The Heritage Foundation
LEADERSHIP FOR AMERICA

BACKGROUNDER

No. 2832 | AUGUST 1, 2013

Government Energy-Efficiency Programs Are Subsidy-Laden Paternalism

Nicolas D. Loris

Abstract

Senators Jeanne Shaheen (D–NH) and Rob Portman (R–OH) recently introduced the Energy Savings and Industrial Competitiveness Act, which provides a host of federal subsidies to make buildings and manufacturing processes more efficient. If the payoff is so great, why can companies and families not make these investments without a push from the federal government? The legislation amounts to nothing more than handouts to companies in the energy-efficiency business at the taxpayers' expense. The Heritage Foundation's Nicolas Loris explains why markets have long been the best tool to drive efficiency, how the arguments for government intervention in the energy sector are off base, and how efficiency mandates and subsidies hurt families and businesses more than help them.

Earlier this year, Senators Jeanne Shaheen (D–NH) and Rob Portman (R–OH) introduced the Energy Savings and Industrial Competitiveness Act. This legislation provides subsidies for building efficiency improvements, workforce training programs, and advanced manufacturing processes.[1] Although some of the more pernicious ideas have been stripped from the bill, Shaheen–Portman remains a special-interest grab bag that skews decisions families and businesses should make on their own by luring them with taxpayer-funded handouts. Although proponents of Shaheen–Portman label the legislation a win for both energy consumers and the environment, it is a costly proposal that will cause Americans more harm than good.

Key Points

- Senators Shaheen (D–NH) and Portman (R–OH) introduced legislation that would provide subsidies for energy-efficiency upgrades in commercial and residential buildings, as well as for manufacturing processes and jobs training programs.
- The taxpayer-funded programs provided in Shaheen–Portman would benefit special-interest groups and promote corporate welfare. Families, businesses, and manufacturers should make efficiency upgrades on their own.
- The low-hanging fruit and "under-investment" in energy efficiency is much smaller than what is often touted, and attempts to correct for investment inefficiencies with mandates and subsidies skew the market and disregard preferences. They also create unintended consequences and market inefficiencies.
- Energy-efficiency regulations are not about reducing carbon dioxide and other greenhouse gas emissions. Most of the benefits the government calculates for efficiency regulations are from telling families and businesses what choices to make.

This paper, in its entirety, can be found at **http://report.heritage.org/bg2832**
Produced by the Thomas A. Roe Institute for Economic Policy Studies

The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
(202) 546-4400 | heritage.org

Corporate Welfare in Shaheen–Portman

Shaheen–Portman does not directly create any new federal efficiency mandates for the private sector, but it does create "voluntary" building codes for states and tribes to adopt and provides a number of handouts to meet and adopt these codes. States and tribes that do not meet the building certification requirements could receive federal support and the Secretary of Energy could also direct funds to implement the requirements. Further, up to $750,000 in taxpayer dollars would go to each state to train building-code officials.

Shaheen–Portman also promotes industrial efficiency programs and manufacturing goals to help energy-intensive companies save money through energy efficiency. The bill would allow the Secretary of Energy to award "grants or other forms of incentives" to study supply chain resources efficiency and to demonstrate energy use reductions of commercial products through supply chain efficiencies. But companies will make these investments on their own—if they believe the technology is promising, worth the risk, and the best use of their investment dollars. There is no excuse for taxpayers to shoulder this burden. Businesses are the ones that should pay to maximize efficiency.

All of the above-mentioned programs are nothing more than corporate welfare that promotes special-interest politicking. It comes as no surprise that over 200 businesses, advocacy groups, and trade associations support Shaheen–Portman.[2] When the federal government involves itself in the private sector by dangling taxpayer-funded handouts, of course businesses are going to support the legislation. For instance, The Dow Chemical Company, which endorses the Energy Savings and Industrial Competitiveness Act, received an Advanced Manufacturing Office grant. With $57 billion in sales and over $1 billion in research and development investments annually, Dow, like many other companies supporting the Act, does not need support from the taxpayer.[3]

Whether government spending on efficiency upgrades saves money is irrelevant. A far more pertinent question is why such upgrades should be supported by taxpayer dollars. Businesses do not need incentives or rewards for energy-saving behavior, because when the savings outweigh the costs, their reward is reduced energy bills and more competitive prices for their products. The companies selling energy-efficient products should promote their services to other companies instead of lobbying Capitol Hill.

Shaheen–Portman offers two compelling options to boost industrial competitiveness: national laboratories and a voluntary SupplySTAR program. For example, in order to improve efficiency, the private sector could utilize the capital and expertise at Department of Energy laboratories and the National Institute of Standards and Technology. Such research, however, should be funded by the private sector—any public-private partnership that is a cost share or federally funded and focuses on commercial energy activities is simply another handout.

