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CLIMATE: ACCF's **Margo Thorning** says Lieberman-Warner bill catastrophic for U.S. economy

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As the Lieberman-Warner climate bill makes its way through the Senate Environment and Public Works Committee, which aspects of the bill will be contested and require compromise? During today's OnPoint, **Margo Thorning**, senior vice president and chief economist at the American Council for Capital Formation, explains why she believes this bill does not account for the economic security of the United States. She says a carbon tax would be a better option, economically, for the United States. Thorning also discusses the upcoming international climate talks in Bali, saying the United States should stay focused on the "major economies" plan established last month. She also explains why binding targets would not work and gives her take on the success of the Kyoto Protocol.

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Monica Trauzzi: Welcome to OnPoint. I'm Monica Trauzzi. Joining me today is **Margo Thorning**, senior vice president and chief economist with the American Council for Capital Formation. Margo, thanks for coming on the show.

Margo Thorning: My pleasure.

Monica Trauzzi: Margo, the Lieberman-Warner climate bill is getting a lot of attention on the Hill and it's set to be marked up in a Senate EPW subcommittee this week. It's expected to make it to the full committee and it's being touted as sort of a middle ground out of all the climate proposals that we've been hearing about on the Hill. You've said that it could be devastating to the U.S. economy, explain why you think that this is not the way to go.

Margo Thorning: I think Senator Lieberman and Warner are to be commended for their efforts to reduce greenhouse gas emissions, because I think we're all united that that's a goal we need to put a lot of resources into. My concern about the Lieberman-Warner bill is that it would require an emission reduction of about 3 percent a year, a 3 percent a year reduction in CO2. The best we've ever been able to do, which was last year, was a 1.3 percent reduction. I think your viewers would be surprised to know that the U.S. actually did reduce CO2 emissions by 1.3 percent in 2006, compared to 2005. And we used 0.9 percent less energy under a voluntary approach, but to try to triple that, especially given our projected population growth. We are expected to have about a 7 percent increase in

U.S. population between 2005 and 2012. Each new person requires a bit more energy. So putting mandatory caps which would require a threefold increase in emission reductions is bound to reduce GDP and net job growth. Previous analysis of other bills that required similar reductions in CO2 emissions suggest that we could see a 1 to 2 percent reduction in the level of GDP by 2012 and perhaps 750,000 to a million fewer jobs. So I have concerns about this cap and trade approach and I think that there are better alternatives.

Monica Trauzzi: But wouldn't things like energy efficiency and technological advancements help us get to that 3 percent point?

Margo Thorning: All the research I've seen suggests that technology is the key to reducing greenhouse gas emissions, but it's not going to be available on the scale we need by 2012 or even 2015. Renewables will probably play a slightly larger role, over time, in emission reductions, but the International Energy Agency in Paris shows that even by 2030 global use of renewables will only be about 8 percent versus 6 to 7 percent right now. So the technology we need to quickly phase-out CO2 emissions is not available. Carbon capture and storage is critical and it's not available yet. So we need time to gradually work toward those types of sharp cutbacks.

Monica Trauzzi: One of the bill's ideas is to set up a financial board of sorts that would oversee the new greenhouse gas market. What's your take on setting up a board of regulators?

Margo Thorning: I think the idea of expecting regulators to know what the price of carbon should be is probably not very well grounded. It does serve as a backstop in that I assume if prices got so high that producers and households were experiencing severe economic pain they could say, well, just go ahead and emit. But it creates uncertainty, because for someone trying to invest in new equipment, if they don't know what the price of carbon will be, that adds to the risk of the investment. That's the problem with a cap-and-trade system and that's what's happening in Europe. Investors don't know what the price of carbon will be from one month to the next or one year to the next and it's been very volatile. So that makes the cost of capital higher, investment more uncertain, and produces less investment. An advantage of a carbon tax, if you want to impose some sort of penalty on carbon use, is that an investor knows, given the projected say set of increases in carbon prices from one year to the next, he knows what the carbon price will be and he can factor that in to what kind of capital equipment he buys, what sort of transport fleet he puts in place, and it provides more certainty. And it also, a carbon tax, provides a stream of revenue for the government to spend on new technology or to pay for offsetting the burden on low income individuals of higher energy prices.

Monica Trauzzi: So, if you were given the opportunity to sort of write your own proposal of how the U.S. should reduce emissions and not hurt itself economically, you'd go with the carbon tax?

Margo Thorning: I would go with the carbon tax and more incentives for new technology development. And I would change the U.S. tax code, because we have the

slowest depreciation allowances for new energy investment of 12 countries that we compared recently. We have very high capital costs for new investment because depreciation is so slow and our effective tax rate is very high, because our corporate tax rate is the highest in the industrial world. So our companies are disadvantaged vis-à-vis our trading partners because of our tax system.

Monica Trauzzi: So, if a cap and trade is not the way to go as you're saying, why has the business community come out in support of a cap and trade?

