

# WebMemo



Published by The Heritage Foundation

No. 2503  
June 24, 2009

## CBO Grossly Underestimates Cost of Cap and Trade

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Last week, the Congressional Budget Office (CBO) released their analysis of the Waxman–Markey climate change bill that had proponents of the bill claiming Americans could save the planet for just \$175 per household. That was the figure CBO estimated cap and trade would cost households in 2020 alone.<sup>1</sup>

Both the CBO's analysis and the subsequent legislation are troubled: The analysis grossly underestimates economic costs while the legislation will have virtually no impact on climate. Overall, there are a number of basic problems with CBO's analysis:

- Their allowance cost numbers do not add up;
- They ignore economic costs such as the decrease in gross domestic product (GDP) as a result of the bill; and
- The analysis is an accounting analysis, not an economic analysis.

**Problems with Costs and Distribution of Allowances.** The CBO's June 19 study projected that the allowance price—the price to emit carbon dioxide—will be \$28 per ton of CO<sub>2</sub> in 2020.<sup>2</sup> Since there are 5.056 billion tons of CO<sub>2</sub> equivalent in the cap that year (the amount of carbon dioxide and other greenhouse gases businesses are allowed to emit), this projection implies a \$141 billion gross cost; however, CBO lists the cost as \$91.4 billion. Although there were no changes to the bill between June 5 and June 19, the CBO projected allowance revenues of \$119.7 billion, \$129.7 billion, \$136 billion, \$145.6 billion, and \$152.9 billion for the years 2015–2019. As the cap on carbon dioxide becomes

more stringent, one would expect the allowance revenue to continue to climb, not dramatically decrease to \$91.4 billion.<sup>3</sup>

The goal of a cap-and-trade program is to reduce the amount of carbon dioxide and other greenhouse gases in the atmosphere. In order to realize such reductions, cap-and-trade programs establish absolute limits on total emissions of greenhouse gases. Before businesses in a covered sector can emit a greenhouse gas, they need to have the ration coupons (also known as allowances) for each ton emitted. The price a firm pays for these allowances, euphemistically referred to as “climate revenue,” should be considered tax revenue. CBO mistakenly assumes that the government spending and distribution of allowance revenue is the dollar-for-dollar equivalent to a direct cash rebate to energy consumers—that is, that the carbon tax is not a tax if the government spends the money, which is simply preposterous.

**Ignoring Economic Pain.** Most problematic is the CBO's complete omission of the economic damage resulting from restricted energy use. As footnote 3 on page 4 of the CBO analysis reads, “The resource cost does not indicate the potential decrease in gross domestic product (GDP) that could result from the

This paper, in its entirety, can be found at:  
[www.heritage.org/Research/EnergyandEnvironment/wm2503.cfm](http://www.heritage.org/Research/EnergyandEnvironment/wm2503.cfm)

Produced by the Center for Data Analysis

Published by The Heritage Foundation  
214 Massachusetts Avenue, NE  
Washington, DC 20002–4999  
(202) 546-4400 • [heritage.org](http://heritage.org)

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cap. The reduction in GDP would also include indirect general equilibrium effects, such as changes in the labor supply resulting from reductions in real wages and potential reductions in the productivity of capital and labor.”<sup>4</sup> In The Heritage Foundation’s analysis of the Waxman–Markey climate change legislation, the GDP hit in 2020 was \$161 billion (2009 dollars). For a family of four, that translates into \$1,870—a pretty big chunk of change that the CBO is ignoring.

It is also worth noting that, of the 24 years analyzed by The Heritage Foundation’s Center for Data Analysis (CDA), 2020 had the second lowest GDP loss. Furthermore, the CDA found that for all years the average GDP loss was \$393 billion, or over double the 2020 hit. In 2035 (the last year analyzed by Heritage) the inflation adjusted GDP loss works out to \$6,790 per family of four—and that is before they pay their \$4,600 share of the carbon taxes.<sup>5</sup> The negative economic impacts accumulate, and the national debt is no exception. The increase in family-of-four debt, solely because of Waxman–Markey, hits an astounding \$114,915 by 2035.<sup>6</sup>

**An Accounting Analysis, Not an Economic One.** The CBO analysis is an accounting analysis of the flow of allowance revenue; it is not an economic analysis of the true opportunity cost of the bill. The analysis’s “net cost” is essentially the cost of producing offsets and other emissions reductions—a process similar to a company’s chief financial officer doing a cash-flow analysis of one investment project. The CBO does not take into account the

dynamic general equilibrium consequences of the much higher energy prices: There are serious economic impacts from the energy price increases that they ignore.

