Sack Goldman Sachs Cap-and-Trade

The revolving door between Washington and Wall Street has produced a new scheme to fleece the public. "Cap-and-trade" is the heart of the Obama Administration's plan to slow global warming and reduce our dependence on fossil fuels. Permits to emit a "capped" amount of carbon dioxide will be traded on Wall Street by big-time players like Goldman Sachs.

Cap-and-trade was anointed hero status for helping reduce pollution from power plants, specifically acid rain from the sulfur in coal. Seldom have accolades been less deserved. Indeed, this "success" story is a case of calling black white.

Here, in essence, is how it worked. Congress passed a law, Title IV of the Clean Air Act, capping sulfur emissions from power plants at 50 percent of 1990 amounts. Utilities reducing emissions more than half could sell excess reductions to other utilities, which then did not need to reduce pollution. Physical changes were simple. Many power plants switched to low-sulfur Wyoming coal and a few installed scrubbers. Sulfur emissions were reduced almost 50 percent in 20 years. Great success? Hardly.

First, it was like a smoker going from two-packs-a-day to one-pack-a-day. Such a cap imposed by law is a floor, as well as a cap. Physicians for Social Responsibility reported on 18 November that continuing coal emissions are significant contributing factors in four of the five leading causes of mortality in the United States – and the mercury, arsenic and other coal pollutants also cause birth defects, asthma and other ailments. The economic value to the public of further emission reductions exceed the cost by a factor of 25, but so far the floor has prevented greater reduction.

What is needed is not a cap/floor, but a system designed to wind down the pollution in accord with the public good, not the polluters' profits. Before defining such a system, let me expose the second, even bigger, whopper in the cap-and-trade gimmick. It is the "horse-trading" that polluters demand before they will allow Congress to pass a cap. Yes, I am sorry to say, in America today, with the role of money in government and a revolving door between Congress and lobbyists, polluters sit astride Congress with such brazen "authority".

The horse-trade demanded by polluters before accepting the Clean Air Act was that old power plants be "grandfathered", avoiding many pollution regulations. These old plants would soon be retired anyway. Wink. Two-thirds of today's coal-fired power plants were constructed before 1970. Utilities find it highly profitable to keep patching up these old polluting cash cows. Meanwhile, public health continues to suffer.

These basic problems, the floor on pollution and horse-trading, recur, in spades, in the cap-and-trade scheme hatched by big banks and Washington to slow carbon dioxide emissions and reduce fossil fuel use.

Cap-and-trade sets a nominal emissions cap by auctioning permits to pollute. This cap is a floor – if emissions went below the cap, permit price would collapse leaving no incentive for further emissions reduction.

Moreover, the cap is a faux cap, a fiction. The real cap is higher, because of "offsets" – alternatives to emission reductions, such as tree planting on degraded land, avoided deforestation in Brazil, or investments in developing countries. Caps are raised by the offset amount, but offsets are often imaginary or unverifiable. Avoided deforestation, for example, does not reduce demand for lumber or food growing area, so deforestation moves elsewhere. Also, offsets encourage developing countries to retain pollution, so they will have offsets to sell.

Horse-trading further mars the outcome. House and Senate energy bills legislate continued coal use, making it implausible that carbon dioxide emissions will decline sharply. Copenhagen discussions also are headed down the cap-with-offsets, horse-trading path, even though this approach can never achieve the sharp emission reductions that science demands.

Let's define a feasible approach. A successful approach must recognize a fundamental truth: as long as fossil fuels are the cheapest energy, their use will continue and even increase. Fossil fuels are cheapest because they are not required to pay for their damage to human health and the environment or for climate impacts on current and future generations.

"Fee-and-dividend" is a simple solution. A gradually rising carbon fee is collected at the mine or port of entry for each fossil fuel (coal, oil and gas). The fee is uniform, a single number, in dollars per ton of carbon dioxide in the fuel. The public does not directly pay any fee, but the price of goods will rise in proportion to how much fossil fuel is used in their production.

One hundred percent of the fee should be distributed to the public. Prudent people will use their dividend wisely, adjusting their life style, choice of vehicle, and so on. Those who do better than average will receive more in the dividend than they pay in added costs.

For example, if the fee were set now at $115 per ton of carbon dioxide it would add one dollar per gallon to the price of gasoline and 8 cents per kilowatt-hour to the price of electricity. Given the amount of oil, gas and coal used in the United States in 2007, that carbon fee yields $670 billion dollars per year. The resulting dividend for each adult legal resident is about $3000 per year or $250 per month. A family with two or more children would receive almost $9000 per year. The dividend would be sent electronically to bank accounts or added to debit cards.

In reality, the fee probably will be introduced gradually over several years, to minimize waste of infrastructure. By the time the carbon fee reaches $115 per ton utilities are expected to have altered fuel choices, reducing the impact on electric rates to 5-6 cents per kilowatt-hour – and the annual per capita dividend may be only $2000-2500. But given that about 60 percent of the public will receive more in dividend than they pay via increased energy prices, the public is likely to support continued increase of the carbon fee.

As the fee rises, tipping points will be reached at which various carbon-free energies and carbon-saving technologies are cheaper than fossil fuels plus their fee. As time goes on, fossil fuel use will collapse, remaining coal supplies will be left in the ground, and we will arrive at our clean energy future – free at last from our fossil fuel addiction.

Economists agree that fee-and-dividend is more efficient and less costly than cap-and-trade. But many economists prefer that proceeds be used to reduce taxes that cause economic inefficiency rather than pay dividends. Their usual suggestion is to reduce payroll taxes, which are regressive.

A problem with reducing payroll taxes is that half of the people are not on payrolls – being either retired or involuntarily unemployed. Thus a dividend is fairer. As a compromise, I suggest that half the carbon fee be given to legal residents as a monthly dividend, and half used to reduce payroll taxes.

Need more insight into cap-and-trade? Consider this perverse effect on altruistic actions. Say you decide to buy a high-efficiency little car. That reduces your emissions, but not your country's or the world's. Instead it allows somebody else to buy a bigger SUV. Emissions are set by the cap/floor, not by your actions.

In contrast, fee-and-dividend has no floor, so every action to reduce emissions helps. Indeed, your action may spur your neighbor to do the same. Such snowballing effects can occur with fee-and-dividend, speeding us toward a pollution-free world.

More convincing needed? Note that the skilled, secretive trading unit of Goldman Sachs is poised to make billions of dollars off cap-and-trade. Banks and other private equity firms already have more than 100 representatives working the issue. The carbon market is expected to be worth more than a trillion dollars. Wall Street wants the market to be loosely regulated, open to speculators, and to include over-the-counter derivatives. Pretty good chance for that, given the Washington-Wall Street revolving door.

Where will the banks' profits come from? All costs of the pollution trading system are extracted from the public, via increased energy prices. And there is no dividend to the public.

In contrast, fee-and-dividend only requires the government to divide the collected fee by the number of legal residents. The entire collected fee goes to the public. Goldman Sachs does not get one thin dime.