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THE COSTS OF ‘CAP-AND-TRADE’

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INTRODUCTION

Hoping to advance the President’s push for a “green” 21st century economy, the House is considering legislation aimed, in part, at limiting greenhouse gas emissions by making fossil energy more expensive. It is far from clear that the measure will do much to correct the phenomenon known as “global warming,” as advertized. But it unquestionably breaks the President’s promise to protect middle-income earners from tax hikes. In addition, it establishes what is effectively a government takeover of 86 percent of the United States’ energy sector – about 7 percent of gross domestic product [GDP] – through a byzantine “cap-and-trade” scheme encumbered by regulations and mandates and exceptions for certain interest groups.

Critical points about the legislation – the American Clean Energy and Security [ACES] Act of 2009 – include the following:

- **It Raises Taxes Through Higher Energy Costs.** By sharply increasing the cost of energy, the bill imposes substantial tax increases that will be absorbed largely by middle-income earners – breaking the President’s promise not to raise taxes for those making less than \$250,000 per year. Although the measure contains a complex scheme of allowances, tax credits, and tax rebates that attempt to reduce the impact on households, the bottom line is inescapable: the higher energy costs will have to be absorbed by someone; and the “someone” will be U.S. taxpayers.
- **It Effectively Establishes a Government Takeover of the Majority of the Energy Market.** The legislation requires companies responsible for more than 86 percent of U.S. energy resources to obtain new emissions permits from the Federal Government to continue producing energy, and includes a series of new mandates on the production and use of energy. It also fails to boost two of the most reliable sources of clean energy: nuclear and hydro-power.
- **It Increases Spending by \$914 Billion.** At a time when Federal spending, deficits, and debt are mounting to unprecedented peacetime levels, the legislation adds an estimated \$914 billion to Federal spending over 10 years.
- **It Increases Foreign Aid and Sends U.S. Jobs Abroad.** As part of the attempt to mask its true costs, the bill effectively increases foreign aid by more than \$14 billion in a single year, a near 54-percent increase. The likely perverse result is that U.S. taxpayers will pay foreign companies to shift U.S. jobs overseas.

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- **It Benefits Special Interests.** In contrast to the President’s pledge to “change the way Washington works,” the legislation gives away 83 percent of its carbon allowances to energy- and climate-related interests, at the expense of U.S. taxpayers.
 - **It Fails to Guarantee a Reduction in Global Greenhouse Gases.** After all this, the benefits of cap-and-trade remain highly doubtful. Some studies show the scheme might move temperatures by no more than a fraction of a degree by the end of this century – which would make little difference on whatever climate effects result from greenhouse gas emissions. There are no effective limits on emissions by foreign countries, such as China and India, that are responsible for the fastest current growth in greenhouse gases.

The discussion below explains these points.

SUMMARY OF THE ACES ACT

According to the Congressional Budget Office [CBO], the ACES act would raise U.S. consumers’ energy costs by \$1 trillion over the 2010-19 period, and would increase Federal spending by \$914 billion, \$50 billion of which would be subject to appropriations. Due to various offsets in the legislation, its spending outpaces its *net* projected revenue collections; consequently it also increases the deficit by \$41 billion, assuming authorized funding is appropriated.¹

The “cap-and-trade” scheme of the ACES act creates tradable allowances for the emission of “greenhouse gases” [GHGs] and hydrofluorocarbons [HFCs], and then sets a cap on how many such allowances are allowed to circulate – making a commodity almost literally out of thin air, and establishing a sort of environmental currency. Anyone who wants to emit must have an allowance, which gives it value. The Environmental Protection Agency would issue allowances to emit those gases; some of the allowances would be auctioned by the Federal Government, and others would be distributed at no charge. The arrangement clearly entails a large imposition of government on the economy, and does so in a largely unprecedented way. As CBO puts it:

While similar in some ways to command-and-control approaches for regulated economic activities, the cap-and-trade system that would be established by the bill for GHG and HFC emissions is fundamentally different because it would create cash-like assets (allowances) whose supply and distribution would be determined by the Federal Government.²

For this reason, CBO also contends all transactions involving GHG and HFC allowances (including those distributed at no cost) should be reflected in the Federal budget.³

¹ CBO cost estimate, dated 26 June 2009, of H.R. 2998, the revised version of the American Clean Energy and Security Act of 2009. Most descriptions in this report reflect CBO’s estimate of the bill as reported by the Committee on Energy and Commerce on 21 May 2009. The Majority has made changes in the bill since then, and where appropriate, CBO’s updated estimates accounting for these changes are reported and identified.

