

Cap-and-Trade's real-world experience as applied to CO2

March 12th, 2009

100% greenhouse gases

3.4% of gh gases CO₂

3.4% of CO₂ caused by human activity

assumption masquerading as a conclusion

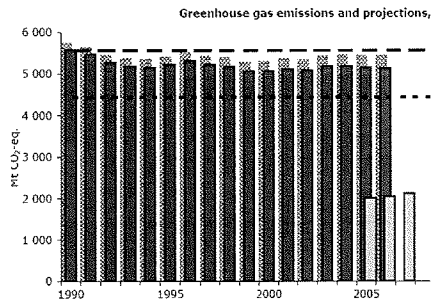
★ Cap-and-trade mythology

- Premise: deemed unsupportable (UK High Court)
- "Industry supports it, how bad can it be?"
- It would "do something"
- Provides "regulatory certainty"
- "Certainty of emissions"
- It is a "market solution"
- "The most efficient way to reduce emissions"
- "It will reduce emissions"
- "We'll learn from and avoid Europe's problems"

Reality of Cap-n-Trade in EU

- Leakage (e.g., Steel, Aluminum) jobs go
- Idling/Gaming (e.g., ceramics, pharma) \$ for \$
- Vows by business that auctioning will force closure/relocation (by chemical, glass, cement)
- Price spikes/windfall profits (utilities)
- **No emission reductions**
- At great cost. So: All Pain, No Gain.
- So: post-2012 agreement "Swiss-cheesed"

EU cap-and-trade performance



From *The Guardian* (!) last month

- "The market must be unashamedly rigged to force supply below demand. The obvious way would be to cut the number of permits in circulation, but in a recession no government will be brave enough to do that. ...
- Like medieval pardoners handing out unlimited indulgences, governments have created a glut. Reformation must follow. Wanted - a modern Martin Luther to nail a shaming truth to industry's door: Europe's whizz-bang carbon market is turning sub-prime."

You will not "just avoid EU's problems" *And, why not let the EU in on your secret?*

- Simply auctioning some portion of the allowances won't do it
- You still have problems of awarding them to favored entities (vs. most efficient way, market)
- You still have gaming, distortion, tax multiplier, and offsets ensuring inefficiency and wealth transfers but also minimizing actual reductions
- And because price increases are *the point*, leakage will always occur, regardless

Always remember who started this and why...
John Palmisano post-Kyoto memo to Ken Lay, 12/97



Kyoto "is exactly what I have
been lobbying for"
"This agreement will be good for
Enron stock!!"

- "Enron now has excellent credentials with many 'green' interests including Greenpeace, [World Wildlife Fund], [Natural Resources Defense Council], German Watch, the U.S. Climate Action Network, the European Climate Action Network, Ozone Action, WRI, and Worldwatch."
- "This position should be increasingly cultivated and capitalized on (**monitized**)."
- "if implemented, this agreement will do more to promote Enron's business than will almost any other regulatory initiative outside of restructuring of the energy and natural gas industries in Europe and the United States."

Reply of subprime morty mess

A rare candid remark, later *strongly*
seconded by our President-elect

- "The chief executive of one utility, Vattenfall ... Lars G. Josefsson, who is also an adviser to German Chancellor Angela Merkel, said **higher electricity prices are 'the intent of the whole exercise. . . . If there were no effects, why should you have a cap-and-trade system?'**"

--The Washington Post, 9th April 2007

This is *Axiomatic*

- Then-candidate Obama: "What I've said is that we would put a cap-and-trade system in place that is more -- that is as aggressive if not more aggressive than anybody else's out there, so if somebody wants to build a coal-powered plant, they can, it's just that it will bankrupt them because they're going to be charged a huge sum for all that greenhouse gas that's being emitted."
- "When I was asked earlier about the issue of coal, uh, you know, under my plan of a cap-and-trade system, electricity rates would necessarily skyrocket."
- For cap-and-trade to work, *it must hurt*
- If it does not hurt, it will not reduce emissions

The fine print of cap-n-trade... From late-'08 Dingell-Boucher draft

- Provides "compensation, through the issuance of a monthly rebate, for the **loss in purchasing power resulting from this Act** and the amendments made by this Act."
- Also, a provision to reduce the transfers *pro rata* in the event the economic pain is so great that even the limited-in-scope Low-Income Consumer Climate Change Rebate Fund cannot handle it.
- *Rather strange for a bill that will grow the economy, no?*

Cap-and-Trade *is* a tax It's just the best kind of tax: *Hidden*

- U.S. Congressional Budget Office calls it a **regulatory tax**:
- "the economic impacts of cap-and-trade programs would be similar to those of a carbon tax: both would raise the cost of using carbon-based fossil fuels, lead to higher energy prices and impose costs on users and some suppliers of energy". - U.S. CBO, "An Evaluation of Cap and Trade Programs for Reducing US GHG Emissions"
- Results are same: energy and consumer prices rise, output, employment and real wages fall
- But it transfers wealth from individuals to well-placed constituencies
- And it is a very expensive tax - 4-5 times as expensive as a direct tax: Pizer, William A., "Prices vs. Quantities Revisited: The Case of Climate Change." Resources for the Future Discussion Paper 98-02.

