Energy prices vs global warming

N K Singh

Posted online: Sunday, May 21, 2006 at 0000 hrs IST

Global warming is in sharp focus. The Kyoto Protocol, namely the UN Framework Convention on Climate Change, enacted in 1997 comes to an end in 2012. The international community of 190 governments is currently meeting in Germany for its extension; achievement on multiple emission-control targets is not in sight. The United States, the world's biggest polluter, did not join this international treaty. It has other ideas about reversing global warming.

In the meantime, excessive emission of carbon dioxide continues to affect millions—changing weather patterns, increasing incidence of floods and with arid zones becoming drier, wet regions becoming wetter, threatened submergence through rising sea levels.

The preponderence of scientific evidence attributes global warming to excessive use of fossil fuel and related carbon dioxide emissions. And yet we are anxious that high fuel prices might stall the sunshine of continued economic buoyancy. There is hesitation everywhere to pass on the high prices of petro products to end-use consumers. President Bush in his State of the Union address in January, while describing Americans as excessive guzzlers of fossil fuels, does not want gasoline prices to be raised, which could moderate consumption. In fact, taxes are being calibrated lest high gasoline prices hurt the outcome of November elections. Dick Cheney, speaking in Vitrius, accused Russia of practising energy blackmail in extracting high prices. That the Russians are consolidating their influence in the Central European countries and are not averse to leveraging their energy power is no secret.

Nonetheless, the Russian plea that higher prices are the outcome of progressively applying market-based principles has fallen on deaf ears. At the recently concluded spring meeting of the IMF and the World Bank, as well as the Annual General Meeting of the Asian Development Bank, there was unanimity that the main exogenous risk to sustained global growth was the unforeseen consequences of high energy prices.

Thus, while India is not alone in attempting to protect consumers, its excessive politicisation is quite unique. Everyone is aware that we went through a period when prices were becoming increasingly market determined till Ram Naik in the earlier government discovered that there was need for a consensus among NDA partners. The present government had no difficulty in fully accepting this and making it even more onerous because consultations now mean consensus not only within the Cabinet (and the warring ministries) but with all allied partners.

What is now being proposed is hopelessly inadequate to fill the large hole of over Rs 73,000 crore created in the finances of oil companies. So how long can the Budget absorb this? Of course, the high prices of crude have conferred windfall revenue gains and part of this could be shared to mitigate the burden of the consumers. However, the general practice of calibrating duty rates to compensate for price volatility is scarcely rational. In good times, oil companies can create a price stabilisation fund and protect its corpus from being integrated with the Budget. The proposal on Oil Bonds may ease liquidity pressures but constitute borrowing and contingent liability, which must be reckoned in fiscal numbers.

Going beyond the current debate, the issue is more basic, namely how to sustain economic growth in an era of high energy prices? Some of the answers are obvious. First and foremost, to increasingly price products at the economic cost and confine subsidies through cleverer financial engineering to the really needy and those below the poverty line. Second, to re-engineer products and processes which are low on energy intensity. A conscious policy which discourages high energy-intensive activity will incentivise labour-intensive technologies. No doubt, the absence of flexible labour policies inhibits the adoption of technologies best suited to our factor endowments.

Third, energy efficiency needs vastly improved commitment and implementation. Currently, it is administered by the Power Ministry, which has no serious stake in pricing of petroleum products except gas for power. The implementation of the Energy Efficiency Act needs closer monitoring.

Fourth, far greater emphasis on R&D in alternative fuels—dual fuel policies must become more attractive. The telling story of how an upstart business in Tennessee is marketing stills that can be set up as private distilleries making ethanol out of fermented starchy crops such as corn, apples or sugarcane, and claims that fuel costs can be reduced by third from the pump price of gasoline, are directions in which we need to move more aggressively.

Fifth, we need to have a floor price on a barrel of oil which could be part of our comprehensive energy security policy. Only this can incentivise long-term investment in yields, flex fuel vehicles and distribution outlets for alternative fuels.

In the end, it would be hypocritical to talk of high global warming and high oil prices in the same breadth. Global warming is primarily a result of excessive fossil fuel use, which is induced by low energy prices. If people pay market-related price for energy, they will learn to readapt activities and lifestyles which conserve energy and also arrest escalation of global warming. As long as we continue to believe that fossil fuel energy is either abundant or more sophisticated technologies make their extraction viable and overlook demand moderation as concomitant to supply elasticties, concerns on global warming will remain peripheral. The malignant side of this asymmetry is that we may neither have cheap oil nor contain climate change. Efficient energy pricing is the inescapable principle on which rests the future of sustainable economic growth. Combining prosperity with acceptable environmental management is never easy.

write to nk.singh@expressindia.com