² CBO cost estimate, dated 5 June 2009, for H.R. 2454, the American Clean Energy and Security Act of 2009, as reported by the Committee on Energy and Commerce.

³ Ibid.

The bill also contains several other provisions, including the following, as cited by CBO:⁴

- It provides energy tax credits or rebates to low-income families to help offset the higher price of energy that would result from the legislation, and would affect low-income households the most.
- It requires certain retail energy suppliers to generate a specific percentage of their energy through renewable sources.
- It establishes a new quasi-governmental agency – a Carbon Storage Research Corporation – to support research and development of carbon-capture technologies.
- It increases, by \$25 billion, the amount of Department of Energy [DOE] loans to auto manufacturers under the Advanced Technology Vehicle Manufacturing Loan Program.
- It establishes a Clean Energy Deployment Administration within the DOE, to provide direct loans, loan guarantees, and letters of credit for “clean” energy projects.
- It authorizes the Department of Transportation to provide vouchers for the purchase of vehicles deemed by the government to be more “fuel efficient.”

In short, the bill throws substantial government support behind a small, high-cost, and unproven segment of the energy sector, and constricts those who generate 86 percent of the energy in the U.S. It does so through a complex mixture of emissions allowances, regulatory mandates, and new government taxes and spending. It also would have significant employment effects, because some number of workers in the manufacturing, energy, and energy-intensive industries would lose their jobs, as further discussed below.

The congressional budget resolution (S. Con. Res. 13) does not include the budget effects of the cap-and-trade legislation in its aggregate numbers. Instead, the legislation is accommodated through a “reserve fund” that allows the spending to occur subject to the adoption of offsets (through spending reductions or tax increases) so that the bill does not increase the cumulative deficit from levels projected in the resolution. During debate on the budget, House Majority Members repeatedly argued the budget resolution did not provide for cap-and-trade. Nevertheless, the Budget Committee Chairman will need to trigger the reserve fund to accommodate the ACES act’s nearly \$1 trillion in spending and revenue increases over 10 years.

HIGHER TAXES THROUGH HIGHER ENERGY COSTS

During a 2008 campaign stop in Dover, NH, then-Senator Obama said the following:

I can make a firm pledge. Under my plan, no family making less than \$250,000 a year will see any form of tax increase. Not your income tax, not your payroll tax, not your capital gains taxes, not any of your taxes.⁵

⁴ Ibid.

⁵ Quoted in *Roll Call*, 12 September 2008.

But the ACES act – which the President termed “a historic leap”⁶ – would violate that pledge. Based on Congressional Budget Office [CBO] estimates, the legislation’s “cap-and-trade” policy would impose an additional \$1 trillion in costs on the U.S. economy over the next decade, most of which ultimately would be borne by middle-income taxpayers; and although proponents try to deny it, these costs truly function as taxes – taxes hidden in higher prices throughout the economy. Nearly all of the additional revenue would be spent on a range of government programs, and – assuming the appropriation of \$50 billion for its discretionary spending activities – the bill also would increase the deficit by \$41 billion (see Table 1 below).

Table 1: Budget Impact of the ACES Act
(in billions of dollars)

	2010-19
Gross Revenue Increase ^a	1,000
Net Revenue Increase ^a	873
Spending	
Mandatory Spending	864
Discretionary Spending	50
Total Spending	914
Net Impact on the Deficit	-41 ^b

Source: Congressional Budget Office, 26 June 2009, cost estimate of H.R. 2998, the American Clean Energy and Security Act of 2009. The measure is a modified version of the bill as ordered reported by the House Committee on Energy and Commerce on 21 May 2009.

^a The gross revenue figure reflects the total 10-year increase in the cost of energy resulting from the legislation, and hence the bill’s total impact on the economy. The net figure accounts for various offsets, but does not reduce the magnitude of the economic effect.

^b Negative number indicates an increase in the deficit.

