

Can We Be Green In A Recession?

David Morris

Vice President

Institute for Local Self-Reliance

1313 5th St. SE

Minneapolis, MN 55405

dmorris@ilsr.org

I appreciate the opportunity to speak to this distinguished audience this evening. My charge is to address the question, "Can We Be Green in a Recession?" Or as the teaser for this meeting puts it, can we be green without green?

Clearly we are in a recession, or worse. Indeed, the last 6 months has witnessed the most precipitous contraction of our economy in at least 100 years. Even the Great Depression did not come on so swiftly. And there is a growing consensus among economists that when we emerge from the recession economic growth rates will not return to their pre-recession levels, levels which themselves were the lowest since world war II.

In Minnesota our legislature is grappling with a \$4-6 billion budget deficit. Politics is the art (notice I didn't say science) of making choices, of allocating scarce resources. And in a recession the resources are so scarce that the choices are where to cut and where to tax, not where to increase spending.

Complicating the issue of whether we can be green without green is that green, at least so far, is expensive. If you buy green energy from Xcel it will cost you about 15% more than conventional power. Organic food can cost twice as much as conventionally grown food. You'll pay a 10-15 percent premium for a hybrid car.

The environmental community argues, with justification, that the price we pay for conventional goods is understated. It doesn't take into account national security costs or global warming costs or soil erosion costs or public health costs. That is true. But in a recession it is hard to embrace full cost accounting. In a recession we find it very hard to act in our long-term interests.

Perhaps the best example of this short term thinking is that one of the first cuts we make in our public and private budgets when money is tight is to delay maintenance, even though we know that will mean much higher costs down the road.

As we grapple with how to be green in a recession there is a sliver of good news. The last time we experienced a severe recession and were fighting in a war at the same time was in 1974. At that time the question of being green in a recession didn't come up. Indeed, green itself was only a concept. The

renewable energy industry didn't exist. Nor for the most part did an energy efficiency industry. We overbuilt boilers and power plants and air conditioner systems. It was the era of the V-8 engine. The term organic foods had just been invented.

Today however, renewable energy and efficiency as well as organic foods are major industries, with national and international distribution systems, warranties, standards and maintenance networks. Which means green not only has a constituency, which it has had for many decades, but it has powerful political clout as well. At the national level, this is the reason that the largest single slice of increased federal spending is going for green industries. But of course, when it comes to budgets, there is no recession at the federal level. Not only is it allowed to run a deficit, something states are constitutionally prohibited from doing, but in a recession it is almost mandatory that it run huge deficits to stimulate the economy.

So let me break down the question of the evening into three questions. Can we be green and save money? Can we be green and gain popular support at the state level in a time of budget cutbacks? Can we be green and equitable at the same time?

Cutting the Green Budget

Let me begin with some comments that might be viewed as inconsistent with my overall message. I firmly believe one of the first steps for those in favor of expanding the green economy must be to identify those areas of green spending that can be cut.

In an era of budget cutbacks those advocating for green need to practice frugality to have any real credibility. To put it bluntly, we can't justify spending scarce public resources to install solar cells on private residences while shutting down clinics or libraries.

Let me offer a couple of places where we can offer cutbacks. I'm sure there are those in this audience who can identify many more.

Renewable Development Fund. We should temporarily shift the revenues going into the Renewable Development Fund (RDF) into the general budget. The RDF was established as a result of the titanic legislative battle in 1994 over whether to grant permission to Northern States Power Company to indefinitely store radioactive wastes from its Prairie Island nuclear reactors. One of the elements of the compromise bill that emerged from the legislature was that NSP had to deposit \$500,000 a year per dry cask into a fund to promote renewable electricity. Last year \$16 million was deposited into that fund and next year there will be closer to \$20 million because NSP's Monticello nuclear facility will begin installing dry casks this year.

The RDF has spent over \$100 million to promote renewable energy. It is doubtful if any but a couple of people in this audience actually know it exists. Its impact is problematic. Its work has never been evaluated. The legislature created the Fund and has already diverted money from the Fund on several occasions. Over the next biennium there could be as much as \$60 million shifted to reduce cuts in social services.

The Minnesota Ethanol Incentive. The second area of cutbacks is to eliminate the state ethanol subsidies. When Minnesota created these incentives it was creating a new strategy that combined agricultural, energy and economic development objectives. Because of Minnesota's distance from corn markets, the price Minnesota farmers receive for their corn is less than their counterparts in more centrally located parts of the country like Illinois. Traditionally the plight of the farmer is to receive a market price that is below his or her cost of production, with the government making up the difference. That means that Tysons and General Mills buy their raw material at below-market prices while the taxpayers make up the difference.

In the early 1990s Minnesota family farmers banded together to try to break out of this cycle by owning a value-added process, in this case, an ethanol and feed biorefinery. They were going to use a new technology, a dry mill, to do so. The state subsidy was intended to allow them to attract financing. The subsidy encouraged small in-state farmer owned plants. Unlike the federal ethanol incentive, this had a limited contract life-10 years.

