Striking Home

The Impacts of High Energy Prices on Families, Communities, and Businesses

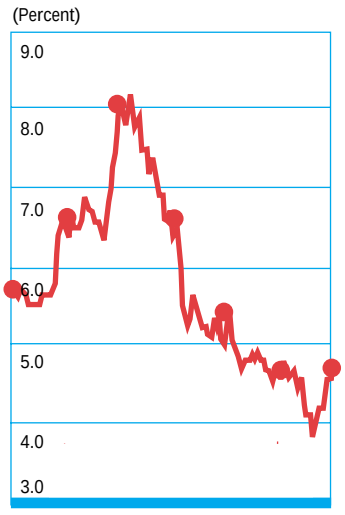
American families, communities, and businesses all depend on reliable and affordable energy for their health, safety, and livelihood. Energy is a critical component of nearly everything that affects our daily lives, from transportation to communication, from food production to medical services, and from air conditioning to heating. Americans expect these services to enhance our lives, and are keenly aware that each additional, unanticipated energy expense is a decrease in funds available for other needs.

Recommendation:

★ The NEPD Group recommends that the President direct the Secretary of Energy to explore potential opportunities to develop educational programs related to energy development and use. This should include possible legislation to create public education awareness programs about energy. Such programs should be long-term in nature, should be funded and managed by the respective energy industries, and should include information on energy's compatibility with a clean environment.

Figure 2-1

Income Spent on Energy



Until recently, the share of disposable household income spent on energy steadily declined, falling to a low of 3.8 percent at the end of 1998. Higher prices for oil and other energy products and record cold temperatures in late 2000 bumped this share up to 4.8 percent in the fourth quarter.

Note: Plotted quarterly through the fourth quarter of 2000.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

Impacts of High Energy Prices on the Daily Lives of Americans

Many American families and businesses have already felt the strain of rising prices and unreliable energy supplies. Every time energy prices rise, American families have fewer dollars available to meet their needs. Low-income households, energy-intensive industries, and farmers generally find it difficult to make rapid adjustments to energy price increases.

Rising oil prices act like a tax by foreign oil exporters on Americans. Changing energy prices impose economic costs, such as forcing plants to change schedules, replace machinery, or even shut down. These costs can eventually impact economic growth. So far, increased capital investment by domestic energy producers has offset only a small part of the dampening effects of higher energy costs on consumer spending.

Families

Energy bills for the 74 million middle-class American households consist primarily of home and transportation related expenses. Heating and cooling expenses represent about 40 percent of household energy costs. Other energy expenses include costs for lighting, hot water, appliances, and transportation.

For almost twenty years, the share of household income that Americans spent on their energy needs steadily declined. However, between 1998 and the end of last year, family spending on energy rose by more than 26 percent, from 3.8 to 4.8 percent of after-tax income (Figure 2-1).

Last winter, heating bills for many families tripled. Roughly 50 percent of American families heat their homes with natural gas. Because the last two months of 2000 were particularly cold in some parts of the country, heating bills increased significantly relative to the previous winter. Last winter, average natural gas heating costs in the Midwest increased by 73 percent, from $540 to $933. New Englanders' heating bills rose by 27 percent, from $760 to $967.

Higher energy prices have forced some energy-intensive manufacturing industries to halt or scale back production and lay off workers.

Many working households can usually accommodate such increases in energy by cutting back on other needs. However, low-income households often have more difficult choices to make. Energy costs for an average low-income household could total 14 percent of family income during the winter of 2000–01, up from about 11 percent for the previous winter. In contrast, energy costs typically represent only about 4 percent of a middle-class family's household budget.

The Low Income Home Energy Assistance Program (LIHEAP) is a federal block grant program that helps low-income consumers pay their energy bills. Last winter, 1.2 million more American families applied for LIHEAP assistance to pay their heating bills, bringing the total close to 5 million American families—up by 26 percent over last year's 3.9 million applicants. As many as 3.6 million families in eighteen states and the District of Columbia risk being unable to pay their bills and having their energy cut off because of the effects of rapidly increasing energy costs.

Recommendations:

★ The NEPD Group recommends that the President take steps to mitigate impacts of high energy costs on low-income consumers. These steps would include:

- Strengthening the Low Income Home Energy Assistance Pro gram by making $1.7 billion available annually. This is an increase of $300 million over the regular FY 2001 appropriation.
- Directing the Secretaries of Interior and Health and Human Services to propose legislation to bolster LIHEAP funding by using a portion of oil and gas royalty payments.
- Redirecting royalties above a set trigger price to LIHEAP, whenever crude oil and natural gas prices exceed that trigger price, as determined by the responsible agencies.

