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The Economics of Global Warming Policy

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Abstract: *Global warming is not a crisis and should not be treated as one. Congress's pending cap and trade bills would do much more economic harm than environmental good, just as the Environmental Protection Agency's recent global warming regulations are bound to do. Such measures kill jobs and impose high costs on the American people—all to make a negligible impact on an overstated threat. On May 17, 2010, Heritage Foundation energy policy expert Ben Lieberman addressed the Heartland Institute's fourth International Conference on Climate Change in Chicago—and explained what really keeps economies humming and environments clean.*

My name is Ben Lieberman and I'm the Senior Policy Analyst for Energy and Environment at The Heritage Foundation. I'm proud to say that I've either participated in, or attended, all four of the Heartland Institute's global warming conferences. If there's a fifth and a sixth, I'll be there, too. I have gotten a lot out of all of them.

What has impressed me most about the last three Heartland conferences, and this one, has been the scientific discussions. From those presentations, we are getting a realistic impression of global warming and how much of a threat it really poses—and what I conclude from a policy standpoint is that global warming is clearly not a crisis and should not be addressed as one. And I would argue that those who attended one or more Heartland conferences are probably the least surprised by the “climate-gate” revelations because we

Talking Points

- Global warming is not a crisis and should not be addressed as one. Pending global warming bills before Congress and the Environmental Protection Agency's regulations would do far more economic harm than environmental good.
- The Waxman–Markey cap-and-trade bill seeks to drive up energy costs so that consumers and businesses are forced to use less energy.
- Waxman–Markey and similar Senate bills would impose annual costs of nearly \$3,000 for a household of four, and destroy more than one million jobs—a very expensive solution to an overstated threat.
- Rather than imposing big government constraints on the economy, the government should unleash the forces of free markets, since they, not regulation, have a proven track record of fostering real environmental improvements over the long term.

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have learned from the real science that virtually every global warming claim that sounds terrifying is not true—whether it's the assertion that we are currently living through a period of historically unprecedented temperatures, or that rapidly melting Himalayan glaciers will be gone by 2035, or that there has been an increase in storm damage attributed to warming.

None of the scary stuff about global warming is true, and what is true about global warming, what the science actually tells us about man's role in changing the climate, is far from terrifying. So those who have attended the Heartland conferences, or read its Report of the Nongovernmental International Panel on Climate Change, are the ones least surprised by the lengths the U.N. scientists had to go in order to manufacture a global warming crisis. In fact, the theme of this Heartland conference might as well be, "We told you so."

None of the scary stuff about global warming is true, and what is true about global warming is far from terrifying.

Science is an important starting point from which to move on to costs. I'll be the first to admit that if those apocalyptic claims about global warming were likely to occur, and if cap-and-trade legislation, or new multilateral treaties, or EPA regulations stood a good chance of substantially reducing the threat, then the costs wouldn't really matter; it would be worth spending a lot on these policies. But neither is true, and what we need to do is weigh the risks of global warming against the risks of global warming policy. We don't want to do more economic harm than environmental good.

If there is one overall theme to the economics of cap and trade, or other proposed global warming abatement measures, it is that there is absolutely no cheap way to curtail carbon dioxide emissions from fossil fuels. This is especially true if you want to reduce emissions substantially and over a relatively short timeframe, which is what most of the activists still insist is necessary. Fossil fuels (coal, oil, and natural gas) comprise 85 percent of America's energy sources, and we use them not because we're stu-

pid but because we're smart: They are the most plentiful and affordable energy supplies that currently exist, and they contribute greatly to our high standard of living. Promises by the President and others that we can move away from fossil fuels fairly easily via cap-and-trade legislation, and that such measures would cost no more than a postage stamp per day are not only untrue, but can't possibly be true. After all, if the price of gasoline stays about the same, car owners will continue to use about the same amount; if the cost of electricity stays about the same, homeowners and businesses will continue to use as much—and the emissions reduction targets will not possibly be met.

Cap and trade has to raise energy prices high enough so that we are forced to use less in order to meet the emissions reduction targets. Inflicting economic pain is not some unintended consequence: It is how any system works that is designed to reduce carbon emissions. President Obama said it best in 2008, before he latched onto the postage stamp rhetoric as a sales pitch, when he declared that under his plan energy prices would *necessarily* skyrocket. Cap and trade is just a convoluted energy tax, and, again, it has to be a painfully high tax in order to reduce emissions. If there is any doubt about it, just look at Europe, which has had a cap-and-trade scheme in place for several years—that has been a failure every way you look at it. It has not reduced emissions, at least not until the recession came along. It has not led to any technological breakthroughs that have reduced the need for fossil fuels. The reason is simple: For all of Europe's high-minded environmental rhetoric, the reality is that none of these nations wanted to bear the exorbitant costs of ratcheting down emissions.