The experiment was highly successful. By 2002 the Minnesota model was being duplicated in many other state. Farmer owned biorefineries were the most common ownership form in the industry. And the subsidy given to the first Minnesota ethanol plants was coming to an end.

And then the structure of the ethanol industry dramatically changed. Congress enacted a national ethanol mandate in 2005. In early 2006, as result of state actions, oil companies abruptly phased out their use of MTBE, the competitor to ethanol as a clean air additive. Given that MTBE at the time had almost 40 percent of the market, this rapid phase-out drove up the price of ethanol. In the succeeding 12 months the price of oil began to rise significantly.

The result is that investors in ethanol facilities could earn their original investment back in less than a year. Wall Street capital flooded in. Instead of a program that creatively tackled a traditional agricultural problem, the ethanol program was instead sold as strategy for eliminating our reliance on oil.

Since 2003, ethanol plants have located in Minnesota not because of the state incentive but because this is where the corn is. Moreover, the incentive now largely benefits out of state companies. There is no longer any justification for

paying the incentive. Eliminating it would add \$50 million that could be used to reduce the budget deficit.

Redirecting Existing Green Funding

Aside from reducing green spending that is unnecessary or ineffective we should redirect existing green spending to reduce the burden of energy expenditures on those households that pay the largest percentage of their income on energy.

Minnesota has not done well in this area. We, along with every other state, have a weatherization program targeting low-income household energy consumption. But very little state money is invested in the program. It is almost entirely federally funded and the new stimulus money will swell its funding.

The state does help out low-income households by assessing utility customers. But this money is not to reduce energy consumption but to pay delinquent bills. This is a kind of circular process that makes us feel good about ourselves for helping the poor while making the utilities feel very good about themselves.

Minnesota does have a utility funded conservation program called the Conservation Improvement Program. Electric and gas utilities are required to spend a certain percentage of their total income on reducing electricity consumption. In 2007 this spending rose above \$100 million. Almost all of it goes to write down conservation investments, that is, to shorten the payback period, usually from 5-7 years down to 2-3 years. As I will discuss shortly, there is another way much less costly and much more effective way to encourage businesses and governments to reduce energy consumption.

This money should be redirected to focus on low income and working class energy conservation programs, supplementing and then sustaining the federal stimulus money in this area.

There is another area where we can design a green strategy to take into account the needs of hard-pressed households during a recession. This is a strategy that can be adopted at the federal level but also at the state and regional level.

Cap and Dividend. Let me explain. Currently Congress, as well as a regional climate change entity of which Minnesota is a part, are debating how to impose a cap on carbon emissions. Most people embrace a concept called cap and trade. I'm not much for the trade part of cap and trade and we can go into that later if you want, but let me focus on the cap part. One of the key issues facing policymakers is what to do with the money collected from the sale of the rights to pollute. A few days ago a letter signed by 45 national environmental organizations to Congress asked that more than a quarter of the revenue be spent on energy efficiency and renewable energy.

The environmental community actually wanted the majority of the money to be spent for this purpose but President Obama's recently released budget calls for a quarter to a third of the revenue to be returned in the form of tax credits to working class and lower income families.

Although it seems logical that money raised from carbon permit auctions should be spent on reducing carbon emissions, it is not a logical use of the funds in a time of severe economic hardship. Given current renewable energy mandates and incentives, further funding in the area would affect marginal advances. Moreover, most of it would be disbursed through the Department of Energy, an agency with a research and development record that has been criticized by government auditors as well as outside experts.

As I said, President Obama wants to spend a minor portion of the revenues to offset the price increases that will come from a carbon cap. This is a step in the right direction, but the best policy is one created by Peter Barnes, one of the members of onthecommons.org. Peter argues that the biosphere is a commons. The sky is owned by all of us equally. If we make the biosphere an economic asset and charge a rental or dumping fee for its use, then we should distribute the resulting income as a dividend on a per capita basis.

ILSR examined the impact of this strategy in the mid 1990s when a bill was before the Minnesota legislature to impose a carbon tax and give the revenue back to households on a per capita basis. The level of the carbon tax proposed at that time is very similar to the anticipated cost of carbon under the proposed cap. On our web site, newrules.org you can read our detailed reports examining the impacts of such a tax and dividend strategy on low-income households, farmers, small businesses, energy intensive industries and the state economy as a whole.

In our studies then, and in several studies now, it is clear that a cap and dividend program has a progressive impact. Low-income households may spend a higher percentage of their income on energy but in absolute amounts they use far less energy per capita, directly and indirectly, than do wealthier households. Thus they would get back more in dividends than they would pay in higher prices for goods and services under a carbon cap.

President Obama's strategy of taking a part of the auction revenue and using it to target working class and low-income households has two flaws.

