

THE SMOKESTACKS TAX

Who Pays, and How Much, With New Regulations

Summary: To date, debate over the proposed Clean Smokestacks bill has focused primarily on the purported air-quality benefits, which would be negligible. Little attention has been paid to the cost, which could be substantial given North Carolina's already high electricity and tax rates compared to its neighbors'. This study estimates the impact on such institutions as school districts and manufacturers. The higher prices and lost jobs must be weighed against any potential benefits.

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Over the past year, a great deal of ink has been spilled on regarding the pros and cons of a bill pending before the North Carolina General Assembly that is officially known as "Improve Air Quality / Electric Utilities" but is unofficially called the "Clean Smokestacks" bill. The primary focus of debate on the bill has been air quality. There have been several points of contention that go to the heart of whether the bill is needed in the first place.

The first has focused on whether North Carolina has a serious and growing problem in areas such as ground-level ozone, or "smog," which is associated with respiratory problems in some groups. In reality, the facts suggest the opposite. Over the last decade, ozone levels have remained low and there is no indication of a worsening trend.¹

The second issue relating to air quality has centered on visibility problems in the North Carolina mountains. The issue here is whether the bill will have any effect. It has been widely recognized, most recently in an extensive study done by the U.S. General Accounting Office, that most of this problem is being caused by power plants located in states to the west of the mountains.²

Finally, and most recently, there have been claims that fine particles, less than 1/100th the width of a human hair, known as soot, are causing increased numbers of deaths from heart disease and lung cancer. But experts have referred to the studies that make these claims as "junk science" and the fact is that there has been no actual scientific evidence that demonstrates a causal relationship between these fine particles and any of these diseases.³

Amidst all this, there has been very little focus on what the Clean Smokestacks bill will cost North Carolinians in higher electricity bills. First it should be pointed out

that North Carolina has the highest electricity rates in the Southeast. On average, North Carolinians face rates that are 9 percent higher than their neighbors — with industrial users paying rates that are 17 percent higher and households paying rates that are 10 percent higher.⁴ The facts show that this legislation will exacerbate an already disadvantaged position.

The Smokestacks Tax

The bill will have the same economic effect on the economy and the population as the imposition of a new and large electricity tax.

But unlike a direct excise tax in a competitive market setting, where the burden of the tax would be born by both the producers and the consumers, this tax will be paid for completely by the customers. This is because the bill contains a provision that will allow Duke Energy and Progress Energy, the two utilities whose power plants will be regulated, to pass along all costs associated with compliance to its customers. Bill supporters saw this as a way of ensuring that the two companies would not oppose the legislation — and it has worked. Both are considered supporters of the bill.

To the extent that the costs of the Clean Smokestacks bill have been mentioned, the focus has been the *total* cost of the bill with an occasional reference to the cost to household customers. The total cost has been estimated at \$2.2 billion over 11 years.⁵ These costs would be paid for by rate increases that would amount to anywhere from 4 to 7 percent, depending on whether one was a household, commercial, or industrial customer.⁶

Many of the supporters of the legislation have downplayed the significance of these costs by pointing out that for the typical family this would “only” mean an electricity bill increase of about \$3 to \$5 a month. On the other hand, if this amount were being proposed as a new tax on electric bills that would show up as a line item on a monthly statement it is likely that very few legislators would support it. The fact that it will be a hidden cost that no one will see and that no legislator will vote on directly makes it politically more palatable and easy to support. So while Democrats and Republicans seem to agree that there will not be a “tax increase” this year, many of those same politicians are supporting the Clean Smokestacks bill, which is essentially a tax hike on electricity.

Who Will Pay the Smokestacks Tax?

Ultimately the largest share of the \$2.2 billion cost will be felt directly by commercial and industrial users. That is, by institutions like schools, retail businesses, hospitals, and manufacturers that typically have very large electricity bills. These are all institutions that, in these days of budget deficits, recession, and job losses can ill afford a large new tax on one of the most important inputs into their production processes.

While the Clean Smokestacks bill will mean only a few dollars a month in direct utility costs for the typical family, the fact is that it is likely to lead to some very significant increases for larger customers. These costs will ultimately be felt by every North Carolinian in the form of higher prices for the goods and services they buy and higher state and local taxes. After all, government is the single-largest user of electricity in the state.

The General Assembly’s fiscal note examining the economic impact of the bill estimates that the legislation will add an additional \$5 million per year over the next 12 years to the state’s budget—a total of \$60 million. Obviously, North Carolina’s state government doesn’t just have this money sitting around. In the face of an estimated \$1 billion budget deficit for the current fiscal year a similar deficit projected for next year, the Clean Smokestacks bill would not only be bad environmental policy but would also be irresponsible fiscal policy.

When broken down further it becomes clear that a significant part of these additional costs to state government will come from higher electric bills to schools. We estimate that North Carolina’s public schools will face electricity rate increases of roughly 4.5 to 5.5 percent if the Clean Smokestacks bill is passed. For many school districts this would mean total annual electricity cost increases of well into the hundreds of thousands of dollars. For larger school districts, whose annual electricity costs are near or above \$10 million annually,⁷ the increase will be very significant.