★ The NEPD Group recommends that the President increase funding for the Weatherization Assistance Program by $1.2 billion over ten years. This will roughly double the spending during that period on weatherization. Consistent with that commitment, the FY 2002 Budget includes a $120 million increase over 2001. The Department of Energy will have the option of using a portion of those funds to test improved implementation approaches for the weatherization program.

★ The NEPD Group recommends that the President support legislation to allow funds dedicated for the Weatherization and State Energy Programs to be transferred to LIHEAP if the Department of Energy deems it appropriate.

The low-income elderly are particularly vulnerable to disruptions in energy supply. If they keep their homes at a reasonable temperature, the high cost of electricity may make it difficult for them to pay their higher electricity bills. This could further result in an elimination of service. Another summer of very hot weather and high energy bills could cause serious health problems for some Americans, particularly those sensitive to high temperatures.

The Department of Energy's Weatherization Assistance Program has reduced the heating and cooling costs of low-income households by weatherizing more than 5 million homes since its inception in 1976. The President has requested $1.2 billion in additional funding for this program over ten years, roughly double the current level of spending. Consistent with that commitment, the 2002 budget will include a $120 million increase over 2001.

The Department of Energy's Weatherization Assistance Program

The energy burden on low-income households, as a proportion of income, is four times greater than for other American households. The Weatherization Program provides grant funding for a network of all states and some 970 local weatherization agencies to provide insulation, duct system improvements, furnace upgrades, and other cost-effective, energy-saving improvements based on the energy needs of each home weatherized. Currently, each dollar spent on home weatherization generates $2.10 worth of energy savings over the life of the home; with additional economic, environmental, health, and safety benefits associated with the installations and resulting home improvements. Typical savings in heating bills, for a natural gas heated home, grew from about 18 percent in 1989 to 33 percent today.

Businesses

For businesses, higher energy prices and disruptions in energy supply may increase inflation and reduce profits, production, investment, and employment. The im-

pact of higher energy prices takes two forms: the higher costs of paying for the energy to run the business, and the higher costs when raw fuel sources are used in manufacturing.

In some energy-intensive industries, rising energy prices have had a significant effect on product prices and operations. For instance, while nonenergy producer prices at the intermediate stage of processing have risen by only 3.6 percent since December 1998, prices of industrial materials and plastic resins, which use petroleum inputs, are up 14 and 23 percent, respectively. DuPont, the leading U.S. producer of plastics, chemicals, and fibers derived from oil and natural gas, faced an increase of $1.3 billion in raw material costs last year, the largest increase in the industry in a decade. The company expects further disruptions this year due to high energy costs.

The Federal Reserve has reported that businesses have experienced higher energy costs for a number of months, but have been unable to pass these increases on to customers due to intense foreign and domestic competition and slowing demand. On March 7, 2001, the Federal Reserve reported that businesses across the country experienced higher fuel and other energy costs in February 2001, but most businesses were unwilling or unable to pass these costs on to consumers.

This absorption of much of the higher costs of energy has deteriorated the profit margins of many businesses. About one-quarter of the increase in total unit costs of nonfinancial, nonenergy corporations in the final quarter of last year reflected a rise in energy costs. A more moderate pace of consumer spending, due in part to higher energy prices (natural gas in particular) also contributed to the margin squeeze. The reduction in businesses' purchasing power has also constrained outlays for plants and equipment and most likely intensified the slowdown in business investment that occurred in the last half of 2000.

Energy-intensive manufacturing industries are very sensitive to changes in energy prices, and adjust their production accordingly. Some companies have been forced to halt or scale back production and lay off workers. Others have deemed it more profitable to sell their energy than to produce their products. In the Pacific Northwest, Georgia-Pacific's paper mill closed down and laid off 800 workers until diesel generators could be installed. In recent months, the company's average power costs soared from $1.2 million to $10 million.

For other industries, such as computer-driven service industries, energy is not an important component of the total cost. However, many such businesses require a high-quality, reliable source of power. Even a brief loss of power can impose significant costs on high-technology firms.

Energy supply disruptions also impose costs on firms when products or prod-

Disruptions in the supply of energy impose hardships on businesses when products or product inputs are damaged or destroyed, or when production runs are interrupted.

