IRET Congressional Advisory

INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

IRET is a non-profit 501(c)(3) economic policy research and educational organization devoted to informing the public about policies that will promote growth and efficient operation of the market economy.

July 25, 2005 **Advisory No. 191**

THE ENERGY BILL CONFERENCE

Dear readers:

Some legislation is so bad that one must either laugh or cry.

Two years ago, we cried that the energy bill was loaded with tax breaks and subsidies to encourage the use of higher cost sources of energy and to promote conservation efforts that eat up more resources than they save.

Fortunately, that bill failed in the Senate (for all the wrong reasons). Unfortunately, the new bill has the same problems, compounded.

So this year, we opt to start with a laugh, to wit, a poem in the manners of Mother Goose, Dr. Seuss, and Ogden Nash. The footnotes are a gas, so to speak. The morals are explored more seriously in the subsequent text, but even that is energized, as it were, with puns.

May the power of the farce be with you.

Stephen J. Entin
President and Executive Director

The Hamburger Bill[1]

There was an old woman[2] who lived in a shoe.[3]
When the price of hamburger[4] went up, she knew what to do.
"Since ground chuck is too pricey, in my opinion,
I'll feed my fifty-one children on rare filet mignon!"[5]

With her limited budget, they ate just three grams each,
And the rest of the meal was priced out of reach.
With no carbs or veggies, it was no nutritional winner,
And all of her children got thinner and thinner.[6]

Child and Family Services ran her budget on a spreadsheet by Quicken,[7]
And their home-ec advisor said, "Dear, switch to chicken.[8]
When living gets costly, buy whatever is cheaper,
Not items that put you in debt even deeper.

"And if buy store bought birdies you rather would not,
You can raise your own fowl on the north end of your lot.[9]
And your millpond[10] is loaded with natural bass,[11]
So your kids can go fishing[12] for protein en masse."

But the old woman was a groupie of Greenpork United,[13]
And by this sound advice was repelled, not delighted.
She stubbornly stuck to her behavior dimwitted,
Until fifty of the children[14] voted[15] to have her committed.

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1 ***Energy bill.***
2 ***Congress.***
3 ***Nat'l historic Indmrk; six dens, river view; lg domed Ir room, 600-car garage, staff qrtrs; landscaped grounds abut federal parkland,- zero property tax; condo fees & maintenance pd by taxpayers.***
4 ***Imported sweet crude oil and gasoline.***
5 ***Ethanol (which only looks cheap and energy efficient if you ignore the cash subsidies and the oil used to produce it, and the lower energy content and the lower mileage you get from it) and solar, wind, and biomass (needing tax credits that someone has to pay for).***
6 ***Except little Dee-Cee, who did the shopping and treated herself to McDonalds en route.***
7 ***If you need a spreadsheet to see that 3 is less than 17, you have your own set of problems.***
8 ***Any other next lowest cost source or grade of oil, natural gas, coal, hydro, or nuclear power.***
9 ***ANWR, if North Slope oil and gas are cost competitive without subsidies, including for pipelines, which should take the most cost-effective route regardless of politics and national borders.***
10 ***Three oceans* and a big gulf. (*Yes, three. Remember the Arctic!)***
11 ***Natural gas (and oil).***
12 ***Offshore drilling, in our own back yard, regardless of state objections, no waiting for "studies".***
13 ***U.S. Soccer League contraction team pledging "Goals for Gaia!"***
14 ***All except Dee Cee, who would have objected, but wasn't allowed to vote.***
15 ***In the 2006 election?***

Bad news bears repeating?

One of the concerns driving the energy bill (pun intended) is that the demand for and price of oil is rising, forcing up the price of gasoline and competing energy sources, such as natural gas and coal, and of electricity derived from them. This hurts people in the wallet. If the rising cost of energy is the concern, why does the energy bill force people to buy even more expensive energy alternatives? Why does the bill push people to spend more on conservation measures than the measures save in energy costs? That is the effect of the energy bill's numerous subsidies and tax credits for uneconomical alternative fuels, and of its mandated use of energy-efficient but cost-inefficient equipment in place of market-based outcomes.

If the rising cost of energy is the concern, why does the energy bill force people to buy even more expensive energy alternatives? Why does the bill push people to spend more on conservation measures than the measures save in energy costs?

From subsidies and credits and long-shot technologies and things that go bump in the budget, Good Lord, deliver us.

The House bill has $8.1 billion in tax reductions over ten years, mostly speeding cost recovery allowances for production of traditional forms of energy, bringing the allowances more in line with the actual cost of the equipment. These changes are consistent with sound tax reform. The Senate would spend $18 billion, about half going for subsidies and credits for alternative, non-traditional, i.e., speculative and otherwise uncompetitive, sources of energy. The Senate would impose $4 billion of "revenue offsets". The conference should favor the House approach.

