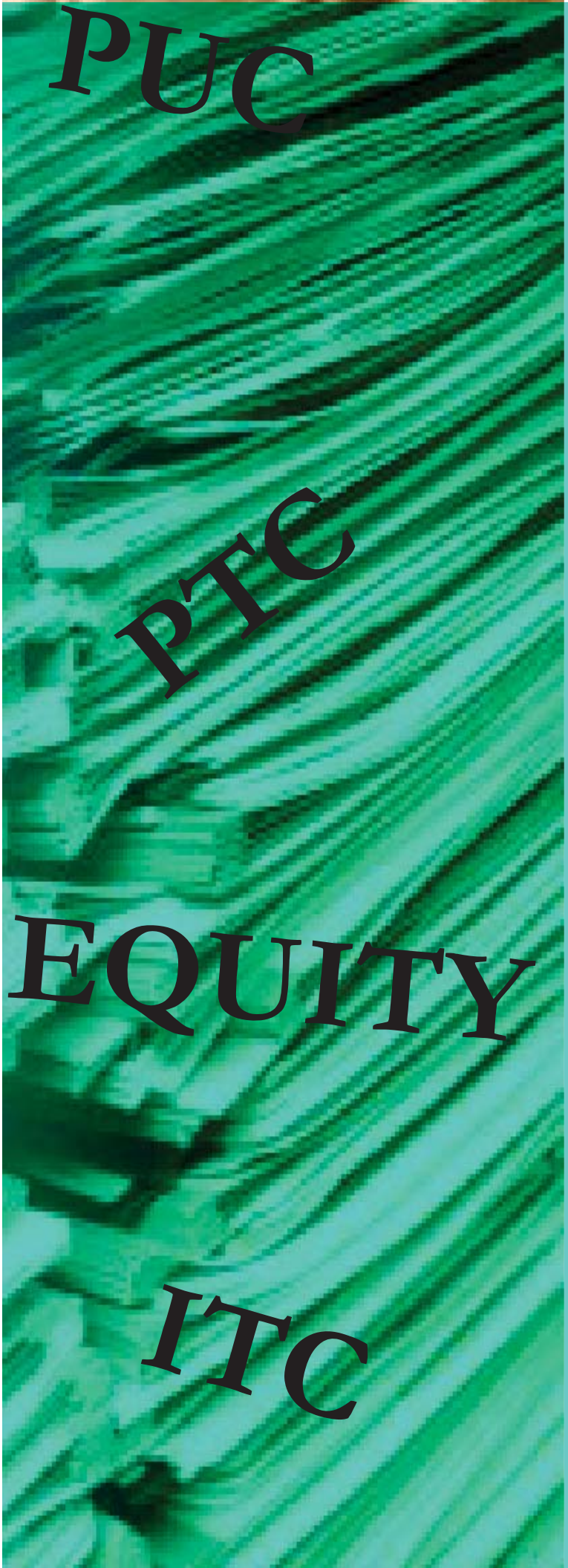
Federal Stick: Taxes Equalize the Playing Field

RPS

CREDIT

TAX

LOAN



The recent news about a record setting polar ice melt is convincing evidence on climate change for some. Researchers at the US National Snow and Ice Data Center (NSIDC) recently reported that the arctic polar ice cap has melted to its smallest size on record. Scientists now believe that it's entirely possible to have an ice-free Arctic by 2030 and an ice-free summer in the North Pole within a few years.

For others, the concern is energy reliability and cost. Businesses and consumers are looking to backstop an aging infrastructure with distributed generation — a combination of renewable energy, storage and smart infrastructure.

This has left many asking questions about how, amidst rising debt and job concerns, can Americans come together to create an energy age that will help decrease warming while ensuring energy security. These concerns are sparking renewed interest in the role of government in the green economy and cleantech. If investment in a green economy is the answer, what role will US tax laws play?

Free Market vs Tax Law for Growing an Industry

Arguments against using the tax code to stimulate renewable energy development usually center on the idea that the free market economy can take care of itself. What is often overlooked, however, is how oil and gas have benefitted from the tax code, and how those benefits continue today.