Margo Thorning: Well, a significant portion of the business community would prefer a carbon tax and there's beginning to be more discussion about that. So I think one reason some in the business community have supported a cap and trade is they expect to make money on it. They've maybe made emission reductions or expect to be able to make emission reductions. They expect to be winners. On the other hand, new companies or companies that are expanding that need more credits will be losers. So the winners under a cap-and-trade system, as is for example in Europe, the big electric utilities have been winners because they've been able to pass forward to consumers the price of the carbon credit even though they were given those credits by the government. So people who expect to make money on it naturally are supportive.

Monica Trauzzi: And you spoke about the job market and the effect that cap and trade could have on jobs. There's a lot of talk about the green collar job market recently and the amount of growth that could happen in that market if we were to switch to a more sustainable means. So your take on the green collar job market, is it too much hype?

Margo Thorning: I think it's not well grounded because what happens when you try to shift people into what's called green jobs is they move out of jobs where perhaps they were more productive, energy prices were lower. You're shifting them into jobs using higher-priced production processes and higher-priced energy. That's why all the simulations, all the macro economic analyses that we've seen over the past decade, they factor into those, that there will be green jobs created. There will be more people working on renewables, producing windmills, parts for windmills, solar panels, etc. But on balance, those people are not as productive as some of the activities that they were pulled out of. So our net economic growth is slower than it would have been otherwise because we made our capital stock prematurely obsolete.

Monica Trauzzi: What about in the inner cities where there's a high incidence of unemployment and we're seeing all these different programs, such as Majora Carter in the South Bronx, trying to push green collar jobs because the people in their communities are unemployed. They don't have any jobs.

Margo Thorning: Well, that takes resources. Taxpayers have to pay for that, so it's coming out of somebody's paycheck. It's coming out of the people who are employed to make these jobs. The most productive way to employ unemployed people is to find jobs where their productivity can be high and where they don't need large subsidies from the taxpayer.

Monica Trauzzi: Democrats are clearly trying to make some progress on the climate issue before the Bali talks that are set for December. Barbara Boxer has said she'd like to get Lieberman-Warner before the full committee before she leaves for Bali. Essentially, they want to show the world that the U.S. is in fact ready to act. So how much of an impact do you think getting this bill to the committee and then eventually to the floor is going to have on the international community?

Margo Thorning: I'm not sure it will have a large impact because, as sophisticated members of the international community know, it's not enough to get it to the floor. You have to actually get it passed and then what about the threat of a presidential veto? I think what people in the international community are beginning to focus on is the fact that each country's situation is different and what may be appropriate for one country or what their citizens may choose to support may be different. And it may be that we can move toward the common goal of globally reducing CO2 emissions by letting each country adopt the strategies and set targets for itself that are most appropriate for its own economy, whether that's energy intensity reduction, adaptation, development of new technologies, and so forth.

Monica Trauzzi: So do you think that the current way that the international community is approaching a post-2012 agreement is wrong? Should we be approaching it differently?

Margo Thorning: I think the initiative, the major economies initiative that the U.S. administration in conjunction with 16 other large industrial emitters, in fact, these 16 countries constitute 85 percent of all greenhouse gas emissions in the world. This approach that they're taking to try to focus on common strategies for technology development, for reducing the barriers to technology transfer, as well as adaptation, mitigation, and climate science. That approach, I think, ultimately will yield a better result because it doesn't put unachievable targets in front of people that impose severe economic pain. One of the things that we looked at over the last year or two is what difference would it make in China and India in terms of their emissions if they had even U.S. level technologies? And we released a study last year in Asia and in Europe, that examined the impact, we quantified the impact on greenhouse gas reduction in China and India if they had access even to U.S. level technology, which is not as efficient even as Japanese. And we found that if they had our best equipment for transport and industrial production and residential building and commercial building, their greenhouse gas emission reductions would be equal to those that would have been achieved by the Kyoto Protocol if all 39 signatories to that protocol achieved their target. And of course, as we all know, they're not going to achieve their target.

Monica Trauzzi: There's still in huge support though for a binding agreement to be discussed in Bali and then further discussed as we move on towards 2009. So if you were advising the Bush administration and the U.S. on how to approach the Bali talks where there are going to be some differences on how to approach 2012, what would you tell them? What should they be focusing on and what compromises might they need to make?

Margo Thorning: Well, I think binding targets are probably, and from all I understand about the 16 major emitters, they prefer not to have binding targets because people understand that economic growth requires energy use. And so they don't want to have their national priorities compromised by binding targets. And the industrialized countries don't have enough money to pay the developing countries to completely change their energy production system. So we need, I think, to focus on how to get better technology developed, how to use more nuclear power, how to burn coal more cleanly, better, more efficient buildings of all types. We need to focus on these kinds of strategies rather than trying to compose an international target that no one can enforce. We don't have any international police that are going to go into China and say, uh-oh, you are emitting more than you're supposed to. We're going to rap your knuckles. We just can't do that. We need to provide the means for the countries to have more energy, cleaner energy, without unnecessarily impinging on their economic growth.

Monica Trauzzi: All right. We'll end it right there. Thanks for coming on the show.

Margo Thorning: My pleasure.