Backgrounder
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Energy Bill Still Too Weighted Down to Power the Country

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The good news is that U.S. Senate leaders have drafted a scaled-back energy bill: the Energy Policy Act of 2003 (S. 2095). The Senate bill would slash about $17 billion from the conference report, the Energy Policy Act of 2003 (H.R. 6), making the 10-year price tag for this package around $14 billion instead of $31.1 billion.

The bad news is that the new, leaner bill "achieves the same goals the old bill did."[1] In other words, special interests would still receive substantial taxpayer subsidies—just not as quickly and as much—due in part to budget gimmicks that delay implementation of most of the provisions until later in 2004.[2]

For example, large agribusinesses would still be enriched through an ethanol mandate; the coal industry would still receive over $2 billion in subsidies; and uneconomical renewable resources would still be given preferential tax treatment. Moreover, unnecessary programs, studies, and grants would still be authorized—such as a $6.2 million study on the feasibility of converting motor vehicle trips to bicycle trips and $50 million to fund a five-year transit bus demonstration program.

Talking Points

- Under the guise of a national energy plan, both the conference bill (H.R. 6) and the "slimmed-down" energy bill (S. 2095) simply enrich special interests with generous taxpayer subsidies ($31 billion in H.R. 6 and $14 billion in S. 2095 over 10 years) without responsibly narrowing the nation's growing gap between supply and demand.
- H.R. 6 and S. 2095 use the tax code to modify economic behavior and distort the economic signaling of the marketplace. This will make the energy sector and the economy more inefficient. The market—not Congress—should determine the nation's energy winners and losers.
- The responsible and efficient way to enhance the nation's energy supplies is to remove the existing legal impediments to developing domestic resources in the Rocky Mountains, offshore, and on the Outer Continental Shelf.
- The ethanol fuel mandates in both bills are simply corporate welfare for large agribusinesses and a hidden tax on consumers.

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1. Press release, "Domenici Introduces Lean Energy Bill in Wake of Frist–Daschle Agreement for Swift Consideration," Committee on Energy and Natural Resources, U.S. Senate, February 13, 2004, at *www.energy.senate.gov/news/rep_release.cfm?id=218069* (February 17, 2004).
2. Update for Tuesday a.m., *Environment & Energy Daily*, February 17, 2004, at *www.eenews.net/EEDaily/Backissues/021704/021704d.htm*.

Likewise, under the new Senate energy bill, federal spending would continue to increase, and Congress would still interfere with the marketplace.

The Senate has just replaced one misguided, billion-dollar, pork-laden bill with another.

Regrettably, the new Senate bill still fails to meet the nation's future energy needs. Total energy consumption is expected to increase more rapidly than domestic energy supply through 2025.[3] As a result, net energy imports are projected to increase from 26 percent of total U.S. consumption in 2002 to 36 percent in 2025.[4] Yet the Senate proposal would do little to narrow the growing gap between supply and demand.

Given the major policy flaws in both the conference report and the Senate bill, Congress needs to scrap both pork-laden proposals, go back to the drawing board, and draft a sensible bill that would enhance the nation's energy security *and* ensure adequate, reliable, and affordable supplies of energy to consumers. A responsible plan would:

- **Authorize** access to domestic energy supplies that are currently off-limits, such as the Rocky Mountains and offshore;
- **End** taxpayer handouts to special-interest groups representing a wide array of large and small businesses, industries, and companies in the energy sector;
- **Strengthen** the country's energy infrastructure by:
    1. *Enhancing* the nation's electric reliability standards to ensure transmission grid reliability,
    2. *Granting* the Federal Energy Regulatory Commission (FERC) limited "backstop" authority to issue permits for interstate electricity lines in bottleneck areas,
    3. *Repealing* the antiquated Public Utility Holding Company Act,
    4. *Reforming* the convoluted federal lands permitting process, and
    5. *Delaying* the FERC plan to create a "standard market design" for the sale of electricity on the wholesale market.
- **Allow** Indian tribes, acting as sovereign nations, to set up their own regulatory systems for energy projects;
- **Privatize** federal power and eliminate the preferences that federal and municipal utilities and electric cooperatives enjoy; and
- **Allow** the market—not Congress—to determine the nation's energy winners and losers.

Moreover, the Senate energy bill would set back movements toward a reformed tax code. Not only does the bill contain enough tax arcana to keep many tax lawyers fully employed—thus, moving the Bush Administration away from its goal of simplifying the tax code—but it would also stand as a monument to using the tax code for economic engineering.

