

A No-Regrets Carbon Reduction Policy

BY BRUCE YANDLE

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With the Bush administration taking a cooperative stance in the Bali climate change discussions and a 2007 U.S. Supreme Court decision requiring the Environmental Protection Agency (EPA) to regulate carbon as a pollutant, the door is open wide for serious consideration of legislative actions designed to reduce United States and world carbon emissions. Indeed, debate on Capitol Hill about climate change legislation is now probably second only in volume and intensity to discussion about how to stimulate the economy and avoid a pending recession.

Of course, we know at the outset that carbon emissions map directly to life and wealth creation. We humans are carbon-emitting creatures and most of our wealth-producing engines exhale carbon. Population growth and longer life expectancies mean more carbon dioxide emissions. More gross domestic product (GDP), translates into more carbon emissions. Proposals for dramatic, short-run reductions are not just costly in dollars, they are draconian in terms of human well-being.

Can free market environmentalism (FME) provide guidance as to which policies might best promote human well-being? Consider these principles:

- Incentives matter.
- Property rights that reward asset managers improve environmental outcomes.
- Competition among suppliers of goods desired by consumers generates a larger yield.
- Decentralization increases experimentation, leading to more innovation and environmental quality at lower costs.

To get started, let's assume that U.S. political action to reduce carbon emissions will be forthcoming in 2008. Then, assume that political actions will be driven primarily by concerns for improving overall human well-being, not by special interest lobbying. With these two assumptions in place, it turns out that FME may offer some help in working through the policy maze.



Posing some questions

At the simplest level of analysis, carbon emission policy can lead to reductions either by making carbon-emitting activities more expensive or by making carbon-reducing activities more attractive. Put another way, carbon emissions can be limited by law (such as cap and trade, or cap without trade) and by use of economic incentives (taxes and subsidies), or by affecting the choice of inputs and technologies (wind, solar, nuclear, coal) that affect carbon emissions.

Saying all this neglects, perhaps, the most important question of all: To what extent is the United States a net emitter of carbon? We know that carbon dioxide is discharged from stacks and tail pipes. But we don't know how much and which escape sequestration processes and actually emerge in the upper atmosphere.

There are, then, several important policy considerations to be made when Congress reopens the climate change debate. Here are four to consider:

1. To what extent is the United States a net carbon dioxide emitter, and are we as a nation equipped to determine when and how much progress is made in reducing emissions? Should we establish procedures to evaluate legislative actions in terms of their carbon emission impact?
2. What about actions that might be taken to hasten the adoption of lower carbon-emitting processes? Is it possible to adopt a “no regrets” policy—one that will generate net benefits even if Americans later reduce their concern about climate change?
3. Simultaneously, if climate change is occurring, what are the actions that might be taken to encourage human adaptation? Can these be framed as “no regrets”?
4. Why have a one-suit-fits-all climate change policy that applies nationwide, if not worldwide? Why not encourage experimentation across the United States?

Establishing a baseline and monitoring

Logic alone suggests that if carbon emissions are harmful to global biota or just undesirable, we should get serious about the matter and do something. The United States should immediately take action to establish a baseline and an emission monitoring program that tells how we are doing in our efforts to reduce emissions. Surely we would do this before imposing costly regulations that affect life and lifestyles. But what baseline will we use? Will it be some measurement of discharge from pipes and stacks? Or will the baseline take account of sequestration activities? If the problem is in the upper atmosphere then net carbon dioxide concentrations, not gross, should be monitored. Put another way, we must find ways to estimate more accurately what actually leaves the earth after sequestration has occurred.

Doing this doesn't necessarily mean that the U.S. government will build and operate the system, but it might mean that U.S. taxpayers will fund the operation of a monitoring network. Then, with a system in place for keeping score, logic suggests that the Office of Management and Budget should be empowered to evaluate all federal legislation and regulation as to net carbon emission impact and blow the whistle when proposed action looks bad. For example, legislation providing subsidies for the production of ethanol or biodiesel will be assessed to determine the net impact on carbon emissions. All newly proposed legislation could be accompanied by a set of carbon notes identifying the estimated carbon effects. An annual report will be provided to the American people giving 1) an estimate of progress or lack of it, and 2) a summary of the effects of legislation in reducing or increasing carbon emissions.

This proposed policy package parallels actions that have been taken to monitor emissions of other Clean Air Act pollutants. With the Supreme Court having ruled that carbon emissions are pollutants, not unlike other pollutants regulated by the EPA, logic suggests that a tracking system be developed for carbon emissions, just as there is for other pollutants.

