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CONGRESSIONAL TESTIMONY

Energy Policies and Economic Stimulus

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David W. Kreutzer, Ph.D.
Senior Policy Analyst in Energy Economics and Climate Change
Center for Data Analysis
The Heritage Foundation

Mr. Chairman, I want to thank you and the members of the Select Committee on Energy Independence and Climate Change for this opportunity to address you.

My name is David Kreutzer. I am Senior Policy Analyst in Energy Economics and Climate Change at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

Concern with the state of our economy is understandable; as is the desire to take action to improve it. The committee has asked me to address several questions regarding economic stimulus as it relates to energy and climate policies.

The first question
How would mandatory restrictions on carbon emissions affect the U.S. economy?

Roughly 75 percent of our energy comes from carbon-based fuels. Mandatory restrictions on carbon dioxide emissions restricts access to energy and drives up its price. In turn this reduces economic growth and destroys jobs.

Last summer, a colleague, Dr. Karen Campbell, and I analyzed the impact on the economy that would result from the higher energy prices if the Environmental Protection Agency regulates carbon dioxide as a Clean Air Act pollutant. I request that the resulting paper, "CO_2-Emission Cuts: The Economic Costs of the EPA's ANPR Regulations," be included in the record.[1]

In the study we investigate the economic impact of a program that reduces carbon dioxide emissions by 70 percent below the 2005 level by the year 2050. Due to the limits of economic models, we look only at the first 20 years of the program at which point the carbon dioxide levels will have been reduced by 30 percent.

The damage to the economy is significant. The aggregate income loss (Gross Domestic Product) over the period 2009 to 2029 is $6.8 trillion inflation-adjusted 2008 dollar.

The job losses are equally stunning. The mandated reductions in carbon dioxide hit the energy-intensive manufacturing sector especially hard with job losses of nearly 3 million in 2029. For some sub-sectors it is even worse. For instance, employment in machinery manufacturing and in rubber and plastic products drops by over 50 percent.

Some of the unemployed manufacturing workers find jobs in the service sector but the net impact drops total employment by over 800,000 jobs in some years. All of these losses are net of any "green" job creation.

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[1] David W. Kreutzer, and Campbell, Karen A., "CO2-Emission Cuts: The Economic Costs of the EPA's ANPR Regulations," Center for Data Analysis Report #08-10, October 29, 2008, The Heritage Foundation, http://www.heritage.org/Research/EnergyandEnvironment/cda08-10.cfm

In short, regulation or legislation that forces cuts in carbon dioxide emissions will severely harm the economy. Just the threat of regulation created by the Supreme Court's Massachusetts vs. EPA decision can be an anti-stimulus.

Firms' current investment decisions depend on the expectation of future profitability. So long as the EPA can impose draconian restrictions on carbon dioxide, even if the restrictions come with a delay of several years, firms will be less inclined to make job-creating investment this year.

A stimulus package should include provision to explicitly exempt carbon dioxide as a regulated pollutant under the Clean Air Act.

The second question
What energy policies should be included in an economic stimulus package?

The current economic crisis is complex. It is also widely spread across the globe. None of the more than 50 national and regional stock indexes listed in *The Economist* magazine was higher last week than at the end of 2007. In 2008 most of these indexes performed worse than the Dow Jones Industrial Average for the United States, which dropped by 33.9 percent.

One common problem faced worldwide in 2008 was the spike in energy costs. This spike only abated when the world economy went into a tailspin—a tailspin that, to some extent, was caused by the high energy prices.

A stimulus package should not constrain energy supplies but allow them to expand. The short-term impact on the economy comes directly from the investment of energy firms as the explore and develop energy resources and indirectly from the investment made by energy-using firms as they become more confident they won't be priced out of future energy markets.

A stimulus package should include provisions to maintain and increase access to energy resources such as those in the Outer Continental Shelf, the natural-gas deposits in shale, and the Artic National Wildlife Refuge.

While the bigger impacts of this policy may not come for several years or more, it should be emphasized that this part of a stimulus package costs the government nothing and may avert an economic crisis in the future.

The third question
As it develops a stimulus package, what lessons can Congress learn from European policies on carbon emissions and energy?

It has been asserted that financing various programs to force a move to a less carbon-intensive economy will actually stimulate the economy, create "green" jobs and increase income. The logic and supporting analysis for this line of reasoning ignores the negative economic impact caused by diverting resources to the "green" projects and from any resulting higher energy costs.

Whether the government expenditure is financed by raising taxes, borrowing or even printing money, there is a cost to the economy. The value of products and services purchased needs to be at least equal to the expenditure. That is, spending a dollar for 80 cents of energy cannot be justified by arguing that it creates jobs.

Europe provides a lesson. Taxes, subsidies and other programs in the countries of the European Union have helped keep their per-capita carbon dioxide emissions to roughly half the level of that in the United States. In addition, because of expensive government programs, several countries—Denmark, Spain, Ireland and Germany—are world leaders in the fraction of electricity generated by wind power.

Though many factors determine economic growth, stock-market performance, and unemployment rates; European performance in these areas does not argue for "green" stimulus or for creating energy security through conservation.

As energy prices gyrated in 2008, the performance of the European Union's economies was not better than in the U.S. From the last week of 2007 until the first week of 2009, the FTSE Euro 100 index (a broad measure of the Euro area stock market) lost 47.3 percent of its value compared to a Dow Jones Industrial Index drop of 33.9 percent over the same period.[2]

The Gross Domestic Product for the Euro Area grew by .7 percent in 2008 compared to a growth of .9 percent in the U.S. In addition, the unemployment rate in the Euro Area was at least a percentage point higher than in the U.S. as of October.[3]

If European energy efficiency results from superior technology, we would expect to see lower energy prices than in the U.S. Instead, we see the opposite.

The latest numbers for electricity costs show that household electricity prices are 50 percent to 200 percent higher in the European Union than in the United States. This is even true for those European countries that lead the world in wind energy technology. The following table shows electricity costs and the percentage of electricity generated by wind in selected countries.[4]

[2] *The Economist*, January 10, 2009, p. 86.
[3] *The Economist*, January 10, 2009, p. 85.
[4] Energy Information Administration website: http://www.eia.doe.gov/emeu/international/elecprih.html

Country	Percentage of Electricity from Wind	Cost per kilowatt-hour in U.S. dollars
Denmark	19	0.322
Spain	9	0.165
Ireland	9	0.244
Germany	6	0.222
United States	1	0.106

Though many factors affect electricity prices, the evidence from Europe indicates that their lower carbon footprint is driven more by demand-killing higher prices than by efficiencies of a new-energy economy.

The European Union can claim to be leaders in producing wind turbines and can point to the many jobs in the factories that build them. But, that doesn't mean that subsidies, tax credits and renewable fuel standards led to a net job increase. The overall EU unemployment rates compared to that in the U.S. would better support a contrary conclusion—that green initiatives cost more jobs than they created.

A stimulus package cannot include programs that fail a straight-forward cost-benefit test. This is just as true for "green" programs as for any other. Programs that fail the cost-benefit test take current resources away from more productive use negating any overall economic benefit.

Conclusion

Legislation and regulations that restrict access to affordable energy will undermine the economy as it works to create jobs and growth. In a similar way, forcing a move to uncompetitive forms of energy also raises costs that thwart economic growth.

Instead, a stimulus package should focus on policies that reduce costs and make production and employment more profitable.

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