Quite apart from the need for more energy supplies, it is grossly unfair to ordinary taxpayers—both businesses and individuals—for Congress to use the tax code to benefit a few at the expense of everyone else.

Both bills would use the tax code to modify economic behavior, distorting the economic signaling of the marketplace and making the energy sector and the economy more inefficient. For example, if the energy marketplace is signaling that petroleum supplies are currently sufficient, then an effort by Congress to create greater supplies through tax incentives would drive down spot petroleum prices, distort returns on equity and assets used in exploration, and dislodge plans by companies to heighten their exploration activity when the price of oil justifies it.

Cost of Energy Plans

A closer look at the conference report and the Senate's new—and purportedly leaner—bill shows just how costly, pork-laden, and irresponsible both proposals are. The Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT)

3. U.S. Department of Energy, Energy Information Administration, *Annual Energy Outlook 2004 with Projections to 2025*, DOE/EIA–0383 (2004), January 2004, p. 6, at *www.eia.doe.gov/oiaf/aeo*.
4. *Ibid.*, pp. 6–7.

estimate that the conference report would increase *direct* spending by as much as $5.4 billion over the 2004–2013 period[5] for such activities as research on ultra-deep wells, coastal restoration in the Gulf Coast, and development of rural electric projects in distressed communities in Alaska.

More alarming, however, are the "incentives" purportedly needed to enhance the nation's energy supplies. In fact, these incentives are nothing more than giveaways to special-interest groups to buy their support for the bill. The CBO and the JCT estimate that the tax giveaways would total over $25 billion between 2004 and 2013, making the total price tag about $31 billion over 10 years.

The conference report, however, has even more giveaways and needless federal spending than are reflected in the CBO and JCT estimates—including a minimum of $46 billion in new spending authorizations over five years, subject to appropriation action. This figure does not even include other provisions in the bill that authorize "such sums as are necessary." Given the rapid growth in federal spending over the past several sessions of Congress, these new authorizations understandably call into question "promises" for fiscal restraint this year.

While less costly than the conference report (the Congressional Budget Office has not yet published an official estimate of S. 2095), the scaled-back Senate bill still uses the federal tax code to load the proposal with giveaways to special interests totaling about $14 billion. For example, the bill would still subsidize production of oil, gas, bio-diesel, and other types of fuels; give generous subsidies to large agribusinesses through a new ethanol mandate; and provide an $18 billion loan guarantee for construction of a natural gas pipeline in Alaska.

Giveaways to Special Interests

The generous handouts to special interests come in a variety of forms, such as tax credits, tax deductions, tweaks to the tax code, and other changes in existing laws. The tax titles (Title XIII) of both energy bills contain a number of subsidies, including the following:

Tax Credit for "Favored" Fuels—Production Tax Credit (PTC). Both the conference report and the Senate bill include a production tax credit (PTC). This market-distorting provision extends preferential tax treatment for uneconomical renewable resources used to produce electricity—including wind, closed-loop biomass, and poultry facilities. The conference report would expand this subsidy to include new resources: open-loop biomass, geothermal energy, solar energy, small irrigation power, and municipal solid waste (the Senate bill would also include bio-solids and sludge). This special-interest handout alone would cost $3 billion over 10 years (2004–2013).

Yet, despite two decades of taxpayer subsidies, grid-connected generators that use renewable fuels are projected to remain minor contributors to U.S. electricity supply—increasing from 9.0 percent of generation in 2002 to only 9.1 percent by 2025.[6] Generation from non-hydroelectric renewables is projected to increase from a mere 2.2 percent in 2002 to only 3.7 percent in 2025.[7]

Instead of subsidizing these uneconomical energy sources, Congress should enact legislation that would permit exploration of areas that are currently off limits, such as the Rocky Mountains, offshore, and the Outer Continental Shelf. This legislation—not taxpayer subsidies—is the responsible way to enhance the nation's energy supplies and provide consumers with abundant, affordable, and reliable energy.

Tax Breaks for Congressionally "Privileged" Fuels and Alternative Motor Vehicles. Both bills also include a variety of provisions that interfere with the marketplace for fuels and the vehicle industry at a cost of $4 billion over 10 years.

One scheme creates an artificial market for four select vehicles (so far rejected by the marketplace)

5. Congressional Budget Office, *Conference Agreement for H.R. 6, the Energy Policy Act of 2003*, letter to Representative Billy Tauzin (R–LA), chairman of the House Committee on Energy and Commerce, November 18, 2003, at *www.cbo.gov/showdoc.cfm?index=4800&sequence=0*.

