Greenhouse Gas Regulation

Market-Based Approach Will Maintain Economic Stability

California is regarded both nationally and internationally as a leader in climate policy. It is important to remember, however, that California makes up a mere 1% of global greenhouse gas (GHG) emissions, sometimes referred to generically as "carbon" emissions. Where California can make the most impact in further reducing GHG emissions is by serving as a model for a robust, cost-effective cap-and-trade system that encourages linkage with other jurisdictions. This system requires buy-in from all parties—not just government and environmental groups, but from the businesses and industries that will support and implement these regulations.

THE BASICS

In 2017, California enacted AB 398 (E. Garcia; D-Coachella), reauthorizing and expanding the California Global Warming Solutions Act of 2006, which first authorized the creation of a market-based cap-and-trade system. A bipartisan bill supported by the California Chamber of Commerce, AB 398 solidified California's future as a leader in the market-based approach to climate solutions.

Under California's cap-and-trade, launched in 2013, GHGs are "capped" at a total overall limit, which declines over time. Entities subject to cap-and-trade are subject to individual emission limits (called "allowances"). They then either sell allowances (in the case of fewer emissions) or buy them (in the case of higher emissions) to meet regulatory requirements. In this manner, emissions are both capped and any excess emissions are priced. Proceeds from the sale of these excess allowances are funneled into the Greenhouse Gas Reduction Fund, which is intended to fund GHG reductions in other sectors of the California economy.

AB 398 extends cap-and-trade through 2030, which provides market certainty and encourages investment. The Legislature also made improvements to the cap-and-trade system, directing the California Air Resources Board (CARB) to evaluate and address carbon credit banking rules to avoid speculation, and to provide additional industry assistance to California businesses that are most susceptible to "leakage"—the climate parlance for the unfortunate fact that environmental regulations sometimes push businesses to relocate out of state, instead causing emissions in a less-regulated state.

AB 398 also sought to set a hard price ceiling on carbon credits so that businesses could be assured that additional credits would not be astronomically high in future years. In doing so, AB 398 sought to strike a balance between ensuring continued economic growth in California while achieving measurable, tangible GHG reductions.

The CARB was directed to create regulations to implement AB 398. CARB finalized the cap-and-trade regulations on December 13, 2018. Over many objections by the business and civil rights community, CARB set price ceilings and market speedbumps for the cap-and-trade auction at a level that is inconsistent with "best available science," and arguably inconsistent with AB 398's bipartisan mandate. Price ceilings are designed to stabilize markets, prevent runaway costs, encourage additional governments to join the state's cap-and-trade system, and minimize leakage of California businesses.

Concerns have become increasingly evident as one of our trading partners—Ontario—withdrew from our cap-and-trade market in 2018. It is important to maintain stability of the market as we move forward with cap-and-trade.

THE POLICY CONCERNS

• **Avoiding New Duplicative Legislation**. AB 398 and its companion bill, AB 617 (E. Garcia; D-Coachella), sought to address a large swath of air quality concerns. AB 398 seeks to place a cap on emissions from entities constituting approximately

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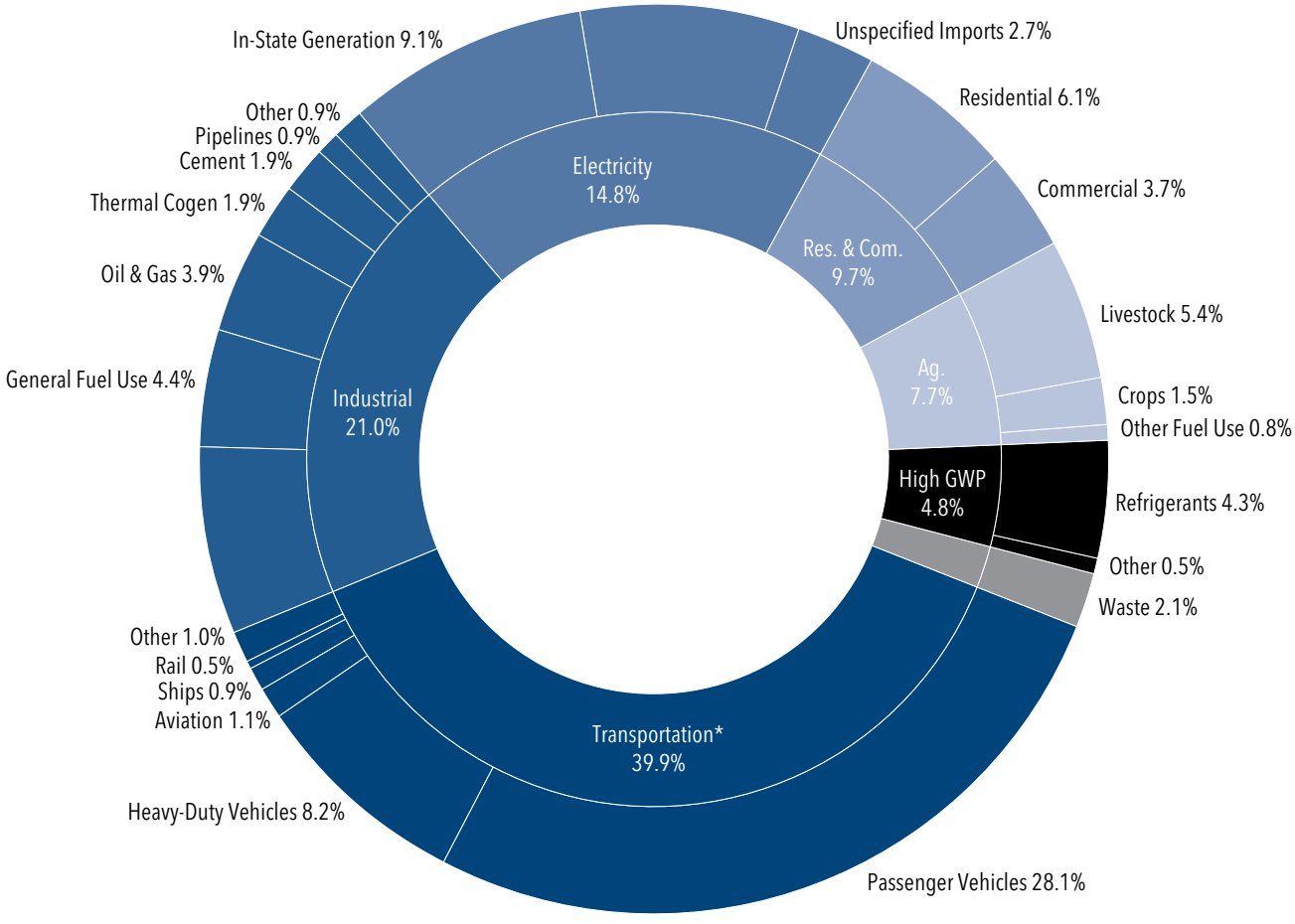
2018 GHG EMISSIONS BY SCOPING PLAN SECTOR AND SUB-SECTOR



