

ISSUE BRIEF

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EFEPA Eliminates Corporate Welfare and Corporate Dependence

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The energy sector has been pronounced as a big winner of the “fiscal cliff” legislation signed into law by President Obama. Lumped into the fiscal cliff bill are extensions of energy handouts that were originally scheduled to retire, as well as retroactively rewarded tax breaks for renewable energy that expired at the end of 2011.

The inclusion of these targeted tax credits takes energy policy in the wrong direction by prolonging unnecessary and damaging corporate welfare for energy companies. Representative Mike Pompeo (R-KS) is seeking to reverse course by introducing the Energy Freedom and Economic Prosperity Act (EFEPA). The legislation would benefit energy producers and consumers by eliminating economically unjustified tax credits for both conventional and

renewable energy sources and technologies while lowering the corporate tax rate to encourage investment and spur economic growth.

Corporate Welfare and Corporate Dependence. Reactions from supporters of the tax credit extensions in the fiscal cliff deal demonstrate why these economically unjustified provisions should not be handed out in the first place. A CEO of one wind farm developer, who is hoping to build three new wind farms, said, “Obviously, the extension makes it all finance-able. It will get us through another year.”¹

The quote speaks to the level of dependence on the subsidy that some in the industry have reached. Rather than create a market in which the producer must innovate and lower costs to be competitive with other generating sources, companies spend more resources lobbying to receive these extensions. If a technology is profitable, however, the investments will occur with or without the subsidy. In that case, the subsidy offsets private-sector investments that would have been made anyway, and the taxpayer dollars are simply a generous handout to the company.

Market Effects of Politically Motivated Energy Tax Breaks. Using the tax code to provide

preferential treatment to energy producers has a number of market-distorting effects. Not only do targeted tax credits misallocate labor and capital by shifting resources away from more competitive use, but they are significantly impacting the production and consumption of energy.

Take the effects of the wind production tax credit, for instance. Power producers compete against one another to sell electricity to the grid.² When selling the electricity to grid operators, wind suppliers can underbid other electricity producers in times of excess supply because the wind producers will collect the \$22 per megawatt hour generated from the tax credit. In fact, wind producers can actually bid *negatively* to supply power and still earn a profit because of the credit.

Although negative prices sound attractive to consumers, they have near and long-term adverse implications on the electricity market. In the short run, integrating an intermittent source such as wind into the power grid in place of what would be more reliable, dispatchable energy makes life difficult for power grid operators, who are constantly trying to balance supply and demand. Thus, wholesale operators must increase the amount of backup power readily

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available because of wind's intermittency, and these operational costs are spread among the ratepayers.³

In the intermediate and long term, wind subsidies can significantly distort the wholesale electricity market when wind displaces conventional sources of energy. Over time, if coal, natural gas, or nuclear power plants permanently close as a result of being priced out of the market because of subsidies granted to intermittent sources of energy, less stable flows of pricier electricity will hurt consumers and threaten grid reliability.

Ending Energy Tax Breaks for Conventional and Renewable Sources. EFEP would allow the energy tax credits set to expire at the end of 2013 and 2014 and expedite the sunset of all other energy tax credits that extend beyond 2014 to a hard deadline of December 31, 2014. The legislation would also repeal any targeted energy tax credits that were extended in the fiscal cliff deal.

The legislation would eliminate the broad array of energy tax credits available today, such as:

- **Transportation.** Tax credits exist for alcohol fuels, biodiesels, renewable diesels, hydrogen, and other alternative fuel mixtures, as do credits for certain plug-in electric vehicles, alternative motor vehicles, and alternative vehicle refueling infrastructure. The fiscal cliff deal also included tax
- credits for two-wheeled or three-wheeled plug-in electric vehicles.
- **Oil.** The oil and gas industry has two directly targeted tax credits that are intended to kick in when the price of a barrel of oil falls below a certain price. One is an enhanced oil recovery tax credit, in which oil producers receive a 15 percent tax credit for costlier methods and technologies. The other is the marginal well production credit for wells that produce 15 or fewer barrels of oil per day, produce heavy oil, or produce mostly water and fewer than 25 barrels of oil per day.⁴
- **Renewable energy.** Throughout the years, Congress changed the Internal Revenue Code to provide a number of tax credits for large-scale and small-scale renewable generation projects including solar, wind, fuel cells, geothermal, and other qualified sources.
- **Nuclear.** The Energy Policy Act of 2005 provides a 1.8-cent-per-kilowatt-hour tax credit for advanced nuclear power produced during the first eight years of production. Although no producer has taken advantage of the credit—since industry has not built an advanced nuclear reactor that has come online—the bill is right to remove the credit.
- **Qualifying gasification and advanced coal projects.** Tax credits are currently in place for gasification technologies that use high temperatures to convert coal, petrochemical residue, or biomass into a gas composed primarily of hydrogen and carbon monoxide used for industrial purposes and synthetic fuels. They are also in place for advanced coal projects that use integrated gasification combined cycle (a process that turns coal into gas) or projects that employ carbon capture and sequestration technologies, among other qualifying projects. The fiscal cliff deal also continues to subsidize Indian coal production at \$2 per ton.

Lowered Corporate Tax Rate. Eliminating these economically unsound tax credits would result in a net tax increase on energy providers, but EFEP would offset it by requiring the Treasury to lower the corporate tax rate permanently. Not only would this ensure that there is no tax increase, but lowering the corporate tax rate would also spur investment, create jobs, and increase gross domestic product and capital stock.⁵

Righting Energy Wrongs. In order to end the current inefficient system of picking winners and losers in the energy sector, government policies intervening in the economy should be removed. Removing the

1. Bloomberg News, "Tax Credit Extension Boosts Wind Power Industry," January 2, 2013, <http://www.startribune.com/business/185492552.html?refer=y> (accessed January 11, 2013).

2. Jonathan A. Lesser, "Wind Intermittency and the Production Tax Credit: A High Cost Subsidy for Low Value Power," Continental Economics, October 2012, http://www.continentalecon.com/publications/cebep/Lesser_PTC_Report_Final_October-2012.pdf (accessed January 11, 2013).

3. Ibid.

4. The legislation does not eliminate broadly available tax credits the oil and gas industry receives that are often targets of drilling opponents. For more information, see Nicolas Loris and Curtis Dubay, "What's an Oil Subsidy?," Heritage Foundation *WebMemo* No. 3251, May 12, 2011, <http://www.heritage.org/research/reports/2011/05/whats-an-oil-subsidy>.

5. Stuart M. Butler, Alison Acosta Fraser, and William W. Beach, eds., *Saving the American Dream: The Heritage Plan to Fix the Debt, Cut Spending, and Restore Prosperity*, The Heritage Foundation, 2011, pp. 5-7, <http://savingthedream.org/about-the-plan/plan-details/>.

targeted tax credits for all energy sources and broadly lowering the tax rate, as Congressman Pompeo's policy does, would allow for a more market-based energy economy that benefits economically viable producers and, ultimately, consumers with reliable, affordable energy.

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