Tax incentives for fossil fuel development began in the early 1900's. According to a DBL Investors study, oil, gas, coal and nuclear energy all received more federal support than renewables when they were starting out. In fact, many of those temporary tax incentives remain, permanently embedded in the federal tax code.

This is in contrast with subsidies for renewable energy that have been small in comparative value. Most are time-limited initiatives, which has reduced their usefulness in an industry that can have ten and twenty year project horizons. Some have already expired, or will by 2013.

According to Nancy Pfund, Managing Partner and one of the authors of the DBL report, "A century's worth of tax incentives is going to put a damper on new product innovation and make it extremely costly to switch energy sources. A huge driver for renewable energy development in the US would be a price on carbon — or the threat of one — which the coal and oil industries vehemently oppose."

Pfund suggests that a fifteen year period is required for a new industry to take hold. During that time, consistent and stable funding is necessary. She believes that subsidies are a key factor in success.

Could new tax laws be key to creating an industry boon?

Laura Lovelace, Co-Founder and Managing Director of Wellford Energy, thinks so. "Throughout US history the government has been involved in expanding development for industries relevant to national security," Lovelace explained. "Certainly renewable energy development meets this threshold for security issues surrounding both petroleum displacement (using biofuels in place of imported oil) and power generation (stability of our grid and certainty of continued power generation)."

State or Federal? Which are Most Effective for Stimulating Growth?

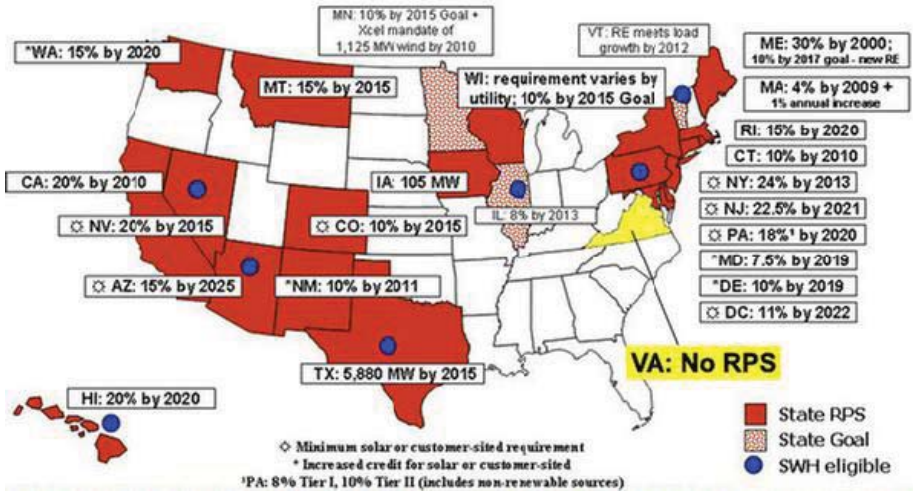
Yet there is also much discussion over which government bodies should step in to stimulate cleantech expansion. According to Lovelace, "The federal and state governments should certainly work as partners with the private sector to expand renewable energy development in the US."

She points to the Defense Production Act as an example, explaining that it allows the President to list an industry as essential to national security, which gives the military the authority to purchase portions of a producer's future product, thereby protecting the producer from market fluctuations. In this case, the federal government's involvement represents a public-private partnership.

Yet, in order to get past a grid-locked federal Congress, Lovelace also suggests that, "The state RPS has certainly been an effective tool for renewable energy expansion. Individual state rulings by certain PUCs [Public Utility Commissions] and utility boards, to allow some costs of Renewable Energy expansion to be included in the rate bases of customers, provided some certainty for Mid-American developers despite the Production Tax Credit uncertainty at the federal level." She went on to note an Iowa Utility Board decision for MId-American Energy Wind project was an example of the latter approach.

When asked whether it should be state or federal government that sets tax laws favorable to cleantech development, Keith Martin, Partner and expert in tax and project finance law at Chadbourne & Parke, finds that "federal policies are more effective because developers can master a single set of rules rather than 50 different state rules."

