

# Opinion: A Serious Solution for Energy Policy

BY FRED UNGER

Every president since Richard Nixon has proclaimed energy policy a national priority. They have all failed to provide any lasting solutions.

We are headed toward failure again. The Waxman-Markey American Clean Energy and Security Act (ACESA) passed by the House of Representatives could set back real solutions to our energy problems by decades, while exacerbating economic problems facing our country.

What matters is not intentions but results. Despite the rhetoric, ACESA won't reduce carbon emission in a meaningful way or create what clean energy solutions need to be successful—a real price on the “economic externalities” of our fossil fuel addiction.

## The American Clean Energy and Security Act Has Major Problems

### 1. The Carbon Cap is Ineffective

The core of the ACESA is a new derivatives market for government permits to emit greenhouse gases, along with offsets, which provide credit for activities such as planting trees or protecting forests, which mitigate impacts of emissions.

Scientists argue the carbon caps in ACESA are too low to impact climate change, while economists and practical observers suggest they are so subject to manipulation they are unenforceable. By allowing billions of tons of unverifiable offsets, many from international sources, no carbon emission reduction would even begin in the United States for at least a decade if all the offsets provided in the congressional bill were utilized.

### 2. New Derivatives Market Threatens the Economy

The *Financial Times* quotes US Commodities Future Trading Commissioner



Bart Chilton predicting carbon markets would become “the biggest of any derivatives product in the next four to five years.”

ACESA credits and offsets create a volatile multi-trillion dollar carbon derivatives market that could impact financial markets much like the recent crash in mortgage-backed derivatives. The inclusion of unverifiable international offsets makes markets harder to understand or regulate, inviting market manipulation and fraud.

In the Friends of the Earth report “Subprime Carbon,” Michelle Chan cautions: “Today speculators do the majority of carbon trading, and they will continue to dominate as carbon-trading markets grow.”

Unlike existing SO<sub>x</sub> and NO<sub>x</sub> emission trading markets with limited sets of players and clear rules, the proposed carbon markets promise pay for impossible to verify assets to unlimited numbers of players.

In a CNBC video, “The Carbon Challenge,” former Vermont Governor Howard Dean declares, “I am terrified of a Bernie Madoff in the cap and trade business who is selling stuff that doesn't exist.”

### 3. ACESA is the Largest Corporate Welfare Program in History

Their campaign position paper declares: “Barack Obama and Joe Biden's cap and trade system will require all pollution credits to be auctioned. A 100% auction ensures that all large corporate polluters pay for every ton of emissions they release, rather than giving these emission rights away for free to coal and oil companies.”

Waxman-Markey gives away 85% of the permits for free.

In his March Congressional testimony, White House Budget Director Peter Orszag said: “If you didn't auction the permit, it would represent the largest corporate welfare program that has ever been enacted in the history of the United States.”

While creating a huge derivatives market for Wall Street, ACESA gives billions in free carbon credits and offsets to coal companies, oil refiners and the utility industry. In “The Cap and Trade Giveaway,” Alan Viard suggests: “Under a system of free permit allocation, the stockholders of companies that receive free permits would receive windfall gains. A cap and trade system with freely allocated permits is equivalent to a carbon tax in which the tax revenue is given to stockholders.”

In a report on cap and trade, the Congressional Budget Office estimated that some recipients of free credits could see their market capitalization double or triple instantly.

Harvard economist Greg Mankiw succinctly blogged: “Cap and trade = Carbon tax + Corporate welfare.”

### 4. ACESA Undermines EPA Authority and Successful Policy at the Regional, State and Local Level

ACESA eliminates EPA's existing authorization to regulate greenhouse gas emissions under the Clean Air Act and pro-

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hibits successful state and regional programs like the Regional Greenhouse Gas Initiative. It imposes federal control over matters like building codes, traditionally the constitutional purview of the states.

Successful state Renewable Energy Portfolio Standards (RPS) are complicated by ACESA. The minimum compliance payments in the proposed Federal RPS are too low to spur markets for renewables. And ACESA allows technologies like waste incineration to compete in renewable energy credit markets with real renewables.

### **5. Massive ACESA Financial and Regulatory Interventions Delay Real Solutions**

Along with cap and trade, ACESA involves hundreds of new regulatory and economic prescriptions, distorting markets based on political calculus and favoring entrenched interests. In a guise of offsetting higher consumer prices, billions of dollars of carbon credits are free to utility companies, undermining competitive energy markets. ACESA further encourages failures like corn-based ethanol, disrupting agricultural markets while providing no net energy or environmental benefit. Regulatory provisions micro-manage virtually every sector of the economy, stifling innovation.

