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Flaws in the "Gang of Ten" Energy Proposal

On August 1, the self-described "Gang of Ten," a coalition of five Democratic and five Republican senators led by Kent Conrad (D-ND) and Saxby Chambliss (R-GA),[i] unveiled a compromise energy plan called the New Energy Reform (New Era) Act of 2008. In a welcome sign in Washington, the measure calls for increased domestic production - though modest in nature and unfulfilled by the plan itself. The remainder of the bill, unfortunately, is the opposite of a "New Era" in Washington, offering more of the same government imposed "solutions" to high energy prices facing families in the United States.

What follows is a point-by-point analysis of the New Energy Reform Act of 2008,[ii] dubbed the "New Era" bill, which the sponsors insist will "reduce gas prices, lessen our dependence on foreign oil, and strengthen our economy."

Section 1: Converting Cars and Trucks to Non-Oil Fuel Sources

The New Era bill contains several measures the authors claim will speed the transition of the U.S. fleet away from conventional gasoline and thus reduce our dependence on foreign oil. Specifically, the legislation devotes $20 billion taxpayer dollars to the goal of having 85 percent of new American vehicles using non-petroleum fuels within 20 years. We quote the following measures from the press release (the only information available):

- **$7.5 billion** taxpayer dollars for R&D focused on major technological barriers to alternative fuel vehicles, such as advanced batteries;
- **$7.5 billion** taxpayer dollars to U.S. auto companies and parts makers to "re-tool and re-equip" to become the world leader in making alternative fuel vehicles;
- Consumer tax credits of up to **$7,500** per vehicle to incentivize Americans to purchase advanced alternative fuel vehicles (those that run primarily on non-petroleum fuels) and up to $2,500 to retrofit existing vehicles with advanced alternative fuel engines.

The $15 billion for R&D and U.S. auto companies is little more than a government giveaway of hard-earned taxpayer dollars. Research and development in these fields is already taking place in large measure in the private sector. The federal government is simply not as efficient as private capital markets in deciding how best to invest in new technologies. Further, if it truly made economic sense to transition this quickly to alternative fuel vehicles, car companies wouldn't need government officials in DC to pay them to innovate.

As far as tax credits, any measure that returns money to taxpayers is good for the economy. However, if the government wishes to provide consumers some relief in the face of high energy prices, it would make more economic sense to lower marginal income tax rates and take steps to increase domestic energy supplies, rather than to require taxpayers to use credits on technologies that currently do not pass the market test.

Section 2: Enhancing Conservation

The New Era measure also contains significant provisions to "enhance conservation and protect the environment," according to its authors. According to the New Era outline, the plan includes:

- Extending renewable energy, carbon mitigation and energy conservation and efficiency tax incentives, including the production tax credit, through 2012;
- New consumer tax credits of up to $2,500 to purchase highly fuel efficient vehicles;
- Extending and expanding the $2,500 tax credit for hybrid electric vehicles;
- $500 million taxpayer funds for R&D into "new materials and other innovations" to improve vehicle fuel efficiency;
- $2.5 billion in R&D on "next generation biofuels" and infrastructure;
- Tax incentives for the installation of alternative fueling stations, pipelines and other infrastructure;
- Expanding transmission capacity for power from renewable sources;
- New dedicated funding for the weatherization assistance program.

This title of the plan fails to create even one drop of new supplies of domestic energy, but focuses instead on tax credits, subsidies, and other taxpayer-sponsored incentives to address the demand

side of the energy equation. During periods of energy scarcity and economic downturn, consumers are done a disservice when government dedicates tax dollars for projects that private investors shun and have little to no chance of providing near-term benefits. Biofuel programs, for example, have contributed up to 75 percent of the spike in food prices,[iii] are not as "renewable" as its proponents claim,[iv] and on net may not even provide environmental benefits.[v] What's more, the plan is light on details. For example, what exactly are "new materials and other innovations" to improve vehicle fuel efficiency and "next generation" biofuels? If the next generation of biofuels means cellulosic ethanol, it is worth noting that Congress has already mandated millions of gallons of cellulosic ethanol to come on line in the next decade even though the technology is currently still not commercially feasible.

