GAO

United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-276443

April 9, 1997

The Honorable John R. Kasich
Chairman, Committee on the Budget
House of Representatives

Subject: Energy Policy: DOE's Policy, Programs, and Issues Related to Electricity Conservation

Dear Mr. Chairman:

As requested, we are providing you with information on the Department of Energy's (DOE) energy policy and programs as they relate to electricity conservation. We used this material to brief your office on March 20, 1997.

As a component of the administration's overall sustainable energy strategy, DOE integrates electricity efficiency into its energy-efficiency and renewable-energy policy and programs. However, neither the administration nor DOE has an explicit electricity conservation policy. For fiscal year 1998, the administration requested a budget for DOE's Office of Energy Efficiency and Renewable Energy of about $1.02 billion, which represents a 27-percent increase over the Office's appropriation for fiscal year 1997.

In the recent past, the Congress passed legislation to facilitate greater competition among wholesale suppliers of electricity. Currently, the Congress is considering, and several states have passed, legislation that would restructure the electric utility industry to facilitate greater competition among retail suppliers. Restructuring may result in lower electricity prices, on average; thus, some consumers may be less willing to invest in energy-efficiency technologies. If electricity prices are lowered and consumption and generation subsequently increase, restructuring could possibly lead to greater power plant emissions and affect environmental quality. At this time, it is uncertain whether DOE's current energy-efficiency and renewable-energy programs are the most cost-effective means for addressing environmental damages.

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Enclosure I provides you with background data, information on DOE's policy and programs, and our preliminary thoughts on the consistency of DOE's current policy and programs in the light of current and anticipated changes in economic conditions and public policies.

We reviewed the National Energy Policy Plan[1] and DOE's statements regarding the Department's current energy policy and programs. In addition, we reviewed the literature on energy policy and consulted with several experts. We performed our review from December 1996 through March 1997 in accordance with generally accepted government auditing standards.

AGENCY COMMENTS AND OUR EVALUATION

We provided DOE with a draft of this report for review and comment. DOE said that (1) our report fails to accurately reflect the proven value and cost-effectiveness of the programs and policies of the Office of Energy Efficiency and Renewable Energy and (2) DOE's policies and programs are among the most cost-effective options for addressing the environmental damages associated with an increase in the demand for electricity services arising from the restructuring of electric utilities.

We believe that the cost-effectiveness of DOE's programs in addressing the environmental damages that may result from the restructuring of the electric utility industry will depend to a great extent on how restructuring unfolds and on the path of future electricity prices. Thus, it is uncertain whether DOE's current programs will reduce additional environmental damages in the most cost-effective way. Even if DOE's current projections were to indicate that the estimated benefits of the Department's programs exceed their costs, possible alternative programs or measures might provide equal or greater environmental benefits for less cost.

DOE also commented that our audits and analysis have shown that DOE's Office of Energy Efficiency and Renewable Energy's programs and policies are among the most cost-effective ways of addressing environmental concerns. However, we have never reported that DOE's programs and policies are among the most cost-effective ways to address environmental concerns. Enclosure II

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[1]*Sustainable Energy Strategy: Clean and Secure Energy for a Competitive Economy*, Pursuant to Section 801 of the Department of Energy Organization Act (U.S. Government Printing Office, July 1995).

contains the complete text of DOE's comments, along with our detailed responses.

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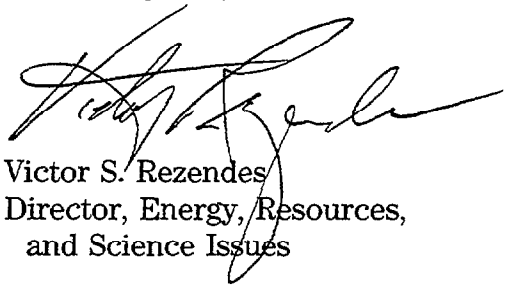
We will make copies of this report available to others upon request. If you have any questions or need additional information, please call me at (202) 512-3841. Major contributors to this report include Charles W. Bausell, Jr.; Timothy J. Guinane; Michael J. Wargo; and William K. Garber.

