ALLEGHENY COLLEGE

Auctioning for a Better Future

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To: Senator Joe Lieberman and Senator John Warner
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Problem: America's Climate Security Act of 2007 currently attempts to limit carbon emissions in a politically feasible fashion. However as a result of political and economic pressures, the bill fails to achieve sufficient standards of distributive justice and environmental sustainability. Although the Lieberman-Warner proposal currently addresses the distribution of funds to low-income communities and rural populations, the allocation of funds is inequitable for middle-class Americans. These Americans already suffer from labor and capital income taxes that create economic distortion when they work to suppress socially desirable activities like employment, investment, and savings. The proposed carbon dioxide emissions cap introduced by Lieberman-Warner will likely worsen these distortions as there are no provisions that would provide tax relief for the middle class. Currently only 20% of emission allowances are auctioned off while the rest are allocated with gratis. This greatly reduces the potential for tax relief through revenue recycling as well as emission reductions. Finally the bill could be made to meet a higher standard of environmental sustainability by setting a limit or expiration date on their lifespan, disabling the ability of their value to rise exponentially as private windfall profits over time.

Solution: America's Climate Security Act of 2007 currently offers initial financial support for people associated with affected industries, states, environmental efforts and low-income rural populations. For example the Energy Assistance Fund would provide fifty percent of its money to low-income energy assistance and twenty five percent for rural energy assistance. Although this bill is currently equitable for low-income communities, at least forty-five percent of Americans are considered middle-class, earning between $25,000 and $100,000 per year, and will not be receiving the necessary support required for a smoother transition into a less energy dependent society. Unfortunately, energy bills are expected to substantially increase, and the economic burden will be placed directly on the middle-class consumer. In order to enhance distributive justice, the Lieberman-Warner Act should provide adaptation assistance for the average American. Overall equity could be achieved if funds are distributed to provide the low-income community with thirty-five percent and the rural community and the middle class with twenty percent respectively. America's Climate Security Act of 2007 will not only become more equitable with these changes but more politically feasible as well a larger number of citizens would benefit from the policy.

Revenue from the auction of emission permits could further enhance political feasibility, distributive justice, and economic efficiency. Tax cuts funded by auction revenue could achieve effective climate change mitigation while producing net economic gains. Reducing labor and capital income taxes would support overall economic growth by encouraging employment, savings, and investment. However this would require sufficient revenues from the sale of carbon credits to counteract existing distortions. This additional revenue should be attained by auctioning off all the emission allowances rather than only 20%, which would also prevent companies from profiting off of allocations and allow the permits to better reflect their true market value. Ultimately revenue recycling in the form of tax cuts could be an effective complement to energy rebates because economic activity is actively encouraged. Research by Ian Perry of Resources for the Future suggests that "the overall costs of reducing CO2 emissions would be much lower under a policy that raised revenues – and used these revenues to cut other taxes – than under a policy that did not raise revenues." This scenario of tax cuts on "good" activities could bolster the equity, economic efficiency, and political feasibility of the Lieberman-Warner bill. Cutting capital income taxes allows people and companies to keep more of their profits from investment, while cutting labor taxes increases the incentive to work. Furthermore broad based tax cuts are almost universally viewed as positive, while some will likely take issue with the prospect of simple government rebates. Thus, our new proposal calls for 100% auction of emissions permits to be recycled back into the economy in the form of capital income and labor tax cuts.

Finally, the bill aims to reduce emissions through a system of banking and borrowing by giving companies an allotted amount of emission allowances. Some have argued for the alternative carbon tax with a safety value which would provide companies with the opportunity to purchase additional emission allowances according to a specific trigger price. However the method of emission allowances has a more positive impact on the environment compared to a safety valve. The latter procedure increases the chance that companies with more resources will continue to buy their pollution rights without decreasing emissions because they have the funds. Therefore a safety valve in a carbon tax system would not provide the same benefits for less prosperous companies. The environmental effects of a tax are less certain and focus more on economic advantages whereas a permit system will undoubtedly cut emissions, increasing the certainty of emissions mitigation.

We recommend an amendment to the way banking emission allowances are handled in relation to time restraints. As this bill seeks to achieve sustainable development to improve environmental conditions, the absence of expiration dates on the emission allowances is out of sync with the bill's intentions. Sections 2201 and 2202 explain how the emissions allowances can be reported after the fact while the value of the permit is maintained with unlimited life. However this method increases the chance of facility owners amassing cheap allowances in the present to sell them for profit in the future. The values for the emission allowances will increase in the future to force additional reductions. This does not encourage facilities to further reduce emissions from the onset of this policy because they can keep their allowances indefinitely. In addition they are not forced to fundamentally redesign how they manufacture goods or services to attack emission hot spots. With an expiration date on emission allowances that are auctioned rather than allocated, it is more imaginable that facility owners would be willing to invest in emerging green technology that would offset their emissions burdens due to high initial cost. These measures also encourage overall carbon reductions and increase the environmental impact of the bill. Therefore the proposed bill should maintain its permit system, but to ensure an improved environmental impact it should add expiration dates to the system.

As a way of improving America's Climate Change Act of 2007 we suggest that energy assistance programs for middle-class Americans, revenue recycling through tax cuts, permit auction rather than allocation, and time restraints on banking emission allowances be added. These changes would ensure equity, environmental sustainability, political feasibility and economic efficiency for the future of climate policy in our nation.

Sources: We met with Associate Professor and Chair of Allegheny's Environmental Science Department, Professor Terrence Bensel. We also collaborated with Visiting Scholar in the Environmental Science Department, Thomas Eatmon. We used secondary sources including the following:

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