

“Oh, What a Tangled Web We Weave . . . “

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Thus begins the childhood admonition regarding “when first we practice to deceive.” But I’m going to discuss another tangled web . . . the morass of worldwide government interventions and regulations that have deepened the present problems with food and energy prices. It is a tangled web, indeed, and the current situation calls for untangling it rather than adding more government programs to the mix.

The story begins in a good way. Start with worldwide economic growth that has pushed up real incomes around the globe, pulling many people out of poverty. Toss in some laudable concerns for the environment. But then look out . . . the tangled web starts being assembled with pleasant sounding but ultimately heavy handed government policies that sent us awry.

The worldwide economic growth experienced in the past decade or two is indeed quite remarkable. Much of it is due to market liberalizations, including the relaxing of trade barriers and impediments to foreign investment, and the dismantling of some inefficient domestic policies in many countries. These events led to increased productivity and incomes for a remarkable number of people. However, the worldwide capacity to produce energy has not kept apace. In other words, demand grew faster than supply. This, of course, forced the price of energy upward. Thus, some increase in the price of energy was probably inevitable. However, subsequent policy actions have made it worse.

The counterproductive tangle of policy began with an ostensibly well-intentioned environmental motive. Because of concerns about global warming, the U.S. and other nations began to require use of biofuels in an attempt to reduce CO<sub>2</sub> emissions. In the short term, this led to further increases in the price of gasoline because capacity was not in place to produce gasoline in the modified manner necessary when using biofuels. Again, it’s the principles of supply and demand at work . . . this time the limited supply pushed up the price. The longer-term effects, however, spillover into agricultural markets.

In response to the above events, farmers converted a great deal of land to crops devoted to biofuels and away from crops for foodstuffs. As always, the laws of supply and demand quickly take hold that the prices of many food items rose.

Here’s where it really gets dicey. Many, many policies of governments around the world have reacted to this perversely. For example, China, Mexico, Malaysia, and Venezuela are all moving to cap prices of various food items.<sup>1</sup> This artificially low price gives incentives for suppliers to produce less and consumers to keep buying. Exactly the opposite of what’s needed for goods that are becoming more scarce! Other government

reactions are just as bad. Consider the market for rice as an example. Due to the above described circumstances, the price of rice has risen rapidly. This high price is an incentive for farmers in rice-producing regions of the world to produce more for export to areas that grow no rice. Yet rice-producing countries like India, Indonesia, Vietnam, China, Cambodia, and Egypt have restricted the export of rice.<sup>2</sup> Again, suppliers are given incentives to limit production precisely at the time when their crops are needed most. The U.S. and EU countries really don't have much to brag about on agricultural policy, either. For years, each has engaged in policies that limit supply and raise food prices.

But let's get back to gasoline prices. Though the biofuels mandate plays a role in the run up in gasoline prices, a big part is from the rising price of crude oil. This has generated tremendous profit for owners of crude oil sources but, as yet, has not generated much of an increase in supply. Why not? A considerable amount of the blame can be placed on bad policy. Here's a few examples. To tap new reserves in Mexico, the expertise and investment of non-Mexican firms is needed, yet the government of Mexico is loath to allow this. Russia is in similar need in order to develop its reserves, but the Russian government has been squeezing Western companies lately, slowing new investment.<sup>3</sup> In the U.S., we continue our moratorium on drilling for the known reserves in the Gulf of Mexico. Yes, there are some legitimate environmental concerns here. But surely, at over \$100 a barrel, there is an economic and environmentally sound way to pump that oil out.

The price system and markets are a great incentive system. High prices simultaneously signal more consumer desire for a good and provide incentives to produce more of it. But while we bemoan the high prices, many of our policies impede individuals and firms from acting on the incentive that high prices send.

Here's a final irony . . . though an exasperating one. All that effort to convert to using more biofuels . . . that added to our gas prices and sent the price of food upward. You know, to reduce CO<sub>2</sub> emissions. Turns out it doesn't work. Recent studies indicate that this policy has resulted in more clearing of land and greater net CO<sub>2</sub> emissions.<sup>4</sup>

Through ineffective subsidization of biofuels, price controls, and impediments to production, governments have created a snarl of policies that have aggravated rather than lessened problems in the markets for food and energy. We don't need any new grand schemes for energy and food policy. Just relieve ourselves of the lousy ones we've got.

<sup>1</sup>See Patrick Barta, "The Outlook: The Unsavory Cost of Capping Food Prices," *Wall Street Journal*, February 4, 2008.

<sup>2</sup>Discussed in Tyler Cowen, "Freer Trade Could Fill the World's Rice Bowl," *New York Times*, April 27, 2008.

<sup>3</sup>See Jad Mouawad, "Oil Price Rise Fails to Open Tap," *New York Times*, April 29, 2008.

<sup>4</sup>Reported in Elisabeth Rosenthal, "Studies Deem Biofuels a Greenhouse Threat," *New York Times*, February 8, 2008.