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April 10, 2013

The Honorable David Camp
Chairman
Committee on Ways and Means
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Sander Levin
Ranking Member
Committee on Ways and Means
1106 Longworth House Office Building
Washington, DC 20515

The Honorable Kevin Brady
Chair, Energy Tax Working Group, Committee on Ways and Means
301 Cannon House Office Building
Washington, DC 20515

The Honorable Mike Thompson
Vice Chair, Energy Tax Working Group, Committee on Ways and Means
231 Cannon House Office Building
Washington, DC 20515

Dear Chairman Camp, Ranking Member Levin, and Representatives Brady and Thompson—

Thank you for inviting public comment on comprehensive tax reform and energy tax expenditures. I serve as the Executive Director of the Bipartisan Policy Center's Energy Project. Founded in 2007 by former Senate Majority Leaders Howard Baker, Tom Daschle, Bob Dole, and George Mitchell, the BPC is a Washington-based think tank that actively seeks bipartisan solutions to some of the most complex policy issues facing our country. In addition to energy, the BPC has ongoing projects on health care, homeland security, housing, political reform, immigration, the federal budget and financial regulatory reform.

The BPC's Strategic Energy Policy Initiative released its bipartisan recommendations in February 2013 after two years of research and deliberation. Led by former Senators Byron Dorgan and Trent Lott, General James L. Jones USMC (Ret.), and former EPA Administrator Bill Reilly, the 20-member Energy Board developed an overarching strategic goal: The U.S. energy system should provide affordable, secure, and reliable supplies of energy and strive for continuous improvement in environmental performance. (Please see the addendum attached to this letter for a full list of the 20-member Energy Board.)

As part of the bipartisan recommendations, BPC's Strategic Energy Policy Initiative recommends reviewing and then phasing out all tax expenditures that serve as subsidies to mature fuels and technologies. The following letter elaborates on this central recommendation and seeks to provide useful bipartisan guidance for the Committee in its deliberations.

Tax expenditures are imprudent and inefficient for energy policy

Our analysis found that tax expenditures are an imprudent tool for implementing energy policy. One reason is that tax expenditures can mask the costs of federal policy. Because they work by reducing

revenues to the government rather than by increasing appropriations and outlays, they are not considered in the course of conventional appropriations processes, which have traditionally provided oversight to federal energy market interventions. The volume of tax expenditures can also vary tremendously depending on factors outside Congressional control; as a result, it is challenging to make accurate forecasts of the actual costs of these measures. Tax expenditures often start as a temporary form of support and later become actually or effectively permanent. Though they are often introduced with a one-to-ten-year expiration date, experience shows that some tax expenditures have been made permanent and many are routinely renewed or extended, often temporarily and sometimes retroactively. This effectively turns temporary provisions into semi-permanent ones and makes the costs of such provisions difficult to forecast.

Tax expenditures can also be inefficient compared to other policies. By relying on adjustments to taxable income or tax liabilities, they narrow the eligible population of direct beneficiaries to only those individuals or companies with significant tax exposure. Particularly for firms in emerging industries often without significant tax liabilities, tax expenditures need to be monetized by third parties; such tax equity financing imposes new transaction costs and lowers the amount of the incentive used for the intended purpose. As a result, tax expenditures that seek to incentivize private investment often do so at greater cost to taxpayers than equivalent direct expenditures. Also, tax expenditures often have been drafted so as to specify particular technologies eligible for support. This increases the risk that companies will make suboptimal investment decisions insulated from market forces. Finally, the cycles of expiration and renewal that typically apply to tax expenditures can substantially exacerbate investment uncertainty for affected industries, creating boom-bust cycles and potentially undermining long-term progress toward the underlying policy goal.

BPC's Strategic Energy Policy Initiative guidelines for maintaining energy tax expenditures

Our 20-member Energy Board agreed that, where bona fide energy market failures demand federal intervention, the tax code should be used only when more effective policies are not available to address the specific market failure in question. Where tax expenditures or similar mechanisms are the best or only available option, they should be enacted for only so long as necessary to meet their intended goals—that is, they should have a clear and predictable sunset date or trigger that fulfills market participants' need for certainty. Finally, once enacted, these policies should be reviewed periodically and ended if not effective. Because the current system of federal supports for different energy technologies is imbalanced with suboptimal policies that are both permanent and repeatedly renewed temporary market interventions, it warrants a comprehensive overhaul.

Phase out energy tax expenditures that subsidize mature fuels and technologies

BPC's Strategic Energy Policy Initiative recommends that the Ways and Means Committee energy working group review the full range of energy tax expenditures and develop a reasonable phase-out

plan, such as 4 years, for those tax expenditures that constitute subsidies for mature fuels and technologies.

