IRET Congressional Advisory

INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

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THE ENERGY BILL CONFERENCE — FUEL FOR FOLLY

The House and Senate have both passed energy bills, which must now be reconciled in conference. Judging from the contents of the two bills, the best outcome for the conference would be a deadlock and a return to square one in the next Congress.

The House bill has three good features, but is saddled with a bunch of ill-advised tax credits and subsidies. The Senate bill has one good feature of its own, and lacks or waters down the good features of the House bill. The Senate bill has fewer subsidies, but adds mandates that would do extraordinary economic mischief.

The House and Senate have both passed energy bills, which must now be reconciled in conference. Judging from the contents of the two bills, the best outcome for the conference would be a deadlock and a return to square one in the next Congress.

The pluses in the House bill are:

• Various provisions for faster tax depreciation or fuller access to depletion or intangible drilling allowances for various conventional energy production and transportation properties against the regular corporate and alternative minimum taxes. Since the ideal tax treatment of investment is immediate expensing, faster or less restrictive write-off of these expenses is sound tax policy. The Senate bill has fewer and less generous provisions.

• Phase-out of a 4.3 cent a gallon tax on railroad diesel and inland waterway fuel.

• Drilling in a tiny corner of the Arctic National Wildlife Refuge. If OPEC insists on keeping world oil prices above the levels needed to make Alaskan oil competitive, it is of benefit to drill there. It would add a bit to world supplies and help keep the OPEC price from going even higher. The Senate bill rejects this provision.

The minuses in the House bill are:

• A raft of so-called "conservation provisions", including new or increased tax credits or mandates for producing energy from uneconomical non-conventional sources (e.g. a mandate for increased use of alternative fuels including ethanol, tax incentives for clean coal and coal gasification projects, agricultural and animal waste, etc.) or buying excessively energy efficient products whose added cost does not match the energy savings (e.g. tightening of the deadly CAFE standards, and credits for "alternative" motor vehicles, energy efficient housing, solar hot water, and other items). These provisions are reminiscent of the silliest features of President Carter's "moral equivalent of war" energy policy. They would divert us from using cheap energy to using more expensive energy or energy substitutes. The market economy normally encourages us to take resources worth $.50 and turn them into output worth $1, adding value in the process. These tax credits and subsidies encourage us to take resources worth $1 and turn them into output worth $.50. This is not a bargain. It does not add to GDP, it reduces it.

• A slew of research and demonstration projects, many of which should either be left to private sector

funding or dropped. If these projects show sufficient promise of yielding a market return, the private sector can do them. If not, they are probably not worth doing. If stronger patent protection is needed to make these experiments worth pursuing, then it is better to amend the patent law rather than throw federal money into the projects.

The plus in the Senate bill is:

• Reform of some highly restrictive regulations in the Federal Power Act, the Public Utility Holding Company Act, and the Public Utilities Holding Company Act of 1978. The changes would ease restrictions on mergers and acquisitions and would help to rationalize the industry and strengthen its finances by achieving economies of scale in management and production. The House conferees are likely to concur.

The minuses in the Senate bill are:

• Many of the wasteful and distorting tax credits that the House adopted. The Senate actually has a few less.

• A large increase in the tax credit per gallon for the retail sale of alternative fuels (read ethanol), and a mandate for the increased use of ethanol that goes even further than the House bill. Ethanol is more expensive (requires more resources to produce) than traditional gasoline. It takes as much energy in the form of oil, gas and coal to fuel the tractors, fertilize the crops, and process the mash into ethanol as the ethanol generates in turn. So the ethanol does not reduce dependence on fossil fuels; it does the environment no good; it is a waste of labor and equipment. Ethanol is a grossly inefficient circuitous subsidy to farmers; we'd be better off sending them bigger checks via a strengthened farm income support program, which at least involves no wasted physical resources. Even better would be a strong push for freer trade in agricultural products and reduced subsidies in Europe, which would bolster U.S. exports.

• A requirement that electricity producers generate 10% of their power from renewable sources by 2020. If these sources become competitive with other sources of power, the power producers will use them without a mandate. If they do not become competitive, this mandate would force us to spend more to obtain our electricity than we need to. Higher cost means higher resource use for the same output, i.e., less efficiency, more waste.

• A requirement, five years hence, that producers who emit more than 10,000 metric tons a year of greenhouse gases report their emissions. In addition to the regulatory burden, this can only be a first step toward implementing Kyoto-style controls through the back door. That road leads to higher production costs, more expensive goods and services, and lower living standards. The Senate rejected Kyoto for good reason, and the Administration has successfully argued against such targets in Johannesburg on the grounds that it would hurt developing nations. If these targets would be hurtful abroad, they would also be hurtful here.

The House bill would cost $36.5 billion over 10 years, about 60% wasted. The Senate bill would cost $20.6 billion over 10 years, about 75% wasted. The wasted money would be better spent on broad-based reductions in the taxation of saving and investment, such as faster depreciation, relief from the double taxation of dividends, a lower corporate tax rate, or liberalized retirement savings plans.

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Note: Nothing here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before the Congress.