The Cap-and-Trade Tax

Although CBO does not expressly apply the term “tax,” its cost estimate classifies cap-and-trade collections as revenue, the same classification used for income, payroll, and excise taxes. Further, CBO describes cap-and-trade as effectively functioning as a tax through its effect on the price of energy production: “The higher prices caused by the cap would reduce real wages and real returns on capital, which would be like raising marginal tax rates on those sources of income.”⁷ Moreover, the costs are compulsory, and they are imposed by government just for doing business that results in CO₂ emissions. The higher energy costs – which will result from the purchase of emission allowances by energy-producing companies – will inevitably fall on consumers. As CBO explains:

Obtaining allowances – or taking steps to cut emissions to avoid the need for such allowances – would become a cost of doing business for firms that were subject to the CO₂ cap. However, those firms would not ultimately bear most of the costs of the allowances. Instead, they would pass those costs along to their

⁶ *The Wall Street Journal*, “Pollution Politics and the Climate-Bill Giveaway,” 23 May 2009.

⁷ Testimony of Douglas W. Elmendorf, Director of the Congressional Budget Office, to the Committee on Ways and Means, U.S. House of Representatives: *Issues in Designing a Cap-and-Trade Program for Carbon Dioxide Emissions*, 18 September 2008.

consumers (and their consumers' customers) in the form of higher prices. Such price increases would stem from the restriction on emissions and in most circumstances would occur regardless of whether the government sold the allowances or gave them away.⁸

The energy cost increases obviously would affect every user of nearly every kind of energy; and they would spread through nearly every other sector of the economy as well:

Although the price of energy-intensive items such as electricity, natural gas, home heating fuels, and gasoline would increase the most, the price of nearly all items would rise in response to the imposition of a cap-and-trade program because energy is an input for almost all goods and services. The price increases for items that were not energy-intensive would account for approximately 40 percent of the total price increases for households.⁹

CBO says cap-and-trade would affect nearly 86 percent of the economy. By comparison, Federal income taxes affect only 60 percent of Americans. Not surprisingly, the cap-and-trade tax burden would fall more heavily on those less able to bear it.

The rise in prices would impose a larger burden, relative to income, on low-income households than on high-income households for two reasons. First, low-income households spend a much larger fraction of their income than do high-income households. Second, energy-intensive items account for a greater share of low-income households' total expenditures.¹⁰

The Breadth of the Tax Impact

The extent to which these de facto energy taxes will affect specific households has become a perplexing question. The confusion arises not from CBO's analyses, but from the complex nature of the legislation itself and how it attempts to redistribute costs and benefits. In addition, U.S. taxpayers will be required to purchase emission allowances from foreigners (described further below), thereby financing the largest increase in foreign aid in U.S. history.

In a recent analysis, CBO estimated the effect would total an average of \$770 per household in 2020.¹¹ This was considerably less than the \$1,600 per household CBO had estimated in September for a hypothetical cap-and-trade system.¹² Most of the difference is that CBO's more recent analysis assumes the U.S. would use carbon offsets that would reduce the cost of cap-and-trade allowances (further discussed below). CBO then took into account various tax credits and

⁸ Ibid.

⁹ Ibid.

¹⁰ Testimony of CBO Director Douglas W. Elmendorf to the Senate Finance Committee, 7 May 2009.

¹¹ CBO, *The Estimated Costs to Households From the Cap-and-Trade Provisions of H.R. 2454*, 19 June 2009.

¹² CBO, *The Distributional Consequences of a Cap and Trade Program for CO₂ Emissions*, testimony before the House Ways and Means Committee, 18 September 2008.

rebates to be provided to households at various income levels to help offset their higher energy costs. The analysis shows that gross energy prices will increase for Americans in every income bracket (see Table 2 below). The incidence of this new energy tax falls most heavily on low-income earners, costing them approximately 2.5 percent of their total income, making it a regressive tax.

But the legislation provides tax credits and rebates to consumers, which CBO assumes would reduce the net impact of cap-and-trade across the various income groups. In the case of low-income earners, the value of credits and rebates would exceed the amount of energy taxes they pay, thereby raising their net income. Thus the measure constitutes another income transfer from middle- and high-income earners to low-income groups; and it adds to a state in which nearly 40 percent of the U.S. population largely escapes paying Federal taxes.

