Promoting Economic Recovery through Climate Legislation

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Fast action to contain the looming climate crisis can help to ensure full economic recovery while at the same time improving our long-term economic, environmental, and national security. Passing climate legislation in 2009 would kick start a wave of clean energy investment to guard against the risk of the United States slipping into a Japanese-style "lost decade" of recession if short term stimulus proves insufficient.

Enacting climate legislation in 2009 would immediately resolve regulatory uncertainty by establishing long-term emissions limits. This is an essential precondition to get capital flowing into long-lived energy infrastructure, including both cleaner energy supplies and increased energy efficiency in the industrial and buildings sectors.

A well-crafted cap on greenhouse-gas emissions, legislated this year but taking effect in 2012, would immediately ramp up innovation and energy efficiency incentives while the new Administration hammers out details of a cap-and-trade market to be launched after the economy recovers. This one-two punch would move the nation toward a secure clean-energy economy through deficit-financed fiscal stimulus spending now, followed by enforcing a cap on emissions to ensure that polluters pay to finish the job once the economy becomes stronger. We can even use a share of future cap-and-trade revenues to retire the debt incurred to finance clean-energy incentives before a carbon cap goes into effect.

As soon as climate legislation passes, businesses will be motivated to reduce their carbon footprint in advance of the cap-and-trade system to be launched in 2012—and smart policy can support this job-expanding investment. Rather than grandfathering allowances to industry based on historical pollution, why not reward companies that beat output-based carbon intensity benchmarks for their industry? Climate legislation should also include a price floor on allowance prices so companies can borrow against collateral from anticipated incentives to begin investing immediately in energy efficiency. States could make a similar play to get started on energy efficiency investments now by borrowing against future performance-based federal efficiency incentives.

Some have argued for a carbon tax over a cap-and-trade system. In fact, a cap-and-trade is more likely to reduce carbon emissions to safe levels than a carbon tax, since it fixes a hard, declining cap on emissions while allowing the price of emissions to float. A carbon tax, by contrast, sets an emissions price and lets the quantity of emissions float. The horse-trading involved in defining a cap centers on distributing a fixed number of

allowances—with equity and productivity implications but no impact on future emissions levels. In contrast, negotiations to define a carbon tax might result in a tax schedule too conservative to clean up the economy, possibly including loopholes protecting key sectors—as happened with various Scandinavian carbon taxes.

Climate legislation can also help restore America's innovation edge. No company wants to make high-risk investments to develop or deploy complex new energy systems when much of the costly learning-by-doing will spill over to benefit fast-followers. Thus, we need to at least double federal clean-energy R&D while also offering stable federal *deployment* support for broad technology categories such as solar photovoltaic power and geothermal energy. Crucially, this support must phase out as each technology gains market share in order to force cost reductions and safeguard public funds.

Similarly, smart climate legislation would directly encourage investment in energy efficiency. Consumers and businesses routinely neglect cost-saving energy-efficiency opportunities because of market barriers such as split incentives between building owners, who choose equipment based on installed cost, and tenants who pay ongoing utility bills. We should, of course, tighten efficiency standards aggressively, but climate legislation must also include incentives for appliance manufacturers, building owners, and vehicle makers to beat these minimum standards. Federal funds should flow to states that demonstrate rapid energy-efficiency improvements through better building codes, regulations that encourage utilities to help customers reduce energy consumption, and other state-level initiatives.

Finally, we should take advantage of low-cost abatement potential in forestry and agriculture – sectors unlikely to be included under an emissions cap. For example, climate legislation could immediately fund reforestation efforts on degraded land to create jobs while expanding the nation's carbon "sink"—nature's way of sequestering carbon.

This multi-part cap-and-invest strategy would allow the United States to move toward a clean, secure economy at negligible net cost, since the benefits of energy efficiency (including lower fossil-fuel prices) would roughly offset the cost of cleaning up our remaining energy supply and expanding our carbon sink.

An increasingly tax-neutral approach clearly makes sense in the long-term, but a portion of funds from auctioning emissions allowances should initially be used for incentives to overcome economic barriers to energy efficiency (such as rewarding states and industries that demonstrate progress in energy efficiency) and bring emerging clean energy technologies (such as solar power) to cost-effective scale. As these intermediate goals

are achieved, a growing share of emissions-related funds should be returned to consumers and taxpayers.

The time has come for the United States to lead the fight against global warming at home and abroad. America is still the world's leading innovator, and many U.S. businesses are starting to recognize the profit potential of clean-energy alternatives. With forceful federal legislation and global negotiations, our nation can transform itself from taxpayer-subsidized financial engineering to real investment in a new energy economy that restores economic growth while protecting the planet and permanently breaking the power of OPEC.

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