Sincerely yours,



Victor S. Rezendes
Director, Energy, Resources,
and Science Issues

Enclosures - 2

ENCLOSURE I

GAO RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

ENERGY POLICY

DOE's Policy, Programs, and Issues Related to Electricity Conservation

ENCLOSURE I

GAO Background

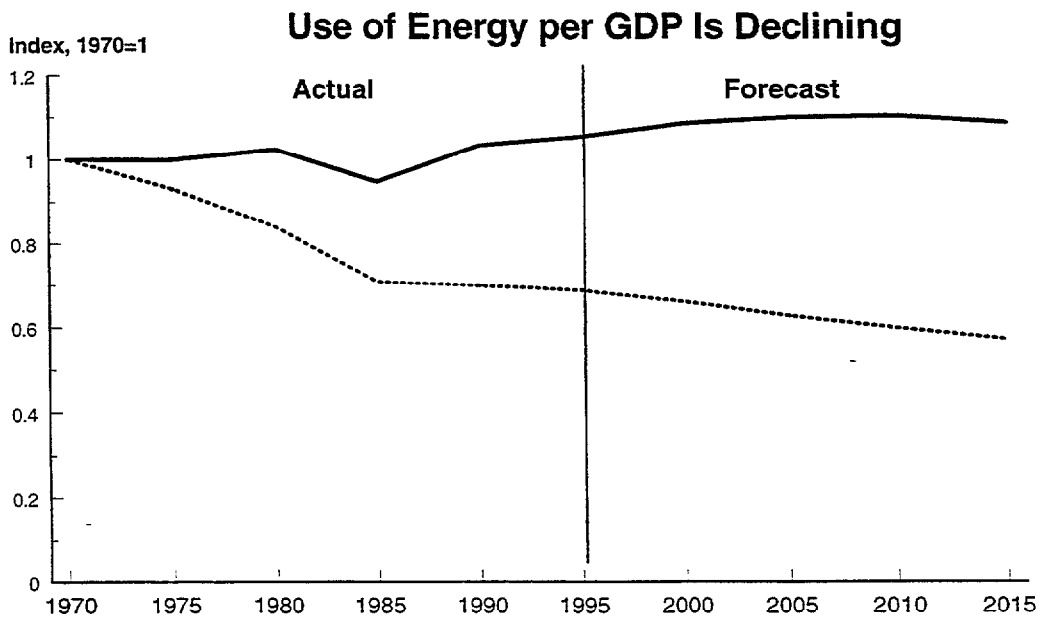
Demand for Energy Is Increasing

- Total energy consumption was up by 36% during 1970-95; is expected to grow by 1% annually during 1995-2015.

Source: GAO's analysis of data from the Energy Information Administration (EIA).

ENCLOSURE I

GAO Background



Index is the ratio of energy use per GDP or capita; 1970 value equals 1.
Source: EIA.

ENCLOSURE I

GAO Background

Demand for Electricity Is Increasing

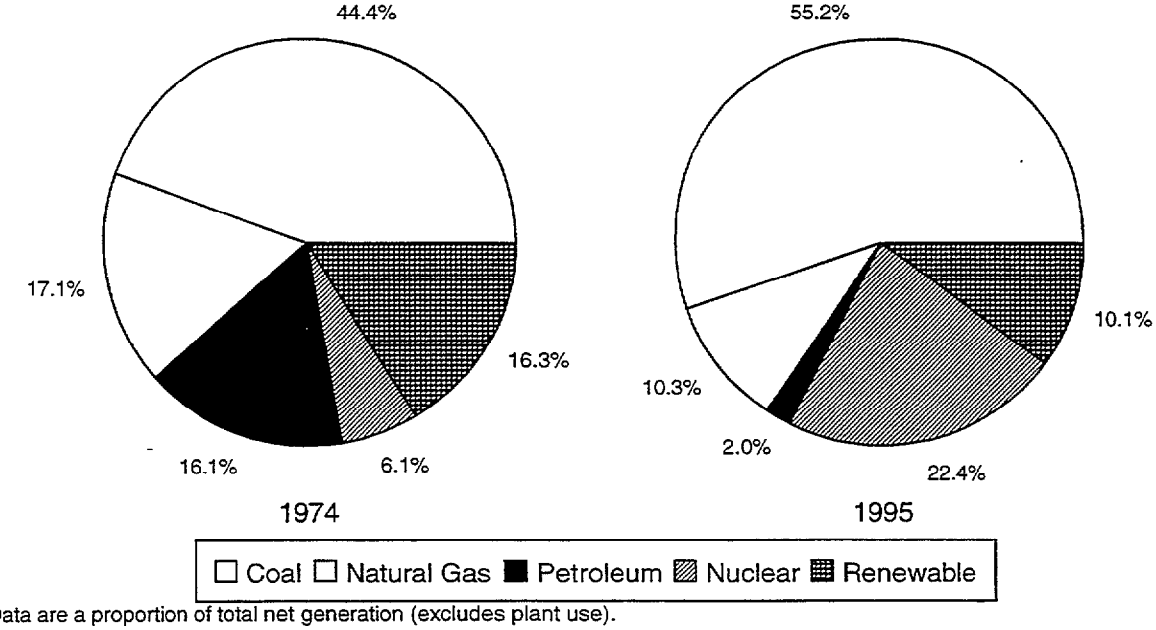
- Electricity sales were up by 116% during 1970-95; are expected to grow by an average of 1.5% annually during 1995-2015 for all sectors.
- Although small as a proportion of total sales, electricity sales to the transportation sector are expected to grow by 11.4% annually during 1995-2015.

