



Presidential Climate Action Project

Climate Action Brief:

Moving Upstream on Cap and Trade

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The failure of the Warner-Lieberman bill makes clear that Congress is rowing upstream on the critical goal of carbon pricing. But upstream is the right place to be if we want an effective market mechanism to reduce carbon emissions.

Make no mistake: The experts, advocates and members of Congress who wrote the Warner-Lieberman bill earned bipartisan support deserve enormous credit for bringing the issue to the Senate floor and the forefront of public debate even if Congress failed to act.

The bill illustrates how complicated and compromised carbon trading becomes when the policy architecture is designed to satisfy competing special interests. We need an approach that is driven by good policy and good science, and that produces an effective, predictable long-term market for carbon trading.

One such approach, endorsed by the Presidential Climate Action Project, is upstream cap and auction, largely as proposed by Yale economist Robert Repetto.¹

In the upstream approach, permits would be auctioned to fossil energy suppliers -- the 1,500 to 2,000 points at which fossil fuels enter the U.S. economy. These include mine mouths, wellheads and ports. That's far fewer permits -- and far lower administrative costs -- than mid-stream or downstream approaches that attempt to regulate tens of thousands of carbon emitters.

Upstream permits can apply carbon pricing to 100 percent of the economy, and would create a more transparent market mechanism that is far more difficult to game. NASA

¹ <http://www.climateactionproject.com/docs/Repetto.pdf>

scientist James Hansen advocates the upstream approach, as does the U.S. Climate Action Partnership, an important coalition of businesses and environmental organizations.

US CAP embraces an upstream program that “requires fossil fuel producers (or shippers in the case of natural gas) to be covered by allowances that equal the emissions released when the fuel is combusted, thereby adding the cost of the emission reduction allowance to the price of the fuel.”

A common argument against upstream permitting is purely political: Critics contend that permitting so few entities will result in too few potential winners to win passage of a bill in Congress. But a consensus on the Hill may prove more difficult for a complex system of trade-offs than for a purer system of trading.

If political trade-offs result in the wrong market architecture, the result will be costly, Repetto contends:

There is a significant danger that policies adopted precipitously or through political negotiations without sufficient analysis and reflection will be inferior...Over a decade, the excess cost of an inferior policy choice could be \$1.75 trillion or more, given the annual growth in the economy. This would be enough to resolve the Social Security shortfall, fund expanded health care coverage, eliminate the budget deficit or fulfill many other worthy public goals...(I)t is quite conceivable that political horse-trading in some Congressional committee room by legislators or even by their staff could result in decisions based largely on political expediency that could entail excess costs of that magnitude. ²

Of course, adding anything at all to the price of fossil fuels is politically challenging when consumers are struggling with \$4-a-gallon gasoline and \$140-a-barrel oil. But the revenues generated from the carbon auction process could be directed to provide relief to energy consumers through a variety of means.

One proposal from Peter Barnes, Senior Fellow at the Tomales Bay Institute, is to return auction proceeds to American families in the form of dividends – regular per capita payments not unlike the recent economic stimulus payments or Alaska’s payment of oil dividends to its residents.

Many economists, including Repetto, prefer reducing taxes for lower- and middle-income taxpayers, paying down the federal deficit or employing a combination of strategies designed to recycle the new revenues into the economy and target assistance to those most severely affected by increased energy costs.

The transition to a post-carbon economy will require major investments, ranging from a national smart grid to higher spending on research and development. But insofar as federal funds are required, there are other sources of revenue that can be tapped. They’ll be discussed in a future Climate Action Brief.

² <http://www.us-cap.org/USCAPCallForAction.pdf>

This brief was prepared by the nonpartisan Presidential Climate Action Project at the University of Colorado Denver. PCAP, which is developing a 100-day climate action plan for the next President of the United States, issues briefs from time to time for the use of the presidential candidates as they consider policies to deal with climate change. Details are available at www.climateactionproject.com