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Marshall Institute Report on Cap and Trade Profiled on E&E TV

A new report by the George C. Marshall Institute released on July 20, 2007, was profiled on E&ETV on July 24. The report, *Why Cap & Trade is the Wrong Policy to Curb Greenhouse Gases for the United States*, authored by Dr. Michael Canes, demonstrates that a C&T system would be far more complex and costly than is yet understood and “the system is likely to be unwieldy, subject to cheating and graft, enabling side payments to unsavory regimes, and necessitating large numbers of administrators.”

The transcript of the interview with Dr. Canes is attached to this release. **Copies of the report are available at <http://www.marshall.org> or by contacting 202.296.9655.**

The George C. Marshall Institute, a non-profit research group founded in 1984, is dedicated to fostering and preserving the integrity of science in the policy process. The Institute conducts technical assessments of scientific developments with a major impact on public policy and communicates the results of its analyses to the press, Congress and the public (www.marshall.org).

Transcript of Interview with Dr. Michael Canes on E&E TV on July 24, 2007

Monica Trauzzi: Welcome to OnPoint. I'm Monica Trauzzi. Joining me today is Michael Canes, senior research fellow at the Logistics Management Institute. Michael is a former chief economist and vice president of the American Petroleum Institute and is author of the new report, "Cap and Trade Is the Wrong Policy to Curb Greenhouse Gases for the United States." Michael thanks for coming on the show.

Michael Canes: Thank you Monica.

Monica Trauzzi: The title seems to say it all. Your new report takes aim at the very popular cap-and-trade approach to reducing greenhouse gas emissions. You say implementing a cap and trade program would be a serious policy mistake. It's currently the most widely supported legislation on the Hill. Why is there that disconnect? What are the main points that you're making about the negatives about a cap and trade policy?

Michael Canes: Sure. Well, there's two separate points here. One is what's wrong with cap and trade? And number two is so why is it so popular? What's wrong with cap and trade is that it's very wasteful. It's going to result in a lot of constraints on the economy. It's going to result in volatility of energy prices that is unnecessary. It is going to create a source of wealth for people to lobby for and for the political sector to distribute. And that's going to result in socially wasteful activity to try to redistribute wealth among parties, including not just within the United States but from abroad as well. And lastly, it's going to have to have a monitoring system. Cap and trade requires policing, and not just in the United States, but internationally, because it will become an international system very quickly. So, in my opinion, it is going to be wasteful. Many, many billions of dollars will go into the construct of this system and it's not necessary. There are better alternatives on the table. Now, why is it politically popular even though it appears to be a more efficient system than other systems? The reason is because it does create a source of wealth. And that means that the business sector sees possibilities of obtaining part of that wealth. And so they view this favorably. The political sector sees ways to distribute that wealth and so it has attractiveness to the political sector. It will result in organized exchanges to exchange these allowances to emit. And those who would set up such exchanges see this as favorable. And ultimately the environmental community finds it favorable because a cap is a cap, and you have a quantitative limit on how much can be emitted. This is a mistake on their part. And the reason for that is the annual rate is not what counts. It is the total stock of greenhouse gases that are in the atmosphere that matters. And whether the rate is a little higher or a little lower really doesn't matter in any given year. But the environmental community likes the certainty and that's why they favor it.

Monica Trauzzi: So would a safety valve provision in a cap-and-trade package, like the one that Senator Bingaman has introduced, be sufficient to you, in your opinion?

Michael Canes: No. It would help in some ways. It would curb the volatility. It would put a limit on how far the price of allowances could rise in any given period. And so in that sense it would result in lower costs than otherwise. The EPA has the ability to put extra allowances into the SO₂ program, but they have not chosen to do so. It has been an extremely volatile program. So even with that feature it doesn't necessarily mean that you're going to constrain volatility. And even then there will be volatility and it's unnecessary.

Monica Trauzzi: Talk a bit more about what would work. Carbon tax, is that the best option?

Michael Canes: I see two other options that would be superior to cap and trade. One is the path that we are following now, which is surprisingly effective. It is a voluntary program. We have set a goal in terms of carbon intensity of our GDP. As you may recall the administration enunciated a goal of an 18 percent reduction between 2002 and 2012. In four years, through 2006, we have actually accomplished about 60 percent of that. We actually have reduced the carbon intensity of our GDP by about 11 percent over four years. So it is working. We do have the voluntary partnerships, private-public partnerships, environmental organizations have such partnerships. We have the Asia-Pacific agreement which brings in India and China and we're trying to get them to focus seriously. And they are focusing seriously. The president has enunciated that he's looking for the 15 largest energy users to set long-term goals. This is a voluntary approach coupled with a heavy research program, but it seems to be working. We seem to be actually doing something. Our carbon, the intensity is falling and even our absolute carbon fell in some of those years.

Monica Trauzzi: But is that going to be enough? If we keep that voluntary ...

Michael Canes: That's a good question.

Monica Trauzzi: ... the biggest emitters, they might not be compelled to reduce emissions to a point that will actually make a difference.