Source: GAO's analysis of EIA's data.

ENCLOSURE I

GAO Background

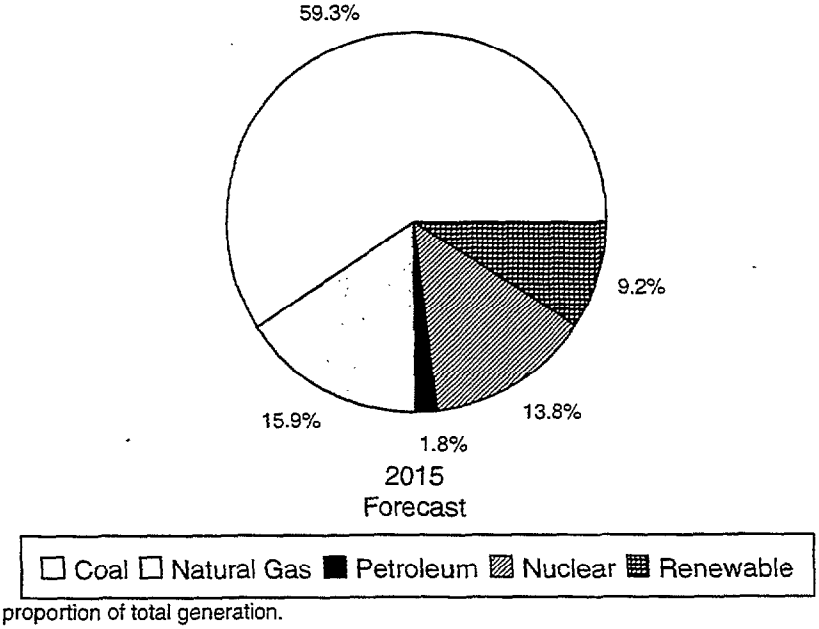
Electric Utilities' Fuel Source Is Changing



Data are a proportion of total net generation (excludes plant use).
Source: GAO's analysis of EIA's data.

GAO Background

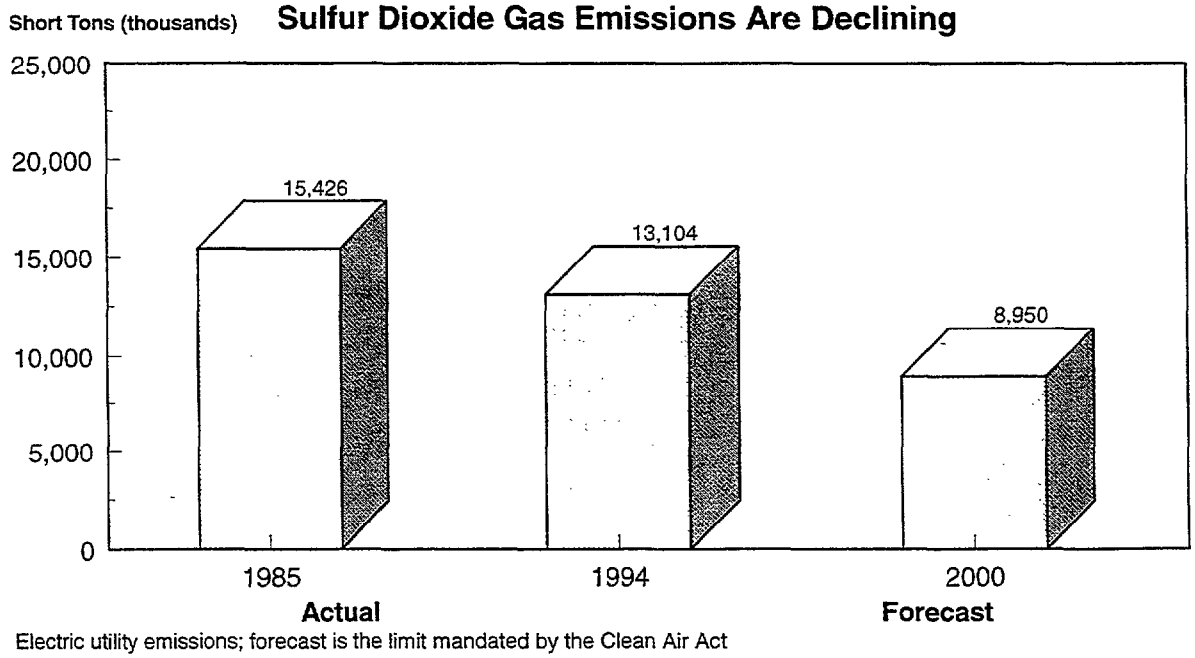
Electric Utilities' Fuel Source Is Changing



Forecast data are a proportion of total generation.
Source: GAO's analysis of EIA's data.

