



By Robert N. Stavins

In Defense of Pollution Markets

Cap-and-trade has been vilified as an energy tax, a Ponzi scheme, and a giveaway to corporate polluters. The fact that none of these attacks are factually correct has not reduced their political effectiveness. When Senate leaders decided they could not assemble the 60 votes necessary to cut off debate on meaningful climate legislation, they pulled economy-wide cap-and-trade off the table. But when attention is again given to national climate policy, as it inevitably will be, consideration should include carbon-pricing, whether through taxes or cap-and-trade, because these approaches have tremendous advantages over the alternatives.

It is important to set the record straight and respond to some of the attacks that have been made on cap-and-trade specifically and carbon-pricing broadly. That is the fundamental purpose of an issue brief Dr. Janet Peace and I have written. "In Brief: Meaningful and Cost Effective Climate Policy — The Case for Cap and Trade" was published by the Pew Center on Global Climate Change in June.

While the justification for putting a price on carbon emissions seems straightforward to most policy analysts, some of the public and even some policymakers have questioned whether creating a market for greenhouse gas reductions would be a cure worse than the disease. One of the questions they ask is why create a market for GHG

emissions, when markets, in general, are subject to manipulation and have failed terribly?

With the U.S. economy experiencing its worst recession since the Great Depression, amidst corporate scandals, pyramid schemes, and a series of government bailouts, some have come to question the ability of markets to perform their basic functions. Despite the past successes of market mechanisms to address environmental problems such as acid rain, leaded gasoline, and stratospheric ozone depletion, there has been growing distrust of markets to help tackle the challenging problem of global climate change.

The storyline goes roughly like this: establishing a "carbon market" for greenhouse gas emissions opens the door for financial intermediaries — banks and brokers — to be involved. Since we know that they cannot be trusted, and only care about making profits (and not about reducing emissions), how could any approach that involves them be part of an effective solution?

In reality, of course, our recent economic turmoil does not mean that markets in any general sense do not work, only that markets require appropriate oversight. Our economy is a market-based system, but oversight — including, where appropriate, effective rules and regulations — can be essential to ensure transparency and prevent manipulation.

In fact, with appropriate rules and oversight, markets have been shown to work exceptionally well to address environmental problems. They provide key flexibility to regulated entities to adopt least-cost approaches to emission reductions, while providing powerful incentives for technological innovation and diffusion, which serve to reduce costs over time. Experiences with market-based instruments for environmental protection include chlorofluorocarbon trading under the Montreal Protocol to protect the ozone layer; sulfur dioxide allowance trading under the Clean Air

Act Amendments of 1990, to curb acid rain; nitrogen oxides trading, to control regional smog in the eastern states; and eliminating lead from gasoline in the 1980s.

Studies have found that these market-based approaches to environmental protection have achieved environmental objectives and done so at lower cost than conventional, command-and-control approaches. Estimates of cost savings range from 7 percent to 96 percent, with more than half of studies showing that market-based programs cut the cost of regulation by well over half compared with command-and-control options. For example, the SO₂ allowance trading program resulted in 33 percent cost savings — on the order of \$1 billion annually — while reducing power-sector emissions from 15.7 million tons in 1990 to 7.6 million tons in 2008. The phase down of leaded gasoline in the 1980s, which

employed trading of environmental credits, was also successful in meeting its environmental targets, while yielding cost savings of about \$250 million per year.

The evidence is incontrovertible — market-based approaches to environmental protection can work, effectively achieving environmental targets and keeping costs to a minimum. These approaches are not deregulation, but reformed and improved regulation. Appropriate oversight and regulation of carbon markets will be required.

When the Congress returns to this issue, cap-and-trade policy and carbon-pricing generally must be considered seriously and debated honestly, otherwise it will be impossible to put the United States on a climate-friendly path of robust and sustainable economic growth.

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It is important to set the record straight about the attacks on cap-and-trade