Many companies have been unable to pass higher energy costs on to their customers, which has sharply reduced their profit margins.

Farmers have been hit especially hard by higher fuel and oil prices, which accounted for over a third of the rise in the cost of running their farms.

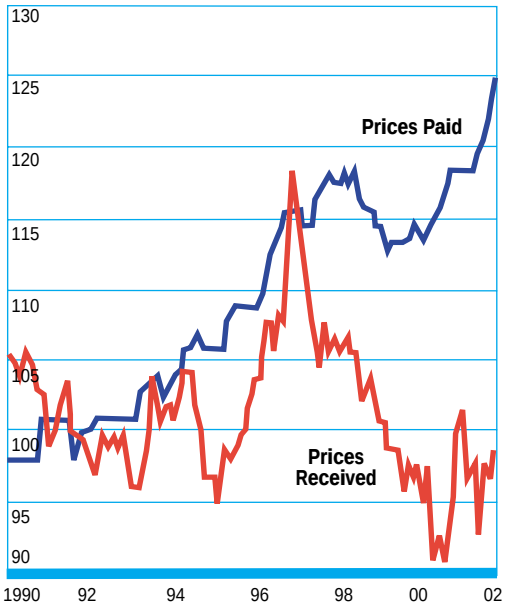
uct inputs are damaged or destroyed, or when production runs are interrupted. For example, a survey of small businesses conducted by the National Federation of Independent Business in February, 2001, found that more than half of the firms surveyed that had experienced blackouts this year in California were forced to reduce or shut down business operations altogether during the blackouts. About one-third lost sales, almost 21 percent said materials were damaged or destroyed, and nearly 40 percent had to absorb wage costs for work that was not completed.

For businesses that seek to mitigate energy price volatility, an important factor is access to derivatives markets. Both exchange-traded futures and over-the-counter derivative contracts allow firms to substantially reduce their exposure to changes in energy prices. A wide variety of highly liquid futures contracts on energy products such as oil, natural gas, and electricity allow energy users and market participants to reduce or add financial exposure to energy prices. More sophisticated and customizable products are available in the over-the-counter derivative markets. As these markets become increasingly liquid and efficient, more firms will take advantage of these products, reducing the economy's sensitivity to shifts in energy prices. However, most small businesses currently lack the resources or sophistication to take advantage of these products, and will therefore remain vulnerable to rising energy costs. The U.S. government should continue to support the development of efficient derivatives markets.

Figure 2-2

Farmers Are Being Squeezed by Energy Prices

(Index: 1990–92 = 100)



Costs for fuel, fertilizer, and electricity have boosted total prices paid by farmers, while prices farmers receive for their products have remained weak.

Note: Prices paid are for goods, services, interest, taxes, and wages; prices received are for all farm products.

Source: U.S. Department of Agriculture.

Agriculture

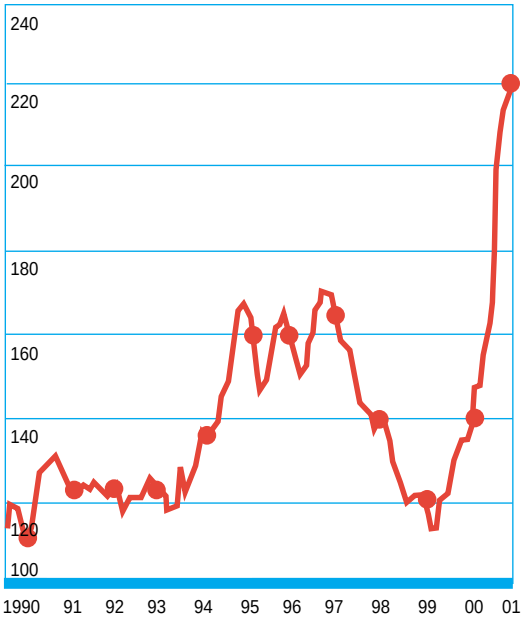
Farmers need ample, affordable energy to run their machinery and equipment. Today, farm production costs are rising sharply, while farm income remains low. Increasing oil prices and interest rates, along with higher prices for other production inputs (including hired labor), boosted farmers' production expenses by 4 percent, or $7.6 billion, in 2000. The rise in farm production expenses has occurred at a time of continued weakness in the prices farmers receive for their products (Figure 2-2).