ENCLOSURE I

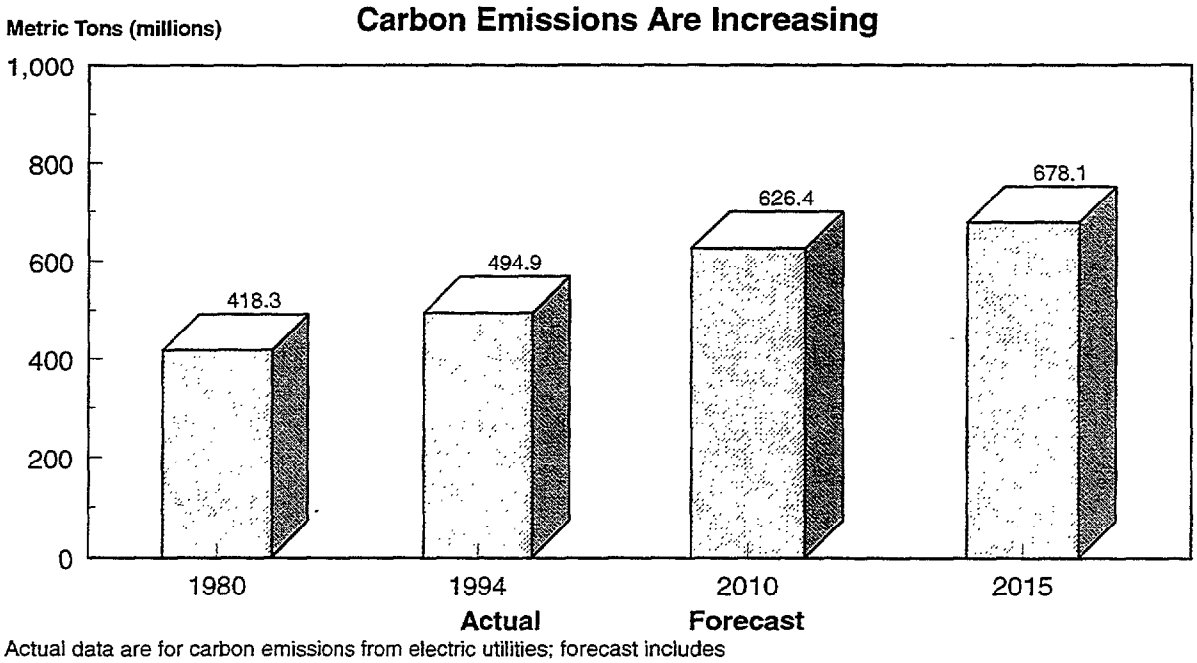
GAO Background



Electric utility emissions; forecast is the limit mandated by the Clean Air Act Amendments of 1990.
Source: EIA.

ENCLOSURE I

GAO Background



Actual data are for carbon emissions from electric utilities; forecast includes emissions from all electric power generators except cogenerators.
Source: EIA.

ENCLOSURE I

GAO Background

Competition in the Utility Industry Is Increasing

- Public Utility Regulatory Policies Act of 1978.
- Energy Policy Act of 1992.
- Federal Energy Regulatory Commission's Order Nos. 888 and 889 (1996).
- Current federal/state efforts.

ENCLOSURE I

GAO Background

Prices for Electricity Are Changing

- Average retail price declined by 26% during 1982-95.
- EIA and Gas Research Institute project annual declines in residential electricity prices of 0.5% and 1.2%, respectively, during 1995-2015.
- WEFA projects annual increases in electricity prices of 0.4% per year during 1995-2015.

Prices are adjusted for inflation. WEFA is a forecasting service.
Source: GAO's analysis of EIA's and Gas Research Institute's data; WEFA.

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GAO

DOE's Energy Policy

The administration and DOE integrate electricity efficiency into a broader energy policy.

Neither the administration nor DOE has an explicit electricity conservation policy.

Energy-efficiency and renewable-energy programs are the DOE programs that are most related to conservation.

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DOE's Energy Policy

DOE's energy-efficiency and renewable-energy policy and programs

- involve a range of energy sources and end-users
- involve programs (e.g., electric vehicle research and development (R&D)) that could result in an increase in the use of certain energy sources (e.g., electricity) and a decrease in the use of other sources (e.g., petroleum).

