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The Experts: Should the Government Finance New-Energy Technologies?

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Pollution Taxes Correct Market Failures Best

There is only one intellectually defensible argument for government intervention in energy markets. And that argument is "market failure." So what's the market failure with regard to emerging energy technologies?

The only serious market failure that can withstand scrutiny is the charge that energy consumers don't pay the full cost of their energy consumption. The environmental and national security costs of energy consumption, the argument goes, are imposed on third parties when, in an ideal world, they would be borne directly by energy consumers. This means energy prices for fossil fuels are too low. Were they "correct," we'd consume less of them and more of something else; ostensibly, emerging—"clean" and domestic—energy sources.

For what it's worth, I have little regard for the proposition that energy imports impose national security costs. Foreign oil producers have ample incentives—and given oil revenues, the necessary means—to provide for the optimal level of production and transportation security to ensure that their oil reaches the global market.

The environmental issue is less clear. There is little doubt that fossil-fuel consumption generates air emissions that harm human health and the environment. But the idea behind environmental regulation is to mirror what we think would likely occur if energy producers and consumers were forced to compensate third parties (economist Ronald Coase) for environmental damages. It isn't entirely obvious that emissions at present are higher than they would be in a well-functioning, compensation world.

If we think that a world of third-party compensation would result in less pollution than at present, then we have a direct remedy; tighter environmental emissions standards. If more emerging technologies arise as a consequence, then fine.

Happily, we have an even better remedy at our disposal; pollution taxes. Monetizing the environmental damages from a unit of this or that pollutant and then imposing a tax on emissions gets the energy price "right" (economist Arthur Pigou) and neatly remedies the market failure; no direct regulation or subsidy to this or that industry are necessary. Letting market actors decide how best to respond to the tax will produce the most efficient, least costly means of pollution control. Letting politicians decide how best to reduce emissions is a recipe for pork barreling, special interest favoritism and excessively costly environmental protection. And for those of you who don't care much

about cost, remember that the more costly it is to reduce pollution, the less demand there will be from voters to "buy" additional increments of environmental protection.

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