

# WebMemo



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## Capping Carbon Emissions Is Bad, No Matter How You Slice the Revenue

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A favorite approach to reducing carbon dioxide emissions among Washington bureaucrats is the “market-oriented” cap-and-trade program, which under a global warming bill proposed by Representatives Henry Waxman (D-CA) and Ed Markey (D-MA), would establish.

Building broad support for this approach, however, has been difficult, leading some in Congress to develop alternatives to cap and trade. Some of these new schemes are as simple as placing a tax on carbon emissions, while others, such as “cap and dividend” or “cap and invest” are variations of the original.

The problem with these efforts is that they do not resolve the central problem that will continue to plague attempts to cap CO<sub>2</sub>: All carbon capping plans are costly energy taxes in disguise that will raise energy prices and unemployment with little environmental benefit.

**Cap and Trade.** Under a cap-and-trade program, each power plant, factory, refinery, and other regulated entity will be allocated allowances (rights) to emit six greenhouse gases. However, only a certain percentage of the allowances will be allocated to these entities. The remaining percentage will be auctioned off or distributed to other emitting entities. Emitters who reduce their emissions below their annual allotment can sell their excess allowances to those who do not. Over time, the cap would be ratcheted down, requiring greater cuts in emissions and more harm to the economy.

There are plenty of reasons why a cap-and-trade program is a bad idea, including lack of transpar-

ency and potential for fraud and abuse. But above all it is an economic burden and jobs killer. A Heritage Foundation analysis of Waxman–Markey found devastating economic impacts. Specifically, the analysis projects that by 2035 the bill will:

- Reduce aggregate gross domestic product (GDP) by \$7.4 trillion;
- Destroy 844,000 jobs on average, with peak years seeing unemployment rise by over 1,900,000 jobs, net of any “green jobs” created;
- Raise electricity rates 90 percent after adjusting for inflation;
- Raise inflation-adjusted gasoline prices by 74 percent;
- Raise an average family's annual energy bill by \$1,500; and
- Increase inflation-adjusted federal debt by 29 percent, or \$33,400 additional federal debt per person, again after adjusting for inflation.<sup>1</sup>

Although touted as market-oriented, placing an arbitrary limit on carbon emissions and permits to emit is market-distorting and attempts to force consumers to change their behavior.

This paper, in its entirety, can be found at:  
[www.heritage.org/Research/EnergyandEnvironment/wm2443.cfm](http://www.heritage.org/Research/EnergyandEnvironment/wm2443.cfm)

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aid or hinder the passage of any bill before Congress.

**Cap and Dividend.** One variant of a cap-and-trade plan is cap and dividend. Just like a cap-and-trade bill, in cap and dividend businesses would bid for carbon credits through an auction, but in this scenario, consumers would receive “dividend payments” from the auction proceeds.<sup>1</sup>

The architects of cap-and-dividend plans acknowledge that capping carbon “will inevitably raise the prices of fossil fuels: coal, oil, and natural gas. The resulting price increases will reduce the real incomes of American families, striking hardest at those who can afford it least: lower-income households for whom fuel costs represent a higher fraction of their expenditures.”<sup>2</sup> Proponents of cap and dividend argue that rebate checks would offset these costs.

Whether the rebate checks would offset the rise in energy costs remains to be seen, but this scenario is highly unlikely to help most Americans. As carbon prices rise, so do the dividend checks, but so do the energy prices consumers must pay. Further, rebates or not, the higher energy prices would reduce economic activity by forcing businesses to cut costs elsewhere, possibly by reducing their workforce, and thus doing damage that no check would cover.

A cap on carbon would inflate the price of non-carbon sources of energy by allowing them into the marketplace at a higher price point than they otherwise would. Subsidies and special tax breaks for renewable energy sources along with caps on carbon provide little incentive for renewable energy source companies to reduce costs, thereby stifling innovation and leading to more dependency on government for handouts.

**Cap and Invest.** Cap and invest is very similar to cap and dividend, but rather than give money to

consumers, it is funneled into government-run research and development projects for renewable energy technology.

Rather than giving any money back to the consumers, all the climate revenue is devoted to unproven renewable technologies. Not only does this thwart innovation by reducing incentives to make renewable technologies more economically efficient, but it places the power to innovate in the hands of bureaucrats. In all sectors of the economy, history shows that it is the private sector—not the federal government—that is best at meeting consumer demand and innovating to provide more efficient products.