Further, the SupplySTAR program proposed in Shaheen–Portman—a program that disseminates information on a voluntary basis about efficiency savings in supply chains—has merit. Yet, the department should not label SupplySTAR companies and products that comply with this program as the "preferred practices, companies and products in the marketplace for maximizing supply chain efficiency," as would occur under Shaheen–Portman. Those preference choices should be made by those in the industry and who use the supply chains.

Government Paternalism—Not Unrealized Savings

Supporters of energy-efficiency mandates and subsidies argue that, by failing to realize all of their possible energy savings, families and businesses are virtually throwing away money. Plenty of engineering analyses support the idea that an "efficiency

1. For a detailed analysis of a specific section of the legislation, see Nicolas D. Loris, "The Shaheen–Portman Energy Efficiency Bill: A Costly, Inefficient Use of Taxpayer Money," Heritage Foundation *Backgrounder* No. 2807, June 7, 2013, http://www.heritage.org/research/reports/2013/06/the-shaheenportman-energy-efficiency-bill-a-costly-inefficient-use-of-taxpayer-money.
2. Shaheen–Portman Energy Savings and Industrial Competitiveness Act Endorsements, S.1000, 112th Cong., 1st Sess., http://www.shaheen.senate.gov/priorities/issues/energy/The%20Energy%20Savings%20and%20Industrial%20Competitiveness%20Act%20Endorsements.pdf (accessed July 29, 2013).
3. The Dow Chemical Company, "Our Company," http://www.dow.com/company/index.htm (accessed July 29, 2013), and The Dow Chemical Company, "Research and Development," http://www.dow.com/michigan/locations/midmichigan/research.htm (accessed July 29, 2013).

gap" exists and investments will yield substantial savings.[4] But there are several problems with these engineering analyses of energy investments.

The most glaring problem with many of these engineering analyses is that they fail to take into account the costs of the paternalistic role of the federal government. That is, when the government forces efficiency measures on people, it takes away choices, or at the very least, overrides them. When families and firms are not spending money for the most energy-efficient technology, it is not that they are acting irrationally; they simply have other preferences, budget constraints, and other ignored costs such as comfort, convenience, and product quality. A family may know that insulating a home will save energy in the long run, but they may choose to spend that money on a vacation or perhaps they do not want to deal with the headache of home renovation.

Other problems with efficiency spending include questions about the cost of the upfront investment, the payback horizons, overstated energy savings, and predictions of future energy prices, all of which play an important role in the actual savings realized from investments and make families and businesses skeptical of efficiency upgrades.[5]

Since each American has many different needs, a one-size-fits-all regulation or subsidy to artificially elevate the importance of energy efficiency is not only wasting taxpayer dollars, it is skewing preference. Businesses and families make energy-saving investments when it makes sense for them to do so.

Not About Emissions Reductions

A 2012 study from Brookings Institution Senior Fellow Ted Gayer and Vanderbilt economics professor W. Kip Viscusi found that the overwhelming majority (87 percent) of the benefits that the government calculates will arise from a host of efficiency regulations come from "correcting consumer irrationality."[6] In other words, using the government's own estimation, most of the benefits come from the government telling families and business how to best use their money.

The actual environmental benefits Americans will enjoy as a result of reducing greenhouse gas emissions (GHGs) total a paltry 2 percent of all projected benefits. The other environmental benefits (11 percent) would come from international reductions in GHGs and increased energy security. Regardless of what one believes about GHGs and their effect on climate, efficiency mandates and subsidies are a grossly inefficient way to reduce emissions. While not specific to Shaheen–Portman, it is clear that energy-efficiency mandates and subsidies are more about usurping individual choice than correcting a supposed market failure.

The Landlord-Tenant Problem

Families and businesses do not always have perfect knowledge about their energy consumption. Furthermore, there may be additional reasons for a less-than-optimal efficiency investment. And should such an inefficiency occur, a government program is not necessarily the best answer. Consider, for example, the landlord-tenant problem.

Since landlords do not pay the utility bills for the space they rent out, they have less of an incentive to pay higher upfront costs for more energy-efficient appliances that will save the renter money on energy costs. Of course, the landlord could offer lower utility costs as a way to attract new renters. Even so, how pervasive is the landlord-tenant problem and does it warrant mandates and subsidies from the federal government to correct it?

A 2010 study from University of California, Berkeley economist Lucas Davis found that landlords buy less energy-efficient appliances where the tenant pays the energy bill than homeowners who pay their own energy bills. Davis estimates that if rental units had the same ownership rates of energy-efficient appliances as homeowners, the total energy use reduction would be small and the total energy

4. McKinsey & Company, "Unlocking Energy Efficiency in the US Economy," July 2009, http://www.mckinsey.com/client_service/electric_power_and_natural_gas/latest_thinking/unlocking_energy_efficiency_in_the_us_economy (accessed July 29, 2013).