Overall, middle-income taxpayers bear the greatest burden of the cap-and-trade tax, when measured against their incomes. According to CBO, this group would pay 1.2 percent of its income for cap-and-trade. They would receive less in tax credits and rebates, making the net effect of the policy much more expensive for them relative to other groups. The net effect on income is expected to be four times greater for the middle-income group than for the high-income group (0.4 percent of income versus 0.1 percent of income).

Regardless of how the bill attempts to mitigate price effects and redistribute income, everyone will see his or her energy bill increase. In fact, CBO predicts the energy price increase would be \$425 for low-income households and as much as \$1,380 for higher income households. Several other expert studies predict these costs would be much higher.

Table 2: Impact of Cap-and-Trade on Household Energy Costs

	Income Bracket (average annual income)				
	\$18,000	\$41,000	\$63,400	\$93,600	\$259,600
Gross Price Increase	\$425	\$525	\$675	\$815	\$1,380
Price Increase as Gross Percent of Income	2.5%	1.5%	1.2%	1.1%	0.7%
Net Price Increase	-\$40	\$40	\$235	\$340	\$245
Net Price Increase as Percent of Income	-0.2%	0.1%	0.4%	0.4%	0.1%

Source: House Budget Committee Republican staff, based on figures from CBO's *The Estimated Costs to Households From the Cap-and-Trade Provisions of H.R. 2454*, 19 June 2009.

But all such estimates are even more uncertain than usual, given the largely unprecedented nature of the cap-and-trade scheme. Further, the intricate income transfers incorporated in the legislation itself cloud the fundamental point: cap-and-trade will raise the cost of energy by \$1 trillion over the next 10 years; indeed, that is the very intent of the legislation – to discourage the use of carbon-emitting energy sources by raising their prices. That cost has to be absorbed by the U.S. economy – that is to say, by U.S. households. If a given household receives a tax rebate or other benefit to offset higher utility bills, someone is financing that benefit – and it may well be the very same household. Shuffling these costs among various income groups cannot erase the loss of economic and income growth that will result.

Indirect Tax Increases

The ACES act also would raise taxes indirectly on consumers by mandating a renewable electricity standard [RES] on utilities, requiring them to purchase 20 percent of their energy

supplies from renewable sources. Renewable energy often is more expensive than energy from traditional sources such as coal or nuclear energy; therefore, consumers can expect higher energy prices as a result of complying with the RES.

The RES is enforced by requiring utilities to purchase renewable energy certificates from other energy providers if they cannot meet the standard. Alternatively, an energy producer can pay a \$25 tax to the State government for every megawatt-hour of power that falls short of the mandate. CBO has estimated the cost of this compliance fee, which will be passed on to ratepayers, to be \$500 million. No official estimate of the cost borne by utilities to obtain renewable energy credits in lieu of paying the fee is available, but this would likely add millions more to the overall cost of complying with the RES mandate. It is also important to note that CBO's estimate of the household costs of cap and trade does not include the added cost of the RES mandate.

Job Losses and Other Costs

By constricting a major portion of U.S. energy production, the ACES act will constrain economic growth. Organizations ranging from the Brookings Institution, to the Heritage Foundation, to the Environmental Protection Agency agree the economy would be smaller under cap-and-trade than without it.¹³ The Brookings Institution says, for example, the legislation would reduce gross domestic product in the U.S. by about 2.5 percent compared to what it otherwise would have been in 2050.¹⁴ This is intentional: cap-and-trade is intended to make energy more expensive, reducing airline flights, trucking services, and production of steel, cement, and every other product that uses energy.

CBO acknowledges that its estimate of the costs of the ACES act reflects only those that would occur once the economy had adjusted to the changes wrought by the legislation. It does not account for the transitional costs that would affect investors and workers in energy and energy-intensive industries. Those who argue that energy-and-climate-change legislation will produce abundant “green” jobs tend not to mention the job losses that would occur.

