The People vs. Cap-and-Tax

The public is largely unaware of a momentous battle about to be fought in Washington. The stakes are enormous. Yet the public has not been well informed.

Ignorance of the matter derives in part from the fact that the conflict was initiated via the highly charged issue of climate change. Climate is complex. People have different opinions about the extent to which humans are causing climate change. Fundamental belief systems are involved and discussion can be emotional.

Yet the core issue can be defined independent of climate. It concerns how society can phase out its addictive use of fossil fuels and move on, in the most economically efficient and equitable way, to a clean energy future. Conservatives, independents and liberals should be united in this fight.

Washington could define a path that would lead the world toward a clean energy future. And, incidentally, it would solve the climate problem – without requiring anyone to agree that there even is a climate problem.

Yet Washington appears intent on choosing a path defined by corporate greed. Unless the public gets engaged, the present Administration may jam down the public's throat just such an approach, which, it can be shown, is not a solution at all.

The frustrating thing to me is my inability to communicate these alternatives to the public. This feeling is consuming, because I believe with all my mind and heart that the well-being of my children and grandchildren (and yours) depends upon whether the public becomes informed and interested. So far, it isn't.

I had an opportunity on a recent David Letterman Show (http://www.youtube.com/watch?v=KiJJgC7B_KY), where I said that, for the sake of the people and the planet, the public must understand the difference between "cap-and-trade" and "fee-and-dividend". Of course, I could not continue with that topic there. But it is the heart of the matter. So how to proceed?

I decided to write an op-ed for the New York Times. I got city-slickered by the editors, as I will relate here. Perhaps this story can help people understand – it is not necessary to be a physicist or economist to understand the basic issues – it is mostly common sense.

My op-ed, which I submitted to the Times in early December, just prior to the UN climate meeting in Copenhagen, excoriated "cap-and-trade-with-offsets". As I will explain, cap-and-trade with offsets is the approach taken in the Waxman-Markey bill that narrowly passed the House of Representatives last June and the Kerry-Boxer bill that is currently languishing in the Senate.

The four legislators whose names adorn those bills have been stalwart environmentalists for their entire long and honorable careers. Yet cap-and-trade, which is ostensibly designed to reduce carbon dioxide emissions and preserve global climate, has been a proven loser in Europe. And the cap-and-trade bills, which also have the support of the White House and its environmentalist allies, are even worse.

Cap-and-trade-with-offsets would benefit a handful of wealthy people, while consigning our children to a downhill slide toward a lower standard of living – on a planet whose wondrous life forms are being decimated. So how can it be the basis of legislation being pushed by the Democratic Administration in both the House and Senate?

Easy. The proposed bills in Congress are loaded with goodies for special financial and corporate interests. These bills would cheat the American public – again. Cap-and-trade was designed in part by Wall Street, which is eager to exploit a trading market expected to grow to two trillion dollars. The revolving door between Washington and Wall Street helped bring the scheme about.

My op-ed [http://www.nytimes.com/2009/12/07/opinion/07hansen.html?_r=1 is the published version; http://www.columbia.edu/~jeh1/mailings/2009/20091207_SackGoldmanSachs.pdf is a saltier version] proposed an alternative approach, fee-and-dividend, designed to benefit the public rather than Wall Street. A carbon fee would be collected from the fossil fuel companies on the first sale of oil, gas and coal at the mine, wellhead or port of entry. One hundred percent of the collected fee would be given to the public monthly, deposited electronically in people's bank accounts or debit cards, an equal amount to each household.

I titled my op-ed "Sack Goldman Sachs' Cap-and-Trade". But editors can distort articles with titles of their choosing – and I know the Times tends to favor mainstream environmentalist ideology. So I asked the editors if they would retain my title. They refused to tell me. For good reason. If I had known their plans, I would have withdrawn the op-ed.

Their published title: "Cap and Fade". Not one person has offered a sensible explanation of that title. Worse, the editors added a subtitle indicating that "fee-and-dividend" was a tax, implying that cap-and-trade was not a tax. This is a case of calling black white and white black.