The CBO and Congress seem to assume that energy price increases can be mitigated by giving allowance revenue back to businesses and consumers. This is not how the economy works. Prices are merely an information signal about the relative scarcity of real resources that are being used. For example, if farmers use their land, labor, and equipment to produce offsets, instead of planting more food crops, the price of food will go up. Yet the CBO report ignores this reality.

The CBO analysis cannot be used to debate the economic cost versus economic benefit of the bill. Instead, it can be used only to follow the money of the allowance revenue so policymakers and the public can understand exactly how that piece of the legislation is being handled. There is value in keeping an accounting of this revenue flow in order to determine who is getting what, but CBO should make it clear that this is the limit of their analysis.

It is inappropriate to go beyond this analysis, for example, by comparing CBO’s cost estimates to those of The Heritage Foundation, the National Black Chamber of Commerce, or even the EPA, as many Members of Congress are already doing. These Members are simply trying to compare two different cost concepts—accounting versus economic. Although the EPA’s analysis is flawed for other reasons,<sup>7</sup> mostly because of unrealistic

1. Douglas Elmendorf, “Measuring the Effects of the Business Cycle on the Federal Budget,” Congressional Budget Office Director’s Blog, June 23, 2009, at <http://cboblog.cbo.gov> (June 24, 2009).
2. Congressional Budget Office, “The Estimated Costs to Households from H.R. 2454 American Clean Energy and Security Act of 2009,” June 19, 2009, at <http://www.cbo.gov/ftpdocs/103xx/doc10327/06-19-CapAndTradeCosts.pdf> (June 24, 2009).
3. “American Clean Energy and Security Act of 2009,” June 5, 2009 at <http://www.cbo.gov/ftpdocs/102xx/doc10262/hr2454.pdf> (June 24, 2009).
4. Congressional Budget Office, “The Estimated Costs to Households from H.R. 2454 American Clean Energy and Security Act of 2009.”
5. William W. Beach, David W. Kreutzer, Karen Campbell, and Ben Lieberman, “Son of Waxman–Markey: More Politics Makes for a More Costly Bill,” Heritage Foundation *WebMemo* No. 2450, May 18, 2009, at <http://www.heritage.org/Research/EnergyandEnvironment/wm2450.cfm>.
6. *Ibid.*
7. For a critique of the EPA’s economic analysis of Waxman–Markey, see David W. Kreutzer and Nicolas D. Loris, “Questions on EPA’s Cost Estimates for Waxman–Markey Climate Change Legislation,” Heritage Foundation *WebMemo* No 2470, June 9, 2009, at <http://www.heritage.org/Research/EnergyandEnvironment/wm2470.cfm>.

assumptions, they at least attempt to estimate the economic cost, which the CBO did not.

**Higher Taxes and Economic Devastation in Return for... Nothing?** Regardless of the CBO's cost estimates of the Waxman–Markey cap-and-trade program, the necessary second part of the question—what benefits do the costs generate?—remains unanswered. Americans will get almost nothing in exchange for these higher taxes, and the legislation will provide nothing for future generations except more debt and less economic opportunity. According to climatologist Chip Knappenberger, Waxman–Markey would moderate temperatures by only hundredths of a degree in 2050 and no more than two-tenths of a degree at the end of the century.<sup>8</sup> This does not sound like a great deal for the next generation—millions of lost

jobs, trillions of lost income, 50–90 percent higher energy prices, and stunning increases in the national debt, all for undetectable changes in world temperature.

The CBO analysis of Waxman–Markey fails to take into account all the adverse effects that will ripple through the U.S. economy if cap and trade becomes law. CBO's grossly underestimated costs means Members of Congress will be grossly misinformed when voting on the legislation.

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8. Chip Knappenberger, "Climate Impacts of Waxman–Markey (the IPCC-based Arithmetic of No Gain)," MasterResource, May 6, 2009, at <http://masterresource.org/?p=2355> (June 24, 2009).