[I]ncreased production of energy from non-fossil-fuel sources (such as wind or solar) and a shift to more energy-efficient production process would create jobs and profit opportunities as well. However, those jobs might be in different regions of the country or require different skills than the jobs being lost, and the profit opportunities might arise from different types of capital; their availability would mute but not eliminate the costs of the transition. Investors would see the value of some stocks decline, and workers would face higher risk of unemployment as jobs in some sectors were eliminated. Stock losses would tend to be widely dispersed among investors because shareholders typically diversify their portfolios. In contrast, the costs of unemployment would probably be concentrated among relatively few households and, by extension, their

¹³ The Brookings Institution, *Fact Sheet: Consequences of Cap and Trade*, 8 June 2009; the Environmental Protection Agency, *EPA Preliminary Analysis of the Waxman-Market Discussion Draft: The American Clean Energy and Security Act of 2009 in the 111th Congress*, 20 April 2009; the Heritage Foundation, *The Economic Impact of Waxman-Markey*, 13 May 2009.

¹⁴ The Brookings Institution, *Fact Sheet: Consequences of Cap and Trade*, 8 June 2009.

communities. The magnitude of those transitional costs would depend on the pace of emission reductions, with more rapid reductions leading to larger costs.¹⁵

CBO also notes that the job losses likely would be concentrated in regions that would have difficulty altering their basic economies:

Some regions and industries would experience substantially higher rates of unemployment and job turnover as the program became increasingly stringent. That transition could be particularly difficult for individuals employed in those industries (such as the coal industry) or living in those regions (such as Appalachia).¹⁶

EFFECTIVE GOVERNMENT TAKEOVER OF MOST OF THE ENERGY MARKET

ACES devotes nearly 1,200 pages to picking winners and losers among the myriad available sources of domestic energy production. What is unique about this gourmet energy plan, however, is its focus on a sliver of the overall available domestic energy supply. Renewable energy is the clear winner in ACES, receiving huge subsidies and government mandates that tilt the playing field in its favor. But these sources account for only 6.8 percent of the U.S. domestic energy supply, according to the Energy Information Administration. Even that figure is higher than the energy suppliers favored in the ACES act, because base hydro-power – which accounts for one third of all renewable power – is not considered a renewable source in the legislation: only wind, solar, tidal, wave, biomass, and geothermal are singled out as winners; and these account for just 4 percent of domestic energy resources. Fossil-fuel energy sources, which make up 86 percent of currently available resources, are forced to obtain government-endorsed allowances to stay in business.

Ironically, the ACES act is mostly silent on promoting nuclear power, which is responsible for more than 72 percent of emissions-free electricity generation, according to the Nuclear Energy Institute. In fact, the Department of Energy issued a report suggesting the single most effective emission control strategy for utilities was to increase nuclear production.¹⁷

The ACES bill also fails to promote increased production of domestic sources of oil and natural gas. Some studies say there are potentially 86 billion barrels of recoverable oil and 420 trillion cubic feet of natural gas in the outer continental shelf. These resources are estimated to potentially contribute as much as \$8 trillion to GDP over the long run – a boost of 2 percent – and create as many as 1.2 million new full-time jobs.¹⁸ ACES also is silent in developing new on-shore oil-shale energy resources. Some studies estimate the potential energy reserves from this

¹⁵ CBO, *The Estimated Costs to Households From the Cap-and-Trade Provisions of H.R. 2454*, 19 June 2009.

¹⁶ Ibid.

¹⁷ Department of Energy, *Voluntary Reporting of Greenhouse Gases 1997*.

¹⁸ The American Energy Alliance, *The Economic Contribution of Increased Offshore Oil Exploration and Production to Regional and National Economies*, February 2009.

source to be equivalent to 1.8 trillion barrels of oil – or enough to cover approximately 360 years worth of imports.¹⁹

INCREASE IN SPENDING

When defending the President’s fiscal year 2010 budget before the House Budget Committee, the Director of the Office of Management and Budget made the following statement: “The [2010] budget includes significant spending constraints and puts the Nation on a path to reducing nondefense discretionary spending as a share of GDP [gross domestic product].”²⁰

Even if the President achieved his discretionary spending levels in the outyears, the ACES act would be a major departure from spending restraint or a reduction of nondefense discretionary spending. As mentioned above, the bill would increase government spending by \$914 billion through 2019. The following is a summary of various items where new money will be spent:

- **Low-Income Energy Rebates.** This \$107-billion program functions similarly to the low-income energy tax credit, but is available to those individuals who do not file tax returns.
- **Carbon Storage Research Corporation.** A sum of \$10 billion is spent on a quasi-governmental entity for carbon capture and sequestration research. Although this entity is not strictly run by the government, it nevertheless, is compelled to collect payments from utilities and spend money on specific purposes; therefore, CBO treats this entity as part of the Federal budget.
- **Spending of RES Compliance Payments.** Penalty collections totaling \$500 million – assessed on utilities for failing to meet the RES mandate – are spent on new renewable energy projects.
- **Natural Resources Climate Change Adaptation Fund.** Another \$5.3 billion is spent on fish and wildlife.
- **Climate Change Health Protection Fund.** The Department of Health and Human Services is given \$900 million to help health professionals prepare and respond to climate change.
- **Stratospheric Ozone and Climate Protection.** A total of \$19.3 billion is provided to support the DOE’s “best-in-class” appliance deployment program and various EPA programs on hydrofluorocarbons.

¹⁹ Congressional Research Service, *Oil Share: History, Incentives, and Policy*, 13 April 2006.

²⁰ Testimony of Peter R. Orszag, Director of the Office of Management and Budget, to the Committee on the Budget, U.S. House of Representatives, 3 March 2009. The President’s budget increases total discretionary spending by 8.5 percent in fiscal year 2010, with non-defense discretionary rising by 12.8 percent. These increases come on top of an already substantial fiscal year 2009 boost resulting from the \$787-billion “stimulus” bill, which included \$311.2 billion in discretionary budget authority. After that, the budget assumes a dramatic reduction in the growth of discretionary spending: an average of 2.2 percent per year for base defense spending, and 2.9 percent per year for non-defense. These are rigorous limits considering non-defense discretionary spending has increased an average of 5.2 percent per year over the past decade (excluding emergencies). There are no mechanisms in the President’s budget to enforce the tight outyear limits on discretionary spending.

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- **Clean Energy Deployment Administration.** The legislation spends \$4.5 billion to establish a new entity within DOE to provide direct loans, loan guarantees, and lines of credit for clean energy projects. The \$4.5 billion would cover the subsidy cost under the Federal Credit Reform Act of approximately \$50 billion in outstanding loans, guarantees, and other credit. CBO projects the subsidy rate of projects funded under this program “would average 13 percent, which is similar to the risk posed by speculative grade bonds”²¹ – or, to use a more familiar term, junk bonds.
 - **More Loans to Auto Manufacturers.** A sum of \$7.5 billion doubles the subsidy amount required by the Federal Reform Credit Act to cover the cost of an additional \$25 billion in loans to automakers for new green cars. In preparing its analysis, CBO assumed an 80-percent default rate. Although bankruptcy proceedings for Chrysler and General Motors [GM] are not yet complete, most experts assume the Federal Government will own a majority stake in GM and a substantial minority stake in Chrysler. This outcome would suggest the government would be essentially loaning money to itself under the proposed program. In this case, CBO might choose to score this program at a 100-percent subsidy cost, because the Federal Credit Reform Act does not apply to intergovernmental loans and the full cost of such loans must be assumed.
 - **Increased Administrative Costs at Federal Agencies.** The bill provides \$7.5 billion to cover the estimated amount agencies will require to cover additional staff and other support to fulfill the requirements of the ACES act.
 - **Energy Efficiency Programs.** A sum of \$6.2 billion is provided for grants and other government assistance to increase lighting efficiency, energy efficiency in Federal and non-Federal buildings, and efficiency projects for industries, States, and local governments.
 - **Clean Energy Programs.** A total of \$2.4 billion would be distributed by the DOE, the EPA, and the Department of Education for the following:
 - For modernizing the electrical grid, \$1.5 billion.
 - To establish centers for “clean” energy research and development, \$870 million.
 - For education grants for “clean” energy, green careers, and climate change, \$250 million.
 - For other unspecified activities, \$22 million.

INCREASE IN FOREIGN AID

The legislation contains two major foreign-aid-like components – the purchase of international carbon offsets, and allowances going overseas to help with international climate change efforts – that would total \$14.2 billion in a single year.²² International carbon provisions are intended to

²¹ CBO cost estimate, dated 5 June 2009, of H.R. 2454, the American Clean Energy and Security Act of 2009, as reported by the Committee on Energy and Commerce on 21 May 2009.