Instead of stopping all this with one-suit-fits-all federal rules, why not encourage experimentation? Why not provide a monitoring system that encourages states and regions to form carbon reduction compacts?



With an improved ability to tell where we stand and how we are doing, the next step would be developing policy instruments for affecting carbon emission output. Surely we would not do that before determining where we are in the carbon reduction struggle.

Beyond cap and trade or taxes

Most legislative attention has followed patterns of the past and assumed that we must have a national blueprint, something akin to the Clean Air Act that imposes a one-suit-fits-all solution for the 50 states, if not the developed world. Proposed policy solutions often focus on some form of cap and trade with occasional attention given to the use of carbon taxes. Carbon-producing industries naturally favor caps that restrict industry output. They like higher prices and reduced competition. They oppose taxes, in any form. Cap and trade joins Bootleggers (those in it for the money) to Baptists (those who simply want less carbon in the air). Subsidizing alternate energy sources, which is always popular with those being subsidized, has focused primarily on ethanol, a high cost carbon emitting fuel. Less attention has focused on longer-term decisions that will support targeted research and development, increase capital turnover, encourage new technologies, and hasten the expansion of safer nuclear power plants that eliminate carbon emissions entirely. These actions could form a “no regrets” bundle.

No regrets

The United States is now one of the highest corporate income tax countries among industrialized nations. This is not because we have raised taxes. It's because everyone else has cut taxes. Higher corporate taxes of all forms discourage formation of new capital, which delays the introduction of cleaner technologies. Eliminating capital gains taxes, reducing corporate income taxes, and accelerating depreciation would get the incentives right for replacing high carbon emitting machines and activities with cleaner processes. Doing so would also increase U.S. GDP and employment growth—a “no regrets” outcome.

Nuclear power produces no carbon emissions but it does come with some risks. To protect community property rights, the current liability cap provided to utility companies by Congress should be reevaluated in terms of experience and preferences for risk reduction. Property rights should be protected with a mean-

BUILDING A FOUNDATION

By applying FME principles to climate change policy, it is possible to build a no-regrets outcome that reduces carbon emissions and yields important long-run economic benefits to America and the world. Incentives, property rights, and decentralized experimentation can form a foundation for effective environmental policy.

ingful liability rule. Yes, there is nuclear waste to deal with, but this too can and should be addressed by the federal government. Developing an expedited nuclear power plant approval process and eliminating the nuclear waste bottleneck would contribute to a long-run reduction in carbon emissions—another “no regrets” policy.

There are a vast number of carbon reduction activities taking place in the developed world, with many involving major U.S. firms. Global industrial firms are encountering emission taxes, cap and trade, and command-and-control regulation in other countries. There is active carbon offset trading in the United States and elsewhere. There is a developing regional trading community composed of 10 northeastern states. California has attempted to pass legislation imposing carbon emission restrictions on automobiles and industrial sources. Other states are investing in carbon sequestration. Carbon offsets produced by Iowa farmers who modify how they plow fields are purchased by Canadian industrial firms. The U.S. states are forming a quilt-like pattern of approaches supported by their populations.

Instead of stopping all this with one-suit-fits-all federal rules, why not encourage experimentation? Why not provide a monitoring system that encourages states and regions to form carbon reduction compacts? Auto production and related mobility are generally given as the reason for having a national policy: Having one car that meets California standards and one more for the rest of the country seems to be the cost-effective solution. But why not let the market, political and otherwise, sort out the problem? Surely there are global auto producers who will respond when California and 10 other states chomp at the bits for low or zero carbon cars. But let those who want lower emission vehicles bear the burden, instead of spreading the cost across others who prefer another approach. Requiring one suit for all will surely delay the supply of cars preferred by a large population of Americans, assuming they are willing to pay for cleaner cars.

Improving adaptation

Taking an FME-based, no-regrets approach to carbon reduction will recognize that:

- Deeply rooted technologies and energy sources can and will be replaced by alternate technologies and non-carbon emitting energy sources;

- Rapid depreciation of existing capital and reductions in capital gains and corporate taxes will hasten adaptation; and
- Subsidies and regulations that distort energy consumption and investment decisions and increase carbon emissions should be eliminated.

If we get serious about reducing carbon emissions, we will want to know how much we are now emitting to the upper atmosphere and how much progress we are making. We will need to get the incentives right, protect property rights, and encourage competition and experimentation in the marketplace.



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