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Goldman Scandal Erodes Case For Cap and Trade

By Robert J. Shapiro and Elaine C. Kamarck

All of us who care about climate change must ask ourselves the following question: Given what we've learned in the past few years -- and especially in the past few weeks -- about how Wall Street operates, do we really want to entrust it with the fate of the planet?

That's just what cap-and-trade proposals aim to do, including the latest version from Senators Kerry and Lieberman. Progressives and conservatives alike must move beyond the emissions trading model and join in promoting a straight-forward, transparent carbon tax that also will rebate its revenues through other tax cuts.

It's a given that the handful of Wall Street firms that now dominate our financial markets would manage a cap and trade "market" in carbon-emissions permits to maximize their own profits. Now we know that they will do just about anything in their pursuit of profits, even misleading their own clients or betting against them. That's the essence of the SEC's recent suit against Goldman Sachs: It alleges that Wall Street's premiere firm permitted one of its major clients, whose business revolved around betting on a declining market, to design a package of securities which Goldman then sold to other clients with assurances that it would rise in value.

Moreover, while Goldman Sachs was pushing these and other mortgage-backed security packages on many of its clients, it too bet against the same market. Even if a court fails to find these various machinations illegal, they reveal the deceptive practices that now pervade many of our markets.

Once we recognize the market's vulnerability to such abuses -- not to speak of outright manipulation -- what justification can there be to entrust the same Wall Street traders with the

operations of a national climate program? Yet, that's just what we would do by enacting a cap and trade system, one quickly capitalized by Congress with $2 trillion in new carbon-emission securities and just as quickly exposing the American economy and people to new financial risks.

Happily, policymakers are not entirely oblivious to these risks. Last week, for example, the Senate Agriculture Committee passed derivatives legislation that would establish a "working group" of eight agencies, including the CFTC, SEC, and EPA, to study "the oversight of existing and prospective carbon markets."

But does Washington really believe that regulators could effectively oversee a new carbon market, when we are just beginning to figure out how to regulate the complex mortgage-based securities and derivatives that brought down the financial system in 2008? The European Union, which for several years has experimented with an "Emissions Trading Scheme" based on cap and trade, hasn't managed it. Evidence shows that this European system has already experienced extreme volatility in its permit and energy prices and significant cases of market manipulation.

It's not surprising that despite these costs, the experiment also has failed to reduce European greenhouse gas emissions. Price volatility and regular market abuses undermine the incentives for businesses to develop more climate-friendly fuels and technologies or for everyone else to adopt them. And without those new, climate-friendly fuels and technologies, we will simply fail to create an enduring "green" economy.

The best policy -- in fact, the only sensible one -- is to establish a clear and stable price on carbon and offset the resulting costs for American households with tax cuts. For these reasons, a straight forward carbon-based tax has long been the preferred solution among many economists and environmentalists.

While only Wall Street traders will truly appreciate how cap and trade operates, everyone will understand the mechanics of a transparent, carbon-based fee. That will be good news for families trying to budget and for businesses calculating the potential returns from large, new investments. By recycling the revenues back to citizens, through reductions in other taxes, the carbon-based fee can protect overall demand in the economy.

And we won't have to trust the fate of our climate to the people who brought us credit default swaps and the most serious financial meltdown in 80 years.

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