Higher fuel and oil prices accounted for over one-third of the increase in farm

Figure 2-3

Farm Costs Are Increasing

(Index: December 1979 = 100)



Rising energy prices had a significant effect on product prices in some industries that are heavily dependent on energy inputs. The most dramatic example is the 90 percent increase in the price of nitrogenous fertilizer since December 1998.

Source: U.S. Department of Labor.

production costs. Retail diesel prices this past winter were $1.60 a gallon, compared to about $1.40 a year ago and only $1.00 two years ago. Propane prices were over $1.60 a gallon this winter, compared to $1.10 a year ago. And, natural gas prices hit $10.00 per million Btus in January, after averaging about $2.50 for most of 1998–99. Although natural gas prices have declined, they remain much higher than earlier levels.

Natural gas is an important component of farm production costs. For example, it is used to dry grain, heat farm buildings, and run food-processing equipment. Heating costs for poultry producers soared last winter, sharply reducing earnings.

Natural gas also is a major component in the production of fertilizers, pesticides, and other farm chemicals. It accounts for 70 to 90 percent of the cost of producing anhydrous ammonia, a key source of nitrogen fertilizer. Surging natural gas prices have boosted the price of nitrogenous fertilizer by 90 percent since 1998 (Figure 2-3). During last December and January, several nitrogen production plants shut down, and capacity utilization fell to 50 percent. Anhydrous ammonia recently sold for $330 a ton in the Midwest, compared to $210 a ton for all of 2000 and $160 to $170 a ton at the start of 2000.

Depending on the region of the country and type of farming enterprises, energy-related expenses range from 10 to 30 percent of operating costs for producing major crops. Farm operating costs are highest where fertilizer use is heaviest and natural gas is used for irrigation pumps, such as wheat, cotton, and corn farms in the West and southwestern plains states. Costs are high for greenhouse and nursery crops that use natural gas for heating. Perishable crops also face problems, as energy costs in processing are markedly higher.

Most of California's 9.5 million irrigated acres use electricity to pump water. In addition to higher bills, California farmers will likly face rolling blackouts this summer, which may disrupt farming and processing operations. Low stream flows in the West this year may lead to more pumping of ground water, which will add to irrigation costs in the West. As a result, the costs of California's agricultural products may rise significantly.

In 2001, farmers' total cash production expenses are forecast to increase by an additional $1.5 billion to a record $179.5 billion.

Farm production costs are rising sharply, while farmers' incomes remain low. Depending on the region of the country and type of farming enterprises, energy-related expenses range from 10 to 30 percent of operating costs for producing major crops

Even though total planted acreage is expected to fall this year, higher natural gas prices will raise expenses for nitrogen fertilizer. At the same time, net cash farm income is projected to decline from $56.4 billion in 2000 to under $51 billion in 2001, as production expenses continue to rise.

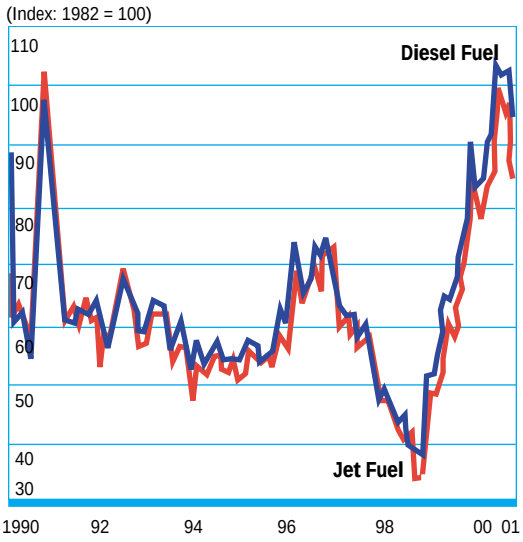
Taken together, fertilizer, fuel, and electricity costs for farmers are forecast to reach $24 billion for 2001, up by about 28 percent from $18.7 billion in 1999. This increase is about 9 percent of U.S. net cash farm income, and that share could be much higher for many individual commodities.

Transportation

The transportation sector accounts for nearly 30 percent of total U.S. energy consumption. The major transportation fuel sources are petroleum-based gasoline and diesel, jet, and marine-mode bunker fuels. Natural gas pipelines are used for product distribution, and electricity is the primary source of power for rail transit and liquid pipeline transmission and distribution.

During 2000, oil prices surged to a nine-year high, and gasoline prices skyrocketed. On average, fuel prices rose by 30 to 40 cents a gallon from 1999 prices, resulting in sharp increases for most modes of transportation, with nearly a 60 percent increase in railroad diesel fuel prices.

