Backgrounder

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The Department of Energy Should Not Be the Green Banker

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Abstract: *The Clean Energy Deployment Administration (CEDA) proposed in the Clean Energy Financing Act would act as a "green bank" to provide loan guarantees to energy and automotive projects that Washington deems worthy. Similar to President Obama's proposed infrastructure bank, in effect, CEDA would distort the energy market by redirecting capital inefficiently and create unlimited taxpayer liability. As demonstrated in several European countries and by the Solyndra scandal, subsidies for green energy programs ensure that the public pays for the failures while the private sector reaps the benefits of any successes.*

On July 14, 2011, the Senate Energy and Natural Resources Committee marked up the Clean Energy Financing Act of 2011 (S. 1510). The bill would establish a federally owned, nonprofit Clean Energy Deployment Administration (CEDA) in the Department of Energy (DOE) to support the deployment of politically defined clean technologies. CEDA, also known as a "green bank," is an outgrowth of the loan guarantee programs of the Energy Policy Act of 2005 and the 2009 stimulus package. It would provide government-backed low-interest loans, credit enhancements, loan guarantees, and other financial mechanisms for certain energy and automotive projects that Washington deems worthy. President Barack Obama included a similar proposal for green projects in the infrastructure bank section of his American Jobs Act.[1]

However, while proponents call this "innovative financing," in reality it is a substantial and costly subsidy that invites unjustified government intervention

Talking Points

- The Clean Energy Financing Act of 2011 would establish the Clean Energy Deployment Administration to provide preferential financing and loan guarantees for clean technologies.
- Banks and venture capitalists, not the government, should assess risk and determine which investments make economic sense. The Department of Energy is not a bank and should not act like one.
- Two kinds of companies seek loan guarantees: economically uncompetitive companies, such as Solyndra, that need the guarantees to survive, and potentially competitive companies, which use the loan guarantee to pad their bottom lines.
- Loan guarantees are subsidies that offset the higher interest rates for high-risk projects by transferring the financial risk to the taxpayer.
- Artificially propping up industries by reallocating labor and capital toward uncompetitive projects, forcing customers to pay higher energy prices, and subsidizing failing projects are costly to the economy and the taxpayer.

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into the private energy marketplace. The Department of Energy has no business playing banker. CEDA would redirect capital inefficiently and create a massive taxpayer liability.

CEDA: A Permanent Loan Guarantee Expansion

When the federal government provides a loan guarantee, it enters into a contract with private creditors to assume the debt if the borrower defaults. According to the DOE, the purpose is to "allow the Federal Government to share some of the financial risks of projects that employ new technologies that are not yet supported in the commercial marketplace or where private investment has been inhibited."[2] If a company defaults on a federally backed loan guarantee, the taxpayer is on the hook.

This is not an appropriate role for the federal government. Two existing federal loan guarantee programs are of dubious value and have questionable objectives. Under Section 1703 of the Energy Policy Act of 2005, DOE has provided billions of dollars in loan guarantees for technologies that "avoid, reduce, or sequester air pollutants or anthropogenic emissions of greenhouse gases."[3] Section 1705 of the American Reinvestment and Recovery Act, more commonly known as the stimulus bill, added $8 billion to support additional loan guarantees,[4] including funding for the notorious Solyndra project.

CEDA would permanently extend these misguided policies by granting DOE unlimited authority to authorize loans without limiting the number of loans it can issue. The initial capitalization or expenditure would be $10 billion, and the Congressional Budget Office (CBO) projects CEDA to cost an additional $1.1 billion over the next five years.[5]

Picking Losers

Although the status of many loan guarantees is either conditional or recently closed, the first loans granted by DOE illustrate some of the problems with the program. The solar company Solyndra received one of the first stimulus loan guarantees—a $535 million loan. During a visit to the plant in 2010, President Obama said, "Companies like Solyndra are leading the way toward a brighter and more prosperous future."[6] In 2010, Solyndra closed one of its facilities and canceled its initial public offering. In August 2011, Solyndra filed for Chapter 11 bankruptcy and laid off its 1,100 workers. The company is now under criminal and congressional investigations into how it secured the loan guarantee, and Solyndra owes the taxpayers $527 million.