²² CBO, *The Estimated Costs to Households From the Cap-and-Trade Provisions of H.R. 2454*, 19 June 2009.

reduce the overall compliance cost of cap-and-trade, and thereby reduce the effect on the U.S. economy. These offsets amount to a huge increase – about 54 percent – in U.S. foreign aid. Inevitably this would boost foreign economies and increase jobs overseas, while offering no benefits to the U.S. economy.

CBO’s cost estimate concludes the use of international allowances – payments by the U.S. to foreign countries to reduce their greenhouse gas emissions – will reduce the price of allowances. This has the effect of reducing the apparent cost to U.S. consumers. But that reduction comes at a heavy price. First, U.S. consumers will need to buy these allowances from foreigners, translating into the largest increase in foreign aid in U.S. history. Second, it will be difficult, if not impossible, to monitor whether the offsets actually reduce greenhouse gas emissions. Hence the U.S. may get nothing for the additional spending. Further, because the bill caps only U.S. emissions – and not those of countries such as China and India, whose emissions are growing the fastest – U.S. manufacturing and other industries relying on carbon-based energy will face an even deeper competitive disadvantage in the global economy. Thus, the likely perverse result is that U.S. taxpayers will pay foreign companies to shift U.S. jobs overseas.

BENEFITS TO SPECIAL INTERESTS

During the 2007-08 presidential campaign, then-Senator Obama often criticized the role of lobbies and “special interests” in the development of public policy. An example was a statement during an October 2008 campaign stop in Wisconsin:

You need leadership you can trust to work for you, not for the special interests who have had their thumb on the scale. And together, we will tell Washington, and their lobbyists, that their days of setting the agenda are over.²³

The President’s budget proposal for cap and trade auctions 100 percent of emissions permits, not giving any away for free to businesses or other groups. During the Business Roundtable in March 2009, the President said: “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.” The President’s budget director even stated during recent testimony before the House Budget Committee: “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.”²⁴

Indeed CBO, in its testimony to the Ways and Means Committee, says the following about the distribution of free credits:

Giving all or most of the allowances to energy producers to offset the potential losses of investors in those industries – as was done in the cap-and-trade program for sulfur dioxide emissions – would also exacerbate the regressivity of the price increases. On average, the value of the CO₂ allowances that producers would receive would more than compensate them for any decline in profits caused by a drop in demand for energy and energy-intensive goods and services whose

²³ Campaign appearance on 1 October 2008, recorded on www.youtube.com.

²⁴ *The Wall Street Journal*, op.cit.

production causes emissions. As a result, the companies that received allowances could experience windfall profits.

For example, in 2000, CBO estimated that if emissions were reduced by 15 percent and all of the allowances were distributed free of charge to producers in the oil, natural gas, and coal sectors, the value of the allowances would be 10 times the combined profits of those producers in 1998. Thus, the windfall gains that they would receive as a result of the free distribution would far outweigh the loss in sales that they might experience as consumers cut back on their use of fossil fuels.²⁵

While ACES does not distribute all allowances to producers as contemplated in the hypothetical example above, it nevertheless illustrates a fundamental problem with giving away free credits.

Table 3: Allocation of Emission Permits

Permit Recipient	Percentage of Total
Free Credits (83.1 %)	
Electricity Producers	43.8%
Natural Gas Distributors	9.0%
Home Heating Oil Programs	1.9%
Trade-Vulnerable Industries	2.0%
Carbon Capture and Sequestration Projects	0.0%
Energy Efficiency and Renewables	9.5%
Building Code Efficiency	0.5%
Clean Energy Innovation Centers	1.0%
Domestic Petroleum Refiners	2.0%
Investment in Workers	0.5%
Domestic Adaptation Programs	1.0%
Fish and Wildlife Adaptation Programs	1.0%
International Adaptation	1.0%
International Clean Technology Deployment	1.0%
Reduction of Deforestation	5.0%
Strategic Reserve	1.0%
Auctioned Credits	15.0%
Unallocated Credits	1.9%
Total	100%

Source: From John Kemp, Reuters, "Preliminary Assessment of Cap and Trade Provisions in the American Clean Energy and Security Act of 2009," 26 May 2009.