The first big push for climate legislation in 2009 came with the House of Representatives' cap-and-trade bill, the American Clean Energy and Security Act, sponsored by Henry Waxman (D-CA) and Edward Markey (D-MA). Waxman-Markey would require a 3 percent reduction in greenhouse gas emissions by 2012 (compared to 2005), a 17 percent reduction by 2020, and 83 percent by 2050. Regulated companies would have to secure enough rights to emit carbon dioxide to account for their annual emissions. Some of these rights, called allowances, would be sold by the government to

emitting companies that needed them, while other allowances would be given for free to favored special interests. In fact, the inducement of free allowances is how proponents of the bill managed to get at least some industry support for the bill. Electric utilities, oil refiners, natural gas producers, and some manufacturers who produce energy on site would be the ones directly regulated.

The good news for the rest of us: Homeowners, car owners, small business owners, property owners, and farmers will not be directly regulated. The bad news is that the higher energy costs would be passed on to the rest of us anyway, and those costs will be there regardless of whether some in industry are bought off with free allowances. It's supply and demand: When you artificially constrain the supply of energy, you will raise the price; and, remember, the price has to increase enough so that we use less and meet the emissions targets.

Now what are those costs? Well, a Heritage Foundation analysis of the costs imposed by Waxman–Markey projects higher energy costs as soon as the bill's provisions take effect in 2012. For a household of four, energy costs go up by \$436 a year, up to \$1,241 by 2035, which is as far out as our analysis goes. Electricity rates go up 90 percent, gasoline prices 58 percent or \$1.38 per gallon, and natural gas 55 percent.

But direct energy costs are only part of the burden. Nearly everything goes up since higher energy costs raise production costs. The total cost of Waxman–Markey works out to nearly \$3,000 per household of four every year from 2012 to 2035.

Beyond the impact on individuals and households, cap-and-trade legislation also affects employment, especially in the manufacturing sector. We estimate job losses averaging over one million. Note that these are net job losses, after the much overhyped new green jobs are taken into account. Some jobs will be destroyed entirely, others will be outsourced to nations like China or India that have no intention of hampering their own growth with similar measures to raise energy prices.

I should add that the costs are not distributed evenly. The burden of higher energy costs disproportionately hurts the poor, who spend a larger

percentage of their incomes on energy. The Congressional Budget Office has been clear on this point. So cap and trade is not only an energy tax, but a highly regressive tax. Cap and trade also hurts some parts of the country more than others. It is no coincidence that Henry Waxman represents Hollywood and Edward Markey represents the Boston suburbs, and that the companion Senate bill is cosponsored by Senators Barbara Boxer from California and John Kerry from Massachusetts. The very latest bill is sponsored by Kerry and Senator Joe Lieberman of Connecticut. The West Coast and Northeast will be harmed economically, but not nearly as badly as other parts of the country, in part because these are the regions whose economies are already stagnant, so reducing emissions won't be as high a hill to climb. These are also the regions that have long since adopted policies that have chased away the manufacturing sector.

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Unlike the West Coast and the Northeast, other parts of the country, like the Midwest, still have manufacturing jobs to lose, and states like Texas still have growing economies—and thus growing emissions. Of course, those parts of the country that rely more heavily than others on coal-fired electricity will be disproportionately burdened, since coal is the first target under cap and trade. Coal-mining regions will of course be very hard hit. And rural America gets a particularly bad deal. Farming and ranching is energy-intensive, and the higher energy and natural-gas-derived fertilizer costs will reduce farm profits by 28 percent in 2012 and 57 percent in the years after that. As with American manufacturers, American farmers would be at a global disadvantage compared to farmers in other countries that will not face higher energy costs.

Overall, gross domestic product is reduced \$393 billion annually below where it would otherwise be (cumulatively, \$9.4 trillion by 2035). We have not analyzed the latest bill from Kerry and Lie-

berman, which is a slightly weaker version, but still very expensive and a substantial jobs killer.