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DOE's Energy Policy

The objectives of DOE's energy-efficiency and renewable-energy policy and programs include

- improving energy productivity and strengthening the economy,
- cost-effectively preventing pollution,
- reducing U.S. vulnerability to global energy shocks,
- lowering the cost of emerging technologies, which helps firms to compete overseas.

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GAO DOE's Energy Policy

DOE's rationale for policy and programs includes market failures, which lead to inefficient resource allocation, such as

- the failure of energy markets to account for external environmental degradation costs associated with energy production and use
- the private sector's inability to profit sufficiently from investments in R&D involving electricity infrastructure and energy-efficient technologies.

ENCLOSURE I

GAO

DOE's Energy Policy

DOE also identifies market barriers that, according to DOE, inhibit cost-effective investments in efficient technologies and practices, such as the

- lack of customer incentives to adopt economical energy-saving measures;
- strong tendency of home builders and buyers to minimize up-front costs;
- absence of credible data regarding the performance and cost of energy technologies;

ENCLOSURE I

GAO DOE's Energy Policy

- fragmentation of the home-building industry, which impedes large-scale, industry-sponsored R&D;
- long life-times of residential structures and energy systems, which inhibit the incorporation of new more energy-efficient technologies;
- lack of building management's attention to energy costs due to fact that energy costs are a small fraction of business expenses.

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GAO Selected DOE Energy Programs

Energy-Efficiency and Renewable-Energy Budget Categories	FY 1997 Appropriation (000)	FY 1998 Request (000)
1. Energy conservation		
(a) R&D	$419,917	$516,600
(b) Building technology, state and community-sector grants	149,845	191,100
2. Solar and renewable resource technologies	269,952	342,500
Prior-year balances and adjustments	-38,932	-35,000
Total	**$800,782**	**$1,015,200**

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GAO Selected DOE Energy Programs

Budget Categories	Examples of Programs/Activities	FY 97 Enacted (000)
(1) Energy conservation	-Electric vehicle R&D	$17,820
(a) R&D	-Motor challenge	5,150
	-Lighting and appliance R&D	6,902
(b) Building technology, state, and community-sector	-Weatherization assistance	120,845
	-State energy program	29,000
(2) Solar and renewable resource technologies	-Geothermal	30,000
	-Biofuels energy systems	55,300
	-Photovoltaic energy sys.	60,000

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DOE's Views on Energy Policy and Programs

DOE views its policy and programs as consistent with current and anticipated economic conditions and public policies.

- Federal R&D funding and deployment activities are needed to mitigate the lack of private sector funding.
- Whether prices rise or fall, efficiency investments are needed to maximize energy productivity and offset environmental degradation.

ENCLOSURE I

GAO Preliminary Thoughts on Energy Policy and Programs

DOE identifies market barriers that inhibit cost-effective investments in efficient technologies and practices.

- Eliminating market barriers may not lead to more efficient resource allocation.
- It is uncertain whether DOE's programs to eliminate market barriers are the most cost-effective means for addressing the environmental costs of energy production and use.

ENCLOSURE I

GAO Preliminary Thoughts on Energy Policy and Programs

Restructuring may result in lower electricity prices, on average, and possibly higher emissions of pollutants from a subsequent increase in consumption and generation.

- At this time, it is uncertain whether DOE's programs are the most cost-effective way to address the environmental degradation costs associated with an increase in the emissions of pollutants.

ENCLOSURE I

GAO

Preliminary Thoughts on Energy Policy and Programs

Even though, on average, electricity prices may fall, restructuring may result in higher prices during peak demand periods. During these periods, consumers would likely use less electricity and adopt more energy-efficient technologies. Thus, restructuring may facilitate the adoption of energy-efficient technologies by some households and businesses.

ENCLOSURE I

GAO

Preliminary Thoughts on Energy Policy and Programs

In a restructured and more competitive energy market, investor-owned utilities may be less likely to sponsor R&D.

- The private sector alone may undersupply investments in certain types of R&D, such as the electricity-related infrastructure.
- It is unclear what other types of R&D investments may be undersupplied by the private sector.

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COMMENTS FROM THE DEPARTMENT OF ENERGY

Note: GAO's comments supplementing those in the report's text appear at the end of this appendix.

Department of Energy
Washington, DC 20585

MEMORANDUM

March 26, 1997

To: Victor S. Rezendes
Tim Guinane, GAO

Through: John Atcheson, EE-70

From: David Boonstra, EE-70/EE-40

Subject: Comments on GAO Report on Electricity Conservation Policy

This memo provides comments on a draft report from the General Accounting Office (GAO) entitled *Energy Policy: DOE's Policy, Programs, and Issues Related to Electricity Conservation*. The "report" is a series of slides which will be presented to the office of Rep. *John R. Kasich*.

