

By Robert N. Stavins

## Beware Scorched-Earth Strategies

With the apparent collapse of Senate consideration of climate policy, it is important to reflect on what could be a serious long-term casualty of these acrimonious debates, namely the demonizing of cap-and-trade and the related tarnishing of market-based approaches to environmental protection.

In an op-ed in the *Boston Globe*, Richard Schmalensee of MIT and I commented on this outcome of the political debates and noted the irony that the attack on cap-and-trade — and carbon-pricing, more broadly — has been led by conservatives, who should, in fact, take great pride as the creators of these cost-effective policy innovations.

In the debates on climate policy throughout 2009 and 2010, conservative Republicans dubbed the cap-and-trade proposals "cap-and-tax." But regardless of what they think about climate change, they should resist demonizing market approaches to environmental protection and reverting to pre-1980s thinking that saddled business and consumers with needless costs.

Market-based policies should be embraced, not condemned by Republicans (as well as Democrats). After all, these policies were innovations developed by conservatives in the Reagan, George H. W. Bush, and George W. Bush administrations.

In the 1980s, the Reagan EPA successfully put in place a cap-and-trade system to phase out leaded gasoline. The result was a more rapid elimination of leaded gasoline from the marketplace than anyone had anticipated, and at a savings of some $250 million per year, compared with a conventional command-and-control approach.

In June 1989, President George H. W. Bush proposed the use of a cap-and-trade system to cut by half sulfur dioxide emissions from coal-fired power plants and consequent acid rain. An initially resistant Democratic Congress overwhelmingly endorsed the proposal. The landmark Clean Air Act Amendments of 1990 passed the Senate 89 to 10 and the House 401 to 25. That cap-and-trade system has cut sulfur dioxide emissions by 50 percent, and has saved electricity companies — and hence shareholders and ratepayers — some $1 billion per year compared with a conventional, non-market approach.

In 2005, George W. Bush's EPA issued the Clean Air Interstate Rule, aimed at achieving the largest reduction in air pollution in more than a decade, including reducing sulfur dioxide emissions by a further 70 percent from their 2003 levels. Cap-and-trade was again the policy instrument of choice in order to keep costs down and achieve the rapid reductions at minimum economic pain. (The rule was later invalidated by the courts, and is now being reformulated.)

> ***In debating risks and costs, there should be no tarnishing of market instruments***

To reject this legacy and embrace the failed 1970s policies of one-size-fits-all regulatory mandates would signify unilateral surrender of principled support for markets. If some conservatives oppose energy or climate policies because of disagreement about the threat of climate change or the costs of those policies, so be it. But in the process of debating risks and costs, there should be no tarnishing of market-based policy instruments. Such a scorched-earth approach will come back to haunt when future environmental policies will not be able to use the power of the marketplace to reduce costs.

Economists have diverse perspectives on the policy alternatives that could be used to address climate change, but virtually all support market-based approaches to the problem. Some favor carbon taxes combined with revenue-neutral cuts in distortionary taxes, whereas others support cap-and-trade mechanisms — or "cap-and-dividend," with revenues from auctioned allowances refunded directly to citizens.

But concerns among economists about specific cap-and-trade legislative proposals pale in comparison with concerns about conventional regulatory approaches advanced as "painless alternatives." Those alternatives — a plethora of standards, special-interest technology subsidies, and tax breaks — are incapable of doing the job, and will be unnecessarily expensive. The cost differences among the various carbon-pricing designs are trivial when compared with the very large costs of command-and-control approaches. At a time at which we are struggling to revitalize the economy, we can least afford to turn our backs on markets and impose unnecessary costs on businesses and consumers.

A price on carbon is the least costly way to provide meaningful incentives for technology innovation and diffusion, reduce emissions from fossil fuels, and drive energy efficiency. In the long run, it can reduce our use of oil and drive our transportation system toward alternative energy sources.

Market-based approaches to environmental protection — including cap-and-trade — should be lauded, not condemned, by political leaders, no matter what their party. Demonizing cap-and-trade in the short term will turn out to be a mistake with serious long-term consequences for the economy, for business, and for consumers.

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