Greenhouse Gas Regulation

Market-Based Approach and Support for Technological Advancement Will Have Broadest Impact

California is regarded both nationally and internationally as a leader in climate policy. Because California makes up a mere 1% of global greenhouse gas (GHG) emissions, it can make the greatest impact on further reducing GHG emissions by serving as a model for a robust, cost-effective cap-and-trade system that encourages linkage with other jurisdictions. It also can serve as the model for technological solutions to the climate crisis, leveraging its world class research institutions, robust technology sector, and passion for innovation to solve some of the world's largest climate challenges.

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, which account for approximately 80% of California's emissions, are subject to individual emission limits (called "allowances"). They then either sell allowances (in the case of fewer emissions) or buy (in the case of higher emissions) to meet regulatory requirements. In this manner, emissions are 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.

Cap-and-trade is in effect through 2030, which provides market certainty and encourages investment. In 2017, the Legislature also made improvements to the 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, moving those emissions to a less-regulated state.

AB 398 also sought to set a hard price ceiling on carbon credits, such 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.

Cap-and-trade is one of the most cost effective and reliable programs that forms the bedrock of California's carbon emissions reduction solutions. In 2021, regulatory changes went into effect that doubled the stringency of the program and imposed steeper reductions. Despite these changes, California's companies achieved 100% compliance with the program, reducing carbon emissions to meet the state's 2030 reduction target of 40% below 1990 levels.

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 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.

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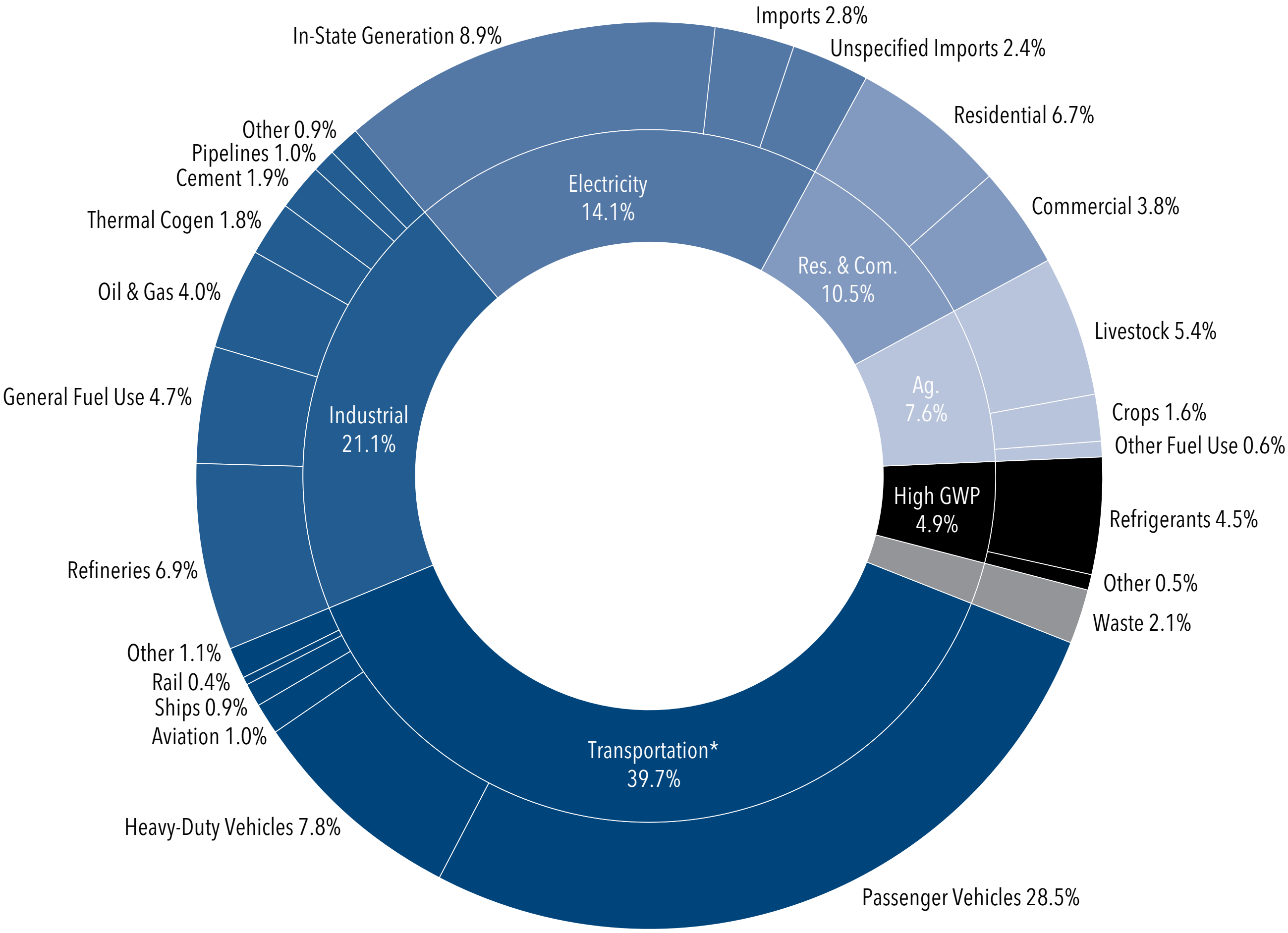
2019 GHG EMISSIONS BY SCOPING PLAN SECTOR AND SUB-SECTOR



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 refiners and oil extraction and production, which are included in the industrial sector.

Source: California Air Resources Board, *California Greenhouse Gas Emissions for 2000 to 2019* (July 28, 2021)

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 creates a disincentive for businesses to support wide-ranging market-based approaches in the future.

• **Efficient Use of Greenhouse Gas Reduction Funds.** Proceeds from the credits produced in the cap-and-trade auction have generated more than $9 billion in funding to state agencies for emission reduction programs and projects. The Legislature left flexibility for state agencies 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 primarily designed 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.

• **Pairing Emission Reductions with Technological Innovation.** California must continue to develop and rely on technology improvements in order to cost effectively reach our climate goals. The state has the opportunity of a lifetime to be a leader in climate tech. According to a recent report by President Biden's Council on Environmental Quality:

"To reach the President's ambitious domestic climate goal of net-zero emissions economy-wide by 2050, the United States will likely have to capture, transport, and permanently sequester significant quantities of carbon dioxide (CO2). In addition, there is growing scientific consensus that carbon capture, utilization, and sequestration (CCUS) and carbon dioxide removal (CDR) will likely play an important role in decarbonization efforts globally; action in the United States can drive down technology costs, accelerating CCUS deployment around the world."

The Biden administration also is supporting policies that attempt to drive down the costs of direct air capture, with the U.S. Department of Energy introducing the "Carbon Negative Shot" as part of its Earthshots Initiative.

Tech companies also are getting on board, making data analysis available to companies to track, audit and reduce their carbon emissions. As part of developing its post-2030 carbon goals and its carbon neutrality goals, California must ensure robust investment and support of technology to complement emissions reduction strategies.

LEGISLATIVE ACTIVITY IN 2022

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 will likely continue to introduce post-2030 climate goal bills, including bills to codify a date for climate neutrality. Whatever the state chooses as its post-2030 climate goals, market-based mechanisms should continue as a primary strategy, and the Legislature should ensure continued support for technological advancement in addition to emissions reductions.

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.

Staff Contact
Leah Silverthorn
Senior Policy Advocate

leah.silverthorn@calchamber.com
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