Cap-and-trade is a hidden tax. An accurate name would be cap-and-tax, because cap-and-trade increases the cost of energy for the public, as utilities and other industries purchase the right to pollute with one hand, adding it to fuel prices, while with the other hand they take back most of the permit revenues from the government. Costs and profits of the trading infrastructure are also added to the public's energy bill.

Fee-and-dividend, in contrast, is a non-tax. The fee collected at the first sale of oil, gas and coal in the country does increase the price of fossil fuel energy. But 100 percent of the fee is distributed monthly to the public as electronic deposits to the bank account or debit card of all legal residents, with half shares for children, up to two children per family.

The dividend keeps families whole while providing an economic stimulus to boot. By the time the fee reaches $115 per ton of carbon dioxide (equivalent to $1 per gallon of gasoline) the dividend will be $2,000-$3,000 per legal resident per year -- $6000-$9,000 for a family with two or more children.

People who keep their carbon footprint smaller than average will make money. The fee will rise gradually so people have a chance to choose more efficient vehicles, insulate their homes, and so on. The dividend will help people afford these investments. Jobs will be created as society retools the economy from high-carbon to low.

Perhaps coincidentally, the Times published alongside my op-ed an article by their columnist Paul Krugman (http://www.nytimes.com/2009/12/07/opinion/07krugman.html) extolling the merits of cap-and-trade. Krugman asserted that cap-and-trade provided the basis for a successful international agreement at Copenhagen on climate.

This one-two punch, evisceration of my article via a nonsensical title and an opposing piece (http://krugman.blogs.nytimes.com/2009/12/07/unhelpful-hansen/) by Nobel Prize winning Krugman, was not enough. By the time readers were ready for their second cup of coffee, at 10:45 AM, an article "Unhelpful Hansen" appeared on Krugman's heavily trafficked blog.

Krugman is one of my favorite columnists. I am amazed at his productivity, and I agree with most of his opinions. I am not suggesting that he was given prior knowledge of my piece by Times editors – I assume that he just works fast. My hope is that he is open to persuasion. Our aims are similar, and this matter is so important that it deserves careful reanalysis.

I also think the public can distinguish the forest from the trees. This topic is not rocket science. It is mostly a matter of common sense. And, contrary to Krugman's insinuation, most economists are in closer agreement with my perspective than with his.

First we must recognize one basic fact. Then I will describe the three main issues on which Krugman and I disagree. Then you can make up your own mind.

Basic fact. As long as fossil fuels are the cheapest form of energy their use will continue and even increase.

Consider the Kyoto Protocol, which was negotiated at a prior UN climate meeting in 1997. National emissions of signatory countries were capped at some agreed levels. Nations evaded these limits by purchasing "offsets" – putative but often illusory reduction in greenhouse gas emissions from developing countries. Offsets destroy the effectiveness of the agreement, because the scientific requirement for stabilizing climate is that the fossil fuel emissions are phased down rapidly. And some nations just ignored the limits, because there was no realistic way to enforce them. However, the fundamental problem was that "Kyoto" did not increase the price of fossil fuels relative to non-carbon energies.

The handful of nations that claimed to have reduced their carbon emissions were joshing their citizens and everybody else. They were just pretending to be "green". Manufacture of products based heavily on fossil fuels simply moved to developing countries, which had no cap. Then the products were flown to the developed countries, while burning aircraft fuel that is untaxed because of a 1940s agreement to support the fledgling airline industry.

Prior to "Kyoto" global fossil fuel emissions were increasing 1½ percent per year. Afterwards, they increased 3 percent per year. Kyoto may not have caused the increase (although shifting production to developing countries, often by coal-fired inefficient industries, with shipping to developed countries, did not help), but it certainly did not stop it.

Now let's address the three main arguments of Krugman, common arguments wielded by proponents of cap-and-trade.

Krugman Argument #1. Cap-and-trade is the only way to get an effective agreement rapidly.

That is a myth. In fact, every cap-and-trade regime has taken many years to hammer out. Kyoto negotiations dragged on a decade and were not completed. Individual countries had to be bribed to participate, yet some still would not. And the result was not successful, as we have seen.

Proposed cap-and-trade within the United States would be even more complex than "Kyoto." The Waxman-Markey and Boxer-Kerry cap-and-trade bills in Congress are larded with 2,000 pages of give-aways to special interests, soaking the public who must pay higher energy prices.