First, it makes the dividend part of cap and dividend a means tested program. We know from experience what happens with means tested programs. Because their constituencies lack political clout, the funding dwindles. Witness the robustness of Medicare, a universal program, versus the fragility and instability of Medicaid, a means tested program.

The Obama and environmentalists' strategy inhibits another broader positive outcome. It doesn't help gain the popular support that is going to be essential to enact a cap. A cap is going to raise prices. That is what it is intended to do. Higher prices give marketplace signals to consumers and producers to change their behavior. If the prices do not go up significantly, behavior won't change.

But Americans will not stand for what will be called a burdensome tax on all goods, especially in times of recession.

A cap and dividend strategy, however, holds the vast majority of Americans harmless from increased prices. If the price of carbon rises so does the dividend level. Once behavior changes and we move into a low carbon, renewable energy economy the dividends will drop but so will the prices of carbon.

Green Bonding

So far I have talked about the spending side of pursuing a green economy in a time of recession. Let me turn now to the most important way in which we can be green without burdening the taxpayers or reducing crucial public services.

That strategy is to have massive public debt financing of energy efficiency and renewable energy in the form of low interest long-term loans to households and businesses.

We need to recognize that investing in a green economy, at least as it pertains to reducing fossil fuel consumption, is unlike investing in education or poverty reduction or transportation. This investment repays itself from reduced operating costs.

There are two primary reasons we do not invest in improving the efficiency of our buildings or cars or in installing renewable energy technologies.

For businesses, the reason is that they have scarce capital resources and prefer to spend them to improve sales or in new product development rather than to reduce operating costs.

For households the primary reason is that they must borrow for short terms at high rates and thus are burdened with high monthly payments for years before the investment repays itself.

Government can overcome both of these barriers by borrowing and lending that money at low rates for long terms so that borrowers can repay the loans through energy savings.

Regrettably, governments right now do not think about using their borrowing capacity for this purpose.

Governments usually issue bonds to build structures that do not pay themselves back. The bonds are repaid by future tax revenue.

Recently there was a meeting in Minnesota to celebrate the best energy initiatives of local governments. One county government had changed its traffic lights to LEDs, an investment that repaid itself in 2-3 years. When asked how many other local governments had imitated that county the answer was none. When asked why that was so the answer was, "a lack of money". Clearly these governments can borrow for 20 years, a period in which the initial investment would repay itself 7-10 times over. But they don't think about doing so.

A few days ago the New York Times reported that the New York city council and mayor are proposing a bill to require all owners of existing large buildings to reduce their energy consumption. The building owners reportedly are up in arms even though the proposed legislation would require them to reduce consumption by only 5%. That means they would earn a 20% after tax return on their investment. Aside from little boy tantrums at being told to do something by government it is difficult to understand that they wouldn't enthusiastically embrace this strategy.

Unless they lacked the financing to do so, or perhaps if they didn't pay the energy bills in their buildings.

Provide them with 20 year financing at 5% interest and they might be much more supportive to the idea.

To enable local government financing of energy efficiency and renewable energy initiatives in the private sector, state law would have to be modestly altered. Currently Minnesota and other states allow localities to designate geographic sections of their communities as special district. Within that district, usually by vote of the existing landowners or businesses, an assessment is imposed, usually for infrastructure improvements.

Two changes would be required. One would add energy efficiency and carbon emissions reductions to the categories that could be financed. The second would create a non-contiguous special district. In this instance, any building owner that borrows money would become a member of a district. Thousands of building owners throughout the city could become members of the district.

New Mexico and California have already modified their existing laws to permit these types of financing initiatives. A bill will be introduced in the Minnesota legislature shortly that will do the same.

The city of Berkeley has launched a financing program for solar and efficiency. The program works like this. A building owner can borrow money raised through the issuance of a city bond. The building owner essentially takes out a 20 year, 5

percent loan. The loan is paid back through property taxes. If the ownership of the building is transferred the property tax assessment is transferred as well. This is how decorative streetlights are financed in Minneapolis, with a special assessment on homeowner taxes. If the home is sold the new owner is still responsible for paying the debt.

Every other year the Minnesota legislature issues about \$1 billion in bonds to construct buildings or build or repair roads and bridges. A \$1 billion bond for reducing operating costs would have equal job creation impacts but far superior economic and environmental benefits.

As individuals we lack the resources to be green in a recession. But collectively, as a result of our borrowing power, we have the resources to invest in projects that reduce our operating costs.

We live in an era of great change. The current economic decline is evidence of this. Minnesota is confronting an unprecedented budget deficit at the same time as Minnesota has pledged to reduce greenhouse gas emissions.

Bertrand Russell, the great British philosopher and mathematician has discussed the difference between change, and progress. Change is inevitable while progress is problematic. Change is scientific, while progress is ethical.

We will have change whether we will it or not. But we will have progress only if we change the rules to guide entrepreneurial energy and investment capital and scientific genius into creating new institutions, new technologies, and a new economy that reduces our carbon footprint while maintaining the quality of life for our citizens.