Section 3: Increased Domestic Production

The Gang of Ten's plan generated significant interest because of its bipartisan calls for additional offshore production in areas currently under moratoria. Upon close examination, that new offshore energy production is far from certain, and may not happen in the near future, if at all. According to the authors, the plan:

- Provides a CO_2 sequestration credit for use in enhanced oil recovery to increase production from existing oil wells while reducing greenhouse gas emissions;
- Opens additional acreage in the Gulf of Mexico for leasing (in consultation with the Defense Department to ensure that drilling is done in a manner consistent with national security) and allows Virginia, North and South Carolina and Georgia to opt in to leasing off their shores. Retains an environmental buffer zone extending 50 miles offshore where new oil production will not be allowed. Requires all new production to be used domestically. Creates a commission to make recommendations to Congress on future areas that should be considered for leasing. Provides for appropriate revenue sharing for states that allow leasing off their shores;
- Provides grants and loan guarantees for the development of coal-to-liquid fuel plants with carbon capture capability. Plants must have lifecycle greenhouse gas emissions below those of the petroleum fuels they are replacing;

- Supports nuclear energy by increasing staff at the Nuclear Regulatory Commission, providing workforce training, accelerating depreciation for nuclear plants, and supporting R&D on spent fuel recycling to reduce nuclear waste.

While this small nod for new energy production is a welcome sign in Washington, the "Gang of Ten" has completely ignored the urgent national need to repeal the offshore energy exploration and production bans that have contributed to the very problem their New Era plan purports to solve. In fact, it appears as though the plan would put such a moratorium in statute, in exchange for giving four coastal states the authority to "opt out" and produce offshore energy at some unforeseen date in the future if their respective legislatures so desire. As such, the potential for increased domestic production is also severely limited, especially given the plan's arbitrary 50-mile buffer zones. This buffer would prevent access to potential resource deposits such as the Gulf of Mexico's Destin Dome, which is some 25 miles offshore.

When the Congressional ban expires in less than two months, on October 1, 2008, a truly "New Era" will begin with the entire 1.76 billion acre outer continental shelf (OCS) open to energy production. It appears it would be better, therefore, if Section 3 consisted of seven simple words: "The Congressional OCS moratorium is hereby repealed." Better still, since the likelihood of its passage before the moratorium expires is slim to none, an even further improvement would be if Section 3 said nothing at all.

The insistence that all new production be used domestically is yet another triumph of symbolism over sense. The United States is a net importer of oil. Any increase in the world supply of crude oil will lower the world price, and hence shower benefits on American consumers. To arbitrarily restrict the sale of U.S. crude to the American market will only increase prices. For example, although the U.S. is currently a large net importer of crude with respect to Canada, the U.S. actually exported 581,000 barrels to its northern neighbor in May of this year.[vi] This is because the market economy doesn't adhere to arbitrary political boundaries, whether they come in the form of trade restrictions or production bans. If it makes more economic sense for crude to cross the border for refining in Canada with the finished gasoline shipped back into the United States, than

that will be the most cost-effective and efficient solution for the market and the consumer. A foolish rule limiting the destination of U.S.-produced crude oil would only hurt American consumers in both the near and long-term future.

Section 4: Speculation

Fortunately, the New Era does not currently call for the Commodity Futures Trading Commission (CFTC) to further regulate investment in oil futures. However, the "Gang of Ten" states that it will await the September CFTC report to make a final determination. In the meantime, the Gang would be well-served by reading the July interagency task force report, which found no evidence that institutional investors were driving up oil prices.[vii] The July report looked at a variety of measures, including the term structure in oil contracts (i.e. near- versus distant-term futures contracts), oil inventory data, and even econometric analysis of the timing of price changes versus the positions of large investors. All such tests revealed no indication that high oil prices were the result of manipulation.

