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Obama compromise on carbon could cut revenues

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By Timothy Gardner - Analysis

NEW YORK (Reuters) - If the United States gives industry too many permits to emit greenhouse gases in a future climate regulation plan, it could cut revenues that had been expected to fund tax breaks and clean energy development.

President Barack Obama indicated to the Business Roundtable on Thursday he had some flexibility in making carbon emitters -- like coal-fired power plants, cement makers and oil refineries -- buy all of the permits in any cap-and-trade emissions plan

"If it's so onerous that people can't meet it, then it defeats the purpose and politically we can't get it done anyway, so we're going to have to find a structure that arrives at that right balance," Obama said late Thursday.

Giving any permits away, instead of selling them all to industry in an auction, would represent a shift in Obama's carbon regulation policy.

During last year's presidential campaign Obama said his climate plan was better than opponent Senator John McCain's because it would make polluters buy all of their permits, which would quickly put a price on emissions and raise funds for clean energy and tax breaks for Americans to transition to such technologies.

In a cap-and-trade market, industry is required to hold a credit for every ton they emit. Backers say such markets push polluters to invest in cutting emissions to avoid having to buy the permits as the cap on pollution goes down over time.

Obama's budget released last month estimated the government would receive \$646 billion from 2012 to 2019 from a program that auctioned 100 percent of the emissions permits. The revenue would fund \$150 billion in clean energy investments over 10 years and a tax credit to help Americans make the transition to a low-carbon economy.

"I think that number will have to be reduced," Divya Reddy, a Washington-based energy analyst at the Eurasia Group, said about the \$646 billion figure. "It's based on the premise that 100 percent of these would be auctioned."

Peter Fusaro, the chairman expert at New York-based Global Change Associates, said giving away some of the permits to industry instead of auctioning them all off could cut revenues to research and development of technologies like carbon capture and storage from coal plants.

That could lead to greater dependence on energy efficiency to cut emissions, "which is important but not the only element we are trying to achieve in a greener economy," Fusaro said.

REVENUE HOLE

Experts said a compromise on the auctions was inevitable as Obama's climate plan could increase costs for companies and consumers during the worst economic crisis since the 1930s.

Reddy said full auctioning was "largely unrealistic" especially in the plan's early years because it would face a fight from industry and politicians in areas of the country like the Midwest and Southeast that are more reliant on coal, the fuel that emits more carbon dioxide than any other.

"Big coal is very strong and there's going to be some kind of accommodation," said Fusaro.

To be sure, Obama could still reach the \$646 billion number if the plan was carried out carefully, said Dallas Burtraw, a senior fellow at the Washington-based think tank Resources for the Future.

The Obama budget based the revenues on an estimate of carbon permits hitting well below \$20 per ton and Burtraw and others said that number was conservative.

But relying on the carbon prices could be tricky especially as they can be moved by things like volatile oil prices.

Obama indicated to the Roundtable that giving away too many allocations can be too much of a good thing. "If you're giving away carbon permits for free, then basically you're not really pricing the thing and it doesn't work, or people can game the system in so many ways that it's not creating the incentive structures we're looking for," he said.

An administration official told Reuters on Friday that the budget proposal had not changed.

Fusaro expected Obama's plan would auction about 50 percent of the permits beginning in 2012 and then quickly move to higher levels. That would be more than the amount offered in last year's main climate bill that died in the Senate.

"He can't give too many of them away or he's got a revenue hole in 2012," said Fusaro.

(Editing by Christian Wiessner)

(Additional reporting by Jeff Mason in Washington)

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