Michael Canes: Well, that is of course the carrot to the voluntary approach. And I can accept that stronger measures might be necessary and if so, then in my view a carbon tax would be the way to go. A tax on carbon is much neater. The revenues from the carbon tax are kept inside the United States. You set it at a level that tries to approximate the costs that carbon is imposing on the world, you might say. It efficiently gets people to economize on carbon. If revenues can be redistributed, say through other kinds of tax reduction, you can actually improve the efficiency of the tax system. The people at Resources for the Future estimate somewhere between \$15 and \$25 billion annually in gains from a \$7 to \$15 carbon tax per ton. So you can improve the economy, it's a more efficient system. You don't have this creation of wealth that people begin to try to lobby for and the people try to distribute. You don't have to deal with international offsets which requires monitoring worldwide of who is producing what in the way of offsets. Are they real? Should they count or should they not? A very expensive way to go. You

can avoid all that with a carbon tax and that is the way I think we should go if we're going to take more serious action than voluntary behavior.

Monica Trauzzi: So, then is there a specific legislative proposal that's been circulated so far on the Hill that you think it's these parameters?

Michael Canes: I have not seen one that quite fits these parameters. I know that Congressman Dingell has proposed a tax, at least conceptually, on carbon. I think his purpose is to see whether or not such a tax could fly. But it's how you pose the alternatives. If you say let's have a tax or let's not have a tax, many people in the public will oppose the tax, no question. If you say let's have a tax that has redistribution, via reduction of other taxes at least equal so that its revenue neutral or even possibly a small tax decrease, a kind of a sweetener, to get people to kind of agree to this, then I think this could fly politically. And I have not seen that.

Monica Trauzzi: So, specifically, what would be your recommendation to policymakers? If you could create the legislation what would you say to policymakers?

Michael Canes: Well, I would say, number one, look hard at the voluntary approach and see whether you can strengthen it. You could, for example, fund the provisions in EPAC 2005, the Energy Policy Act of 2005 that dealt with climate change. Appropriations have not been forthcoming and there are some programs for technology demonstration in the developing world and some other things that could help. You could also try to speed up the turnover of the American capital stock, which would reduce the energy intensity of our GDP. You can do that through depreciation allowance improvement or through tax incentives for vehicle purchase, highly efficient vehicle purchase. So you could do that. I would look to that first, but if you feel at the end of that, that that is not going to be sufficient, then I would say look at a carbon tax and redistribute those revenues in a way that reaches the people pretty much that are having to pay the carbon tax. Probably Social Security tax reduction or income tax reduction would be the ways to do it.

Monica Trauzzi: What should be weighed more heavily, the economics of the policy or the environmental benefits?

Michael Canes: Well, you're doing this for environmental purposes and you can use economic based policy to encompass the objectives.

Monica Trauzzi: But some proposals would provide more environmental benefits.

Michael Canes: Well, in a sense. But, as I said, it isn't necessary to cap the annual amount of carbon produced to get the effect you want. What you will get with an annual cap is volatility because the allowance price would be volatile and it's tied to the energy price and the energy price is pretty volatile. And that has been studied. What is the consequence of having volatile energy prices in the economy? And that we know will cause GDP affects. How big? A few tenths of a percent of GDP. But a few tenths of a percent of GDP in the United States is a lot of money. One-tenth of 1 percent is \$13

billion, so two or three-tenths of a percent is up to \$50 billion if you get that kind of affect. You don't want volatility in these prices. If you set a carbon tax, it enters into energy prices once and for all and then people know what the energy price is. And we're not going to get volatility from this policy. So it is a superior policy to cap and trade for that reason.

Monica Trauzzi: As someone who worked for the American Petroleum Institute are your loyalties still with the petroleum industry? Do you think your credibility comes into question when you put out a report like this saying cap and trade isn't the way to go, yet you did work for the petroleum industry years back?

Michael Canes: I did, but I retired from the petroleum industry actually in 2000 and I have been working for a not-for-profit consulting firm. We consult with government agencies and so we do take a different perspective on energy problems than I did when I was with API. It's not a matter of loyalty. It's a matter of trying to find what is the most efficient policy? What will accomplish the ends that we want to get with the least wastage? And I see a cap and trade policy as tremendously wasteful and something that we can avoid by not going that direction. I think that the political incentives are strong for a cap and trade. I understand that, but I think if the public understands that there is a better way to go and that we can do it more fairly and we can accomplish the objectives that we want to with respect to carbon management and can do it much more cheaply and efficiently, then I think hopefully support will rise that this is the better way.

Monica Trauzzi: And what would a cap and trade approach do to the price? And what impact would that have on the overall economy?

Michael Canes: It depends on how you design the system. The same would be true for a carbon tax of course, how big a carbon tax. But basically if the price of the allowances were say about \$10 per ton of carbon that would mean about ten cents a gallon in the price of motor fuels. So right now people are calling for somewhere in the \$10 to \$15 range, so that would mean 10 to 15 cents on a gallon. In Europe today the price of the forward markets for the allowances there is about \$25 a ton so that would mean about 25 cents on a gallon of gas if we got that here.

Monica Trauzzi: All right. We're going to end it right there. Thanks for coming on the show.

Michael Canes: Thank you Monica. I appreciate being invited.

Monica Trauzzi: This is OnPoint. I'm Monica Trauzzi. Thanks for watching.

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