Despite strong statements from the President and his budget director against the use of free credits, the AECS act would give away nearly 83 percent of credits under its cap-and-trade program. CBO predicts that approximately 80 percent of total spending under the bill (\$693 billion) stems from credits given away to various entities for free. Table 3 above provides an estimate of how emissions credits would be distributed under the ACES act in 2012. The fact that the AECSA departs from the President's proposal and gives away 83 percent of credits for free highlights that special interest influence in Washington continues to thrive. In fact, *Congressional Quarterly*, in an article on 19 March 2009, mentions the following:

A study by the Center for Public Integrity found that climate-change issues now account for about 15 percent of all Washington lobbying, involving groups as diverse as dairy farmers and defense manufacturers. "The funds that this bill

²⁵ Op.cit. Elmendorf testimony to the House Ways and Means Committee, 18 September 2008.

creates — all that is a huge opportunity to have your favorite industry or client have a pipeline to a virtually endless source of future funds,” said Jeff Munk, a lobbyist with Hogan & Hartson LLP.²⁶

UNCERTAIN ENVIRONMENTAL BENEFITS

Yet after all this, the benefits of cap-and-trade remain highly doubtful. Some studies show the scheme might move temperatures by no more than a fraction of a degree by the end of this century – which would make little difference on whatever climate effects result from greenhouse gas emissions.

In a recent study based on a broad spectrum of research, CBO explains that a variety of unpredictable factors already cloud the degree of climate change likely to occur over the next century. These include how population growth, technology, and economic change will influence land cover and the growth of emissions; and how rapidly the climate will respond to accumulating greenhouse gases and other changes, and how much warming will ultimately occur (what is referred to as the climate’s sensitivity).²⁷ Because of these variables, CBO reports:

Uncertainties regarding the amount of future emissions and the climate system’s response appear to make roughly comparable contributions to the overall uncertainty about the impact of warming over the 21st century. Taken together, those uncertainties are sufficiently large that many experts have been reluctant to project a likely range of long-term changes in the global climate, and no firm consensus on such a range exists.²⁸

Another problem is that the effects of greenhouse gas concentrations that already exist – however extensive they might be – will continue; and even significant policy changes cannot alter that.

Even immediate, dramatic reductions in emissions would not necessarily halt changes to which past emissions have already committed the climate: if concentrations were stabilized today by cutting emissions immediately to a small fraction of current levels, the average global temperatures would gradually continue to rise – increasing by another 0.5°F to 1.6°F above recent levels by the end of this century, according to one study.²⁹

CBO also notes that determining the amount of emissions that would produce a specific goal for the climate also is highly questionable. For example, if the climate’s sensitivity to greenhouse gases is low, concentrations could double and still hold 21st century warming to no more than 5°F. On the other hand, if the climate is highly sensitive, policies would have to sharply limit

²⁶ *Congressional Quarterly*, “Projected Cap and Trade Generates Many Ideas on How to Spend It,” 13 March 2009.

²⁷ CBO, *Potential Impacts of Climate Change in the United States*, May 2009.

²⁸ *Ibid.*

²⁹ CBO, *Potential Impacts of Climate Change in the United States*, May 2009. The study referred to is *Climate Change 2007: The Physical Science Basis. Contribution of Working Group I to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change*, published by the Cambridge University Press.

emissions. But again, this degree of climate sensitivity is unclear. Specific outcomes cannot be guaranteed; policies can only shift the odds.

Finally, climate change is a global problem and requires international contributions. For every ton of carbon the U.S. avoids, China, India, Russia, and others will produce many more. Without the efforts of these countries, U.S. efforts to limit greenhouse gases may have limited benefits for the environment, but they will inevitably put the U.S. economy at a competitive disadvantage.

CONCLUSION

As noted, the 1,200-plus page ACES act entails a large imposition of government on the economy, and does so in a largely unprecedented way. But several points about the legislation seem to be clear at this stage:

- Everyone will see their costs rise, in what amounts to a substantial tax increase, with the greatest burden on middle-income earners.
- The legislation favors a sliver of costly energy producers while constricting the majority of the market.
- The bill will increase spending dramatically to support a multitude of new programs.
- There is no assurance it will produce the environmental benefits proponents claim.
- It will hinder U.S. economic growth while increasing foreign aid by nearly 54 percent and shifting U.S. jobs overseas.
- Special interest politics will only grow stronger with windfall profits going to winners, and higher costs, less energy, and a more difficult business climate going to losers.

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This document was prepared by the Republican staff of the Committee on the Budget. It has not been approved by the full committee and may not reflect the views of individual committee members.