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Viewpoints: Cap and trade should look to broader goals

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It is election season and no one is talking seriously about cap-and-trade programs for greenhouse gas emissions in the United States. Congress has not touched this issue since the Waxman-Markey national cap-and-trade program for greenhouse gases was killed in 2010.

President Barack Obama is pointing fingers at Republicans for originating the idea way back in the 1990s. And Mitt Romney now says he is opposed to it. Only the state of California is bucking this trend.

In a couple of weeks, California will hold its first auction for greenhouse gas allowances under the Global Warming Solutions Act, better known in California as AB 32. The goal of AB 32 is to reduce greenhouse gas emissions in California to 1990 levels by 2020. A potpourri of measures is being used to meet this goal, and one is a cap-and-trade program.

California has long been a leader in the design of environmental policies. It has the most stringent standards for gasoline in the United States, aggressive energy efficiency standards, and starting in January, will be the first state to require electricity suppliers, oil refineries, transportation fuel suppliers and other large consumers of fossil fuels to reduce their total greenhouse gas emissions through a cap-and-trade program.

No one should kid themselves: A California-only cap-and-trade program will not yield substantive environmental benefits. Worldwide greenhouse gas emissions are nearly 75 times greater than the greenhouse gas emissions attributable to the state of California.

In fact, the estimated increase in annual greenhouse gas emissions from China by 2020 swamps the cumulative reduction in greenhouse gas emissions expected under California's cap-and-trade program by nearly 20-to-1.

What, then, is the benefit of such a program? A California-only cap-and-trade program for greenhouse gas emissions can ultimately produce substantial environmental benefits if it can be leveraged into a regional or national program that eventually links with similar programs in other parts of the world.

In general, as the geographic scope of a market-based program that prices greenhouse gas emissions expands, the ability to have substantial environmental benefits likewise expands.

Therefore, California's governor and its Air Resources Board, which is charged with implementing the program, should focus on realizing these broader benefits down the road, rather than attempt to achieve sizable emissions reductions from state businesses in the near term.

Making the operation of the California market as transparent as possible to market participants, minimizing administrative costs of participation and identifying tangible instances where a carbon price caused firms subject to the cap to invest in greenhouse gas- reducing technologies will demonstrate to

the rest of the United States that a market-based approach is compatible with a vibrant and growing economy.

Focusing on achieving sizable emissions reductions from California entities through a complex market design with high administrative costs is likely to impose significant costs on the California economy with no compensating environmental or economic benefits. Maximizing the short-term pain to the California economy with virtually no environmental gain greatly increases the likelihood of a negative demonstration effect from the program.

The consequences of a negative demonstration effect should not be underestimated. Volatile or sky-high carbon prices, extensive litigation and accusations of manipulation of the market for allowances will do little to reinvigorate a national conversation on pricing greenhouse gas emissions.

As the cap-and-trade market is implemented, California policymakers should focus on ensuring a stable, yet modest, allowance price that yields observable investments in technologies to reduce greenhouse gas emissions. California should also avoid the temptation to set market rules that would prevent this market from being scaled to the national level or make it difficult to link with other cap-and-trade markets.

To maximize environmental benefits from the rollout of its cap-and-trade program for greenhouse gas emissions, California should focus on achieving a positive demonstration effect from the program by doing as little as possible to harm the state's economy, as transparently as possible and as fast as possible.

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