It's a global warming tax

- Public skeptical of "global warming"
- Public skeptical of taxes
- It's a global warming tax
- Public sensitized to energy price hikes
- EU public quickly concluded: issue is just about raising revenues (especially e.g. UK)

Al Gore to the FT, Nov. 2006 Democrats remember BTU

- "I worked as vice-president to enact a carbon tax. Clinton indulged me against the advice of his economic team..."
- One House of Congress passed it, the other defeated it by one vote then watered it down, and what remained was a pitiful 5 cent per gallon gasoline tax.'
- Even that turned out too much for some: 'That contributed to our losing Congress two years later to Newt Gingrich.'

-- "Elevenses with the FT: Emission statement,"
November 3, 2006 (ellipses in original)

Wrongly called a "Market Solution" because buying and selling are involved

- Cap-and-trade is an ugly combination of two of the greatest ills of the past two centuries to affect the market economy:
 - Cartelization, and
 - Central planning
- It is a State-run, administrative allocation/rationing scheme
- Cap-and-trade is as if, instead of seeking to cut back on smoking by taxing it, you allocated Soviet-style production permits to cigarette manufacturers. *Not* a market solution.
- If it's a market solution then so is every aspect of Zimbabwe's economy, as are wartime ration coupons, but Cap-and-Trade is even more subject than the latter to "gaming" by well-positioned interests and other social costs

★ Common Misstatements

- "Co-benefits" argument is absurd (least efficient path)
- As are claims of "will reduce emissions"
- "Certainty of emissions!" is an *unsupportable* excuse to avoid taxing instead of rationing
- That that's the lead argument shows how bad the case for cap-and-trade really is
- There *are* alternatives, that actually encourage economic growth and emission reductions, which is very rare, and hard

> revenue raiser! How?



"Do nothing"?

- Disingenuous: No proposal would "do something"
- Cap-and-trade, or the entire suite of recommendations, actually "do nothing" *climatically*, the comment's point
- CO2 window is about closed, this is a *gesture*
- Of course, their schemes *do* have negative costs
- Our argument instead is to "first do no harm"
- Rarely is all-pain-no-gain acceptable. Certainly not now.
- It is a worthwhile discussion *why is it so negatively received to raise the highly likely (read: demonstrated) costs of these proposals pushed in name of highly unlikely end-of-days fear-mongering?*

logarithm

no! normal temp

no gain



Quick Recap

- Rest of the world is adamantly staying out
- Economic activity *will* "leak"
- When EU claimed to "act", they leaked...*here*
- Emissions went up*, EU suffered economically
- If US acted in absence of China, India, Mexico...
- Wash, rinse, repeat, only even more futilely due to ours being enforceable/less open to "outs"
- We will suffer *completely for naught*
- Hard fact: "mitigate" both truly global and deeply, or not at all and continue the historical response of the most successful societies

* EU emissions as well as globally

Kyoto not enforceable

weather unpred

About the more efficient direct tax: You do not need to propose the tax

- Simply ask: "Cap-and-trade's a disaster where tried. If you're serious why aren't you proposing a tax instead?"
- It's far less inefficient, meaning less expensive and harms seniors/poor less.
- Of course we do understand that means no goodies for lobbyists, but that's ok.
- *Right?!*
- You can propose tax *incentives* [e.g., expensing]

Likely Copenhagen Scenario(s)

- Non-binding promises because LDCs' "no"
- So, massive wealth transfer to maintain the illusion of continuing Kyoto, and another "historic agreement to agree later"
- Where's the e.g., \$50 bn/yr come from?
- At minimum, "domestic first!" strategy will push decision out in time (which kills it?)
- But it's possible that EPA ANPR will by that time be waived about as our "policy"

Strategic Considerations

- EU is mired due to political "face"
- US is also driven by image concerns
- The present question for administration/ proponents is *which will drive which?*
- US unlikely to agree without some tangible policy adopted here, will find punt
- EPA unlikely to be allowed to follow thru
- Used to herd holdouts to beg Ds for deal

