

[Cap and trade and carbon taxes](#) [1]

Written by [Tim Worstall](#) [2] | Sunday 14 September 2008



Much as it pains me to say so, Oliver Tickell has a [good piece](#) [3] in *The Guardian* on the subject of carbon taxes and cap and trade systems. If we start from the point that climate change is happening and that we're causing it (not accepted by everyone I know, but let's just start from there shall we?) then obviously we will want to get those costs of emissions, currently not accounted for in market prices, accounted for in market prices.

We can do this in one of two ways, by issuing permits that allow emissions, or simply by adding a tax to carbon (more accurately, carbon dioxide equivalent or CO₂-e) emissions. Under the EU's emissions trading system we've been shuffled into the former solution. Now this might seem a little odd, someone here arguing against what looks like the more market based solution. But cap and trade is the wrong one of the two to choose.

As Tickell points out, only a small fraction (under 10%) of these permits are in fact auctioned. Most are simply given away. The companies that receive them, most especially those that receive an excess over their needs can thus sell them. Yes, of course, this does indeed help to reduce emissions for incentives do indeed matter. But this give away is also corporate pork, a subsidy to those lucky firms. Given that allocations are based upon past emissions, it's also a subsidy to incumbents, a barrier to new entrants into the markets. Further, a subsidy in the future to those who have not as yet cut emissions from already available technology unlike some competitors. So we've got a problem in the implementation of the plan.

But more than that, we've also got a conceptual problem. With cap and trade we can set the amount of emissions but we don't know what that limit will cost us. With a carbon tax we can set the price but not the level of emissions. If the tax and the permit prices are the same then of course so will emissions be the same. If we're to be honest though, we don't actually want to set the emissions, we want to set the cost of them. As explained [here](#) [4], we only want to pay up to the amount that emissions will cost us to reduce emissions. We certainly don't want to pay more than that future cost. Thus the carbon tax method, the method that allows us to set the price, is the better one.

We can be thankful of course that everyone in the (serious part of the) debate is advocating more or less market based methods, rather than say legislating standards or technologies, but it is something of a pity that of the two major contenders we seem to be rushing headlong into adopting the wrong one.

[blog comments powered by Disqus](#) [6]

Links:

[1] <http://www.adamsmith.org/blog/environment/cap-and-trade-and-carbon-taxes>

[2] <http://www.adamsmith.org/taxonomy/term/5778>

[3] <http://www.guardian.co.uk/commentisfree/2008/sep/12/carbonemissions.climatechange>

[4] <http://bluematter.blogspot.com/2008/09/on-externalities-and-pigouvian-taxation.html>

[5] http://disqus.com/?ref_noscript

[6] <http://disqus.com>