NEED TO KNOW

AMERICANS FOR PROSPERITY FOUNDATION

ENERGY TAX SUBSIDIES: PICKING WINNERS AND LOSERS

For years the federal government has tried to control America's energy choices, using a litany of subsidies and tax credits to "pick winners and losers" and provide favorable treatment for politically connected industries. In addition to expanding government control beyond its proper limitations, these interventions cause market distortions and unintended consequences. Below are a few examples.

CLIMATE TAXES

Perhaps the best-known intervention was the cap-and-trade energy tax that nearly passed in 2009 under then-Speaker Nancy Pelosi, Senate Leader Harry Reid, and President Barrack Obama. The Plan would have required businesses and manufacturers to purchase allowances from a limited supply of tradable carbon permits, effectively a tax on emitting carbon. After House passage, the proposal was rejected in the Senate primarily because word got out about the high economic costs it would impose. One study showed that cap-and-trade would destroy up to 2.4 million American jobs and cause gasoline and electricity prices to rise rapidly (3).

There is already one cap-and-trade program for carbon in operation. Ten Northeastern states participate in the Regional Greenhouse Gas Initiative (RGGI), a cap-and-trade plan that aims to reduce carbon dioxide emissions in the power sector. Arguing that the initiative has merely increased taxes with no corresponding environmental benefits, Governor Chris Christie announced in May 2011 that New Jersey would leave the initiative (4).

ETHANOL TAX CREDITS AND SUBSIDIES

The ethanol industry receives what some call a "triple-crown" of government support: a $1.00 per gallon production tax credit in 2016, protectionist tariffs blocking competition from foreign imports, and a Renewable Fuel Standard that mandates Americans use 35 billion gallons of ethanol annually by 2022. The Agriculture Department has also provided funds to investors installing blender pumps at refueling stations that dispense ethanol. This doesn't even count the many state subsidies and mandates (5). Minnesota, for example, requires all gasoline sold in the state to contain a blend of at least 20 percent ethanol ("E20") as of 2015.

QUICK FACTS

- The U.S. Energy Information Administration reported that the federal government spent $29.3 billion on tax credits and direct subsidies to energy markets in fiscal year 2013, more than double what was spent in 1999, even after adjusting for inflation (1).

NOTABLE & QUOTABLE

"Haven't federal investments in energy technology proven successful in the past? No. While anecdotes abound here, systematic evaluations of federal programs find no evidence that 60 years of federal energy tech spending have produced more benefits than costs."

- **Jerry Taylor and Peter Van Doren**, Senior Fellows, The Cato Institute (2).

The tax code should be used for one thing: to generate revenue for the government's legitimate functions. What we see today instead is policy makers using the tax code to pick winners and losers in the market.

The first ethanol tax credit was introduced in 1978, but despite over 30 years of favorable treatment the ethanol industry has achieved little. Americans still rely on traditional sources of fuel and prices at the pump have recently skyrocketed. At the same time, the unintended consequences of government's heavy-handed support have taken a toll on the economy. Diverting corn from food to fuel has increased food prices for everything from cereal to dairy to meat and poultry. Ethanol's supposed environmental benefits have also been called into question, prompting environmental groups to actively oppose the subsidies (6). The Environmental Working Group, for example, has argued that "the intensification of corn production – spurred in large part by exploding ethanol production – threatens to exacerbate global warming, and harm water quality, water supply, and wildlife" (7).

NATURAL GAS-POWERED VEHICLES

Recently, some have suggested adding even more special handouts to the tax code – creating tax credits to support the manufacture and purchase of natural-gas-powered vehicles. Proponents argue that natural gas is a cheap energy source with plenty of domestic supply, and if government could just give it a little boost with targeted tax preferences, it could lower prices at the pump and reduce oil consumption.

Natural gas might be the wave of the future for affordable, American energy, but if our experience with ethanol has taught us anything, it's that propping up any energy source with ill-conceived government handouts almost certainly will impose harmful, unintended consequences. For example, these subsidies will cause demand, and therefore the price, of natural gas to rise. This is good for natural gas producers as it will drive up their sales and profits, but it's bad for businesses that use natural gas in their production processes, and bad for their customers who will face higher prices.

LET CONSUMERS AND THE FREE MARKET DECIDE

America has recently seen tremendous energy innovation. However, energy sources and technologies should sink or swim on their merits and their ability to deliver value to customers, not because of political favors. American businesses, consumers, and the economy would be better served if Washington got out of the way and allowed free-market competition and innovation to drive American energy choices.

The tax code should be used for one thing: to generate revenue for the government's legitimate functions. It should have low rates, a proper neutral base, and few special provisions. Today we see policymakers using the tax code to pick winners and losers in the market.

Endnotes

1. Federal Financial Interventions and Subsidies in Energy Markets, 2007 (April 2008) (online at http://www.eia.gov/oiaf/servicerpt/subsidy2/pdf/subsidy08.pdf).
2. Jerry Taylor and Peter Van Doren, A Teachable Moment Courtesy of Solyndra, (September 13, 2011) (online at http://www.cato.org/pub_display.php?pub_id=13676).
3. Economic Impact of Waxman-Markey Bill, H.R. 2454 (August 12, 2009) (online at http://www.accf.org/publications/126/accf-nam-study).
4. Chris Christie: New Jersey's Future is Green (May 26, 2011) (online at http://www.nj.gov/governor/news/news/552011/approved/20110526a.html).
5. Biofuels: Incentives and Mandates at the State Level (August 10, 2011) (online at http://www.pewclimate.org/what_s_being_done/in_the_states/map_ethanol.cfm).
6. Coalition Applauds Bipartisan Bill to Eliminate Ethanol Subsidy (May 3, 2011) (online at http://www.foe.org/coalition-applauds-bipartisan-bill-eliminate-ethanol-subsidy).
7. ENVIRONMENTAL WORKING GROUP, Time to Change Direction in Biofuel Policy (August 2008) (online at http://www.ewg.org/factsheets/The-united-environmental-impacts-of-the-renewable-fuels-standard).

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