Section 5: "Offsets"—Also Known as Huge Tax Hikes

In a final section euphemistically labeled "Offsets," the "Gang" outlines its plan for meeting the New Era's bill's $84 billion price tag. According to the outline:

> *"The $84 billion in investments in conservation and efficiency in the New Era bill will be fully offset with loophole closers and other revenues. Approximately $30 billion will come from new revenues from the oil and gas industry through such measures as modifying the Section 199 manufacturing deduction for oil and natural gas production…Remaining offsets will be finalized in consultation with the Finance Committee after accounting for interaction effects with other pending legislation."*

First and foremost, leaving $54 billion up in the air to be "finalized" is telling of the lack of due diligence that went into the plan. Further, it is disingenuous to refer to the Section 199 manufacturing deduction as a "loophole." When Congress passed the American Jobs Creation Act of 2004, it included a deduction to encourage American companies to provide jobs in the United States. The "loophole" was not targeted specifically for oil and gas companies, and indeed many

other companies continue to use it. If Congress has changed its mind, and no longer wants to provide tax incentives to discourage American companies from outsourcing portions of their workforce, is certainly their prerogative, but let's call it what it is – a tax on oil and gas companies. Singling them out and denying them and our economy the benefits of the tax deduction, while retaining the tax treatment for other companies makes no economic sense whatsoever. A tax increase on domestic production would do nothing to further the goal of reducing foreign imports. In fact, it would increase the supply of foreign imports because it would make them cheaper than domestic supplies.

Conclusion

Giving a nod to increased domestic energy production is a welcome development. Unfortunately, there is absolutely nothing new in the "Gang of Ten" plan to deliver a new era of energy policy. In fact, it represents more of the same government-centered 'solutions' that helped deliver the present energy crises in the first place. Taxing efficient producers to the tune of $84 billion to funnel the revenue into less efficient, but politically-expedient alternatives is a failed approach. If the government wants to help average Americans, it can open ANWR and the outer continental shelf to energy production, and facilitate the leasing of over *2 trillion* barrels in oil shale on U.S. lands.[viii] Other than that, politicians should just get out of the way and let free markets do their job. A New Era for domestic energy will begin on October 1, when the bans imposed by Congress expire and offshore drilling and oil shale production become legal again. The "Gang of Ten" would better serve the needs of American families by renouncing their recent plan and simply step aside.

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[i] The gang of ten consists of: Senators Kent Conrad (D-N.D.), Saxby Chambliss (R-Ga.), John Thune (R-S.D.), Lindsey Graham (R-S.C.), Blanche Lincoln (D-Ark.), Mary Landrieu (D-La.), Johnny Isakson (R-Ga), Bob Corker (R-Tenn.), Mark Pryor (D-Ark.), and Ben Nelson (D-Neb.).

[ii] The press release describing the New Era is available from Kent Conrad's website: http://conrad.senate.gov/pressroom/record.cfm?id=301684&. Accessed August 4, 2008.

[iii] For a discussion of ethanol's effect on food prices, see the World Bank report: http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2008/07/28/000020439_20080728103002/Rendered/PDF/WP4682.pdf, p. 17. Accessed August 5, 2008.

[iv] The Cato Institute's Jerry Taylor reports that ethanol may not even be fully "renewable," since up to 74 percent of its energy content is used by coal and natural gas to convert corn into ethanol. See Alexander Farrell, Richard Plevin, Brian Turner, Andrew Jones, Michael O'hare, and Daniel Kammen, "Ethanol Can Contribute to Energy and Environmental Goals," *Science* 311, January 27, 2006, p. 506-507.

[v] Robert Niven, "Ethanol in Gasoline: Environmental Impacts and Sustainability," *Renewable & Sustainable Energy Reviews* 9:6, 2005, pp. 535-555. Niven's review of the literature suggests that ethanol decreases some emissions (such as carbon monoxide), but increases other emissions, ironically including total hydrocarbons.

[vi] See EIA's monthly figures at:
http://tonto.eia.doe.gov/dnav/pet/pet_move_expc_a_EPC0_EEX_mbbl_m.htm. Accessed August 4, 2008.
[vii] The July CFTC interagency task force report can be obtained at:
http://www.cftc.gov/stellent/groups/public/@newsroom/documents/file/itfinterimreportoncrudeoil0708.pdf. Accessed August 4, 2008.
[viii] See IER's fact sheet concerning oil shale: http://www.instituteforenergyresearch.org/2008/07/22/oil-shale-leasing-rules/.