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A Flex-Fuel Mandate Is Pro-Market

If we produce more oil, OPEC will sell less to keep prices high. So Congress should encourage car makers to look for new alternatives.

By ROBERT C. MCFARLANE

The current election cycle and the rising price of gasoline have rekindled interest in energy security and how best to achieve it. We've had these spasms of interest and hand-wringing before—many times. And each time we believed we had identified a way to overcome our vulnerability to the disruption or unaffordable pricing of oil, the price would decline, we would become complacent again, and effective, long-term solutions were forgotten.

This time, however, the stakes go well beyond the price of a fill-up at the pump. They involve a predictable renewed recession and prolonged, severe economic hardship for all Americans. As we tackle this energy challenge again, if the outcome is to be any different it may help to start with a few facts:

• Petroleum products drive 97% of all air, sea and land transportation in our country. Oil is truly the lifeblood of every industrial economy. If goods don't move, revenues stop, jobs are lost and economies collapse. Oil is a strategic commodity, an essential good which if disrupted or priced extravagantly can cause our economy to collapse.

• Unlike other essential commodities such as clothing and food, where we have choices, in transportation fuel we're stuck with petroleum alone. It enjoys a monopoly.

• The price of oil is set by a foreign cartel. The Organization of Petroleum Exporting Countries (OPEC) owns almost 80% of global oil reserves yet produces only 36% of daily global supply. This dominant position enables OPEC to raise or lower their production to maintain the global supply-demand relationship that suits their interest. If U.S. oil companies produce more, OPEC will produce less.

That's why increasing domestic production of oil or increasing fuel efficiency can reduce our trade deficit and the $400 billion (at current oil prices) we send overseas annually, but they won't change the price we pay at the pump. In 2008, when the price of oil went to $147 per barrel, the United Kingdom was self-sufficient thanks to the oil it produced in the North Sea. Yet U.K. truckers went on strike over the extravagant price of diesel, which was driven by the global price of oil. Oil is a fungible commodity traded globally but priced by a cartel.

This is not to say that we shouldn't try to produce more of our own. Of course we should. But that is not enough. To outmaneuver OPEC we need to eliminate oil's monopoly as the only transportation fuel.

In recent years, we've discovered that we are blessed with truly unfathomable amounts of natural gas embedded in shale deposits—primarily located in Pennsylvania, New York, Texas and Oklahoma. Natural gas can be used in various forms to fuel vehicles. Compressed natural gas (CNG) is well-suited to drive long-haul and other fleet vehicles, although it's quite expensive to adapt a truck or car to burn natural gas.

For light trucks or automobiles, a better approach lies in using natural gas to make the liquid-fuel methanol, a high-octane, clean and safe fuel (which race-car drivers love) whose spot price is roughly $1.10 a gallon. New cars and trucks can be adapted to burn methanol, ethanol, gasoline or any combination of the three for less than $100 per vehicle. The Methanol Institute, a private industry group, estimates that after compensating for methanol's lower energy content and adding the cost of distribution, taxes and infrastructure, producers can deliver an amount of fuel equivalent to the energy in a gallon of gasoline for approximately $3.

But we must get busy, because we're about to face additional upward pressure on the price of oil. Former Shell CEO John Hofmeister has predicted that the rapid run-up in demand for oil over the next two to three years—primarily in China and India, and by as much as 10 million barrels per day—may well outstrip supply and raise the price of oil to more than $200 a barrel. A gas price almost double what we're paying now would constitute only a fraction of the impact on our economy. We will go back into recession and stay there for a long time.

Today, you hear candidates for president espousing partial solutions. President Obama calls for unnecessary, expensive tax credits (up to $40,000 per truck) to persuade long-haul vehicle owners to convert to CNG, and he wants to extend similar, though much smaller, tax credits to promote alternative fuels. Former Speaker Newt Gingrich calls for more oil drilling here, which is fine. And yet, as explained earlier, that alone will not have much effect on the price of gasoline.

Let's open our market to good old American competition. Friedrich Hayek and Milton Friedman stressed that the foremost economic duty of government is to eliminate cartel pricing. Bills are now pending in both houses of the Congress (HR 1687 and S1603) that seek to do exactly that by requiring car makers to enable fuel competition in their own product lines—adding flex-fuel, all electric, hybrid electric, or any other way auto makers choose to implement the law.

Thanks to the windfall discovery of incalculable quantities of unconventional gas in our country, we can do this. If Congress acts, we can finally establish energy independence through competition.

Mr. McFarlane served as President Reagan's national security adviser from 1983-85. He is the co-founder of the United States Energy Security Council, a bipartisan nonprofit organization committed to competition and energy security.

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