paperbacks from Nader's summer vacation student lawyers – unless someone tries to impose price controls on the pepperoni industry.

The Domino's Effect

With price controls, however, this complex chain of economic events is disrupted. No one is quite sure just how much pepperoni should be produced or which pizza shops should get priority consideration in receiving the now short supplies – short in relation to public demand at the artificially low price of pepperoni. (The word "shortage" should always be qualified by the words "at some price.") Soon, the Italo-American Society will be picketing on the Capitol's steps, the Amalgamated Brotherhood of Pizza Producers will be petitioning the Department of Agriculture, and the Food and Drug Administration will send out preliminary warnings against debased pepperoni quality to all the pepperoni producers of the nation. We will then have a full-blown crisis. The public will be asked to order at least one mushroom pizza for every three pepperoni pizzas, with rationing of pepperoni pizzas threatened if "voluntary" restraints – one's patriotic duty in the war against spiraling pepperoni Prices – should fail. Then the Cost of Living Council will add a new department: the Pepperoni Control Division.

A chain of underground black market pepperoni pizza parlors will then spring up. All over America, certain unpatriotic citizens will be whispering into door-slits, "Luigi sent me." A simple shift in taste at the individual level, when coupled with price controls, can produce a macro catastrophe. (In the midst of this crisis, no one even notices that Congress has passed, and the President has signed, an omnibus bill onto which – in section 64b – a \$17,234,187.57 appropriation for the floundering mushroom industry has been attached.)

Therefore, we can adopt a simple (though not infallible) principle: when micro decisions produce macro crises on a regular basis, someone – probably the civil government's

officials – is interfering with the right to exchange property (including labor) on a market with freely changing prices.

Who's to Blame?

Did the Arabs' cutting off of "our" oil produce a crisis in the 1970s? (This really means that in several nations, Arab politicians stole the oil from private land-owners, thereby creating the national monopolies. The best example is Khadafi's socialist revolution. In other Arab nations, feudal monarchs restricted the output of their families' oil fields. The best examples are Saudi Arabia and the Persian Gulf states.) Why does a reduction in supply from one supplier create a crisis? What about new sources of supply?

Why didn't we immediately tap into our national reserve, the north-slope Alaskan oil? Because ecology advocates had prohibited the construction of the pipe to transport it; they got government agencies to slow down construction. Also because ecologists got the politicians to prohibit any drilling for new oil in places like the Santa Barbara channel. (This ecological activity was legitimate, at least in part, because the laws of private property are not enforced by the courts and legislatures. Oil firms were not completely responsible financially for their own errors of judgment in not protecting the environment against oil spills).

There were other reasons for our dependence on imported oil. Interference in capital markets by governments makes it more difficult for newer, smaller, innovative firms to gain needed capital to develop alternative power sources. Government bureaucrats interfere with licensing of alternative power sources (yes, even non-polluting systems) that are already developed. The State makes free market responses to new demand more difficult, and then the bureaucrats blame the free market for failing to respond.

Are we using too much energy today, that is, more than Washington would prefer? Well, why shouldn't we? Governments have subsidized cheap power for years. In many states, they did not permit public utilities – themselves the monopolistic creations of governments – to raise prices on their various products. Governments deliberately subsidized the public by keeping electricity prices lower than the companies have insisted was necessary. So, the American public accepted as valid economically the one indicator there is to measure the value of the energy source: the **cost-per-unit** consumed. Power companies found it necessary to keep older, less efficient equipment. They found it difficult to raise capital on the free market, for their bonds were rated low (and therefore the interest they must offer to pay must be higher) because some local public utilities commissions have had their eyes on the ballot box instead of the scarcity of capital. The energy crisis of the 1970s was a joint effort by governments here and abroad.

There is also the problem of inefficient public utility managements that are shielded from free competition. For years, they have faced political battles with the public utilities commissions instead of economic battles with competitors that might otherwise have been able to enter the market. Who can say what alternatives might have been developed? Who can estimate the loss of efficiency that has come about because newer, more creative, more innovative firms have been kept out of monopolistic, government-created closed markets?

The public supposedly has been protected by these various power monopolies. Now the government finds that the public must cooperate in order to make the jerry-built government monopolies work more or less successfully. But the public is not given an economic incentive to **co-operate**. Are electricity rates boosted sufficiently to cut down the consumption of electricity? No, indeed; that might be politically dangerous! So we go to voluntary controls in the

name of the national emergency. They are too much like the "voluntary price guidelines" that were scrapped on August 15, 1971, in exchange for full-scale price and wage controls. We co-operate voluntarily, or else . . . rationing. Nice, inefficient, unpleasant, jerry-built, creaking, black-market creating, bureaucratic power-enhancing rationing. All in the name of consumer protection.

The Issue Then Becomes Moral

There is another consequence of "voluntary" controls to consider. When an energy crisis appears, citizens are asked to cut back on their consumption of power. They are asked to do this in the name of patriotism in order to deal with a national emergency. Before this crisis, individuals were free to use up as much power as they chose, so long as they were willing to pay for it. No one worried about what his neighbor might think about the "morality" of a home heated to 75 degrees. With free pricing, the expenses associated with such physical comfort would have to be borne by the user. But when the crisis hits, we are warned that those people who keep their homes warmed are unpatriotic, even immoral. They are encouraged to regard their neighbors with suspicion. They are made to feel guilty. Exceedingly ugly circumstances may arise – indeed, did arise – when someone in a neighborhood wants to put up the traditional Christmas lights or floodlights for home protection.

The macro crisis was nationalized officially in the 1970s; micro-decisions were identified as part of the public morality, and hence the pressures of public opinion are brought to bear on "deviants." It took the Christmas lights industry over a decade to recover from Jimmy Scrooge, and we still do not see the lights that we did in the mid-1970's. Public opinion was dead-set against Christmas lights for years. As Tocqueville wrote in the 1830s, few things in social life count as highly or are as uncompromising as public opinion, especially in the United States. Displays of the public morality can be irrational and very insensitive to the subtle questions of personal choice. Mobs are not easy to reason with. Sullen, envious neighbors are

not inclined to listen to **marginal utility analysis**. Yet the daily press reports an endless stream of statements from **public officials** created a vigilante mentality among the public in the 1970s.

So, instead of producers competing against each other in order to give the customers what they want, we saw the **incredible** spectacle of gasoline companies telling **customers** to walk more or to ride the bus! They **literally** spent millions of dollars to buy television **advertising** to ask us not to use their products. And because of the threat of direct rationing and the creation of a "temporary **emergency** control board," this advertising may have been **well** spent by the oil companies. The competition we saw was not between the gas company and the electric company, but between the ecologists' political bloc and the energy-crisis political bloc. This, it should be noted, is precisely what **Soviet Russia** developed: the only competition is that **between** government bureaucratic agencies. The consumer simply hopes and prays that the system will operate after the political dust has cleared, or at least has **settled** into another province's back yard.

Conclusion

The answer to the macro economic crises lies in the re-establishment of the free mobility of risk-capital, the free **bargaining** of private citizens with each other, the free **movement** of prices, and the eradication of "free" goods and the fallacious philosophy which undergirds them, whether in this country, Libya, Venezuela, or Japan. Let the free market do the micro-economic rationing efficiently, and we will not need to be burdened with the ghastly inefficiency of state-wide or Federal economic planning.

Micro-economic decision-making is the primary device for keeping crises on a micro level. At least, under **micro-economic** crises, someone gives me a direct incentive for sitting in **70-degree** semi-comfort: I do not wind up with a monthly bill that produces **65-degree** financial discomfort in the summer and **75-degree** financial discomfort in the winter.