### **6. ACESA Fails in Pricing “Economic Externalities” of our Fossil Fuel Dependence**

The *Wall Street Journal* quotes President Obama saying in March: “If you’re giving away carbon permits for free, then basically you’re not really pricing the thing and it doesn’t work—or people can game

the system in so many ways that it’s not creating the incentive structures that we’re looking for.”

By giving away 85% of carbon credits, establishing ineffective carbon caps and allowing offsets, ACESA doesn’t provide price feedback in energy markets and in the economy generally that are essential for making clean energy cost-competitive.

Volatile price swings undermine investor ability to put a predictable value on alternatives to incumbent energy systems. The speculative derivatives markets inherent in ACESA encourage volatility. The *Wall Street Journal* reported that in Europe, “Prices for carbon permits have whipsawed from a high of 30 euros a ton to a low of 2 euros a ton.”

### **7. ACESA Undermines Political Viability of Real Solutions**

In a presentation at Dartmouth College, NASA climate scientist James Hansen declared: “Cap and trade is not going to work . . . in Europe it has been completely ineffective.” His conclusion is confirmed by *Euractiv.com* reports of European governments proposing new carbon taxes, effectively acknowledging the failure of their cap and trade program.

In their *Philadelphia Enquirer* editorial “Cap-and-Trade Does More Harm Than Good,” environmental attorneys Laurie Williams and Allan Zabel state: “The Waxman-Markey approach would not only guarantee a decades-long failure in the United States; it would also undermine U.S. credibility in international negotiations on climate change.”

Ex-Secretary of State George Shultz, speaking to the International Association for Energy Economics, suggested of

Waxman-Markey: “It is going to be so obviously corrupt it is going to discredit the whole idea.” Having negotiated the Montreal Protocol, the most successful international environmental treaty in history, Shultz suggests a straight carbon tax would give the US far more credibility in negotiating climate treaties.

Greenpeace summarizes: “The Waxman-Markey bill sets emission reduction targets far lower than science demands, then undermines even those targets with massive offsets. The giveaways and preferences in the bill will actually spur a new generation of nuclear and coal-fired power plants to the detriment of real energy solutions. To support such a bill is to abandon the real leadership that is called for at this pivotal moment in history.”

ACESA will inevitably increase costs throughout our economy, but does not provide effective mechanisms for average people to cover those costs. With all of these problems and no credible prospect of meeting its stated goals, if we allow ACESA to pass, it could be decades before voters trust Congress to attempt any meaningful solution to our fossil fuel addiction.

### **What an Effective Solution Would Look Like—Revenue Neutral Carbon Tax**

On January 26, President Obama made his first major policy address on energy. He described our energy challenge clearly: “At a time of such great challenge for America, no single issue is as fundamental to our future as energy. America’s

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dependence on oil is one of the most serious threats that our nation has faced. It bankrolls dictators, pays for nuclear proliferation and funds both sides of our struggle against terrorism. It puts the American people at the mercy of shifting gas prices, stifles innovation, and sets back our ability to compete.”

A simple carbon tax addresses all the challenges President Obama cites. And if implemented in a revenue neutral manner by replacing payroll taxes or providing direct rebates to all citizens, a carbon tax also addresses the serious economic problems we are facing.

Strong price signals from a carbon tax would shift markets and do not require the risks and inefficiencies of excessive regulation or huge speculative derivatives markets. Today we tax work and productive investment while encouraging waste and pollution with subsidies and tax breaks for oil, coal and other entrenched industries. It's time to think rationally about using this powerful lever of government to discourage what we don't want, like wasting energy, while encouraging work, job creation and sensible investment.

Williams and Zabel suggest: “While cap-and-trade-and-offsets will enrich special interests and delay the transition away from fossil fuels, carbon fees with monthly rebates could be the centerpiece of an affordable, equitable, rapid transition to a clean-energy future.”

Waxman-Markey is not the only energy bill in Congress.

Representatives Inglis (R-SC), Flake (R-AZ) and Lipinski (D-IL) worked

across party lines proposing H.R. 2380, The Raise Wages, Cut Carbon Act of 2009. Their bill puts inescapable prices on carbon emissions immediately that are far greater than the EPA and Congressional Budget Office estimate Waxman-Markey will provide ten years from now. Instead of Waxman-Markey's hundreds of billions of dollars in corporate welfare, H.R. 2380 would reduce regressive payroll taxes while providing increases to people receiving social security to directly offset the economic impacts of the tax. Congressman Inglis' website suggests “By reducing payroll taxes and taxing carbon dioxide, we can turn an environmental fix into a decisive, economy-expanding national security fix.”

