Opinion: Getting the facts straight on California's energy policy

By James Sweeney
Special to the Mercury News
Posted: 05/07/2010 03:47:12 PM PDT
Updated: 05/08/2010 07:56:11 PM PDT

California’s Global Warming Solutions Act (AB 32) is due to take effect early next year. The closer we are to implementing this historic legislation to curb emissions, the greater the intensity of the surrounding editorial commentary. Critics claim AB 32 is inflexible and would seriously harm California’s economy. The reality is quite different.

The law addresses climate change with flexibility. A central element of AB 32 is an emission trading system similar to the cap-and-trade program for acid rain enacted in 1990 during President George H.W. Bush’s administration. Under this approach, California sets the level of emission reductions but gives companies the flexibility to find low-cost ways to achieve reductions. In addition, companies can trade emissions permits; this promotes reductions by firms that accomplish reductions most efficiently. Numerous studies show that this approach allows overall emissions-reduction goals to be achieved at significantly lower cost than under conventional command and control.

AB 32 and other California climate efforts also include so-called "complementary policies," which are not market-based. These policies include a low-carbon fuel standard, a 33 percent renewable energy portfolio standard, utility-based energy efficiency programs, "smart growth" incentives for counties and cities, and automotive fuel efficiency standards. Critics claim these measures are costly. Some are. Yet, including many of these measures is likely to reduce costs of AB 32 compared with a policy that includes only cap-and-trade. This is because some complementary policies address important market failures that cap-and-trade cannot.

Critics claim AB 32 will harm California’s economy. A well-constructed study by Charles River Associates offers the most pessimistic results of all credible studies to date, yet the impacts predicted are small. CRA predicts that with AB 32, California’s economy will grow an average of 2.3 percent annually to 2020, compared with 2.4 percent annually in the absence of AB 32. In contrast, analysis by the California Air Resources Board shows smaller or approximately neutral impacts. University of California studies and a Brattle Group study show a neutral or minimal impact on the state’s economy.

Differences between the CRA and CARB impact estimates are driven by one key difference. CRA assumes no market failures. The assumption that California's economy is operating perfectly (except for the generation of greenhouse gas emissions) assures a conclusion that complementary policies have no useful role. In contrast, the CARB report assumes that market failures exist and therefore, cost-reductions through complementary policies are possible.

Given these differing assumptions, it’s no surprise that CRA estimates of AB 32 impacts are larger than
CARB estimates, although even with this difference, both show only very small overall economic impacts.

In addition, both reports ignore possible gains from technical progress or new business formation associated with investment in green tech. Such an omission biases both results toward overestimating costs.

A recent Wall Street Journal editorial stated, "while almost all of AB 32's benefits are speculative and uncertain, its costs are hitting businesses and residents now." AB 32 has not yet been implemented. The only way it could have impacts today is through behavioral changes in anticipation of the policy. California businesses that have curbed emissions are factoring in costs of these improvements and seeing financial savings. Although California is experiencing hard economic times, the difficulties are the result of the global financial meltdown and subprime mortgage crisis, not AB 32.

California's effort not only yields climate benefits, but also may trigger further benefits by providing a model that helps catalyze similar efforts in other states or at the federal level. It is reasonable for California to undertake these small costs, given the large climate change problem and the benefits from addressing emissions.

JAMES SWEENEY is Professor of Management Science and Engineering and Director of the Precourt Energy Efficiency Center at Stanford University. He wrote this article for this newspaper.