China Syndrome

Follow us in rationing CO2? They're just not that into it

- "Many argue that the PRC will make sharp cuts in carbon emissions but only if the U.S. does so first. This claim borders on nonsense."
- Beijing does not want to harm the competitiveness of its firms with carbon restrictions. This is certainly true, but it has nothing to do with whether the U.S. is willing to harm the competitiveness of its firms first. That is because U.S. firms are well down the list of China's competitiveness concerns...
- Chinese firms may be competing first and foremost for the U.S. market, but they are competing *against* other export platforms to the U.S. in East Asia and around the globe.
- "...if China were to impose carbon-driven restrictions on firms operating in China without the U.S. "going first" ... the relocation process [under which China is focused on encouraging relocation of East Asian output to the Chinese mainland, primarily for the purpose of export] would reverse: East Asian firms would disinvest in China, moving production to the second-most competitive regional location for textiles, computer assembly, furniture, and other products. Depending on the goods, this could be Vietnam, Bangladesh, Indonesia, or others. These countries would then be the source of the bulk of U.S. imports."

■ Derek Scissors, PhD, Heritage Foundation, March 2009

"But we must act or our [fill-in] industry will be 'left behind' ..."

- That is deeply flawed logic or rationale
- "Action" should be judged on its merits
- For example, "... or the U.S. windmill industry might be left behind!"
- As with the U.S.... *Concorde* industry, et al.
- So, what if we were a windmill leader?
- Being the leader in something is not *prima facie* a worthwhile use of resources

Now-typical EU headlines

- "Industry shelving investments over EU emissions plan"
06 February 2008 <http://www.eubusiness.com/news-eu/1202313722-31>
- "Green laws and regulation risk energy crisis, say Europe's power companies", *The Guardian*, 07 February 2008
<http://www.guardian.co.uk/environment/2008/feb/07/energy.renewableenergy>
- "RWE halts investments in German power plants due to rising emission costs", *Forbes*, 31 January 2008
<http://www.forbes.com/markets/feeds/afx/2008/01/31/afx4596286.html>
- "Carbon Trading Scheme to Wipe Out European Paper Industry" – *Printweek* 29 January 2008 <http://www.printweek.com/news/279830/EU-carbon-trading-scheme-wipe-paper-industry-profits/>

Avoid?!

auctioning

Lemans - merrill

ETS-specific Mythology

- ETS had nothing to do with energy price increases (after collapse...)
- 2005-2007 was a "trial period" (only called that once the failures became obvious, in 2007)
- ETS has EU "on track" to meet reduction promises
- ETS "surplus resulted from over-performance, and/or a "data problem", not from setting the allocations too high
- ETS has fixed its problems
- Auctioning would fix the allocation problems
 - (a) requires unattainable political will
 - (b) would need equally unattainable full auction, and
 - (c) can do that better with a tax
- This failed central planning simply requires more planning and smarter planners

The Human Costs of Emissions Caps

- Raising energy costs kills. According to a Johns Hopkins study, replacing ¾ of US coal-based energy with higher priced energy would lead to **150,000 extra premature deaths** annually in the US alone.
- Reducing emissions hits the poorest hardest. According to the recent report by the Congressional Budget Office, a cap and trade system aimed at reducing emissions by just 15 percent will **cost the poorest quintile 3 percent of their annual household income**, while benefiting the richest quintile.
- Raising energy costs loses jobs. According to a Penn State University study, replacing 2/3 of US coal-based energy with higher-priced energy will **cost almost 3 million jobs**, and perhaps over 4 million.

EU outcome is expected, and will be ours under current construct and dynamic

- All projections of energy demand and available technologies (more instructive than climate model projections) say these cuts require *massive* impoverishment or population reductions (Hoffert et al. Science (11/2002))
 - Biomass "has too low a power density...for biofuels to contribute significantly to climate stabilization."
 - Solar energy, even in sun rich America, would require a massive area of land (220,000 km²) to provide the emissions-free energy needed, but all the photovoltaic cells made from 1982 to 1998 combined would only cover an area of 3 km².
- "Energy sources that can produce 100 to 300 percent of present world power consumption without greenhouse emissions do not exist operationally or as pilot plants."

For policy purposes: please distinguish between "acting" and gestures

- If CMMGW were real... *trouble*. **Only gestures ever proposed.**
- Expensive gestures. Futile ones (Wigley, Hoffert et al. Science, 2002).
- They *cannot* conceivably have *any* climatic impact.
- There's a need to say one "did something". It won't.
- As an American you already *are* the world leader
- Let that secret out
 - "Europe's doing it" is a myth
 - Unless that means "killing their own economy"
- Tell the *truths*: From science scandals to mythology: **clarify.**