The inner ring shows the broad Scoping Plan sectors. The outer ring breaks out the broad sectors into sub-sectors or emission categories under each sector.

*Transportation sector represents tailpipe emissions from on-road vehicles and direct emissions from other off-road mobile sources. It does not include emissions from petroleum refineries and oil extraction and production, which are included in the industrial sector.

Source: California Air Resources Board, *California Greenhouse Gas Emissions for 2000 to 2018* (2020 Edition)

80% of specified emission sources in California and put a price on carbon. Where AB 398 addresses emissions that are more global in nature (GHGs), AB 617 created a community-based process to address air quality concerns that tend to be more local in nature.

Despite these far-reaching laws, California continues to enact piecemeal bans and procurement requirements for utilities, agriculture, and energy producers. For example, a bill introduced in 2018 sought to curtail all natural gas electricity production in California, despite cleaner natural gas being used to reduce overall emissions and provide for energy stability (which is in short supply) when solar or wind are unavailable. AB 398 attempted to address some of this duplication, banning local air districts from adopting or implementing an emission reduction rule from a stationary source that also is subject to cap-and-trade. Duplicative legislation hinders economic expansion in this state and is a disincentive for businesses to support wide-ranging market-based approaches in the future.

• **Efficient Use of Greenhouse Gas Reduction Funds**. Profits from the credits produced in the cap-and-trade auction have generated more than $12 billion in funding to state agencies for emission reduction programs and projects. The Legislature left flexibility in determining appropriate projects. However, AB 398 established GHG reduction fund spending priorities, including:

• Air toxic and criteria air pollutants from stationary and mobile sources.

• Low- and zero-carbon transportation alternatives.

• Sustainable agricultural practices that promote transitions to clean technology, water efficiency and improved air quality.

- Healthy forests and urban greening.
- Short-lived climate pollutants.
- Climate adaptation and resiliency.
- Climate and clean energy research.

The bill also contained certain reporting and oversight requirements to ensure market performance and track progress on emission reductions to ensure California meets its ambitious climate change goals. The Legislature should ensure that GHG reduction funds are directed toward projects that create measurable and substantial reductions in GHG emissions, which is the goal of the cap-and-trade program.

Although proceeds are used to fund other GHG reduction and environmental programs, California's cap-and-trade program is designed primarily as an emissions reduction tool. As emissions decrease, so too will proceeds from the cap-and-trade auction. Reactionary policy to reduce proceeds will serve only to further drive down auction prices. California should avoid repeated changes to price floors, price ceilings, and allowances in order to allow the market to work properly to reduce emissions in the covered sectors, and not view cap-and-trade as a revenue source. Instead, the market should work as intended, reducing emissions—and auction proceeds—over time to meet the overall goal for these regulated facilities

This issue came to a head in 2020, when drastic reductions in emissions in California due to stay-at-home orders reduced the cap-and-trade auction proceeds and there were legislative moves to change cap-and-trade as a result. Cap-and-trade—by design—will have reduced proceeds when GHG emissions are reduced. Thankfully, the Legislature ultimately understood this issue and did not make reactionary changes to the program. Auction results normalized after a few down quarters, and the stability of the cap-and-trade market remained intact. This program will continue to ratchet down on emissions, and revenues will continue to decline as designed.

LEGISLATIVE ACTIVITY IN 2021

The Legislature will continue to advance climate policies, including introducing bans or limits on industry that already is subject to the cap-and-trade laws. It is important to maintain economic stability of the market-based program. If California is to be a leader in climate change, it must successfully balance scientifically proven GHG emissions with economic growth.

The California Chamber of Commerce expects continued debate over the use of cap-and-trade funds, which should be directed to programs that demonstrate cost-effective and significant GHG reductions. Changes to the cap-and-trade program to try to increase auction proceeds at the expense of stability of the market must be avoided. The Legislature may also try to introduce alternatives to cap-and-trade, such as a carbon tax or other command-and-control mechanisms that duplicate cap-and-trade.

CALCHAMBER POSITION

The CalChamber supports climate change laws and regulations that are cost-effective, technology-neutral, and promote the use of market-based strategies to reduce GHGs. The Legislature should ensure that any changes to California law safeguard the economy while having a demonstrable impact on GHG reduction and attract private capital to the state.

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