General Comments

We request that the following general comments be included in the letter from Mr. Rezendes to Mr. Kasich in the section set aside for "agency comments." If the general comments are not included in this section, the Department would consider this a serious breach of GAO's obligation to present agency viewpoints.

See comment 1.

The U S Department of Energy believes that the report fails to accurately reflect the proven value and cost-effectiveness of the programs and policies of the Office of Energy Efficiency and Renewable Energy (EERE). Many assertions are unfounded and lack substantiation.

* EERE's programs and policies are among the most cost-effective ways of addressing environmental concerns, as evidenced by GAO's own audits and analysis.

* The report question's whether EERE's programs are cost-effective even though an analysis conducted by the ***GAO itself*** shows that the cost savings to consumers from only two EERE programs is greater than the entire research and development budget of EERE over the years 1978 to 1996 (see attached table).

* By inaccurately severing the link between market failures and market barriers in the Department's policy rationale, the report unfairly criticizes the Department's policy of removing market barriers to energy efficiency investments. In fact, EERE works to remove ***market barriers*** to energy efficiency investments in order to address the ***market failure*** of external environmental costs of electricity

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ENCLOSURE II

production and use.

See comment 2.

* The report prematurely questions the efficacy of EERE's programs in a restructured electricity industry for the following reasons:

> — Because electric industry restructuring is still in its formative stages, it is premature to speculate on what the ultimate effect of restructuring will be or exactly how the Department's programs will need to adapt.
>
> — No evidence is cited to indicate why the problem of sub-optimal private research and development will disappear once the electricity industry is restructured.
>
> -- In the long term, retail electricity prices will be important in determining whether consumers will invest in energy efficiency. On the one hand, if electricity prices rise, then energy efficiency will be even more needed to maximize our Nation's energy productivity to fuel our economy. On the other hand, if electricity prices decline and electricity consumption increases, energy efficiency investments will be needed to offset the environmental degradation caused by an increase in electricity generation. Under any scenario, energy efficiency investments will be needed to improve our Nation's energy productivity, prevent pollution, keep America secure, and engage the international market. Indeed, these investments will become increasingly important as the international community moves to meet the challenge of climate change.

See comment 1.

These general comments are discussed in more detail in 3 memos from DOE to the GAO dated March 25, 1997, February 18, 1997, and January 29, 1997.

Specific Comments

See comment 1.

• On page 1 of the cover letter of Mr. Rezendes to Mr. Kasich, the following statement is made:

> If electricity prices are lowered and consumption and generation subsequently increase, restructuring could possibly lead to greater power plant emissions and affect environmental quality. At this time, it is uncertain whether DOE's current energy-efficiency and renewable-energy programs are the most cost-effective means for improving environmental quality.

Now on p. 24.

On page 23 of the report, a similar statement is made. **Both of these statements should be deleted or replaced** because they unfairly question whether EERE's programs are cost-effective without offering a reason why or what alternative might be more cost-effective. In fact, based on a study **conducted by the GAO itself**, it would be

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appropriate to assert that DOE's programs appear to be the **most cost-effective** option in addressing environmental costs associated with an increase in the demand for electricity services.

Based on GAO's audit of the programs of the Office of Energy Efficiency and Renewable Programs, the attached table entitled "Highest Returns on Government Investments" shows how cost-effective EERE's programs are. The cost savings to consumers from only two EERE programs more than doubles the entire research and development budget of EERE over the years 1978 to 1996.

See comment 2.

- The report seems to imply that if restructuring lowers electricity prices there will be no need for the Department's energy efficiency programs. This reasoning is fallacious for the following reasons:

  * Because electric industry restructuring is still in its formative stages, it is premature to speculate on what the ultimate effect of restructuring will be or exactly how the Department's programs will need to adapt. Even if the price of electricity is reduce on average, there may be large segments of the market (e.g. some residential and small commercial enterprises) for which the price will increase.

  * After restructuring, the problem of sub-optimal private research and development will remain because industry support of technology development will still be hindered by a focus on short-term profitability, a lack of resources, the inability of individual firms to capture the full benefits of specific technology improvements, and the general under investment in research that benefits the common good more than the corporate bottom line.

  * Under any scenario, energy efficiency investments will be needed to improve our Nation's energy productivity, prevent pollution, keep America secure, and engage the international market. Indeed, the Department's efficiency programs will become increasingly important as the international community moves to meet the challenge of climate change.

Now on p. 18.

