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The Bait-And-Switch On Cap-And-Trade

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President Obama's speech to the nation last week about the oil spill in the Gulf of Mexico followed a predictable script. Whenever a problem confronts this administration, the president's answer is sure to include one of a trio of his 2008 campaign initiatives: health care reform, action to address climate change or education reform.

Obama claimed in 2008, for instance, that these long-term, slowly acting changes were a fix for a temporary downturn in the economy. Now, in an even greater leap of logic, he contends that the 1,427-page Waxman-Markey bill (which addresses climate change) is the proper response to the oil spill.

Obama's advocacy of this bill exemplifies the incoherence and dishonesty of our present debate about energy policy. Two distinct problems — those associated with oil imports and those associated with greenhouse gas emissions — are treated as if they were one and the same.

At a minimum, those alleged problems have wildly different causes necessitating equally different responses. If we fear oil imports, we should tax foreign oil or administratively restrict imports. If we fear greenhouse gas emissions, we should tax those emissions or administratively restrict their release.

Those direct responses will by definition increase the price of gasoline in the first case and all forms of fossil fuels to varying degrees in the second. The more "progress" we wish to achieve in the course of our pursuit of "energy independence" or a carbon-free energy economy, the larger the price increases will have to be.

The president eschews direct confrontation with these alleged menaces because the public has little stomach for major, sustained increases in energy prices, particularly when the economy is ailing and gasoline prices are at historically rather high levels.

So he followed the established but failed practice of proposing complex, indirect remedies that aim to hide costs from consumers (and thus, voters). At best, this political sleight-of-hand makes import reductions and emission controls far more costly to achieve than would otherwise be the case. Economic harm is the more likely outcome.

Regardless, the animus toward foreign oil is unjustified. Historically, domestic energy producers have claimed that foreign suppliers are unreliable in order to restrict competition. Unfortunately, those arguments are readily embraced by the economically gullible.

Given the large number of suppliers and low transportation costs, a loss of supply from any one source can be relatively easily answered by buying from another. Fears of coordinated producer blackmail run aground on the fact that suppliers need us far more than we need them. That's because the typical oil-exporting country is undiversified and a loss of oil revenue would destroy its economy. An oil supply disruption, however, would do far less damage to industrialized importers.

Similarly, if greenhouse gas emissions are a problem (and it is not altogether clear that they are), direct control of greenhouse-gas emissions is preferable to a complex set of rules. Economists dealing with these issues recognize that, in principle, either a carbon tax or a pure allocation of emission rights (popularly termed cap-and-trade) would work best.

Many prefer a simple tax because experience with quota systems proves that difficult problems arise regarding how to allocate the initial rights to emit. Regardless, even fervent supporters of action have long recognized that U.S. emission reductions were futile unless China and

India also acted. Otherwise, warming will scarcely be affected.

Unfortunately, there is little reason to believe that U.S. action will prompt similar action in those states.

Waxman-Markey, despite its own and the president's suggestions to the contrary, is predominantly a greenhouse-gas control measure. It works on imports very indirectly (and very minimally) by attempting a long-term re-engineering of the car.

More importantly, the bill imposes a convoluted cap-and-trade program with every conceivable problem that might be imagined with such programs.

Exceptions are provided for politically well-connected industries. Permits are first given away and then subsequently auctioned with the funds to be used to underwrite various inefficient corporate subsidies, a regime so complicated and convoluted that the relevant provisions constitute over half of the sprawling bill. They are preceded by many pages dictating how electricity is to be generated and what fuels shall be used.

In sum, even accepting that there is a problem to solve, the bill's dictates violate virtually everything that economists know about designing an efficient environmental policy.

Would the Gulf spill have been any less damaging or any less likely to occur had Waxman-Markey been passed, say, 10 or 20 years ago? Of course not. No matter what one thinks about the merits of the bill, it would not have reduced the profits associated with oil production enough to have deterred investment in the deep waters of the Gulf.

Nor would it have changed any of the decisions made by BP officials on the Deepwater Horizon platform or any of the BP management practices that allegedly made an accident more likely.

In short, the president's speech to the nation was a classic political bait-and-switch maneuver that, unfortunately, errs not only by embracing make-believe solutions but bad make-believe solutions at that.

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