Quite a price tag—but what does it buy in terms of avoided harm? Keep in mind, even if you assume continued warming from the release of carbon dioxide, unilateral measures don't prevent other nations from doing what is in their own best interest. We know from the collapse of multilateral climate negotiations in Copenhagen last December that major developing nations like China and India have no interest in jeopardizing their economic growth by agreeing to emissions reductions. In fact, developing world emissions surpassed developed world emissions in 2005 and are projected to increase seven times faster through 2030, according to the Energy Information Administration. China alone emits more than the U.S., and its emissions are projected to increase nine times faster than ours. And China will continue to do so whether or not federal legislation or regulations are imposed. So the impact of U.S.-only measures would be negligible.

The only serious analysis of the impact on temperatures of the Waxman–Markey cap-and-trade bill was conducted by climate scientist Chip Knappenberger, also a participant in this conference. He estimated that even if one assumes that man-made global warming is real and will continue, this bill would reduce the earth's future temperature by no more than 0.2 degree Celsius by 2100—an amount far too small to matter. So we are talking about nearly \$5 trillion for each tenth of a degree in a century's time. The Kerry–Lieberman bill would also cost trillions for each tenth of a degree. In my view, that's the worst tradeoff in history. All economic pain for little environmental gain, even if you assume man-made global warming in the decades ahead.

All cap and trade would do is leave us poorer in the future than we would otherwise be. Less wealth means less resilience, less adaptive capacity, and less ability to deal with whatever challenges the future may throw at us, whether caused by global warming, or, which is more likely, unrelated to global warming. In other words, by spending a lot of money on what is likely to be a futile attempt to make the future better, we will make ourselves poorer and actually worse off, both now and in the future.

The term “cap and trade” has become a pejorative. Proponents of the emission-reduction bills no longer want to use the term. That's because the public sees it for what it is. So now we see alternatives being discussed, such as “cap and dividend,” in which the proceeds from the sale of allowances are refunded to the public. Some are dispensing with the myth that this is not a tax and calling for direct taxes—carbon taxes—which is still a bad idea, but I at least give proponents credit for being honest. Some proposals call for national renewable electricity standards, which would require a certain percentage of electricity to be generated by alternative-energy sources like wind or solar power that supposedly have lower carbon dioxide emissions. Those can be seen as sort of a scaled back version of cap and trade, but still very expensive. For example, The Heritage Foundation has published a new study concluding that a renewable electricity standard would cost \$5 trillion in total and destroy over a million jobs. We are also seeing Congress being bypassed and unelected bureaucrats at the Environmental Protection Agency implementing as much of this anti-energy global warming agenda as they can. But no matter how it is done or what it is called, keep in mind it's a tax on energy and it has to be a hefty tax on energy to make any difference. So there would be a significant hit to households, businesses, and the American economy overall.

Global warming isn't a justification for bigger government; if anything it's a justification for smaller government.

Now, as you may have guessed, I am not a fan of big government solutions to global warming, however large or small of a problem we think it is. But there is an alternative to cap and trade, or multilateral treaties, or EPA regulations or other big-government measures that will almost certainly do more harm than good. That alternative is the free market, limited government, rule of law, property rights, and free trade. In my view, global warming isn't a justification for bigger government; if anything it's a justification for smaller government.

The Heritage Foundation just published its *2010 Index of Economic Freedom*, which ranks each nation by its level of economic freedom. Something we have learned is that the nations ranked as having the freest economies also tend to be the ones with the cleanest environments.

The reasons are clear. Free economies tend to be prosperous economies, and wealthy societies are the ones with the means and the desire to address environmental problems. In addition, free economies tend to foster technological development that allows people to produce more with less. Markets are the best way of improving efficiencies, and that includes efficiency in energy use.

This is evident with regard to carbon dioxide emissions. The freest economies lead the way with technologies that reduce carbon intensity, that is, carbon emissions per unit of production. A recent

study by the Cascade Policy Institute comes to a similar conclusion as a forthcoming Heritage study: The freest economies have lower carbon intensity, and thanks to constant technological improvements, those carbon intensities continue to fall. Less-free economies emit more carbon dioxide per unit output, and are not improving in the way of freer economies.

So I would argue against command and control and against large-scale interference with the economy. I would argue in favor of free markets, which will leave us wealthier and more technologically advanced and thus better equipped for the future. And that's a policy that makes sense whether or not global warming turns out to be a problem.

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