TUESDAY, JANUARY 19, 2010

Cap-And-Trade: Time For Plan B?

By **Amy Harder**

What are the alternatives to an economy-wide cap-and-trade system for controlling greenhouse gas emissions?

Has the drive for a cap-and-trade bill run out of steam? Sen. Charles Grassley, R-Iowa, for one, predicts that the Senate won't pass a cap-and-trade bill this year. If so, what are other options? Sens. Maria Cantwell, D-Wash., and Susan Collins, R-Maine, proposed a cap-and-dividend system, which would cap carbon emissions at the source, such as oil or coal producers or importers, rather than regulating power companies or manufacturers. Other senators have suggested setting up a utility-only cap-and-trade program to control greenhouse gas emissions from the electricity sector. Furthermore, some experts are speculating that a carbon tax would be more likely to be approved by Congress.

What are the advantages and disadvantages of the alternatives? Is any effort to put a price on carbon doomed to fail this year?

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JANUARY 22, 2010 7:52 AM

Better Solutions Than Cap-and-Trade

By **Margo Thorning**
Chief Economist, American Council for Capital Formation

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It seems that cap-and-trade is running out of steam, particularly when one looks at the heavy cost to industrial states. Last week, I spent several days in the Great Plains states speaking to business groups and the media on the acute economic effects that a cap and trade system on GHGs could have on their local economies. Residents from the Siouxland area in particular are very concerned about this impact.

Jobs are clearly the dominant issue weighing on the mind of the electorate as demonstrated by this week's stunning upset by Senator-elect Brown in Massachusetts and to enact a sweeping cap and trade system that would slow economic recovery seems unlikely.

The cap and dividend system proposed by Senators Cantwell and Collins is a better alternative to Waxman-Markey or Kerry-Boxer due to the fact that it puts a ceiling on CO_2 allowance price rises. However, if Congress truly feels compelled to enact climate change policy this year, then a carbon tax is a much more transparent, efficient and fair way to approach to curbing greenhouse gas emissions.

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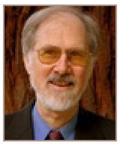

Think Globally for Action in the Senate

By Steven Stoft
Director, Global Energy Policy Center

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Once again the developing countries said what they always say, but this time, a little louder. Fortunately, someone at Copenhagen had not drunk the capper's Kool-Aid. Obama signed an Accord with no hint of caps for the top five poor countries. And then he finally dispelled the myth that Kyoto was built on. "Kyoto was legally binding and everybody still fell short anyway." Kyoto-style caps are a poison that has destroyed global climate policy. But like the deadly cyanide, the taste of poison has been masked by the Kool-Aid of tough targets and emission certainty.
Todd Stern's trend-line caps would cap India at half the emissions level of the US in 1880, not 1980! And had China accepted such a cap from Stern in 2000, China would have been buying about $90 billion worth of carbon permits on the international market right now. From Who? Europe? How would they explain that to their citizens? As Stern says, "You've just got to do the math. It's not a matter of politics or morality...
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JANUARY 21, 2010 2:16 PM

The Path to 60 Votes

By Tom Kuhn
President, Edison Electric Institute

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It's often tough to predict what will happen in the Senate, and that's certainly the case right now. While some are looking at alternatives to an economy-wide climate bill, Majority Leader Reid recently reiterated his commitment to pursing comprehensive energy and climate legislation this year.

The Edison Electric Institute continues to favor enactment of comprehensive legislation that reduces greenhouse gas emissions 80 percent by 2050, while providing strong consumer cost-containment provisions to help mitigate electricity price increases as we transition to a low-carbon future. This remains the best way to achieve environmental goals, while softening the impact of higher energy prices on U.S. jobs and the economy. We also believe it's the surest path to achieving the 60 votes necessary to move legislation in the Senate.

The Senate has many options on the table as the new year begins to unfold. We hope that comprehensive cap-and-trade legislation with strong consumer protections remains a centerpiece of discussions as the debate continues.

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JANUARY 21, 2010 1:04 PM

Who Needs a Carbon Market?

By Graciela Chichilnisky
Director, Columbia Consortium for Risk Management, and Professor of Economics and Statistics, Columbia University

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As our legislators weigh the pluses and minuses of a US cap and trade system -- a US carbon market -- a few critical features must be taken into consideration:

1. There is no need for any single nation to adopt a carbon market internally even if the nation is an active participant in the international carbon market. The international carbon market I designed and wrote into the Kyoto Protocol in 1997 is generally identified with the European Union Trading System (or EUTS) that is now trading since 2005 and involves about $125 billion/year trading. Its trading doubles each year and it is expected to become the largest commodity market in the world soon. Trading in the EUTS emphatically does not require an internal

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carbon market. It requires only a binding commitment by a nation to carbon emissions bounds.