Figure 2-4
Transportation Costs Are on the Rise



The recent 140 percent rise in producer prices for intermediate diesel and airline fuels has affected the price of passenger and freight transport.

Note: Plotted through February 2001.
Source: U.S. Department of Labor.

A recent study by a San Francisco Bay business group concluded that blackouts could cost California as much as $16 billion annually, and $5 billion in the Bay area alone.

Price spikes have hit the travel and trucking industries particularly hard and have led to the closure of some operations. Trucking bankruptcies are currently at an all-time high. Over 3,500 motor carrier operations failed in 2000, a dramatic increase over the previous record high of 2,700 motor carrier failures in 1997. Producer prices for intermediate diesel fuel and aviation fuel each rose by about 140 percent from a low in December 1998, affecting passenger and freight transport in the highway, airline, rail, and other transportation sectors (Figure 2-4).

For most transport operations, energy-related expenses were 7 to 14 percent of total operating costs in 1998–99. This share was expected to jump to 10 to 25 percent in 2000. Excluding private auto travel, U.S. passenger and freight operations in 1999 generated about $600 billion in annual revenue and paid approximately $60 billion for fuel and power. If the volume stayed the same in 2000, the various increases in fuel costs for each mode of transportation would yield a fuel bill of

about $80 billion—an increase of one-third over the prior year's bill.

Economic Impacts of California's Energy Crunch

In California, 43 percent of small businesses surveyed in February, 2001, said the power problem had dimmed their views about California as an attractive place for doing business. When asked whether they agreed with the statement, "The electricity problem has forced me to take concrete steps exploring the possibility of moving my business out of California," 18.3 percent of small business respondents said they either agreed or strongly agreed with the statement. More than 31 percent said they will probably or definitely cut back on planned business investment, and almost 20 percent are exploring a move to another state. Half of these small businesses concluded that blackouts would reduce their earnings.

The Silicon Valley Manufacturing Group recently estimated that its nearly 200 members lost over $100 million dollars because of one day of rolling blackouts in June 2000. Countless more millions of dollars have been lost by interruptible commercial power users. Fontana-based California Steel Industries estimates it lost $2.4 million in a single day after its interruptible power was cut off twice for a total of about 12 hours. A recent study by a San Francisco Bay business group concluded that blackouts could cost California as much as $16 billion annually, and $5 billion in the Bay area alone.

The example of California's utilities illustrates the potentially severe negative effects on companies whose business is highly sensitive to energy prices. In this instance, rising energy costs coupled with an inability to pass those costs along to customers has created a sharp increase in short-term liabilities. Pacific Gas & Electric has been forced to file for bankruptcy as a result, and Southern California Edison, while avoiding bankruptcy for the time being, has seen its access to credit markets disappear and the value of its financial assets plummet. Resulting concerns about solvency have led to a withdrawal of bank-lending facilities and supplier credit.

The situation in California is of particular concern because of the major role the state plays in the regional and national economies. California's economy is equivalent to about 13 percent of U.S. gross domestic product (GDP), and it has accounted for an even larger share of U.S. GDP growth in recent years. Some businesses and consumers have been affected by production losses, lost wages, and higher energy bills resulting from rolling blackouts and higher natural gas prices.

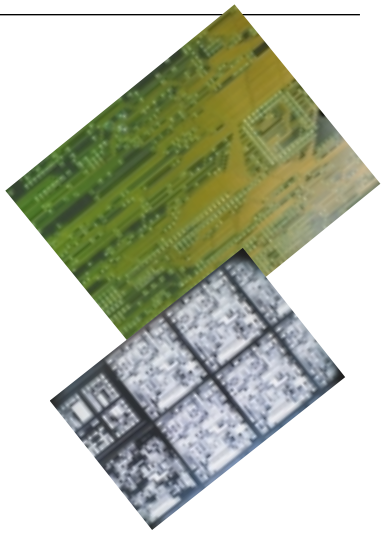
The power supply crunch in California and the West could affect the region's economy, as energy supply uncertainty could reduce investment in the region. California's troubles could also spill over to the national economy:

- California accounted for 11 percent of U.S. manufacturing output in 1998. Sectors in other regions that rely on those products, or that supply inputs to California manufacturers, may share any pain caused by the energy squeeze.
- Disruptions to California's economy could have negative impacts on our international trade. California accounts for over 16 percent of total U.S. commodity exports; nearly 25 percent of industrial equipment and computers, electronics, and instruments exports; and over 15 percent of farm commodity and food product exports.
- The credit problems of the California utilities have boosted commercial paper rates for all lower-rated borrowers, and liquidity in the commercial paper market has fallen. This will push some firms to seek other sources of financing, which can be more costly than commercial paper.