Solyndra is not the only "green" company having financial troubles. First Wind Holdings, another loan guarantee recipient, withdrew its initial public offering.[7] In these instances, the reason for providing financing was unclear because they were not economically viable endeavors. When the government makes decisions best left to the market, it increases the opportunity for and likelihood of crony capitalism, corruption, and waste.

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1. The infrastructure bank is a similarly bad idea. See Ronald D. Utt, "Obama's Peculiar Obsession with Infrastructure Banks Will Not Aid Economic Revival," Heritage Foundation *WebMemo* No. 3346, August 30, 2011, at *http://www.heritage.org/Research/Reports/2011/08/Using-Infrastructure-Banks-to-Spur-Economic-Recovery*.
2. U.S. Department of Energy, Loan Programs Office, "What Is a Loan Guarantee?" at *https://lpo.energy.gov/?page_id=29* (September 27, 2011).
3. U.S. Department of Energy, Loan Programs Office, "1703," at *https://lpo.energy.gov/?page_id=39* (September 27, 2011), and 42 U.S. Code § 16513.
4. 42 U.S. Code § 16516.
5. Congressional Budget Office, "Clean Energy Financing Act of 2011," *Cost Estimate*, August 16, 2011, at *http://www.cbo.gov/ftpdocs/123xx/doc12386/s-ceda.pdf* (September 27, 2011).
6. George Avalos, "Fremont Solar Tech Firm Solyndra to Shut Down, Lay Off Hundreds of Workers," *Mercury News* (San Jose), August 31, 2011, at *http://www.mercurynews.com/bay-area-news/ci_18795739?source=rss* (September 1, 2011).
7. David W. Kreutzer, "Green Jobs and Red Tape: Assessing Federal Efforts to Encourage Employment," testimony before the Subcommittee on Investigations and Oversight, Committee on Science, Space, and Technology, U.S. House of Representatives, April 13, 2011, at *http://science.house.gov/sites/republicans.science.house.gov/files/documents/hearings/2011%2004%2011%20David%20Kreutzer%20Green%20Jobs%20Testimony.pdf* (September 27, 2011).

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Loan guarantees artificially make even dubious projects appear more attractive and lower the risk of private investment. For instance, private investors sunk $1.1 billion into Solyndra. Much of the private financing came after the Department of Energy announced Solyndra was one of 16 companies eligible for a loan guarantee in 2007.[8] Private investors look at loan guarantees as a way to substantially reduce their risk. Even if a project seems to be a loser but has a huge upside (especially if complemented with other policies like a federal clean energy standard), private companies can invest a smaller amount if the government will back the loan. If the project fails, they still lose money, but the risk was worth it. Without the loan guarantee, these projects would probably not have been pursued, and that is why they fail.

Subsidizing Winners

In other cases, private financing was available so there was no need for preferential financing. For instance, Nordic Windpower received private funding in 2007, two years before the company received its loan guarantee.[9] Google invested $100 million in Shepherds Flat Wind Farm.[10] Although that investment was made after the loan guarantee, Google determined it to be a worthwhile investment. If that is the case, then the project should not need a loan guarantee.

Even if a project with a federally backed loan is successful, attributing the project's success to the loan guarantee is a huge assumption. Venture capitalists and other investors, who have much more expertise and knowledge than government bureaucrats in making investment decisions, are in a better position to determine which ideas and businesses have the most potential. Without the loan guarantee, projects with the least promise would either not attract investment or simply fail, freeing capital for risky, but more promising ventures. In contrast, a government loan guarantee program ensures that the public pays for the failures while the private sector reaps the benefits of any successes.