Solar and wind. Solar power and wind power would get an extension of expiring tax credits to encourage their use. Without these credits, they could not compete with traditional sources of power. The resources needed to create and maintain the solar arrays and windmills, involving large up front capital outlays, cost more than the resources used to produce and employ energy from traditional sources. We get less total output and income from our limited supplies of labor and capital using these alternative fuels. If these were labor intensive operations, it would be called featherbedding. Since they are capital intensive, we'll just call it waste.

Ethanol. Ethanol, an alternative vehicle fuel, costs more to produce than ordinary gasoline or diesel. That is why it cannot compete without subsidies, credits, or differential tax treatment. People pay for these subsidies as taxpayers, and for the net cost of the fuel as consumers. When the two costs are added together, people are paying more for the alternatives than they would have paid for the gasoline or diesel fuel.

Furthermore, each gallon of ethanol delivers less energy than a gallon of gasoline. Vehicles get lower gas mileage on ethanol blends. More of it must be burned to go the same distance. Buying more mean paying more. According to the Environmental Protection Agency (see www.fueleconomy.gov), test vehicles burning a blend of 85 percent ethanol and 15 percent gasoline get gas mileage about 25 percent lower than on gasoline alone. They would need to burn four-thirds as many gallons to go the same distance. Even if the ethanol blend cost the same as gasoline after the ethanol tax break, it would still cost 33-1/3 percent more to drive the same distance. Even requiring a 10 percent ethanol and 90 percent gasoline blend, which presumably would reduce mileage proportionately less, would raise the cost of driving by about 3 percent. With gasoline prices more than double a year ago, why would we want another 3 percent hike in the cost of driving? (Let alone the cost of the subsidy.)

Mandated field tests, fuel switching, low income conservation assistance, and consumer energy education at public expense. The Senate bill is chock full of non-market based mandates, credits, studies, and demonstration programs that experiment with or prop up the use of alternative fuels, or favor, subsidize, and promote conservation via the purchase of energy efficient appliances and other products. These efforts are best described as wasteful, speculative, expensive, and meddlesome. For example, it contains:

- Congressionally mandated increases in CAFE standards if the Transportation Department doesn't move fast enough. (People are more likely to die in small cars. Add that price to the cost of the gasoline that would be saved.)

- Guidelines for federal procurement of alternative fueled and hybrid vehicles, a mandate for exclusive use of alternative fuels in dual fueled vehicles, and federal purchasing requirements for ethanol-blended gasoline and biodiesel.

- Mandate pilot program for alternative fueled school buses, a fuel cell bus development and demonstration program, a renewable fuel program, and a loan guarantee program for converting municipal solid waste into fuel ethanol and other commercial by-products.

- Biodiesel credit expansion, credits for new hybrid vehicles, alternative fueled vehicles, and related infrastructure.

- Authority for grants to state and local governments, private non-profit community development organizations, and Indian tribes to improve energy efficiency, to develop renewable energy supplies, and to increase energy conservation in low-income areas. Authority for the Secretary of Energy to allocate funds to States that establish an energy efficient appliance rebate program. Credits for energy efficient buildings, public housing, private housing, home improvements, and business installation of fuel cells and microturbine power plants. Amends many programs to favor increased use of and education about energy-efficient products.

- Extension of the renewable electricity production credit to electricity from biomass, swine and bovine waste nutrients (what, no sheep and goats?), geothermal and solar energy, small irrigation power, municipal biosolids, and recycled sludge.

Unfortunately, the energy conference will not include the MTBE legal protection from the House bill, for fear of another rejection by the Senate. A proposal was rejected to substitute a fund for MTBE clean-up... [which] would have pushed most of the cost of what is largely a federal mistake onto the budgets of states and private industry.

Some of these efforts would be prompted naturally by the increased cost of oil and gasoline, where they make economic sense, without federal intervention. To force these changes beyond that point, and to use taxpayer money, would be wasteful. Federal education efforts are nothing in comparison to the lesson people learn when they see the prices displayed at the pump or open their electric and gas bills. If money is to be given to state and local governments, or to the poor, they may have more urgent uses for that money than buying energy efficient buses, stoves, and air conditioners. There has been no cost-benefit analysis of these programs.

The search for hydrogen-powered and fuel cell cars and for better gas-electric hybrids should be left to the private sector. Hybrid technology is more advanced, and there are several hybrids on the market now, but hydrogen and fuel cell cars are still experimental. Even with the better gasoline mileage the hybrids provide, and the current high price of gasoline, the fuel savings do not cover the added cost of the hybrid over the life of the car. The tax credit for buying hybrids should be ended.

Decisions as to production and consumption of these vehicles should be left to the market. The mandated use of hybrids or vehicles that run on natural gas in government car and bus fleets should be ended too. They should be used when they are cheaper for taxpayers and riders, and not otherwise. Instead, the Senate bill expands on federal purchases of ethanol-blended gasoline and biodiesel.

