

Economic Aspects of Permit Auctioning and Revenue Recycling

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Preview of Key Take-Home Messages

- Auctioning Permits has economic, fiscal, equity and competitive advantages.
- Recycling auction revenues through targeted tax cuts markedly improves the economic impacts of a cap-and-trade system.
- So doing could improve economic performance whatever the effects on climate change

The Economic Case for Auctioning Permits

- Auctioning permits raises considerable revenue that can be used to offset negative economic impacts.
 - As would a comparable carbon tax
- Auctioning avoids the regressive equity effects of “grandfathering”
 - Which awards emitters valuable assets but passes costs along to consumers
- Auctioning creates a level playing field for incumbents and new entrants

What are the “negative economic impacts” that should be offset?

- Whether auctioned or grandfathered, caps cause higher energy prices that raise costs for consumers and investors.
- Those higher costs act like surcharges on existing payroll, income and profits taxes.
 - These taxes already distort labor and capital markets. Surcharges make distortions worse.
- In early years, these tax effects have larger impacts than the abatement costs.

How can revenue recycling offset these impacts?

- Using revenues to cut marginal tax rates will reduce distortions in labor and capital markets.
 - “Lump-sum” checks to every household won’t do that.
- Cutting marginal tax rates offsets the implicit surcharges imposed by higher energy prices.
- Compared to free allocation, which produces no revenue, or “lump-sum” distribution, which corrects no distortions, revenue recycling greatly improves economic performance.

How large an improvement might there be?

- According to macro-economic models, revenue recycling could add a trillion dollars to GDP by 2030
 - through a higher growth rate over 20 years.
 - Compared to not recycling revenues
- This is in addition to the benefits of reducing greenhouse gas emissions.

Can there be a “Double Dividend”?

- A “double dividend” means that economic performance improves if auction revenues replace other tax revenues, whatever the effects on climate.
- A double dividend is likely if other taxes are more distorting than energy taxes are.
 - The more tax avoidance is possible, the more distortion a tax creates
- Many economic studies find that a double dividend is likely.

What about other Uses of Auction Revenues?

- Better ideas:
 - Support for advanced energy R&D
 - Deficit reduction
- Worse ideas:
 - Low-income energy assistance programs
 - “transition assistance” to energy industries