



Putting a Price on CO<sub>2</sub> Emissions  
Alternative Approaches to Pricing  
and Use of Revenues

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## Approaches to Putting A Price on CO<sub>2</sub>

### Cap and trade

- Volatile and uncertain carbon prices
- Uncertain costs to the economy and consumers
- Rigid emissions budget, unless costs become politically unsustainable

### Linked fee – adjusted annually based on past year average price

- Eliminates CO<sub>2</sub> price volatility for transportation fuel users
- Eliminates effects of oil market shocks on CO<sub>2</sub> prices in capped sectors
- Provides more effective long run incentives than cap and trade

### Price collar with cap and trade

- Reduces volatility and uncertainty of prices and costs
- Emission reductions less certain but location of collar can be adjusted

### Carbon tax

- Price volatility removed completely
- Year by year emission reductions are uncertain but long term goals can be achieved with high confidence

## Issues and Observations

### **CO<sub>2</sub> price volatility serves no useful purpose**

- Stable and predictable prices provide a stronger incentive for long term investments

### **Reserve Funds have not worked in other commodities**

- The only sure way to set a price collar is giving the Administrator unlimited authority to buy at the floor price and sell at the ceiling

### **If you are confident in estimates of a particular CO<sub>2</sub> price with cap and trade, then you can be equally confident**

- A carbon tax at that level will achieve the stated goals
- A price collar around that level will achieve the stated goals

### **No system can make emission reductions certain, but setting a price rather than a cap can make unpleasant surprises less likely**

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## Uses of Funds

### **Two principles to avoid wasteful expenditures**

#### **Public Finance**

- Revenues go into the general fund
- Programs compete on their merits for funding

#### **Economics of taxation**

- Taxes should be designed to provide needed revenues with the least excess burden
- Using CO<sub>2</sub> revenues to avoid increasing marginal tax rates on businesses and households provides the greatest economic benefits
- Direct rebates to households are the next best alternative

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