RSC Republican Study Committee
REP. TOM PRICE, M.D. (R-GA), CHAIRMAN
PAUL TELLER, EXECUTIVE DIRECTOR
424 CANNON HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
rsc.price.house.gov
ph (202) 226-9717 / fax (202) 226-1633

RSC Outlook: Cap & Tax Overview

April 2009

On March 31, Energy & Commerce Committee Chairman Henry Waxman released a discussion draft of legislation that contains a study to implement a cap-and-trade system, or more accurately: "cap and tax" to reduce carbon-dioxide emissions and require that an increasing share of U.S. electricity supply comes from "renewable" sources of energy like solar or wind power. A brief analysis of the bill can be viewed here. In addition to the Waxman proposal, President Obama's FY 2010 budget calls for a massive cap and tax proposal that would raise $640 billion in new taxes on American businesses. In light of speculation that the House may consider some form of legislation involving a cap and tax scheme in the next month, the RSC has prepared the following document.

What is Cap and Tax?

A cap and trade system sets a limit, or cap, on carbon dioxide emissions from fossil fuel use. The effect would amount to rationing emissions from fossil fuels that produce carbon dioxide. Essentially, the federal government would set some sort of *cap* on total carbon dioxide emissions and establish a yet to be defined carbon allowance on each utility or company (also undefined what companies would be subject to an allowance). Those companies that emit less carbon dioxide than permitted by the allowance may *trade* credits to other companies that exceed the allowance. Many conservatives commonly call this proposal "cap and tax".

Cap and trade proposals have existed in concept for almost 40 years, but did not gain serious attention until the Kyoto Treaty was proposed in 1997, which binds most developed nations to a cap and trade system for the six major greenhouse gasses. The United States overwhelming refused to ratify the treaty (95-0 vote) because many in Congress believed it would place us at a severe economic disadvantage for little environmental gain.

The last major cap and trade proposal considered in the 110th Congress was the Lieberman-Warner Climate Security Act (S. 2191). According to studies by Charles River Associates, Lieberman-Warner would reduce household spending by $800 to $1,300 per household by 2015 and raise utility prices by 36 to 65 percent in that same time frame. Additionally, they estimate S. 2191 would result in the loss of 1.2 to 2.3 million jobs due to the impact of higher energy costs on economic activity. Despite these costs, this proposal is actually *far less sweeping* that what has been proposed by the Administration or Chairman Waxman.

Auction Problems

In his FY 2010 budget, President Barack Obama proposed cutting greenhouse gases 14% by 2020 and 83% by 2050 from 2005 levels by auctioning off the emission credits. Unlike the European system which allocates some permits, President Obama called for auctioning off all greenhouse gas emissions permits.

According to the administrations' own budget estimates, the government plans to raise between $1.3 – $1.9 trillion by auctioning off carbon dioxide emissions permits over the next 8 years. The cap and tax proposal creates an artificial market to find revenue to pay for various social programs the Obama administration plans to enact such as moving towards a national health care system and the "making work pay" tax cuts that cut taxes by $400 for individuals that make under $75,000 a year ($1.10 a day).

In addition, a cap and tax auction results in the cartelization and central planning of our economy because it is a government administered rationing scheme. Even the Environmental Protection Agency's own *Region 9 (California)* lawyers admit it "can easily be subject to gaming and manipulation, creating artificial scarcity that is likely to result in disruptions and unfairness." Auctioning the allowances will create the problem of awarding them to favorites because the process is done through a political allocation, and not through the market. This system leads to serious potential for corruption since local officials would have political (and perhaps monetary) incentives to help their local businesses get more credits. And businesses in the aggregate may have powerful economic incentives to get more credits than their designated allotment in a given year. Finally, auctioning the allocations will lead to a poorly regulated derivate market, where many of the same companies that led us into the financial collapse, will now be in the business of selling and controlling the allocations.

Effect on U.S. Economy

Moving into a cap and tax system would place the United States economy at a distinct competitive disadvantage because it would place additional costs on American manufactures and cede market share to overseas competitors not subject to limits on greenhouse gas emission. Cap and tax does not only apply to the traditional energy producers, domestic industries like paper, cement, fertilizer, steel, and glass manufacturers also worry that increased cost burdens imposed by climate-change laws will put them at a severe competitive disadvantage to their international peers. Even Energy Secretary Chu stated at a House hearing, "If other countries don't impose a cost on carbon, then we will be at a disadvantage."

Since a carbon rationing scheme could potentially apply to thousands of different products, some conservatives fear that this would violate U.S. obligations under the World Trade Organization (W.T.O.). Any restriction or tariff that would have to be placed on the many products affected by a cap and tax program would cause other countries to place a tariff on U.S. products regardless of carbon content. Placing tariffs on products to compensate for our cap and trade would raise tensions, decrease trade, and violate international law.

With more than a third of the world's population, China and India have no intention of imposing cap and trade especially during an economic crisis. A cap and tax plan would be the greatest outsourcing boon in history because many U.S. manufactures will find it more appealing to do business in nations that have energy polices not designed to increase the cost of doing business.

Cost and Tax Issues:

"Under my plan of cap and trade, electricity rates would necessarily skyrocket."

– Candidate Barak Obama.