- The report fails to put into context the role of market barriers in DOE's policy rationale for energy efficiency programs. For example, on page 17, the report states:

  > Of secondary importance for rationale, DOE cites market barriers that inhibit cost-effective investments in efficient technologies and practices, such as:

See comment 3.

To clarify DOEs rationale, that sentence should be replaced with the following:

> Because energy-efficient technologies and practices can mitigate the environmental external costs of electricity generation and transmission (a **market**

ENCLOSURE II

> **failure**), DOE seeks to eliminate **market barriers** that inhibit cost-effective investments in efficient technologies and practices, such as:

Now on p. 23.
See comment 3.

Also, on page 22, to clarify DOE's rationale, the first sentence and the first bullet should be deleted and replaced with following:

> Because of the ***failure*** of the ***market*** to adequately consider electricity-related external environmental costs, DOE is working to remove market barriers for technologies that are not harmful to the environment.
>
> * Because this ***market failure*** is not sufficiently addressed, the reduction of ***market barriers*** in energy-efficient technologies may lead to a more economically efficient resource allocation.

Now on p. 25.
See comment 4.

- On page 24, the report states the following:

> Even though on average electricity prices may fall, restructuring may result in higher prices during peak demand periods. During these periods, consumers would likely use less electricity and adopt more energy-efficient technologies. *Thus, restructuring may facilitate the adoption of energy-efficient technologies* by some households and businesses.

Although electricity restructuring may indeed facilitate the adoption of energy-efficient technologies by some households and businesses, the reasoning stated above is flawed. It is important to make the distinction between ***load-shifting*** and ***load-reduction***. Higher prices during peak demand periods may shift the demand for electricity to times when the price is lower (*load-shifting*). For example, a consumer could install a timer on their dishwasher to run it in the middle of the night when demand and prices are low. However, if on average electricity prices remain the same or lower than before the introduction of time-of-day rates, there would be no additional incentive for consumers to install technologies which are more energy-efficient. In other words, peak pricing would offer no additional incentive for the consumer to reduce the total amount of electricity consumed each day (i.e., *load reduction*).

Now on p. 26.
See comment 5.

- On page 25, the following statement is made about a restructured electricity industry:

> Private sector alone may undersupply investments in certain types of R&D such as electricity infrastructure. It is unclear what other types of R&D investment may be undersupplied by the private sector.

These statements unfairly imply that whereas public funding of electricity infrastructure R&D may be appropriate, funding of other types such as energy efficiency R&D may not be. However, there is reason to believe that R&D on both energy efficiency and electricity infrastructure will be undersupplied. It is commonly recognized that industry

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See comment 7.

support of technology development is often hindered by a focus on short-term profitability, a lack of resources, the inability of individual firms to capture the full benefits of specific technology improvements, or the general under investment in research that benefits the common good more than the corporate bottom line

Now on p. 22.
See comment 6.

- The bullets on page 21 appear to be a paraphrase of the Department's draft policy statement in a memo to the General Accounting Office dated January 29, 1997 (pages 5 and 6). However, in the translation, important meaning was lost. The simplest way of *making the bullets accurate would be to delete the phrase "in near term"* in the first bullet and delete the phrase "in long term" in the second bullet.

Now on pp. 8 and 9.
See comment 7.

- The pie charts on pages 7 and 8 appear to be inaccurate -- the data should be reexamined and the charts should clearly point out the assumptions which were made in their development:
  - The percent share attributable to renewables appears to be inaccurate with inflated numbers in 1974 and underestimates in 1995 and 2015.
  - It appears that the pie-charts do not include data from independent power producers (IPPs).

For information on historical electricity data, contact Howard Walton from the Energy Information Administration at 202/426-1223. For information on forecasts of electricity, contact Mary Hutzler from EIA at 202/586-2222.

See comment 8.
Now on pp. 20 and 21.

- As indicated in the February 18, 1997 memo to the GAO, the examples of programs listed in the tables on pages 19 and 20 do not provide a representative sample of the programs of the Office of Energy Efficiency and Renewable Technologies. The February memo provides a more appropriate sample.

See comment 9.
Now on p. 14.

- As noted in previous comments, we would prefer that the term "conservation" be replaced with the term efficiency (page 13, second bullet).

Now on p. 16.
See comment 10.

- On page 15, fourth bullet, it would be more accurate to replace the word "and" with the word "which."

The following are GAO's responses to comments made by the Department of Energy in its memorandum dated March 26, 1997.