5. Hunt Allcott and Michael Greenstone, "Is There an Energy Efficiency Gap?" *Journal of Economic Perspectives*, Vol. 26, No. 1 (Winter 2012), pp. 3–28.

6. Ted Gayer and W. Kip Viscusi, "Environmental Benefits of Energy Regulations Are Negligible," Mercatus Center, George Mason University, August 2, 2012, http://mercatus.org/publication/environmental-benefits-energy-regulations-are-negligible (accessed July 29, 2013).

bills for the rentals would only be 0.5 percent lower.[7]

Landlords are also likely to invest less in energy-saving insulation that affects heating and cooling, which constitute a larger percentage of residential energy use, but again, the energy savings is small. New York University professor Hunt Allcott and Massachusetts Institute of Technology professor Michael Greenstone estimate that after accounting for the number of renters paying their own utility bills and their reduced energy efficiency, the landlord-tenant problem increases energy use by only 1 percent.[8]

In other words, the landlord-tenant problem exists but it is much smaller than what it is made out to be. In fact, Allcott and Greenstone conclude that

> the available evidence from empirical analyses of weatherization, demand-side management programs, automobile and appliance markets, the "landlord-tenant" agency problem, and information elicitation suggest that while investment inefficiencies do appear in various settings, the actual magnitude of the Energy Efficiency Gap is small relative to assessments from engineering analyses.[9]

Because of the heterogeneity in consumer preference and the other costs associated with efficiency mandates and subsidies, attempting to correct for such a small inefficiency, while improving the lives of a few, will negatively impact the majority of Americans.

Removing Mandates and Subsidies Removes Impediments to Market Efficiency

Producers have a much better ability to meet consumers' demands than any government mandate or subsidy program. Congress should recognize how markets have improved energy efficiency in the U.S. and:

- **Prevent federal funding for efficiency improvements in residential, industrial, and commercial buildings, and prevent mandatory building codes.** If commercial and residential building-code requirements and efficiency upgrades are truly voluntary, businesses and homeowners can make their own determination as to whether the benefits are worth the investment. Localities should handle building-code modifications to the extent that any are necessary.

- **Eliminate the Advanced Manufacturing Office.** Manufacturers can—and do—make these investments on their own and the Advanced Manufacturing Office has proved to be nothing but corporate welfare that offsets investments the private sector should be making.

- **Promote voluntary programs that provide information.** Better information can make families and businesses more aware of opportunities for efficiency upgrades and potential savings. Many of these tasks can be carried out by the private sector, but government programs that remain voluntary, with no taxpayer strings attached, can help.

- **Reject subsidies for worker-training programs.** The market will determine the number of engineers, architects, and educational programs necessary to provide energy-efficiency improvements.

- **Ensure that energy performance saving contracts for the federal government focus on reducing energy costs—not promoting politically preferred technologies and reducing greenhouse gases.** Congress should provide strict oversight, transparency, reliable data, and cost-savings verification with each energy savings performance contract and with each party to

7. Lucas Davis, "Evaluating the Slow Adoption of Energy Efficient Investments: Are Renters Less Likely to Have Energy Efficient Appliances?" Energy Institute at Haas *Working Paper* No. 205, June 2010, http://ei.haas.berkeley.edu/pdf/working_papers/WP205.pdf (accessed July 29, 2013).
8. Allcott and Greenstone, "Is There an Energy Efficiency Gap?"
9. Ibid., p. 25.

the actual contract. When done correctly, these contracts have value and can save taxpayers money.

- **Make immediate expensing permanently available for all business investments.** Immediate expensing allows companies to deduct the cost of capital purchases at the time they occur—rather than deducting that cost over many years based on cumbersome depreciation schedules. This reform will promote investment in new capital and improve economic and energy efficiency.

Focus on Market Efficiency—Not Efficiency Mandates and Subsidies

Energy-efficiency spending programs and related legislation have enjoyed bipartisan support because politicians view such spending as a win-win proposition: Efficiency subsidies and mandates are low-hanging fruit that will save consumers money and reduce greenhouse emissions. But Washington should realize that the economy does not need government mandates, rebate programs, or spending initiatives to make businesses and homeowners more energy efficient. The special interests that stand to gain from these efficiency-spending initiatives will support and exploit them. Shaheen–Portman is no different from such past initiatives and provides corporate welfare to a number of vested interests.

When companies and consumers do not take full advantage of efficiency gains, it is because they are weighing other factors that influence their decision making. When the government attempts to improve energy efficiency with federal programs, it ignores the heterogeneous nature of producers and consumers and negatively impacts the majority of Americans. Markets have driven the energy economy in the right direction and Congress should refrain from more unnecessary and harmful intervention in the energy sector.

Nicolas D. Loris *is Herbert and Joyce Morgan Fellow in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.*