The *Miami Herald* reports that H.R. 2380 “would initially impose a tax of \$15 a ton of carbon dioxide on the producers and distributors of gasoline, natural gas and coal, with the tax rising to \$100 a ton over three decades.” Such clear policy signals allow businesses throughout the economy to plan effectively and make long-term investments.

Inglis, Flake and Lipinski propose that, “The tax applies to fossil fuels as they enter the economy: at the mine mouth, the oil refinery and the natural gas pipeline. This upstream application of the tax will make it easy to implement and reduce administrative costs.” They suggest “Consistently applying the same tax to all domestic and imported products will keep this border adjustment in compliance with existing WTO agreements.” And they are willing to take political risk and treat voters honestly, publicly pre-

dicting that customers of coal-fired utilities would see cost increases of 83.5% in the first year.

In his recent *New York Times* column, “Show Us The Ball,” Thomas Freidman reports that: “Representative John B. Larson, chairman of the House Democratic Caucus, circulated a draft of a similar bill that would impose a per-unit tax on the carbon-dioxide content of fossil fuels, beginning at a rate of \$15 per metric ton of CO<sub>2</sub> and increasing by \$10 each year. The bill sets a goal, rather than a cap, on emissions at 80% below 2005 levels by 2050, and if the goal for the first five years is not met, the tax automatically increases by an additional \$5 per metric ton. The bill implements a fee on carbon-intensive imports, as well, to press China to follow suit. Larson would use most of the income to reduce people's payroll taxes.”

Revenue neutral carbon tax solutions offer a rational market-oriented solution by putting a real price on carbon emissions. They are favored by the vast majority of economists on all sides of the political spectrum. By effectively discouraging petroleum use, such taxes address our trade imbalances and enhance our national security interests while stimulating markets for clean energy, energy efficiency and fuel-efficient vehicles. Plus, these taxes are good economic policy, reducing the penalties on work and job creation in regressive payroll taxes.

We need to dependably get the “economic externalities” of fossil fuels accounted for directly in the real economy. A simple carbon tax is the most effective way to do that.

## Make Sure the Senate Hears Us

Willem Buitter, former chief economist of the European Bank for Reconstruction and Development, summarizes the political challenges in “Carbon Offsets: Open House for Waste, Fraud and Corruption.” He notes that politicians “prefer cap and trade because it hides/obscures the fact that for it to work, it must be equivalent to a tax; however, it does not look like a tax and will not show up in conventional tax burden calculations. Also...you can hand out the credits free of charge to your friends (including the heavy historical polluters). The amounts of money involved are vast and the opportunities for graft, bribery and corruption limitless.”

Before suggesting Waxman-Markey is about the best we can expect from Congress in “Just Do It,” Thomas Friedman summarizes the bill well: “It is too weak in key areas and way too complicated in others. A simple, straightforward carbon tax would have made much more sense than this Rube Goldberg contraption. It is pathetic that we couldn’t do better. It is appalling that so much had to be given away to polluters. It stinks. It’s a mess.”

NESEA members are practical idealists. We cannot settle for ACESA as the best Congress can do. We cannot accept politically expedient “solutions” that we

know are bound to fail. If we support legislation that does far more harm than good, then we become part of the problem, rather than part of the solution.

Political challenges facing a carbon tax are certainly no more formidable than the practical problems with ACESA. It is time to move beyond political horse-trading to a serious solution. Willams and Zabel argue: “Those who favor Waxman-Markey as a political best-case scenario lack faith in the American people.”

We need government policy that makes environmental and economic sense. Let’s call on our senators to reject Waxman-Markey and implement a simple carbon tax that puts a significant and inescapable price on carbon emissions—right now.

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*Long-time NESEA member Fred Unger manages development and operations for several large solar, wind and real estate projects. He is President of Heartwood Group, Inc. [www.HeartwoodSolutions.com](http://www.HeartwoodSolutions.com)*

### EDITOR’S NOTE:

*Just days before the US went to war in Iraq, in a Building Energy ’03 conference session on System Dynamics chaired by David Foley, a discussion ensued about the idea of a “Freedom Tax” on fossil fuels. Since then, NESEA has hosted several conference sessions on the subject of this article. Discussions continue on the NESEA Blog.*

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