BPC recommends phase out because a sudden end to current policies could be needlessly disruptive and potentially harmful to industries, companies and their employees, and investors who have made plans and investments on the basis of current policy.

In its review, the committee should consider resolving two primary questions:

- What energy tax expenditures constitute a *subsidy*?
- What fuels and technologies are considered *mature*?

For the former, the committee should examine which of the numerous energy tax expenditures indeed constitute a subsidy. Not all energy tax expenditures are subsidies. For example, our Energy Board does not consider the exclusion from taxable income of disability payments from the Black Lung Trust Fund to former coalminers to be a subsidy to coal. Similarly, certain aspects of energy tax expenditures that might appear as subsidies may in effect be particular measures that establish consistent rules across industries. For example, accelerated depreciation is a measure that encourages investment for many capital-intensive industries, and it is therefore not a specific subsidy to fuels and technologies per se.

For the latter, the committee should decide which of the various fuels and energy technologies that benefit from tax expenditures are mature. We recommend that the committee devise a reasonable and consistent standard for gauging maturity and consider total market share, rates of deployment/production, and technology and/or fuel costs and prices in the context of that standard. Furthermore, we think developing more general guidelines instead of a technology-by-technology assessment can be important to differentiate between particular subsets of technologies and fuels. For example, onshore wind power may be mature, but high-altitude wind power is not.

While the determination of these two characteristics is beyond the scope of this letter, BPC stands ready to assist the committee in making these determinations if requested.

Phase out the renewable energy production tax credit

BPC's Strategic Energy Policy Initiative also recommends that Congress extend the renewable energy production tax credit, initially at its current level, and develop a specific decline path to achieve a complete phase out by the end of 2016. Currently, wind power projects account for nearly all renewable production tax credits. In order to increase wind power exposure to market forces at a pace that permits successful industry adaptation, the value of the credit should decline over time on a pre-determined schedule or other basis informed by relevant market conditions, such as installed capacity, market prices, or other set of salient factors. This approach can serve as a model for phasing out energy tax subsidies to other mature fuels and technologies. We note that certain immature technologies eligible for the renewable production tax credit, such as wave and tidal energy, would also be adversely

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affected by phase out. As we have stated previously, Congress should focus on phasing out tax subsidies for mature technologies, and the committee should consider a way to accomplish this without being overbroad in reach.

While a specific plan for a phase out is beyond the scope of this letter, BPC stands ready to assist the committee in devising a phase out plan if requested.

Again, thank you for your leadership in working to produce a comprehensive tax reform proposal that specifically addresses energy tax expenditures. BPC looks forward to working with you and your colleagues to address this important issue. If you have questions or would like additional information, please do not hesitate to contact me at 202-204-2400 or manderson@bipartisanpolicy.org.

Sincerely,

Margot Anderson

Margot Anderson,
Executive Director, Energy Project
Bipartisan Policy Center

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ADDENDUM: BPC Strategic Energy Policy Initiative Members

CO-CHAIRS: **Byron Dorgan**, former Senator (D-ND) and **Trent Lott**, former Senator (R-MS)

ENERGY SECURITY CHAIR: **General James L. Jones USMC (Ret.)**, former U.S. National Security Advisor; President and CEO, Jones Group International

ENERGY AND ENVIRONMENT CHAIR: **William K. Reilly**, former U.S. Environmental Protection Agency Administrator

BOARD MEMBERS:

Ralph Cavanagh, Energy Program Co-Director, Natural Resources Defense Council

Clarence Cazalot, Chairman, President, and CEO, Marathon Oil Corporation

William M. Colton, Vice President, Corporate Strategic Planning, Exxon Mobil Corporation

David Cote, Chairman and CEO, Honeywell International, Inc.

Mark Gerencser, Executive Vice President, Booz Allen Hamilton

James T. Hackett, Executive Chairman and former CEO, Anadarko Petroleum Corporation

Edwin D. Hill, International President, International Brotherhood of Electrical Workers

William A. Von Hoene Jr., Senior Executive Vice President and Chief Strategy Officer, Exelon Corporation

Colette D. Honorable, Chairman, Arkansas Public Service Commission

Thomas O. Hunter, Ph.D., Former President and Lab Director, Sandia National Laboratories

Ellen J. Kullman, Chair of the Board and CEO, DuPont

VADM Dennis V. McGinn, President, American Council on Renewable Energy

Matt Rose, Chairman and CEO, BNSF Railway Company

Richard Schmalensee, Ph.D., Professor of Management and Economics Emeritus and Dean Emeritus, Massachusetts Institute of Technology

Susan Story, President and CEO, Southern Company Services, Inc.

Susan Tierney, Ph.D., Managing Principal, Analysis Group; Former Assistant Secretary for Policy, U.S. Department of Energy