



# Tax Policy Guidelines For Energy Restructuring



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## **I. Introduction**

**The National Energy Marketers Association (NEM)** is a national, non-profit trade association representing both wholesale and retail marketers of energy and energy-related products, services, information and technologies throughout the United States. NEM's membership includes: small regional marketers, large international wholesale and retail energy suppliers, billing and metering firms, Internet energy providers, energy-related software developers, risk managers, energy brokerage firms, and information technology providers. Our membership has both affiliated and unaffiliated companies.

NEM is committed to working with representatives of state and federal governments, large and small consumer groups and utilities to devise fair and effective ways to implement the competitive restructuring of natural gas and electricity markets. NEM and its members appear before state Public Utility Commissions, the Federal Energy Regulatory Commission and legislative bodies throughout the nation. NEM members urge lawmakers and regulators to implement:

- Laws and regulations that open markets for natural gas and electricity;
- Rates, tariffs, taxes and operating procedures that lower the cost of energy;
- Standards of conduct that protect consumers;
- Rules to permit competition on the basis of price and quality of service; and
- Policies that encourage new technologies, including the integration of energy, telecommunications and Internet services.

## **II. Restructured Energy Markets Can Lower State Expenditures and Raise Revenues Without New Energy Taxes**

Virtually every other industry that has deregulated has experienced an average price reduction of approximately forty-percent. Annual impacts on the U.S. economy associated with energy price competition range in the tens of billions of dollars per year. These impacts are felt nationwide and from state to state. Unregulated energy marketers are the driving force of price competition in a deregulated energy market. New energy taxes will undermine both the favorable microeconomic and macroeconomic effects of energy price competition.

Energy taxes take many forms across the country. Some states tax energy use. Some states tax energy sales. Some states tax energy transportation. Some states tax energy consumption. Regardless of how energy is taxed, it is important to understand that energy taxes are both regressive and undermine the competitiveness of local businesses. Competitive restructuring of energy markets is an excellent opportunity for states to reduce energy taxes with minimal budget impacts.

### **III.**

#### **Tax Equity and Tax Neutrality**

#### **Argue in Favor of Lower Energy Taxes**

Given the potential for increased economic activity, competitive advantages for local businesses and the fiscal stimulus of lower energy taxes, states should not rush to impose new taxes on competitive energy services in conjunction with the restructuring of state energy markets. Principles of Tax Equity and Tax Neutrality argue strongly against new energy taxes.

#### **A. Lower Energy Prices Reduce State Budget Expenditures**

As energy markets are restructured, utility rates will be unbundled to permit price competition by suppliers of energy and related products and services, information and technology. Price competition, in turn will permit state governments to reduce expenditures on energy and related services. In many cases, significantly. Lower energy prices also increase the competitiveness of local business, attract new business to the state, increase economic activity and operate in a manner similar to a tax rollback for businesses and consumers alike. Consequently, state economies and budgets will benefit in a number of ways from restructuring natural gas and electricity markets. The larger a state's budget, the more it can save by restructuring its energy markets.

As states restructure, static revenue estimates associated with unbundled utility rates and services may not capture the full value to the state government of energy price competition. Clearly, competitive energy prices reduce state expenditures on energy and related services. However, revenue estimates should be dynamic in nature and capture the increases in tax collections associated with a more competitive business environment and greater economic activity. Lastly, given the regressive nature of energy taxation, estimates of the increase in consumer spending and related fiscal stimuli should also be projected before new taxes are imposed.

If the full benefits of competition are properly projected, a state may not experience a net budget shortfall attributable to a reduction in utility taxation. If a state is unable to perform accurate dynamic revenue estimates and is forced instead to rely solely on static short-term revenue loss projections which measure solely the lost revenues attributable to reductions in utility taxes alone, great care should be taken before responding with new taxes. If short-term static revenue estimates are used and project a material shortfall, and a state decides to impose new taxes to address this shortfall, it should do so using the broadest possible tax base and not target a fledgling new industry and low income consumers with regressive new energy taxes.

A state should not impose higher new taxes on competitive energy suppliers merely because it anticipates lower taxes on utility services. Rather new taxes should only be imposed using the broadest possible tax base in keeping with the principles of tax equity and tax neutrality.

#### **B. New Energy Taxes Which Target Competitive Energy Suppliers Violate the Principles of Tax Neutrality**

Principles of tax neutrality do not permit tax policy to skew investment decisions in a competitive economy. Sound tax policy ensures that taxes do not influence marginal investment behavior thereby titling the playing field in favor of one economic activity rather than another. To do so would be to favor one industry over another or to encourage the deployment of scarce economic resources in a less than efficient manner, costing the economy and society unnecessarily.

Currently, some states tax the transportation, sale, use or consumption of energy but do not impose the same type or level of taxes on the transportation, sale, use or consumption of food, clothing, housing, heating oil, or other essentials. New tax policy that arises as a result of restructuring should not place unregulated energy marketers at a competitive disadvantage with competing utilities, other competing fuel sources or investments in other industries. New taxes (whether or not they are formally denominated as such) that place an unequal tax burden on competitive energy selections result in higher prices for consumers, skew investments away from competitive energy markets and create incentives for consumers to switch fuels which can have both economic and environmental impacts.

As states unbundle traditional utility rates and services and permit new businesses to compete on prices, added value and quality service, this is the perfect time to reexamine both the level and wisdom of state energy taxes.

### C. Tax Equity Favors Lower Energy Taxes

Equity requires fairness in the tax burden imposed by new taxes. Energy taxes are regressive by their very nature. Energy is a necessity for consumers and businesses alike. Higher energy costs hurt lower income individuals and small businesses the most. New energy taxes impose a disproportionately higher burden on those least able to afford them.

NEM urges states to use energy restructuring as an opportunity to reduce the overall tax burden on consumers as well as businesses. Lower energy prices are the most efficient low-income assistance program possible. Lower income individuals and small business can receive more economic benefit from substantial reductions in energy prices than is normally possible with direct subsidies from the state treasury. Moreover, there are no public administration and bureaucracy costs to reduce overall consumer benefits.

If states impose new energy taxes despite their regressivity, tax equity **also demands** that any new taxes place equal burdens on similar economic activities and they should be competitively neutral as well. For example, if the transportation of gas or electricity is taxed, then the transportation of food, fuel oil or clothing should be taxed in an equal amount. If there is a use tax on natural gas then there should be a use tax on competing fuel sources and other essentials as well. However, to be clear the imposition of any new taxes as a result of restructuring is unnecessary, economically inefficient, regressive and will undermine the very benefits that price competition can offer. If, despite these impacts, a state decides to impose new taxes to offset a reduction in utility taxes, the tax base should be as broad as possible and it should not unfairly target one industry or one economic activity, thereby improperly skewing competitive investment decisions.

## IV. Conclusion

The energy industry is in the early phases of significant change. Competition in energy and related products, services, information and technologies holds enormous promise for lower energy costs for consumers and businesses alike. State tax officials must be cognizant of the incredibly regressive and anti-competitive impacts of new taxes. New energy taxes will delay or reverse the economic benefits of price competition. Accordingly, before any new taxes are imposed, a state should employ a dynamic economic analysis of the impacts of energy price competition on the state economy and budget. Any taxes that are imposed should be based on the above principles of tax equity and neutrality.