Eakinomics: Is the CLEAN Future Act Good Economic Policy?

Ewelina Czapla has a nice description of the Clean Electricity Standard (CES) embedded in the Climate Leadership and Environmental Action for our Nation’s (CLEAN) Future Act introduced by the House Energy and Commerce Committee Democrats. The CES is intended to reach zero greenhouse gas emissions in the electricity sector by 2035, while the goal of CLEAN as a whole is zero net emissions by 2050 throughout the economy.

As a general matter, a CES is typically a requirement that a certain percentage of utility sales be met through “clean” (zero- or low-carbon) sources such as renewables, nuclear energy, coal or natural gas fitted with carbon capture, and other (as-yet-not-in-existence) technologies. When viewed from this perspective, the CES appears to be another heavy-handed regulatory approach to reaching a policy goal. As AAF has documented, the regulatory approach is typically (very, very) much more expensive than a price-based approach such as a carbon tax. The carbon tax provides natural incentives to conserve (use less), switch to cleaner products, innovate to eliminate the need for carbon, and so forth. Price-based approaches allow for climate objectives to coexist with growth aspirations. Indeed, an efficient, revenue-neutral carbon tax that used the resulting revenues to lower tax on the return to capital and labor should have no impact on growth at all.

But not so fast! It turns out the CLEAN version of the CES allows for credit trading. Credit trading transforms a purely regulatory fiat (20 percent from zero-emissions sources in 2025 or else!) to a system with price incentives. Here, in simple terms, is how. Each year the federal government would award to generators of electricity credits equal to the fraction of power generated with zero-emissions technologies. They would pass long the credits to their utility customers in proportion to their purchases. At the end of each year, the utilities that purchased their power would be required to turn in to the government credits equal to the standard for that year.

Now, suppose my utility bought its power from exclusively carbon sources and got no credits as a result. It will need to come up with credits for 20 percent of its power. If the system as a whole is in compliance, that means someone else has more credit than they need, perhaps a lot more. My utility can simply buy them. But as the CES standard tightens, it will be harder and harder to find people with excess credits, and the price of credits will rise. That effectively makes my “dirty” power much more expensive and I will want to find some other source. At the same time, it will be a cash source for clean generators; they will want to invest in more (and cleaner) sources that give them credits to sell.
In the process, the price incentives for shifting to cleaner sources, investing in cleaner technologies, and innovating new technologies have been introduced. If implemented effectively, it can be consistent with good growth policy. The catch, as Czapla points out, is that the technologies that would permit the aggregate standard to be met do not yet exist. Until they do, there is no amount of re-arranging the credit deck chairs that is feasible, and problems will ensue.

The climate debate has just begun in earnest, and many more proposals will be forthcoming. It will be important to ensure that the climate incentives continue to be aligned with the need for economic growth.