To be more precise: the carbon market of the Kyoto Protocol is consistent with any form of carbon control on the part of a participating nation - including cap and trade, or taxes, or direct carbon emissions limits, to name a few. As the US increasingly participates in the international climate change negotiations and regulations, therefore, it could do so with an internal tax system to regulate its emissions, or using any other internal measure - including an internal cap and trade system.

2. Carbon taxes seem easier to understand than a cap and trade system, because we are used to using taxes for public goods. But taxes have several drawbacks: the most obvious is that they do not control the quantity emitted - which is the key point one is trying to achieve - except indirectly, and if they do so they are not necessarily reliable. With taxes one pays more for emitting - but there are no firm emission limits in the aggregate that one achieves from a carbon tax, no matter how successful this may be. Cap and trade, by contrast, starts with an aggregate limit that cannot be exceeded.

Another drawback of the carbon tax is that its revenues - which can be allocated for the public good - need not do so. There is a "political" and a "time" separation between the act of taxing emissions - and the act of investing or spending the amount taxed. In the carbon market, by contrast, each dollar paid by an over emitter goes directly and instantaneously to an under emitter. One is penalized, the other is rewarded, exactly as one would want it to be. No political or time separations exist with the carbon market.

Finally the carbon tax is a chosen number - while the carbon market price is determined by market forces, and therefore represents more efficiently the consumer's preferences, it is allocated more efficiently, and the carbon price of course the limits on emissions that the nation decides it wishes to achieve as a whole.

3. There is a close connection between international and domestic policies, and the former tend to dominate. Domestic cap and trade system and domestic carbon taxes in any given nation are likely to become "subordinated" to the international carbon market - namely, the carbon price (or carbon tax) in both will converge -- this is what is generally called a "no arbitrage" dynamics of markets. It can be seen as follows: if can buy a carbon offset (for emitting a ton of carbon) cheaper in the US market than I can in the Kyoto Protocol market (the EUTS) -- then I will always do so until through excess demand at home prices equalize in both markets.

Since the US emits a fraction of the global emissions - the larger market (in this case, the EUTS) will always dominate the domestic market. The same is true with US carbon taxes, that will eventually will tend to equalize with the international price for emitting carbon in the EUTS. This is natural and to be expected. At the end of the day, therefore, it does not matter much what one does domestically - except for the efficiency and ability t impose hard limits mentioned above.

4. In addition, carbon markets have other features that carbon taxes cannot emulate. With carbon markets, being clean translates in direct and marketable profits. Being clean is more profitable, being dirty is less so. In the case of carbon taxes, instead, it is a mater of paying less taxes -- while in the case of the carbon market one actually makes money from being clean, from using clean energy sources, etc.

The profit motive that arises from markets is strong -- and should not be underestimated. Hundreds of towns and cities in the US have expressed their desire to join the Kyoto Protocol carbon market - including California - because the profit motive is so powerful, and because they believe in the goal of reducing emissions in a binding way (which taxes do not guarantee).

5. It is true that carbon markets can be awkward for smaller transactions involving single individuals, which is the case when taxes are more efficient. A nation can adopt both a carbon market and carbon taxes.

A nation can also participate in the carbon market (EUTS) only as a seller (after it has adopted internationally binding emission limits) or only as a buyer - or as both, which is the standard today.

6. The "convergence" feature described above between domestic carbon prices or taxes and international prices - is a powerful market force and it will eventually prevail. It will lead to a convergence between domestic and international objectives, which is a welcome outcome. This is a very positive feature of the international carbon market that operates no matter what each nations does internally.

The future of the global economy will also change as the international carbon market makes clean energy more profitable than fossil energy.

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This will affect the production of each good and service in the global economy - all goods that are intensive in fossil fuels become less profitable, and those using clean energy become more profitable, since energy is the mother of all markets and everything uses energy to be produced.

41% of our global carbon emissions come from power plants - and the power plant infrastructure according to the International Energy Agency involves about US$50 trillion in infrastructure that has to be restructured. Taxes may not be as efficient as markets to help the transition to clean energy in the world economy - and in the US.

US industry - for example our automobile industry - needs reliable "carbon price" signals - and although taxes are more stable than carbon prices - the latter may represent more accurately the cost of emissions to the global economy.