For example, the Smokestacks Tax for the Wake County school system will total over \$500,000 a year while Charlotte-Mecklenburg’s portion of the tax will be a little over \$490,000. If we assume that the total annual compensation costs of an

Costs of Smokestacks Tax to NC Schools — A Representative Sample

District	Smokestacks Tax	Teaching Position Equivalencies
Wake	\$503,000	14.4
Forsyth	\$200,742	5.7
Carteret	\$55,920	1.6
Wilkes	\$46,212	1.3
Wayne	\$97,860	2.8
Duplin	\$33,580	0.95
Columbus	\$37,233	1.1
Mecklenburg	\$490,639	14

SOURCE: Electricity costs from most recent year available obtained from central offices of each listed school district.

entry-level teacher with a bachelor's degree is about \$35,000, this means that these two school districts would be able to hire about 14 new teachers each if it were not for these additional electricity costs.

The bill will also be a hardship for smaller school districts. For example, Wayne County's share of this hidden tax will be about \$100,000 or the equivalent of nearly three new teachers and Carteret County will experience a Smokestacks Tax of about \$55,000, or the equivalent of about one and a half new teaching positions.

For taxpayers and parents, the relevant question is whether they prefer stricter new controls on power plant emissions that are likely to have an imperceptible impact on air quality or more teachers and smaller class sizes for their public schools. These are the kinds of trade-offs that will have to be made if the bill is passed.

Schools are clearly not the only institutions potentially affected by the bill. Some of the state's hardest-hit businesses will be large manufacturing companies. Unfortunately, these are also businesses that are being hardest hit by the current recession. One of the best examples is the state's textile industry, where on average nearly 5 percent of total costs of production is due to electricity. In some plants, such as those that produce yarn and thread, electricity costs reach nearly 8 percent of total costs.⁸ Furthermore, as noted above, these companies are already paying rates that are 17 percent higher than the regional average.

For an industry facing tough national and international competition, the added costs of the legislation could be devastating. Depending on its size, a given textile plant will use anywhere from 10 million to 50 million kilowatts per year of electricity.⁹ This would imply a Smokestacks Tax of \$30,000 to \$150,000 annually for each plant.¹⁰ If a textile company is operating 10 plants in the state (some operate many more) then the increased electrical costs for that one company alone due to the new tax could be as high as \$1,500,000 annually, depending on the size of the plant and who their electricity provider is. This is the equivalent of about 47 full-time textile worker jobs — for one company.¹¹

Conclusion

The Clean Smokestacks bill is a tax, and unlike the "pollution problems" that the bill is supposed to solve, the Smokestacks Tax would be real. Furthermore, from textile workers to public school children, this tax will be borne by average North Carolinians who can ill afford its costs. Also, with the new tax increases already passed in 2001, which elevated North Carolina's tax burden far above that of the rest of the Southeast, the Smokestacks Tax will only add insult to injury. It will have further detrimental effects on the state's already precarious competitive position costing more jobs and encouraging new industry to look elsewhere when considering where to set up shop.

— Dr. Roy Cordato is Vice President for Research and Resident Scholar at the John Locke Foundation.

Notes

¹ Roy Cordato, "Foggy Facts on Smog," *Spotlight*, No. 212, The John Locke Foundation, March 7, 2002.

² "Air Quality and Respiratory Trends in and Near the Great Smoky Mountains," USGAO, Washington D.C., Briefing Report to Congressional Committee, May 2001.

³ Dr. Kay Jones, "Junk Science on Soot" *Spotlight*, No. 213, John Locke Foundation, March 21, 2002.

⁴ "Estimates of the Benefits and Detriments of Electric Industry Restructuring in North Carolina," Research Triangle Institute, Center for Economic Research, RTI Project Number 7135-052, p. 3-18 and p. A-2.

⁵ Duke Energy estimates costs of \$1.5 billion and Progress Energy (CP&L) estimate costs of \$700 million, as reported by Joe Johnson, "Power Rates Could Spike 7% in NC," *The Business Journal*, May 25, 2001.

⁶ This is based on estimates by the Public Staff of the Public Utility Commission of the added costs per kilowatt-hour of electricity due to the clean smokestacks bill.

⁷ Data pertaining to electricity costs and electricity providers for public schools were obtained from the individual school districts.

⁸ Op cit at note 4.

⁹ Information concerning kilowatt usage per plant was obtained through conversations with industry representatives.

¹⁰ The Public Staff of the Public Utility Commission estimates that the Clean Smokestacks bill will add from .25 to .35 cents per kilowatt-hour to electricity costs. The estimate here uses an average of .30 cents per kilowatt-hour as a multiplying factor.

¹¹ This is based on a total compensation cost of about \$16 per hour per worker working 2000 hours per year.