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Prop. 87: Paying for misguided innovation

Californians pay plenty for a gallon of gasoline.

Unfortunately, Proposition 87, the Clean Alternative Energy Act, would only make matters worse. The act would increase gas prices and our dependence on foreign oil, while creating a vast new bureaucracy that is unlikely to speed the successful development of alternative fuels.

Prop. 87 would place a tax on oil production in California, to fund a new bureaucracy charged with encouraging the development and adoption of alternative fuels. The new agency would be mandated to exist for a minimum of 20 years, and be required to spend \$4 billion within its first 10 years of existence.

Supporters of Prop. 87 claim it will not increase gas prices for Californians, because it is a tax on oil company profits – not production. The proposition goes so far as to mandate that no costs may be passed on to consumers. But the authors of this proposition are no more able to repeal the laws of economics than they are able to legislate away the laws of gravity. Taxing profits from oil extraction discourages the activity – production – that generates those profits. Oil production in California fell by 3.8 percent in 2005, and production has decreased every year since 1996. Taxing oil production will accelerate this trend, by discouraging new oil exploration and encouraging the premature closing of existing oil fields. As a field ages, its oil becomes more expensive to extract. Most fields have oil remaining in them when they are closed down, because it is too expensive to extract. When these fields are taxed, the optimal time to shut down production occurs sooner, and more oil is left in the ground.

Consumers would still be able to purchase oil at the world market price, but not as cheaply as Californian oil. A barrel of Saudi Arabian oil must be transported to California. A barrel of Californian oil is already here, so producers don't need to pay the same transportation costs.

While the tax would increase prices for consumers, the new government agency would probably not encourage the market to efficiently develop and adopt alternative fuels. If the new agency makes no meaningful advances in alternative-fuel development,



Loud and clear

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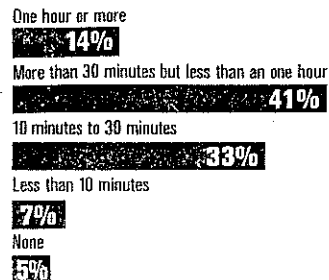
nothing in Prop. 87 would limit its funding. This is a recipe for waste.

Market participants have already begun researching and adopting alternative-fuel technologies. As oil becomes scarcer and fuel prices increase, consumer demand for alternative fuels will also increase. Automobile companies, venture capitalists and inventors will all have the incentives they need to develop alternative-fuel transportation that will best serve consumer demands. A California bureaucracy dispensing billions of dollars to researchers will only distort those incentives and will likely drive the market away from serving consumer demands.

Proposition 87 is a bad deal for oil producers, consumers and those who want efficient alternative-fuel vehicles developed. With the taxing of oil production, consumers will be forced to pay more at the pump. Meanwhile, the new bureaucracy is more likely to hamper the development of efficient alternative fuel technology than it is to help it.

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How much time do you spend on lunch?



This week's question:

Which has more influence in politics, business or labor?

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