6. U.S. Department of Energy, Energy Information Administration, *Annual Energy Outlook with Projections to 2025*, DOE/EIA–0383 (2003), January 2004, p. 85.

7. *Ibid.*

by providing a new tax credit for the purchase of hybrid motor vehicles, lean-burn diesel vehicles, alternative-fuel motor vehicles, and fuel motor vehicles. The conference report would also repeal (the Senate bill would modify) the current-law phase-out for the credit for electric motor vehicles. The free marketplace—not Congress—should determine whether consumers want these particular vehicles.

Select fuels, such as bio-diesel and certain bio-diesel mixtures, would also receive special treatment by means of a new tax credit. Additionally, the eligibility for the small-producer ethanol credit would double from a production capacity of 30 million gallons per year to 60 million gallons, and cooperatives would be allowed to pass through this credit to their patrons.

Taxpayer Subsidies for Specific Residential and Business Property. Likewise, the conference report and the new Senate bill include a variety of market-distorting, energy efficiency measures—including tax credits, deductions, and provisions to entice the purchase of specific products; the manufacture of particular appliances; the construction of certain homes; and specified improvements to existing property—at a price tag of $2 billion over 10 years. While conservation and energy efficiency are important components of a responsible energy policy, accurate price signals from the market—not congressional meddling with the market—should determine which energy efficiency measures consumers take and which products they purchase.

Subsidies for the Coal Industry. Coal-fired electricity generation is expected to continue growing in 2004 and 2005, driven by increasing demand for electricity.[8] While coal is essential to electricity production and the national economy, the costs of new, innovative, clean coal technologies should be borne by the industry—not the taxpayers. Both proposals include over $2 billion in handouts to the coal industry over 10 years.

Handouts for Oil and Gas Industries. Proponents of the generous tax breaks for the oil and gas industries—such as a tax credit for oil and gas production from marginal wells (wells that produce fewer than 15 barrels of oil a day and less than 90 thousand cubic feet of natural gas per day)—argue that these subsidies are not handouts, but merely incentives needed to increase domestic energy supplies. In the conference report, these subsidies would enrich the oil and gas industry by about $7 billion over 10 years. The Senate bill would delay some of these subsidies to make the proposal appear less costly in hopes of garnering votes from fiscal conservatives.

However, these incentives are needed only because Members of Congress do not have the political will to ensure that U.S. consumers have adequate, affordable, and reliable supplies of energy. If this were their goal—not special-interest handouts—they would have authorized oil and gas exploration in Alaska, in the Rocky Mountains, and on the Outer Continental Shelf. The tax breaks for the oil and gas industries would likely increase domestic supplies to some degree, but this is the wrong way to do it.

Tax Breaks for Reliability. The tax tweaks in this category are intended to enhance the delivery of the nation's energy supplies. For example, these provisions shorten the class life and recovery periods for natural gas gathering lines, distribution lines, and electric transmission property. They permit small-business refiners to claim an immediate deduction for up to 75 percent of the costs of complying with environmental regulations on sulfur emissions, and they also modify special rules for nuclear decommissioning costs. The Joint Committee on Taxation estimated that these handouts would cost taxpayers about $4.3 billion if Congress adopted the conference report.

The new Senate bill contains similar provisions. While well-intended, these tax tweaks favor certain investments rather than allowing market signals to determine where those investment dollars should go.

Additional Special-Interest Giveaways. The conference report also includes miscellaneous tax breaks for a variety of special interests. In fact, one of these taxpayer subsidies even gives a two-year suspension of tariffs on imported ceiling fans. According to *The Wall Street Journal*, this provision

8. U.S. Department of Energy, Energy Information Administration, *Short-Term Energy Outlook—January 2004*, released January 7, 2004, at *www.eia.doe.gov/emeu/steo/pub/steo.html*.

was added as a favor to Atlanta-based Home Depot, Inc.[9] While still too costly, the new Senate bill strikes this industry-specific handout from the energy bill.

Loan Guarantees

Regrettably, Congress's largesse is not limited to the tax title. Buried in both bills are various loan guarantees for specific projects. For example, the report authorizes a loan guarantee of up to $18 billion to support the construction of an Alaska natural gas pipeline from the North Slope to the lower 48 states—a project that industry has considered too economically risky to attract private investments.

Likewise, the bills authorize the Secretary of Energy to make loan guarantees (amounts to be determined by the Secretary) for a variety of clean coal projects around the country—including coal gasification, integrated gasification combined cycle technology, and petroleum coke gasification. While advancing clean power is commendable, the private sector should finance these projects without taxpayer subsidies.