The main advantage of the hydrogen and fuel cell cars is that they are low- or non-polluting, and some may argue that the pollution externality justifies the government intervention. Unfortunately, commercially viable versions and the fueling stations they would need may be costly to develop and years away. Current technology makes new vehicles very clean. It is not clear (pun intended) that the benefits of eliminating remaining emissions would be worth the cost of developing the alternatives. A cost benefit analysis is in order before we commit government money.

Fix the grid, lock out the lawyers, twirl the clocks, and call it quits. The remaining energy bill provisions are costly bloopers.

The Senate bill favors one potential natural gas pipeline in Alaska over other possibilities (including lines through Alaska and Canada that might reach added deposits) and would subsidize construction via an unnecessary Federal loan guarantee.

A few good mentions?

There are a few items in the bills that are worth doing. They should be stripped out and passed separately, or as part of fundamental tax reform or deregulation legislation.

Promoting upgrades in the electric power grid, regulatory reform, extension of PriceAnderson legal protection for nuclear power. The bills would repeal the Public Utilities Holding Company Act of 1935 and amend the Public Utility Regulatory Policies Act of 1978. Repeal of PUCO is long overdue. This Depression era relic forbids control by one company of non-adjacent electric power providers. It limits the number of investors that can bring new money to this important sector, and makes it harder to upgrade the power grid and improve interconnectivity. The bills also seek to foster better coordination of information sharing and crisis management among utilities through stronger regional oversight by regulatory agencies. Added regulatory powers for FERC over mergers and regional coordination are controversial.

Faster depreciation for energy and pollution abatement facilities. Tax provisions that would allow faster depreciation of certain energy-related and pollution control investments are a good step, but it would be a better step if the enhanced cost recovery were extended more evenly across all such investments. Ideally, all investment should be expensed the year it is undertaken (with adjustments to the tax treatment of financing to avoid negative tax rates), as would be the case under fundamental tax reform.

MTBE legal protection. MTBE, an additive mandated by federal law to promote cleaner burning of gasoline, has, when spilled or leaked, polluted water supplies in various states. It renders the water unpalatable even in small concentrations, and is difficult and expensive to remove. The House bill would block frivolous lawsuits against the makers of MTBE that are based on "defective product" arguments. These arguments are themselves defective, and are motivated by the deep pockets of the suppliers, not the merits of the case. These suits needlessly drive up legal costs for producers. These costs are then passed on to consumers, who are the real source of the money in the deep pockets.

Unfortunately, the energy conference will not include the MTBE legal protection from the House bill, for fear of another rejection by the Senate. A proposal was rejected to substitute a fund for MTBE clean-up, paid for by manufacturers, refiners and gasoline retailers (including those who did not spill

the product), states, and the federal government. It would have pushed most of the cost of what is largely a federal mistake onto the budgets of states and private industry.

MTBE is not "defective". It is a chemical. It is what it is, and it does what it does. It is not polluting the water because companies are delivering an impure version of it. (They are not.) It is polluting the water because some people spill it, or leave it in leaking underground storage tanks. One might as well ask, if some pranksters dumped a truckload of salt into the town reservoir on Halloween, would the town council be justified in suing Morton? Of course not. Should they punish the pranksters? Of course. Under the House bill, the spillers would remain liable for clean-up costs, as they should be. Only the manufacturers would be off the hook for the defective "defective product" arguments. The Courts have ruled that cigarettes and guns, while dangerous, are not "defective products". When a gun is used in a crime, it is the criminal, not the manufacturer, who is at fault. The same principles apply to MTBE.

If there is a secondary tort here, it is government hubris. MTBE was mandated by the government as an additive to oxygenate gasoline to reduce pollution. Its properties were known. Other chemicals could have been used, but the government chose that one. Maybe it shouldn't have, but it did. Maybe it should have studied it a bit more first, but it didn't. Maybe the Clean Air Act sponsors should have had lunch with the Clean Water Act people, who might have reminded them about the leaking underground storage tank issue and the related "LUST" tax before MTBE was voted on. (Aren't both Acts voted on by the same Congress? Didn't anyone notice?) Maybe Congress should have let the market explore other ways to reduce pollution, but Congress thought it knew best and took the ball into its own hands - and fumbled it.

Extend daylight savings time into late March and early November. O.K., if it is shown to be cost effective. It would require adjustments of power meters and billing software, the cost of which would show up in electric rates, but it would reduce the cost of lighting in the early evening.

Conclusion

Fix the grid, lock out the lawyers, twirl the clocks, and call it quits. The remaining energy bill provisions are costly bloopers. They are reminiscent of the "agony of defeat" video clip from the "Wide World of Sports" lead-in. They should be dumped in a heap. Again.

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