Design of a U.S. cap and trade program

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“Climate Change Policy: Lessons from the European Experience”
Center for European Studies, Rutgers University
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Is cap and trade dead?
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Depends on what you mean by “cap and trade”...

and by “dead.”
Major policy design issues (1/6)

**Targets and timetables**

HR2454:

- 2012: 3% below 2005
- 2020: 17% below
- 2050: 83% below

**Notes:**

- 2005 emissions were 17% above 1990.
- We are currently looking up at the 2012 target.
Major policy design issues (2/6)

Scope and point of reg.

Scope should be as broad as possible to capture largest gains from trade.

“Point of regulation” refers to who is responsible for submitting allowances.

- Economists tend to favor “upstream” point of regulation.
- But the political process favors a midstream system.
Offsets effectively expand the scope of the market.

But strong scientific review is crucial.

Not all offsets are created equal:

- Domestic offsets
- Tropical forest carbon (REDD)
- International
  - CDM (project-based)
  - Sectoral crediting
Major policy design issues (4/6)

A legitimate environmental and economic issue behind the façade of protectionism.

Avoid carbon leakage from trade-exposed manufacturing sectors.

Solutions:

- Output-based allocation
- Border adjustments
Major policy design issues (5/6)

A price collar, sure – but will it be “hard” or “soft”?

Classic tension between greater certainty about cost and greater certainty about outcomes.
Major policy design issues (6/6)

What matters is **how allowance value is distributed**, not auction vs. free allocation.

Chart shows HR2454 allocation

- **Public purposes**: 27%
- **Households (consumer tax rebate)**: 18%
- **Households (Low-income)**: 15%
- **Industry (trade-exposed)**: 7%
- **Industry (other)**: 16%
- **Small business**: 7%
- **Households (LDC allocation)**: 9%

Total for 2012-2050: $1.3 trillion (present value)
Putting it all together (1/2)

Targets and timetables
Scope and point of reg.
Offsets
Int’l competitiveness
Cost containment
Allocation

Everything is connected!
Putting it all together (2/2)

What’s missing:

- Financial market regulation
- Incentives for coal, CCS, nuclear, etc.
- Complementary measures
- Offshore drilling

Targets and timetables
Scope and point of reg.
Offsets
Int’l competitiveness
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Comparison of legislative proposals

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Waxman-Markey vs. Cantwell KGL:
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6. Behavioral lessons?