Viewpoints: Suggestions for improving cap-and-trade program here

Share
By Robert F. Lawrence
Special to The Bee
Published: Thursday, Dec. 30, 2010 - 12:00 am | Page 13A

The California Air Resources Board's new "cap-and-trade" regulation would limit greenhouse gases at unnecessary expense. The goal, articulated in AB 32, the Global Warming Solutions Act, is to reduce greenhouse gas emissions to 1990 levels by 2020.

While the new regulation has been applauded by Gov. Arnold Schwarzenegger, environmentalists and electric utilities, and survived Proposition 23, the likely impacts of the program have not been publicized.

Cap-and-trade is based on a simple concept. A cap-and-trade program establishes a cap on specific environmental impacts, and then allows the regulated community to trade the resulting "rights" to pollute. If done correctly, cap-and-trade harnesses private-sector incentives and funnels resources to the entities that can most cost-effectively reduce pollution.

Cap-and-trade programs have been used successfully to reduce pollution, without significant economic damage to regulated communities. In 1990, the United States established a federal cap-and-trade program for sulfur dioxide emissions that did not immediately impose a limiting cap, but instead phased in reductions in emissions after five years for large emitters and in 10 years for all other regulated entities. The program achieved better-than-hoped-for success, at a cost less than "command and control" alternatives.

California's program does not follow this successful model. ARB's cap will reduce aggregate allowable greenhouse gas emissions beginning Jan. 1, 2012. This program denies businesses adequate time to make capital improvements and process changes.

Instead, the only option available to some businesses will be to reduce operations, unless they can pass along the allowance costs to their customers. Even if California businesses learn how to reduce emissions, the program will impose a minimum fee of at least $10 per metric ton (about 7 cents per kilowatt hour for gas-fired generation).

Under ARB's program, electric distribution utilities would receive allocations of allowances sufficient to cover all of their baseline electric distribution, but will establish the prices of the allowances by auction. Other regulated businesses would not receive allowance allocations, but would have to bid against utilities for the right to emit greenhouse gases. The highest bidder for the allowances would win the right to continue operating.

The problem with this plan is twofold. First, investor-owned utilities will be required to outbid any other person in the market. They must serve their electricity demand, and they will be able to pass the costs of compliance on to captive ratepayers through regulated (mandatory) rate increases. Other regulated entities compete with other businesses inside and outside the state, including internationally, and cannot pass through these costs. The utilities are therefore in a much better position to win the auctions.

Second, the proceeds of the allowance auctions will be used to rebate the electric utility ratepayers on a per capita basis. This means that the amounts paid by other energy users will be paid to electric utility ratepayers. Electric utility ratepayers will therefore be subsidized by other regulated businesses.

Not only does this plan allocate the costs of the program unevenly, but it also keeps electric rates lower than they would otherwise be. It therefore eliminates much of the "price signal" to electric ratepayers to reduce their demand. Over time, it is almost certain that electricity use will grow, and other fossil-based energy use in California will decline. In January 2015, this competition is extended to all fossil fuels, so that the electric utility sector will bid against suppliers of gasoline or propane, for example, in order to fund rebates to electricity customers.

ARB's program need not create these damaging impacts in order to successfully limit and reduce greenhouse gas emissions in California. A less damaging program would include the following elements:

• A higher cap initially, with a steeper decline in the cap during later years of the program. If the program is implemented with an initial cap that does not constrain business-as-usual operations, California businesses can prepare.

• A phase-in period of at least three to five years for cap reductions. If the aggregate cap were established at levels that took effect in three to five years, then California businesses could invest in options for compliance.

• Issue allowances for free. The program requires payments to electricity ratepayers instead of investments in conservation or technology. If the allowances are issued for free, the savings would be directly invested in emissions reductions.

© Copyright The Sacramento Bee. All rights reserved.