GAO'S COMMENTS

1. Whether or not a particular program will be cost-effective in addressing the environmental degradation that may result from electric utility restructuring depends to a great extent on how restructuring unfolds and on the path of future electricity prices. As a result, it is uncertain whether DOE's current programs will reduce additional environmental damages in the most cost-effective way. Other alternative programs could achieve the same or greater reductions in environmental degradation for less cost. The term cost-effective has a specific economic meaning. For example, a cost-effective program is one that achieves a specific reduction in emissions of pollutants at the lowest possible cost, among possible alternative programs. On the other hand, a program for which the estimated benefits exceed the estimated costs may not be cost-effective if an alternative program achieves the same or a greater reduction in emissions for less cost.

Regarding DOE's comment that our audits and analysis have shown that DOE's Office of Energy Efficiency and Renewable Energy's policies and programs are among the most cost-effective ways to address environmental concerns, GAO has never reported that DOE's policies and programs are among the most cost-effective ways to address environmental concerns.

Our statement that DOE cites market barriers as of secondary importance for its policy rationale reflects language suggested by DOE officials during their review of our draft report on February 26, 1997. We welcome DOE's clarification that DOE is seeking to remove market barriers as a means to address the market failure aspect of environmental degradation rather than using the existence of these market barriers as a specific rationale for the policy and programs. It remains uncertain, however, whether eliminating these market barriers is the most cost-effective means for reducing environmental degradation.

2. We agree with DOE's comments that electric industry restructuring is still in its formative stages. As a result, it is uncertain whether restructuring will result in greater environmental degradation than otherwise would be the case, and if so, whether DOE's current programs are the most cost-effective means for addressing additional environmental damages. In addition, our report states that in a restructured and more competitive energy market, the private sector alone may undersupply investments in certain types of research and development such as the electricity infrastructure.

We also agree that in the long term retail electricity prices will be important in determining whether consumers will invest in energy efficiency. If electricity prices rise,

we would expect some consumers and businesses to undertake more energy-efficiency investments than they would have otherwise. As a result, there should be less need for a federal role in encouraging the adoption of energy efficiency technologies. If on the other hand electricity prices fall, lower prices may induce an increase in the emissions of certain pollutants through an increase in the consumption and generation of electricity. In this case, a federal role may be needed to help reduce environmental degradation. Finally, the issue of climate change is currently being studied and the best approach for resolving this issue has not yet been determined.

3. We have revised our report to clarify that DOE has identified market barriers that, according to DOE, inhibit cost-effective investments in energy efficiency technologies.

4. We agree that electricity restructuring may facilitate the adoption of energy-efficiency technologies by some households and businesses. We also agree that higher prices during peak periods (for example, during 4 p.m to 7 p.m.) will induce some consumers to shift their demand to off-peak periods (for example, after 7 p.m.). Some consumers and businesses, however, may not have the flexibility to shift their demand to off-peak hours. For example, restaurants provide services during peak hours and thus may not have the flexibility to shift their electricity demand. Indeed, in response to higher electricity prices during peak hours, restaurants may choose to adopt more energy-saving equipment as a way to reduce energy costs.

5. From an economic perspective, a federal role in supporting research and development may be justified in cases where private firms are unable to capture all of the benefits of their research investments. In such cases, the research may provide important spillovers in the form of benefits captured by other firms for which the firm making the investment does not receive compensation. This type of research may benefit society by leading to greater innovation and higher economic growth than would otherwise be the case. Conversely, a federal role may not be economically justified if the research primarily benefits the firm conducting the research, or for which the benefits to society are limited.

6. We deleted the words "In the near term" and "In the long term" from the report.

7. The data are from EIA's *Annual Energy Review 1995* and *Annual Energy Outlook 1997, With Projections to 2015*.[1] As stated in our report, the data are for electric utilities, and as a result, do not include data for nonutility generators like independent power producers. EIA's *Annual Energy Review* does not include a comparable historic

[1]*Annual Energy Review 1995*, Energy Information Administration (DOE/EIA-0384(95), July 1996) and *Annual Energy Outlook 1997 With Projections to 2015*, Energy Information Administration (DOE/EIA-0383(97), Dec. 1996).

data series for non-utility generators. The *Annual Energy Outlook* forecast indicates that for electric utilities and non-utility generators combined, the proportion of generation attributable to each fuel source in 2015 would be 49.6 percent for coal, 28.6 percent for natural gas, 1.5 percent for petroleum, 10.8 percent for nuclear, and 9.5 percent for renewable.

8. As indicated in our report, the list of programs represents selected examples of current DOE programs, which are related to electricity production, use, and conservation, and is not meant to be comprehensive. In addition, the programs listed in our report are a subset of those identified by DOE in its memo dated February 18, 1997 as an appropriate sample.

9. We have revised the report to clarify that neither the Administration nor DOE has an explicit electricity conservation policy.

10. We have replaced the word "and" with "which."

(141004)

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