The cap and tax program is expected to create a nearly $2 trillion national energy tax that will cost American families approximately $2,000 per year over the lifespan of the Obama budget. This is arguably the biggest tax increase U.S. history. In addition, the Heritage Foundation has concluded the Lieberman/Warner cap and trade bill - a much less aggressive plan President Obama's - will cost $5 trillion in lost Gross Domestic Product and 3 million manufacturing jobs. Finally, the Office of Management and the Budget estimates that just a 15% cut in emissions would cost the average household about $680 not including decreased output.

Cap and tax also treats families differently depending where they live. Those who live in the Midwest, southeast, and plain states would be taxed far more disproportionately than those who live in California or New England. Many of these states primarily rely on coal for power production and would face higher penalties on their electricity because they are using the most efficient and least costly fuel. 86% of Ohio's energy demand relies on coal. In Indiana, it is 94%, in Missouri 85%, in Pennsylvania 56%, and in Wyoming 95%. Cap and tax is a transfer or wealth from those in the industrial and coal producing states to those in who reside in Silicon Valley or Cape Cod.

Rep. John Larson (D-CT), even admits that what proponents call "cap and trade" is essentially a tax, stating. "We're going to be paying taxes - higher taxes - one way or the other. Is there anyone on the panel that would disagree that this issue, if we're to combat it forthrightly and level with the American people, that this doesn't concern taxation?" Not only is this a tax, but Obama supporter Warren Buffet calls it "pretty regressive."

When President Hoover raised taxes in the 1930s, it worsened the depression, which continued through the rest of the decade. Raising energy taxes – with a regressive tax nonetheless – will kill jobs and make it more difficult for working families to deal with the ongoing financial crisis. In addition, cap and tax will violate Mr. Obama's campaign promise to not raise taxes on families making less than $250,000.

What will Cap and Tax Achieve by the year 2050?

Unfortunately, not much. The Administration and House Democrats are proposing to spend trillions of dollars to remove what amounts to a very small amount of carbon dioxide contained in our atmosphere, shown in this chart. Greenhouse gasses make up less than 2% of the atmosphere, and of that percentage, Carbon Dioxide makes up around 3.5% of all greenhouses gasses. And very little of that amount is man made, since natural carbon combustion occurs frequently. The 2005 Hayman fire in Colorado produced more carbon dioxide that year than its entire population. In addition, according to the Institute for Energy Research, a similar cap and tax plan (S. 2191) would only lower global temperatures by eighteen one hundredths of one degree by 2050.

Since 1997, Europe has engaged in similar style cap-and-trade system that serves as an example of how the system can be manipulated. The system has been plagued with industry leakage, price spikes, and windfall profits - all without emission reductions. According to one study, Spain's carbon emissions have *increased* by 50% since the Kyoto agreement was signed.

Key Conservative Take Away Points on Cap and Tax

- ***Government Planning Scheme.*** Government-run cap and trade is, by definition, a central economic planning scheme in which the government decides which industries and companies deserve more or fewer credits and what business factors and economic outputs are "necessary." Lowering greenhouse gas emissions, especially in the short terms, means government-directed decreases in economic activity.

- ***Stifles Private-Sector Innovation***. Government-run cap-and-trade stifles innovation since companies are artificially constrained in their economic activities, thereby dampening the incentives to create new products and services. As Jim Manzi wrote in *National Review* on June 25, 2007, "The loss of economic and technological development that would be required to eliminate literally all theorized climate-change risk would cripple our ability to deal with virtually every other foreseeable and unforeseeable risk, not to mention our ability to lead productive and interesting lives in the meantime." Additionally, government-run cap-and-trade, like government-run anything, would dampen the incentives for developing private-sector cap-and-trade initiatives, which would be market-driven and thus more efficient.

- ***Higher Consumer Energy Prices.*** Because a scarcity of a high-demand product yields higher prices, government caps on energy production and usage would lead to higher energy prices. As CBO notes, "Regardless of how the allowances were distributed, most of the cost of meeting a cap on CO2 emissions would be borne by consumers who would face persistently higher prices for products such as electricity and gasoline." Such price increases would be felt most harshly in poorer households, who spend a larger percentage of their incomes on energy.

- ***Job Losses, Lower Wages, and Stock Devaluation.*** As CBO noted as a corollary from the previous bullet-point, "As some parts of the energy sector and various energy-intensive industries adjusted to a decline in demand for their goods, current workers and investors in those industries would experience costs in the form of lower wages, job losses, and reduced stock values."

- ***Potential for Corruption.*** Government-run cap and trade has serious potential for corruption, since for example, local officials would have political (and perhaps monetary) incentives to help their local businesses get more credits. And businesses in the aggregate may have powerful economic incentives to get more credits than their designated allotment in a given year.

- ***Windfall for Traders.*** Government-run cap-and-trade naturally yields substantial sums for traders. This may be profitable for them, but this is money that could have been put into innovation and investment.

- ***Not Likely to Actually Reduce Emissions.*** Government-run cap-and-trade has never been shown to actually reduce greenhouse gas emissions, yet isn't that the stated goal of cap-and-trade proponents? Just because the government requires a certain decrease in emissions within a certain timeframe does not mean such decreases can occur in that time period.

- ***No Guarantee that Reducing U.S. Emissions Stops "Global Warming".*** Scientists agree that global warming is caused by a multitude of factors, some natural and perhaps some man-made. U.S. emissions are a small fraction of carbon dioxide in the atmosphere, and China's and other developing countries' emissions are increasing dramatically faster than are those of the United States.