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Robert Lawrence: CARB diet bad for California economy

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The California Air Resources Board adopted last week a "cap-and-trade" program, beginning in 2012, to limit greenhouse gas emissions. The regulations are based on Assembly Bill 32, the Global Warming Solutions Act of 2006, and are intended to reduce greenhouse gas emissions to 1990 levels by 2020.

However, California's cap-and-trade program is little more than a complex tax that does not induce green energy investment and runs a serious risk of harm to California's economy.

Cap-and-trade can be a system for regulating environmental impacts in a manner that harnesses the incentives of private enterprise. Under cap-and-trade as originally developed, a governmental entity sets a "cap" on an industry's aggregate effect upon specific environmental resources, and it allows the regulated community to "trade" the rights to pollute. If done correctly, cap-and-trade funnels resources to the entities that can most effectively (and cheaply) cut pollution and eliminates governmental involvement in the regulated market.

The form of cap-and-trade adopted by CARB misses the mark on four key issues. First, successful cap-and-trade programs impose limits that are initially set *above* prevailing emissions levels. This approach avoids sudden economic shocks from a new regulatory system.

Second, cap-and-trade programs (and other regulatory programs) often provide three-to-five-year lead times before limitations kick in. This cushion allows the affected industries time to plan capital improvements and operating alternatives that reduce cost shock.

Third, the most successful cap-and-trade programs allocate allowances for free, not by auction. When the right to pollute is allocated for free, a value rises only in proportion to the need to cut emissions. As compliance costs increase, so does the incentive to invest in conservation or alternative energy.

Fourth, successful programs allow a relatively free market in trading the emissions allowances. This market allows rapid adjustments in prices of allowances to meet market changes, and directs revenue to finance lowest-cost pollution controls.

California's program gets these key points backward. First, it establishes an emissions cap that may be beneath current levels, then cuts it further over time.

Second, the program will be effective in just over one year, leaving essentially no time to install technological alternatives. The only option will be reduced operations.

Third, California will impose a minimum auction price of $10 per ton of greenhouse gas emission (based on carbon dioxide equivalents). This fee and the proceeds of the auction will be used by governments or utilities for public purposes, instead of being used by regulated entities to reduce emissions.

Fourth, all actions will be intermediated by governmental agencies. There is little price transparency, and no ability for the market to respond or efficiently allocate the costs based on market economics.

Utilities are bound to win the competition for allowances. They are required to serve their customers' demand for energy and are entitled to recover any costs for allowances through their ratepayers. The proceeds of allowances purchased by other types of regulated entities will be routed to utility ratepayers as well, implementing subsidies that are sure to encourage demand.

In contrast, the prices that industrial and commercial entities may charge are constrained by out-of-state competition, including international competition. Goods and services originating in California will become more expensive, and less competitive, as a result of greenhouse gas caps and trading.

By making the cap-and-trade program immediately effective, requiring auctions, setting minimum prices and allocating allowances to utilities, CARB will drive industry out of business or to other states.

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