

Though the budget released yesterday by the Obama Administration was short on details, it was long on big pronouncements that fundamentally shift federal policy in important areas. On the climate change front, the budget for the first time reveals the administration's thinking on how it would distribute money raised from allowances issued under a proposed cap and trade scheme to regulate carbon emissions. Obama's priorities on climate change are welcome news — aggressively capping greenhouse gas emissions, expanding spending on energy programs, encouraging research on a range of promising technologies and working to expand and upgrade energy transmission lines are crucial elements of a comprehensive policy. The administration's plan to distribute cap and trade auction revenue also may have two significant virtues: incorporating progressive tax policy with progressive relief for energy consumers who will face price increases as cap and trade pushes energy prices upward.

It isn't news that a cap and trade scheme is likely to raise energy prices and to disproportionately affect states that depend heavily on coal (principally in the midwest and southeast). But what hasn't been emphasized is the wildly different effects a cap and trade scheme will have on individual consumers depending on their income levels and on where they live. The Obama plan, whether intentionally or not, manages to take these disparities into account by using auction revenue to extend an across the board refundable tax credit. Before explaining, here are the basics:

Obama has embraced — as he did during the campaign — a cap and trade program to regulate carbon dioxide and other greenhouse gas (GHG) emissions that scientists believe with near certainty are warming the planet. Under the program, the U.S. would cap the total amount of GHGs that can be emitted from numerous sources throughout the economy. In order to enforce the cap, GHG emitters (utilities, manufacturing facilities, etc.) would need one allowance or credit for every ton of GHGs they emit. Obama's plan now makes clear that these allowances will be auctioned rather than given away. That means that current emitters will need to pay for the right to emit GHGs. No one knows exactly how much money would be raised from an auction because it's not clear how much an allowance would sell for. In the European Union, which has a similar scheme, [recent allowance prices have ranged from \\$13/ton to as high as \\$38/ton](#).

Regardless of the price, auctioning allowances will produce a lot of money, at least \$79 billion in 2012, according to the Obama administration ([Table S-2 of the "A New Era of Responsibility" Summary Tables](#)). So, what to do with all the money?

Obama [proposes](#) to direct \$15 billion annually to investments in clean energy. The remaining revenues will be used to fund the Dedicated to Making Work Pay tax credit. This credit provides a refundable income tax credit of \$400 per worker, phased out as income

increases.

The Obama plan is extremely smart politically. Tying stringent regulation of GHG emissions to tax relief makes the medicine much easier to swallow. It has another major virtue as well.

Climate policy may have quite regressive effects for energy consumers (regressivity means here that energy price increases as a result of cap and trade policy will impose a greater burden on lower income households than higher ones relative to their resources). In an extremely interesting [report](#), Resources for the Future economists Dallas Burtraw, Rich Sweeney and Margaret Walls analyze how a cap and trade scheme and resulting auction revenues would affect energy consumers across the country. They also analyse how to offset the regressivity of resulting energy price increases. The RFF authors conclude that the most *regressive* way to spend auction revenues is to reduce income taxes. By contrast, the most *progressive* spending program would expand the Earned Income Tax Credit.

Though Obama doesn't propose an increase in the EITC, as it is known, his refundable tax credit shares some of the same virtues. We don't yet know whether the Dedicated to Making Work Pay tax credit would fully offset the regressivity of energy price increases and it may be that too much of the tax relief is targeted at higher income levels that can absorb energy price increases more easily ([the full credit is available to couples making \\$150,000 or less](#)). But Obama might be calculating that he's likely to get more political support for climate policy by providing middle class tax relief with the auction revenue.