American consumers and businesses are best served when markets function freely. Free markets allow prices to reflect changes in demand and supply, and avoid subsidies, price caps, and other constraints.

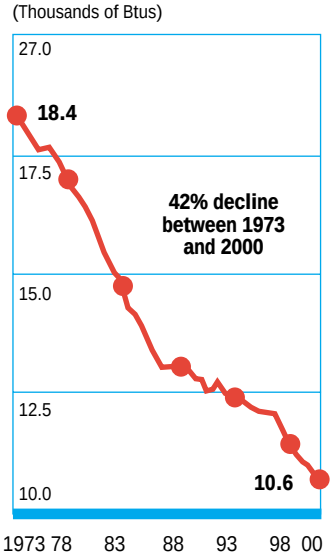
Improvements in Energy Efficiency Can Help

Improved energy efficiency strengthens energy security. The 42 percent decline in the intensity of U.S. energy use since the energy crisis in 1973 reflects a combination of technological advances, conservation ef-



The Silicon Valley Manufacturing Group recently estimated that its nearly 200 members lost over $100 million dollars because of only one day of rolling blackouts in California.

Figure 2-5
Conservation Through Higher Efficiency
Energy Consumption per Dollar of Real GDP



Energy intensity is the amount of energy used to produce a dollar's worth of gross domestic product (GDP). As a result of the 42 percent decline in energy intensity since the first energy crisis in 1973, the U.S. economy is far better prepared today than it was in the 1970s to adjust to energy price or supply shocks.

Note: Real GDP in 1996 chained dollars.
Source: U.S. Department of Energy, Energy Information Administration.

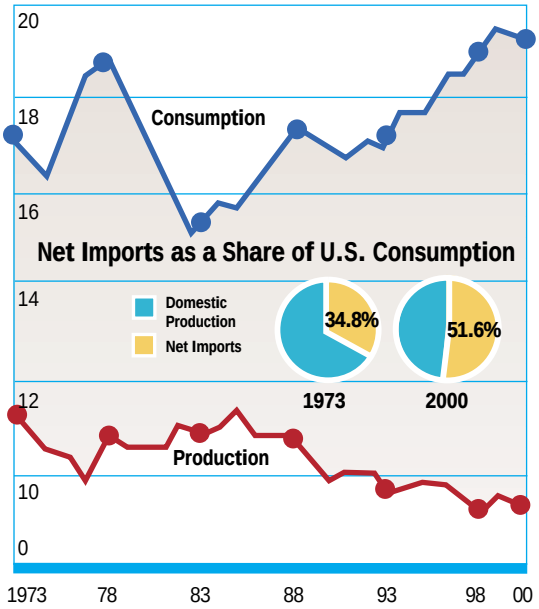
forts, regulatory action, market response, and a shift toward a service economy (Figure 2-5). Our improvements in energy efficiency have prevented our current energy problems from becoming worse.

The macroeconomic effects of a substantial rise in energy prices take two forms. First, to the extent that energy resources are imported, more U.S. dollars must be sent abroad to finance energy consumption, thus reducing funds available for investing in our own country. Second, higher prices cause dislocations among certain sectors of the economy, which could ultimately feed through to lower GDP growth and higher inflation.

Reliance on Foreign Energy

Between 1973 and 2000, U.S. dependence on foreign oil rose from about 35 percent to more than 52 percent of U.S. consumption (Figure 2-6). During the same period, the import share of natural gas consumption climbed from less than 5 percent to more than 15 percent and continues to rise.

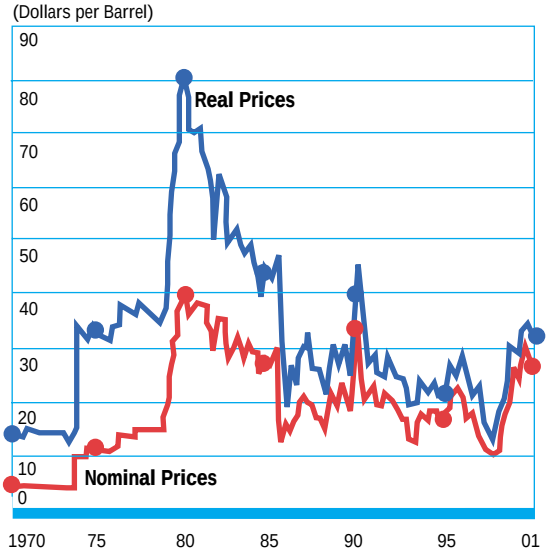
Figure 2-6
Dependence on Oil Imports Is Rising
(Millions of Barrels per Day)



Over the past few decades, U.S. consumption of oil and petroleum products has increasingly outpaced domestic production. Today the United States imports over half of the oil it consumes—up from about 35 percent in the early 1970s.