The real tragedy is that these energy taxes fall disproportionately on the poor, since low-income households spend a larger percentage of their income on energy. A new study found that the carbon cap in the Lieberman–Warner bill is comparable to a tax hike for the average American household of \$1,100 in 2008, which would rise to over \$1,400 in 2015 and nearly \$3,000 in 2050.<sup>3</sup> While this is without rebates, if no portion of the energy tax revenue is given back to the consumer in a cap-and-invest plan, the tax obviously becomes costlier.

**Carbon Tax.** A carbon tax is a direct, more predictable tax on carbon emissions, but that does not make it any more acceptable. Proponents argue that it is better than a cap and trade because it will not unpredictably fluctuate with the ebbs and flows of the market as evidenced by Europe’s carbon trading problems.<sup>4</sup>

Regardless of the efficiency of a carbon tax, any tax to reduce carbon dioxide similar to those proposed in cap and trade would cause significant economic damage and would do very little to reduce global temperatures. Furthermore, the economic

1. William W. Beach, David W. Kreutzer, Karen Campbell, and Ben Lieberman, “The Economic Impact of Waxman–Markey,” Heritage Foundation *WebMemo* No. 2438, May 13, 2009, at <http://www.heritage.org/Research/EnergyandEnvironment/wm2438.cfm>.
2. James K. Boyce and Matthew Riddle, “Cap and Dividend: How to Curb Global Warming While Protecting the Incomes of American Families,” Political Economy Research Institute University of Massachusetts, Amherst, November 2007, at <http://www.capanddividend.org/files/WP150.pdf> (May 12, 2009).
3. Bryan Buckley and Sergey Mityakov, “The Cost of Climate Regulation for American Households,” George C. Marshall Institute, March 2, 2009 at <http://www.marshall.org/article.php?id=636> (May 12, 2009). Numbers adjusted for inflation.
4. Julian Glover, “A Collapsing Carbon Market Makes Mega-Pollution Cheap,” *The Guardian*, February 23, 2009, at <http://www.guardian.co.uk/commentisfree/2009/feb/23/glover-carbon-market-pollution> (March 30, 2009).

pain of higher energy prices will reduce disposable income for other goods and services. Once the economy expands, bureaucrats would likely raise the tax on businesses, which would ultimately be passed on to the consumer.

And again, America's poorest would be hit the hardest. Congress would likely tinker with income tax policy further, making it even more regressive to compensate while increasing the overall burden on Americans in the same way Europe has tinkered with its systems to compensate for the regressive effects of its insidious value-added tax.<sup>5</sup>

Many proponents of a carbon tax emphasize that the economic burden would be less if the plan were coupled with a reduction in the capital gains tax or the payroll tax, but this scenario is highly unlikely. Although cutting taxes further would encourage entrepreneurial activity and investment in labor and capital, this would do little to offset the high energy prices that fall particularly hard on low-income households.<sup>6</sup> Moreover, it is clear from Obama's budget blueprint that this regulatory tax regime is also about raising massive amounts of revenue to

fund a huge expansion in government, specifically health care.

**The Climate "Benefit."** There are risks to global warming, but there are also risks to global warming policies. Even if one of these plans could be implemented effectively, the impact on global temperatures would be insignificant. Analysis by the Environmental Protection Agency shows that if the United States implemented a 60 percent reduction in CO<sub>2</sub> emissions by 2050, the global temperature would be reduced by 0.1–0.2 degrees Celsius by 2095.<sup>7</sup>

The bottom line is that cap and trade or any variant thereof would be a drag on the U.S. economy at a time when it can afford it the least. Moreover, any positive effect on global climate change would be negligible. In a cost-benefit analysis, the costs of capping carbon dioxide are large and immediate, but the benefits are small and remote.

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5. Dan Mitchell, "Beware the Value-Added Tax," Heritage Foundation *Backgrounder* No. 1852, May 16, 2005, at <http://www.heritage.org/Research/Taxes/bg1852.cfm>.
  6. Terry M. Dinan, "The Distributional Consequences of a Cap-and-Trade Program for CO<sub>2</sub> Emissions," Congressional Budget Office, March 12, 2009, at <http://www.cbo.gov/doc.cfm?index=10018> (May 12, 2009).
  7. David W. Kreutzer, "The Economics of Cap and Trade," testimony before the Ways and Means Committee, U.S. House of Representatives, September 18, 2008, at <http://www.heritage.org/cda/upload/KreutzerTestimonyTrade.pdf>.