

Cap and Trade vs. Carbon Tax

The debate between cap and trade and carbon tax can have a win-win solution.

The solution is:

A carbon tax is a price floor of a cap and auction system.

Here's how:

About Cap and trade:

- The state 'caps' total CO2 emissions and issues that number of emission permits annually.
- The number declines from year to year until a safe level of emissions is reached.
- Companies must acquire permits in order to emit CO2 or bring carbon into the state.
- Companies can buy and sell permits.

Permit price volatility is an issue:

Cap and trade has a cap, but permit prices can be volatile. If prices are too low, companies will not want to make large investments in low-carbon technologies.

Auctioning is necessary:

Previous cap and trade systems allocated permits to companies for free. Economists now know that most or all permits should be auctioned (sold) to companies in order to collect revenue to invest in public goods and consumers compensation.¹

About a Carbon Tax:

Many economists believe a tax on CO2 is the most efficient market approach to climate change.

A Carbon Tax has the following advantages:

- Predictable carbon prices
- Easier to understand
- Revenue can be returned to consumers via tax cuts, dividends, and/or used for public goods

A tax without a cap may not reduce emissions:

• ExxonMobil's profits soared when gas prices rose. Driving habits will not shift overnight. A carbon tax cannot ensure that total emissions will decrease.

Put tax revenues in a dedicated fund:

Voter distrust of spending priorities could doom a carbon tax. A dedicated fund could reduce the possibility of special interest spending, or priorities that are only peripheral to climate or sustainability (corn-based ethanol, nuclear., etc).

A carbon tax is a price floor of a cap and auction system.

California's AB32 Market Advisory Committee wrote:

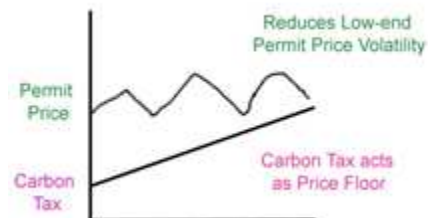
"While a price ceiling could jeopardize environmental integrity and reduce the return on investments in clean technologies, a price floor would reinforce environmental integrity and the value of clean investments. The Committee encourages CARB to consider enforcing a price floor."

A carbon tax that increases over time will act as a price floor to reduce permit price volatility in a cap and auction system.

This system does not replace other regulatory means of meeting California's AB32 emission reduction goals.

Combining cap and auction and carbon tax provides an overall emissions cap, reduced price volatility, and a price signal to companies to encourage long term investments in low-carbon technologies.

This factsheet is part of a series promoting public trust approaches to a future carbon market. The factsheets are available for free at www.carbonshare.org.



¹ <http://www.carbonshare.org/docs/Bibliography-links2.doc>