Fee-and-dividend, in contrast, is defined by a single number: the fee (tax) rate that the fossil fuel companies must hand over at the first sale of oil, gas or coal. All the government must do is divide this collected revenue by the number of legal residents and punch a button monthly to deliver the dividend to the public.

What is the chance that a United States cap-and-trade law could be a precursor for a global agreement? Zero. There is no chance that China will accept a cap. Nor should they. They are still in the early phase of their economic development.

But would China be willing to place a carbon fee on their fossil fuels? Yes, for many reasons. First, China wants to avoid, or at least minimize, the problems of fossil fuel addiction that plague the United States, such as the need for military protection of global supply lines. Second, China would be hit hardest by climate change, with several hundred million people living close to sea level and a still-enormous agrarian population. Third, air and water pollution from fossil fuels are a huge problem in China.

China is taking the right steps. They are investing heavily in energy efficiency, renewable energy, and nuclear power, threatening to take over technical and economic leadership as the

United States continues to dawdle. The Chinese government knows that replacement of fossil fuels with energy efficiency, renewable energies, and non-carbon energies requires a price signal (in addition to other more-targeted policies and investments).

Compare the difficulty of negotiating national carbon fee (tax) rates with the difficulty of convincing China that they should have Waxman-Markey-like cap-and-trade. Because of our historical energy profligacy, versus China's energy penury, a U.S. cap — even expressed as a percentage reduction — has no moral standing in China. On the other hand, the Chinese leadership appears to be smart enough to realize that a rising carbon price is just what their country needs as the underpinning to policies aimed at a clean energy future.

International agreement requires principally that the United States and China agree to apply such internal fees across the board on fossil fuels at the mine or port of entry.   Agreement on such action is in the best interests of both nations, making it far easier to reach than agreements on caps.

With the United States and China acting in concert on a carbon fee, Europe, Japan and other nations would surely follow. Import duties based on standard amounts of fossil fuels used in production could be applied to products from countries that did not have a carbon fee, removing any competitive disadvantage from the fee and providing strong incentive for participation in the carbon fee.

Krugman Argument #2. Cap-and-trade and fee-and-dividend are really equivalent.

Krugman says that the fee-and-dividend I propose is "essentially equivalent" to cap-and-trade. Here I may not have been clear. I do not dispute the economic theory that a cap and a fee are, in principle, equivalent. But cap-and-trade's complexity allows special interests to take over, killing its effectiveness.

The devil is in the implementations, as I discuss in my book "Storms of My Grandchildren". I believe lay people can appreciate the differences. Cap-and-trade's complexity provides a breeding ground for special interests. A fee at the mine, wellhead or port of entry, with distribution of proceeds to the public, has a great advantage in simplicity. Let me note here its superiority in transparency and fairness.

One can appreciate the difference in transparency by comparing the 2,000-page Waxman-Markey cap-and-trade bill with the simplicity of a single fee (tax) rate on fossil fuels. With fee-and-dividend we know who gets the money – equal amounts to all legal residents. But try reading the Waxman-Markey 2,000-page bill to figure out who would get the money! Why do those special interests deserve it anyhow?

Regarding fairness, I should note that there is a variant of fee-and-dividend preferred by Al Gore. He would use the money collected by the fee to reduce payroll taxes, rather than give

U.S. residents a dividend. It seems to me that a payroll tax deduction fails the fairness test, because half of adults are not on payrolls, being either retired or out of work involuntarily.

However, some economists also prefer a payroll tax deduction. Their argument is that reducing taxes on employment creates jobs and stimulates the economy. It seems to me that dividends do the same, but I suppose that using half of the collected fee to reduce payroll taxes would be an acceptable compromise. However, it would be important to be certain that the payroll tax deduction is real and matches the fee collection. With a dividend it is easier to be sure that the government is coughing up the full amount.

Krugman Argument #3. Wall Street will not be involved in carbon trading

Krugman says that my suggestion that carbon trading will be an open invitation to Wall Street to again pillage the financial system "is bizarre." What is bizarre, in my opinion, is his implicit presumption that government regulators can outwit Wall Street executives.