Note: Petroleum includes both crude oil and petroleum products.
Source: U.S. Department of Energy, Energy Information Administration.

Figure 2-7
Oil Prices Have Risen Sharply
Monthly Spot Price of West Texas Intermediate Crude Oil
(Dollars per Barrel)



Despite the sharp rise in crude oil prices since late 1998, real prices still remain lower than at any time from 1974 to 1985.

Note: Real prices in 2000 dollars. Prices deflated using the Consumer Price Index–Urban (CPI–U) Research Series for all items linked to CPI–U–X1 prior to December 1977.
Sources: Wall Street Journal; U.S. Department of Labor, Bureau of Labor Statistics.

Imports of energy products make up nearly 11 percent of all U.S. imports. By contrast, U.S. energy exports are relatively small. The energy trade deficit relative to our GDP represents the share of U.S. income that must be exported to purchase foreign fuel to meet domestic energy needs. The U.S. energy trade deficit in 2000 was about $120 billion, most of which was spent on oil imports.

As a share of GDP, the energy trade deficit had fallen to as low as 0.4 percent at the beginning of 1999, when prices for imported crude oil were less than $10 a barrel. However, by the end of 2000, these prices had tripled to more than $30 a barrel (Figure 2-7). As a result of both the oil price spike and growing U.S. demand, the energy deficit deteriorated significantly to 1.3 percent of GDP by the fourth quarter of last year—the largest deficit relative to GDP since the mid-1980s (Figure 2-8). The rise in oil prices alone has added about 0.7 percent of GDP to the U.S. trade deficit, compared to 0.9 percent in the euro currency area, and 0.8 percent in Japan.

Financial markets react to energy costs and the effect those energy costs have on both individual firms and sectors of the market.

Figure 2-8

The U.S.Energy Trade Deficit Has Worsened

(Percent)

The energy trade deficit relative to GDP represents the share of domestic income that must be exported to support domestic energy needs. For the past several years, the United States has been a net importer of energy products. As a consequence, our energy trade balance has been in deficit. By the fourth quarter of 2000, the energy deficit had deteriorated significantly to 1.3 percent of GDP—the largest since the mid-1980s.

Note: Plotted quarterly through the fourth quarter of 2000.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.

Net U.S. oil imports are 4 billion barrels a year, which means that each $1 increase in the price of imported crude oil boosts U.S. expenditures by about $4 billion. Given these guidelines, the $20 per barrel increase from early 1999 to late 2000 translates into an export of roughly $80 billion a year (0.9 percent of GDP) when measured from the low price prevailing at the end of 1998.

Impacts of Energy Prices on Financial Markets

An analysis of the financial impacts of higher energy prices can be divided into two parts: the effects on individual firms whose securities comprise the financial markets, and the macroeconomic impact on inflation and interest rates. Rising energy costs and greater volatility in energy prices can have a negative effect on both individual firms and the broader financial environment, generally producing lower asset prices and higher interest rates. The financial market impact to date of rising energy prices has been limited to firms with high sensitivity to energy costs and to those with significant exposure to the California crisis. The second broad effect of rising energy costs is an increase both in measured inflation

and in expectations for future inflation. Both factors have considerable impact on interest rates and, therefore, on the borrowing costs for businesses and consumers throughout the economy.

Inflation Expectations and Interest Rates

Measurable inflation, for both producers and consumers, is a primary concern of the Federal Reserve in conducting monetary policy. Energy costs represent roughly 16 percent of the producer price index for finished goods and 8 percent of the consumer price index. This means that sharply rising energy costs can have a substantial impact on the Federal Reserve's decision-making process. Additional impacts will come from the market's anticipating Federal Reserve actions and pushing short-term interest rates higher than they otherwise would have been. Higher short-term interest rates raise the nominal cost of borrowing for firms and individuals and can slow economic growth.