The bills also authorize the Secretary of Energy to provide loan guarantees (no amounts given) for the construction of facilities to produce Fischer-Tropsch diesel fuel[10] and its commercial byproducts. Likewise, both bills authorize the Secretary of Energy to provide loan guarantees (no amounts given) for construction of facilities to process and convert municipal solid waste and cellulosic biomass into fuel ethanol and other commercial byproducts. If these facilities really merit construction, the marketplace will attract the private capital needed without the generous "assistance" of taxpayer dollars.

More Excessive Spending

Lest any special interest connected to the energy sector be left out of these generous taxpayer subsidies, Congress also created a host of unnecessary programs, studies, and grants. Under the conference report, these new spending authorizations would cost taxpayers tens of billions of dollars over the 10-year period.

The new Senate bill also includes costly and unwarranted new authorizations, such as $1.1 billion to restore the coastal impact of offshore oil and gas drilling, and $500 million for the development of rural electric projects in Alaska.

More Favors for Special Interests

Among the major beneficiaries of these handouts are corn farmers and big agribusinesses. One company alone, Archer-Daniels-Midland (ADM), produces over 40 percent of the nation's ethanol. Under the Clean Air Act of 1990, the federal government mandated reformulated gasoline (RFG) to improve air quality in smoggy cities. RFG requires either methyl tertiary butyl ether (MTBE) or ethanol to make gasoline supposedly burn cleaner.[11] Both bills create an artificial market for ethanol by mandating a doubling of its use by 2012. Consumers will pay for ethanol's special treatment with increased prices at the pump. Consumer demand—not congressional favors for special interests—should determine whether there is a viable market for ethanol.

Further, due to concerns about ground water contamination, both the conference report and the Senate bill ban the use of MTBE by December 31, 2014, and provide $2 billion in grants to assist producers of MTBE in converting to production of other fuel additives.

Given that the federal government established a fuel oxygenate standard that encouraged the use of MTBE, the conference report includes liability protection for producers and users of MTBE during the industry's 10-year phase-out. This safe harbor provision became one of the most contentious provisions in that report. The House approved the conference report on November 18, 2003, by a bipartisan vote of 246 to 180.

9. Shailagh Murray and John J. Fialka, "Energy Bill Is Laden with Tax Breaks," *The Wall Street Journal*, November 18, 2003.
10. Fischer-Tropsch diesel fuel contains less than 10 parts per million of sulfur and is produced from coal or coal waste through liquification.
11. Ben Lieberman, "NY's New Gas Crunch," Competitive Enterprise Institute, November 16, 2003, at *www.cei.org/utils/printer.cfm?AID=3751* (February 6, 2004).

Due in large part to this MTBE liability protection, however, Senate proponents of the report have been unable to garner the votes necessary to break a filibuster. Senate leaders recently negotiated an agreement on a new energy bill (S. 2095) that deletes the safe harbor provision, and the Senate is expected to vote on the new bill in the near future. Nonetheless, the House and Senate versions will still need to be reconciled before either energy plan can become law.

Other generous handouts for ethanol and motor fuels programs in these bills include $12 million for a resource center to further develop bioconversion technology using low-cost biomass for the production of ethanol at the Center for Biomass-Based Energy at the University of Mississippi and the University of Oklahoma; $125 million for research grants and development of renewable fuel production technologies; and $750,000 in grants to producers of cellulosic biomass ethanol and waste-derived ethanol in the U.S.

Moreover, in both bills, Congress would continue to meddle with the market by authorizing spending for research and development in specific areas of the energy sector. For example, the conference report authorizes $2 billion over five years for a hydrogen research program and almost $38 billion over five years for other select categories of energy research and development. These include commercial application activities such as $3.9 billion for energy efficiency; $3 billion for renewable energy; $2 billion for nuclear energy; $2.9 billion for fossil energy; and almost $24 billion for science projects.

The list of new spending authorizations for unnecessary taxpayer-funded programs, grants, and projects in these bills goes on and on. Congress needs to stop trying to micromanage the energy sector and allow the marketplace do what it does best—choose the nation's energy winners and losers.

Conclusion

Congress needs to remember that the primary purpose of a comprehensive energy plan is to provide consumers with sufficient, affordable, and reliable energy supplies. Regrettably, neither the conference report on H.R. 6 nor the new, slimmed-down S. 2095 achieves this objective. Instead, both bills simply enrich a wide range of special interests at the expense of taxpayers and consumers. Consumers would be better off without an energy bill than with either of these seriously flawed energy plans.

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