"However, there are examples where state policies have played an important role in areas where the federal government has been unable or unwilling to act. They include the state-level efforts to limit greenhouse gases that contribute to global warming and renewable portfolio standards." ▶



State-by-State RPS: Renewable Portfolio Standards. Such standards require a set percentage of energy production to come from renewable sources.

"The federal and state governments should certainly work as partners with the private sector to expand renewable energy development in the US."

Laura Lovelace,
Co-Founder and Managing Director of Wellford Energy,

"A century's worth of tax incentives is going to put a damper on new product innovation, and make it extremely costly to switch energy sources."

Nancy Pfund,
Managing Partner, DBL Investors

"An MIT study last month said a carbon tax at $20 a ton would raise $1.5 trillion over the next 10 years. Unfortunately, it is hard to see such a tax being enacted under any realistic scenario."

Keith Martin,
Partner at Chadbourne & Parke

Carbon Tax: A Win or a Barrier to Investment?

A burning question going into the next election remains: could a carbon tax be a silver bullet? The idea is not a new one; consider America's first cap and trade system, the Regional Greenhouse Gas Initiative (RGGI). An Analysis Group report shows that under the initiative, the majority of power plants subject to the requirements met their compliance obligations within the first three years of the program. Additionally, their carbon dioxide emissions fell by an average of 23% during that time; 16,000 jobs were created; and the regional economy gained more than $1.6 billion in economic value.

California is also a pioneer in American carbon tax law with their carbon tax initiative coming into effect in 2013. Through California's Cap and Trade Program, it is anticipated that revenues from the sale of allowances at auction will generate billions of dollars for the state.

Under the California House's recent bill AB1532, those funds

will be distributed to activities such as clean energy generation, low-carbon transportation, and sustainable infrastructure development. The intention is to reduce greenhouse gas emissions while maximizing economic, environmental and public health benefits to the state, fostering job creation, investing in disadvantaged communities, and providing opportunities for small business, schools and other community organizations to benefit.

It remains to be seen how many businesses will respond to the new legislation by simply moving out of the state. In an ideal situation, all states would operate under the same requirements, leaving this option off the table for businesses wanting to remain in the US. That would be the power of a federal law.

In general, both Lovelace and Martin believe that a federal carbon tax is useful for spurring cleantech growth. Unfortunately both also see that, despite certain support, it is not currently a politically palatable option.

Nevertheless, it may be the only way forward. As Martin explained, "The government has no money to spend on new incentives. A carbon tax would be a way to provide incentives and help to close the budget deficit. An MIT study last month said a carbon tax at $20 a ton would raise $1.5 trillion over the next 10 years. Unfortunately, it is hard to see such a tax being enacted under any realistic scenario."

Lovelace would like to see lawmakers and policy administrators include a subsidy phase out in tax credits that would "send a signal that this tax credit will exist until a point where some sort of scale and/or cost-competitiveness has been reached. This could help to avoid the yo-yo effects of current tax-extender policy."

She goes on to say that "we are already seeing plenty of US technology invented here and being commercialized in China, which would not be necessary if we had some US policy stability."

Tax Now Could Avert Expenses to Come

In its 2011 World Energy Outlook, the International Energy Agency projects that, "For every $1 of investment in the power sector avoided before 2020, an additional $4.3 would need to be spent after 2020 to compensate for the higher emissions."

Given recent events in the Arctic, suggesting that climate change is happening faster than expected, now is the time to take serious action. Will the federal government be the voice of leadership in support of renewable energy development and a green economy? Or will it be left to individual states and ultimately grassroots efforts?

Regardless, it seems obvious that in order for cleantech to have a fighting chance, the rules need to be changed, and tax laws may be the way to accomplish that. As Martin put it, "I think the government has to play a role if it wants the US to shift to using cleaner sources of energy more rapidly than the market would shift on its own."

By Maryruth Belsey Priebe, Senior Editor

More on carbon finance