Rising energy prices can also raise the inflation expectations of lenders, which can result in higher interest rates for borrowing at longer maturities. Rising long-term interest rates can reduce long-term investment, limiting future economic growth and productivity gains. Such an outcome would carry negative consequences for growth-sensitive financial sectors, such as equity and high-yield debt markets.

More broadly, declining credit fundamentals for certain business sectors could raise borrowing costs for firms not directly affected by higher energy prices. For example, commercial paper rates for all lower-rated borrowers have been affected by the credit problems of the California utilities, and liquidity in the market has fallen. As a result, firms may need to seek other sources of financing, such as bank loans (if obtainable) or asset-backed loans, that can be more costly than traditional commercial paper issuance.

Global Financial Markets

The upward pressure on interest rates that may result from higher U.S. energy costs also affects markets beyond our borders. U.S. monetary policy and related movements in short-term interest rates can have a significant impact on other countries. While the effect varies from region to region, many emerging market economies, particularly in Latin America, are vulnerable to upward moves in U.S. interest rates.

Higher nominal interest rates in the developed countries tend to reduce the amount of capital flowing to emerging markets. To the extent that this reduces investment, economic activity may be further reduced. In addition, borrowing in dollars is a significant source of funding for sovereign and private-sector entities worldwide, particularly in the emerging markets. Rising U.S. interest rates will increase the interest expenses for these borrowers, diverting funds from more productive uses and reducing overall credit quality.

The global market for energy is highly fragmented and region-specific, with the exception of oil. Nevertheless, certain nations and regions are net importers of energy and are highly sensitive to changing prices. Japan, a major importer of oil and natural gas, is particularly vulnerable. Europe is a net importer of energy, with certain exceptions, while emerging market nations vary widely in their dependence on foreign energy sources.

At the macroeconomic level, rising energy prices will increase the current account deficit of energy-importing nations. Since current account deficits must be financed, these nations will most likely need to pay higher interest rates to attract the necessary capital. As noted, this will tend to reduce domestic investment and lower long-term growth. In some countries, such as the United States or Japan, changes in interest rates and growth expectations can have substantial global impact.

Central banks and monetary authorities vary in the degree to which they focus on inflation in setting monetary policy, making some countries more or less likely than others to raise interest rates in an environment of rising energy prices.

Although Japan maintains a current account surplus due to manufacturing exports, its role as an international creditor could diminish. This may have additional impacts on the global financial markets, since Japanese financial institutions are generally suppliers of global credit.

The impact of rising energy costs on the dollar is likely to be mixed. While slower U.S. growth generally reduces demand for dollars, rising oil prices are likely to increase demand, since oil contracts are usually denominated in dollars.

Summary of Recommendations

★ The NEPD Group recommends that the President direct the Secretary of Energy to explore potential opportunities to develop educational programs related to energy development and use. This should include possible legislation to create public education awareness programs about energy. Such programs should be long-term in nature, should be funded and managed by the respective energy industries, and should include information on energy's compatibility with a clean environment.

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★ The NEPD Group recommends that the President increase funding for the Weatherization Assistance Program by $1.2 billion over ten years. This will roughly double the spending during that period on weatherization. Consistent with that commitment, the FY 2002 Budget includes a $120 million increase over 2001. The Department of Energy will have the option of using a portion of those funds to test improved implementation approaches for the weatherization program.

★ The NEPD Group recommends that the President support legislation to allow funds dedicated for the Weatherization and State Energy Programs to be transferred to LIHEAP if the Department of Energy deems it appropriate.

★ The NEPD Group recommends the President recognize unique regional energy concerns by working with the National Governors Association and regional governor associations to determine how to better serve the needs of diverse areas of the country.

★ The NEPD Group recommends the President direct FEMA to prepare for potential energy emergencies.

- FEMA should work with states' Offices of Emergency Management as they expand existing emergency operations plans to identify potential problems and address consequences of the power shortages. FEMA should use its current Regional Incident Reporting System to identify any situations that might demand immediate attention.
- Using the structure of the already existing Federal Response Plan, FEMA should conduct Regional Interagency Steering Committee (RISC) meetings for states affected by the energy shortfalls. The RISC is a FEMA-led interagency committee comprised of agencies and departments that support the Federal Response Plan. Either an upcoming, scheduled RISC meeting or a special-focus RISC meeting can be held to identify the short-term energy outlook, as well as any expected consequences, in each of the states during the peak summer season.