Congress can write a cap-and-trade bill that tries to exclude Wall Street. But to think that Wall Street will not get involved in carbon profits, directly or indirectly, is naïve. This is a free country. Wall Street banks can buy the companies most affected by carbon price.

Notice what happened after we bailed out the big banks? They decided the chump-change in loans to home-owners wasn't worth their trouble. Instead they went to trading – in the stock market – making billions. Their secretive trading units are good – very good – there is a reason that they get big bonuses.

Wall Street and the big banks took us to the cleaners once – shame on them. If we allow Congress to pass cap-and-trade, letting the banks do it to us again – shame on us.

Trading schemes make sense only when they provide added value. Carbon trading provides mostly added cost. What we need is a transparent, honest approach that benefits the public.

The Fundamental Requirement

We can cure our fossil fuel addiction and in the process reduce emissions that cause climate change. It requires that we take actions for the public interest, not for special interests.

What we need is an approach that addresses the fundamental fact that keeps us addicted to fossil fuels: they are the cheapest form of energy, provided their prices do not have to include the damage they do to human health, the environment, and the future of our children.

For the sake of the people, especially young people, there should be a rising price on carbon emissions. The price should rise at a known economically sensible rate, so that businesses have time to plan their investments accordingly. The money collected should be put in the hands of the public, so they are able to make the purchases necessary to reduce their carbon footprint.

The money collected should <u>not</u> be used by Congress to invest in energy R&D. It has been shown time and again that Congress does not invest efficiently, and certainly not compared to the private sector. Private sector investments will be made if a rising price of carbon emissions is legislated through a carbon fee that makes the rising price explicit. The government already has resources to support research – it should not steal fee-and-dividend money from the public.

Contrary to claims of mainstream environmental groups and others politically invested in cap-and-trade, the legislative train has not left the station. There is time to negotiate and pass a simple transparent bill that is in the interest of the public. It should be a bi-partisan bill that can be supported by conservatives.

Congress is accustomed to working with special interests. There is a revolving door between Congress and lobbyists. Ex-members know the Washington ropes. The lobbyists wrote most of the pages in the 2,000-page bills in Congress.

We, the public, cannot allow politics-as-usual to steamroll this topic. It is too important for the health of our economy, our children, and the other life on the planet. Fortunately, there are members of Congress who are beginning to understand the problem and move in the direction to address it.

Congressman Larson's bill, with a rising carbon fee, addresses half of the task. The rate at which the fee rises in this bill is perhaps too slow, but the important point is to provide the business community and the public some certainty that carbon prices will rise so they can make decisions and investments accordingly.

Senator Cantwell's cap-and-dividend bill also addresses half of the solution – distributing 100 percent of the proceeds to the public as a dividend. However, it is just as important to dispense with the "cap" approach, still present in the Cantwell bill, as it is with the "trade" aspect.

A cap is more complex than a fee (dollars per ton of CO_2, applied uniformly at the source), so a cap is more subject to jerry-rigging by special interests. But the fundamental reasons to remain dead-set against the cap approach are these:

(1) Caps inherently cause prices to fluctuate wildly. Even if legislators attempt to outsmart the market by building in limits on the fluctuations, there is still uncertainty in the impact on energy prices. Business people need to have confidence about how prices will change in the future. Ditto, the public. If they expect prices to be fluctuating they are not as likely to make the lifestyle decisions that are needed to move us toward the cleaner future beyond fossil fuels.

(2) A cap-and-dividend approach is not a route to a global agreement. There is no way that developing countries such as China can accept a cap, given their state of development. The United States should be a global leader. The way to do that is to demonstrate an understanding of the global problem and provide a leadership example in solving it.

Postscript

One of the economists I consult with suggested alternative ways to address Krugman's arguments. These suggestions are so extensive that I cannot incorporate them as if they were my own – but they provide additional insight. So I edited them a bit and put on my web site at http://www.columbia.edu/~jeh1/mailings/2010/20100112_PeoplePostscript.pdf. This discussion refers to two of arguments listed above, and to an addition argument (Cap-and-trade worked for acid rain, so it will work for climate change).

Letter

The letter delivered to the chairperson of the Carbon Trading Summit is at http://www.columbia.edu/~jeh1/mailings/2010/20100112_PeopleLetter.pdf