Loan Guarantees Distort the Market

Proponents of loan guarantees who argue that these programs come at minimal cost and are not subsidies ignore the fact that CEDA loans cause the same harm as direct government subsidies by distorting normal market forces and encouraging dependence on the government. By subsidizing a portion of the actual cost of a project through a loan guarantee, the government is allocating resources away from more-valued uses to less-valued uses. In essence, these guarantees and loans direct labor and capital away from more competitive projects.

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A loan guarantee program signals to the energy producer that the project does not need to be competitive. Rather, the green bank simply has to like it. This reduces the incentive for the energy investor or business to manage risk, innovate, and increase efficiency, and it crowds out other innovative energy projects that do not receive loan guarantees. While a loan guarantee or a below-market loan may be good for the near-term interests of the individual recipient, it is not good for taxpayers or long-term competitiveness.

Loan guarantees also encourage more government dependence. If the government moves to

8. IStockAnalyst, "Fremont's Solyndra Goes from Stealth to Solar Star," October 7, 2008, at *http://fefwww.istockanalyst.com/article/viewnewspaged/articleid/2686855/pageid/1* (September 30, 2011).
9. SustainableBusiness.com, "Nordic Windpower Raises $38M Led by Khosla Ventures," January 6, 2010, at *http://www.sustainablebusiness.com/index.cfm/go/news.display/id/19506* (August 29, 2011).
10. Rick Needham, "Shepherding the Wind," Google, April 18, 2011, at *http://googleblog.blogspot.com/2011/04/shepherding-wind.html* (August 29, 2011).

more actively subsidizing clean energy technology through CEDA, investors will wait to determine who the government winners will be before they spend more of their own money on innovative ideas, expanding their businesses, or hiring more employees. As Darryl Siry, former head of marketing at Tesla Motors (a loan guarantee recipient), said, "The existence of an 800-pound gorilla putting massive capital behind select start-ups is sucking the air away from the rest of the venture-capital ecosystem…. Being anointed by DOE has become everything for companies looking to move ahead."[11]

Reshaping, Not Stimulating, the Economy

The CBO's cost estimate for CEDA notes that funding would be available for "energy, transportation, manufacturing, commodities, residential, commercial, municipal, and other sectors of the economy."[12] Expanding the list of potential recipients to include coal with carbon capture and sequestration, natural gas vehicles, and energy efficiency technologies would not make the green bank acceptable. It would simply expand the green bank's potential to distort more sectors of the economy with subsidized financing.

As the subsidies are removed from these green energy industries, they collapse because they were developed in a bubble in which market demand and price signals were muted. The European experience with subsidizing renewable energy is a perfect example. This inevitable confrontation with reality demonstrated that the industry lacks the tools to survive unaided. When faced with a need for drastic budget cuts and job creation, Spain, the United Kingdom, Germany, France, and the Czech Republic decided to reduce subsidies for green energy programs, such as wind and solar energy. As a result, some companies have collapsed and others are either collapsing or face difficult roads ahead. Although each European country has taken a different approach to subsidize green technologies, the results have been the same: Artificially propping up industries by reallocating labor and capital toward uncompetitive projects and forcing higher energy prices on ratepayers is costly to the economy and the taxpayer.

Protecting Taxpayers and the Economy

Congress should resist the temptation to distort the energy market even further. Specifically, Congress should refuse to expand loan guarantee programs or to implement any new capital subsidy programs, whether through CEDA or the infrastructure bank.

American taxpayers cannot afford these programs, and they would put taxpayers on the hook for an untold number of projects that could fail. Even if the selected projects succeed, such programs give preferential treatment to those companies lucky enough to receive a loan guarantee from the government and increase the opportunity for and likelihood of fraud and corruption. The government needs to stop trying to pick winners and losers in the marketplace.

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11. Darryl Siry, quoted in Neil King Jr., "Venture Capitol: New VC Force," *The Wall Street Journal*, December 15, 2009, at *http://online.wsj.com/article/SB126074549073889853.html* (September 27, 2011).
12. Congressional Budget Office, "Clean Energy Financing Act of 2011," p. 2.