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JANUARY 21, 2010 10:44 AM

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Why a Cap Matters

By Jon A. Anda
Vice Chairman and Head of Environmental Markets, UBS Securities

Neo-classical economics would have us pick a price for carbon where marginal cost equals marginal benefit - and choose a price limit (i.e. a carbon tax) over a quantity limit where the marginal benefit curve is flat. A freshman economics class would not be the least bit challenged by this construct. They may be challenged, however, by the graph shown in the link below – not so much in what it means, but in choosing a policy to address it. Maybe, just maybe, this is why a hard emissions cap, and the capital investment it would drive (coincident, if done right, with greater energy productivity) is worth whatever complexities it presents. Saying a carbon tax is more efficient raises the question: "more efficient at what?"
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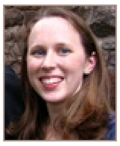

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"Time for Plan B" is Right!

By Janet Larsen

In our 2008 paper, "Time for Plan B: Cutting Carbon Emissions 80 Percent by 2020," [PDF] Lester Brown, Jonathan Dorn, Frances Moore, and I lay out an ambitious plan to cut worldwide net carbon emissions 80 percent below 2006 levels by 2020. As part of that plan we call for tax restructuring: instating a carbon tax of $20 per ton that would increase predictably by $20 each year, and offset that with a reduction in income taxes (or credit, for those earning too little to pay income tax). A dividend system could work similarly. As others have turned it, the goal is to tax what you burn, not what you earn.
As we note in "Time for Plan B": "Restructuring taxes is more efficient, easily understood, and transparent, and it can be implemented quickly and economy-wide. A carbon tax that is offset with a reduction in income taxes would permeate the entire fossil fuel energy economy. The tax on coal ...
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Mass. Race Raises New Questions

By **William O'Keefe**
CEO, George C. Marshall Institute

The outcome of this week's Massachusetts special election leaves leaders on Capitol Hill facing a host of new questions. The biggest one is do they get the message that voters have been sending since the Tea Parties were first held and which was unambiguously sent on Tuesday? If they get it, the question about energy policy is how to successfully manage the Senate's new make up in order to pass an effective, sustainable climate policy? A complex question. Yet, the answer is simpler than it appears.

Now that Democrats no longer have the 60-vote majority necessary to sustain even the hope of passing the contentious cap and trade bill in 2010, lawmakers serious about addressing greenhouse gas emissions need to look elsewhere. That means giving serious consideration of alternative policies—there costs, benefits, and rationale.

One of the nation's pre-eminent economists, William Nordhaus of Yale, has made the case, "a harmonized international carbon tax is likely to be a more effective mechanism [than cap and trade] for responding to the threat ...
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Change in the Air?

By **Margaret Kriz Hobson**
NationalJournal.com

Yesterday's Massachusetts Senate election changed the political dynamics in the Senate. No longer do the Democrats control the super majority needed to pass broad climate change legislation. Some pundits say the election was proof that the public opposes big government programs and higher energy prices linked to the comprehensive cap-and-trade bills passed by the House and the Senate Environment and Public Works Committee. Does the election change what the federal government is likely to do on climate change? Or was the global warming legislative debate moving beyond cap-and-trade even before the election?

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Free Goods and Markets

By **Jon A. Anda**
Vice Chairman and Head of Environmental Markets, UBS Securities

Capping a free good and letting a competitive market find replacements is a pro-business solution to a social need. Taxing a free good means the Government sets the price BUT will likely need to change that price over time (particularly with carbon). Free enterprise advocates who want a carbon tax - followed by their own future fights to keep the tax low - are advocating a free enterprise of convenience rather than competition.

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President Kennedy's Advice Key to Today's Climate Debate

By **William O'Keefe**
CEO, George C. Marshall Institute

There are basically three policy routes for controlling emissions—cap and trade, carbon tax, and policies and measures (CAFE, efficiency standards,

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incentives for new technology, etc). Although the last possibility, policies and measures, produced significant reductions in carbon intensity over the last 10 years, many in the environmental movement claim it's no longer an acceptable choice, unless everything else fails. That effectively narrows our options to two.

Cap and trade is enormously complex, leaving it vulnerable to rampant manipulation and outright fraud. Analysts worldwide have extensively documented its failings and its deficiencies relative to alternatives. For instance, the Marshall Institute has published two studies on this very issue—"A Cap and Trade System v. Alternative Policies to Curb U.S. Greenhouse Gas Emissions" and "Why Cap and Trade is the Wrong Policy to Curb Greenhouse Gases for the United States...

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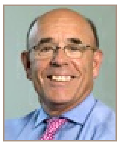

Benefits Of A Carbon Tax

By Paul Portney

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It is still far from clear whether a cap-and-trade approach to carbon control will emerge from congress for signature by President Obama. The smart money seems to suggest that it will not. IF cap-and-trade fails, it's fair to open up the debate again to see if there is an alternative that is preferable. Despite being in the minority on this issue, I believe that we would do much better in the U.S. to approach climate control using a carbon tax. To be sure, there are respects in which cap-and-trade may be preferable to a carbon tax, not the least of which is that -- until now, at least -- the belief among experts is that the former is more politically palatable than the latter. But if a cap-and-trade bill cannot be passed, it'll be time to reconsider that argument.

Briefly, the advantages of a carbon tax are its transparency, the reassurance it provides to business that costs will not go sky-high and, finally, its revenue raising potential. This last point is by far its most compelling advantage.

Regarding transparency, except ...

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Cap-And-Trade Still Possible

By Dirk Forrister

Managing Director, Natsource LLC

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It's way too soon to write an obituary for cap and trade this year. Yes, the Senate, like a boa constrictor, is trying hard to digest a major health care bill – and it has other major legislation to consider on financial services reform and jobs. But intelligently drawn climate legislation can help unleash major new clean energy and climate mitigation projects across the country, creating new jobs in a sector that's been in the doldrums due, in part, to uncertainty about federal climate rules. It can also avoid a potential detour into EPA regulation under the Clean Air Act, which is bound to be less flexible and more costly than a new federal law.

Of the alternatives to cap and trade floated in this week's question, I see no hope of a meaningful carbon tax passing any sooner than cap and trade legislation. The Clinton-era BTU tax taught a painful lesson for Democrats – that carbon taxes have a major political cost at the ballot box. The cap-and-dividend proposals are similarly flawed, as they penalize industry and create inefficiencies...

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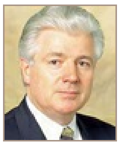

'Leave The Gun, Take The Carbon Credits'

By **Alan Oxley**

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The collapse of any prospects for global emissions trading scheme at Copenhagen drove another nail in the coffin of the proposed US program. In order to understand the reason behind its fall, just dispatch the overly complex anti-growth and anti-free enterprise ogre in the cap and trade concept: the cap.

Much has been made of the scams, profiteering and financial skullduggery which inevitably comes with a multi-billion commodities market. Take, for example, the incidence of fraud in Europe's existing trading scheme. In less than two years, criminals were able to game the EU's Emissions Trading System for over $7 billion in purloined tax revenues. And abuse isn't limited to white collar crimes. Last year, Interpol identified the emissions market as a potential playground for organized crime syndicates. ("Leave the gun, take the carbon credits.")

The great focus given these rampant scandals in the "trade" portion left little attention for an adequate debate over the what and how of the "cap." This feature of the...

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Plan A Should Be Fixing The Problem

By **Bill Snape**
Senior Counsel, Center For Biological Diversity

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One of the more surreal aspects of the current climate change debate in Congress is how almost everyone wants to talk about everything except solving the actual problem. And the problem is that humanity is already above the target CO_2-e part per million (ppm) standard in the atmosphere that the best available science tells us to achieve. Present atmospheric CO_2 is at roughly 390ppm and science tells us to get to 350ppm or lower. But it is clear that the "business as usual" crowd finds loophole-laden and hyper-flexible economic mechanisms more comforting than concrete science-based greenhouse pollution reductions. By way of example, many "cap and trade" supporters have become catatonic in their group-think belief that any cap and trade system will get us to the Holy Grail. Whatever legal mechanism Congress eventually passes to address global warming must meet two fundamental tests: 1) It must build upon the science-based foundations of the Clean Air Act; and 2) It must be straight-forward.

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Cap-And-Dividend Simpler

By **Jon A. Anda**
Vice Chairman and Head of Environmental Markets, UBS Securities

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Einstein supposedly remarked that "everything should be made as simple as possible, but not simpler". The CLEAR proposal, with an upstream point of regulation and pro-rata rebate of auction revenue, might meet this test very well. A few key revisions, however, would keep it from slipping into "simpler":

1. A price cap may turn CLEAR in CTEAR, thus ruining both the acronym and the environmental efficacy of the policy. Markets with price caps aren't really markets - and unintended consequences from controlling prices are more a rule than an exception. And since CLEAR lets the Executive Branch and Congress adjust policy stringency...a price cap is redundant in any case.

2. Abatement opportunities are cheapest in the early years. With little shrinkage in Carbon Shares at the outset, and a 2-year banking limit, CLEAR discourages the low-hanging fruit. Banking should be extended to at least 5 years - and abatement requirements leveled (CLEAR's 0.25% rising to 9% over 35 years - and 2% per year flat - leaves plenty of middle gr...

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