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'Cap and trade' gaining favor

Congress taking up business-friendly proposals to reduce global warming

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As environmental activists and politicians, including Al Gore, descend on Capitol Hill this week to urge action on global warming, nearly all are touting a business-friendly solution -- as are California regulators who are drawing up the state's new system to curb greenhouse gas emissions.

It's called emissions trading, or cap and trade, and it has won support from corporations and lawmakers who worry that strict global warming limits could damage the U.S. economy.

"There's a lot of education needed in Congress that global warming legislation isn't going to hurt the economy, and (cap and trade) is a big part of this," said Lexi Schultz, a Washington representative for the Union of Concerned Scientists.

But the track records of similar programs in Europe and Southern California are mixed, experts say.

"What California is doing on this issue is brave and encouraging, and for that reason the state and Congress should heed Europe's lessons," said Yvo de Boer, secretary-general of the U.N. Framework Convention on Climate Change, the world body that oversees the Kyoto Protocol and the negotiations for a successor pact after Kyoto expires in 2012.

Former Vice President Gore is scheduled to testify today to the House and Senate, capping a series of rallies and hearings that demonstrate the pent-up momentum behind Democratic leaders' promises to take action on climate change after years of Republican resistance.

In Congress, all five bills on global warming being debated -- with two more expected to be introduced soon -- rely heavily on the creation of an emissions trading system, in which companies are given limits for their emissions of carbon dioxide and other greenhouse gases and then are allowed to buy and sell their excess or deficit emissions as if they were financial securities.

California regulators are drawing up plans for an emissions trading system under a state law enacted last year calling for the reduction of greenhouse gas output to 1990 levels by 2020, a cut of about 25 percent. And California recently signed agreements with Oregon, Washington, Arizona and New Mexico -- as well as with British Columbia -- to form a cross-border emissions market.

"California is really establishing a de facto national standard, and it's likely to heavily influence the shape of whatever action Congress eventually takes," said Blas Perez Henriquez, executive director of the Center for Environmental Public Policy at UC Berkeley's Goldman School of Public Policy.

Many environmentalists had long supported traditional forms of top-down government regulation, especially what is known as a carbon tax, which would levy a tax on energy sources that emit carbon dioxide.

"Most people believe that the two big alternatives out there are a carbon tax or cap and trade," said Sen. Dianne Feinstein, D-Calif., speaking at a climate change conference at UC Berkeley last month. "I fall into the cap and trade thing, largely because I don't see a carbon tax ever getting enacted in the United States."

In recent months, big-business interests have rushed to jump on the cap-and-trade bandwagon. In January, companies with large emissions outputs such as GE, Alcoa, DuPont, Caterpillar and Duke Energy came out in support.

Last week, the chief executives of GM, Ford, Toyota and Chrysler did the same in testimony before Congress.

And on Monday, a coalition of institutional investors, including Merrill Lynch and California's two giant pension funds, the Public Employees' Retirement System and the State Teachers' Retirement System, threw their weight behind cap-and-trade legislation.

Schultz said one of her key selling points is the argument that emissions trading "will spur technological innovation" as businesses seek to reduce their greenhouse gas output and sell the emissions credits that they no longer need.

Backers cite the national cap-and-trade system created by the 1990 Clean Air Act to fight smog. This program -- which regulates the particulates and sulfur dioxide that create conventional air pollution, not the nine greenhouse gases such as carbon dioxide that cause global warming -- governs power plants nationwide and is generally viewed as successful.

But greenhouse gases are more complicated to regulate than smog, traders say.

"Setting up a market for greenhouse gases is tremendously tricky," said Mark Trexler, director of global consulting services for EcoSecurities, a London consultancy and broker in carbon credits.

One danger, Trexler said, is that companies will be granted too many credits -- which, in effect, gives them permission to keep polluting. This mistake has severely shaken the European Union Emission Trading Scheme, set up to comply with the Kyoto Protocol, as prices have collapsed from about \$38 per ton of carbon dioxide in 2004 to Tuesday's closing average of \$1.40.

"A mistake very clearly made in Europe was to allocate too generously, so companies did not need to make an effort to reduce emissions," De Boer said. "This created significant distortions and windfall profits."

"Setting credits should be about who gets gored," said Josh Margolis, managing director of Cantor Fitzgerald Brokerage, a financial services firm for energy markets. A properly designed program is one that "is going to affect you like no other you have ever imagined," he added.

Experts point to a similar mistake made in 1994 when the Los Angeles area's air quality management authority -- which regulates pollutants other than greenhouse gases -- replaced its system of fixed quotas with a cap-and-trade program.

Under this new program, known as the Regional Clean Air Incentives Market, or RECLAIM, the area's formerly rapid pace of air-quality improvement slowed to a crawl because utility companies were granted overly high limits for emissions of nitrogen oxides and sulfur dioxide.

Some environmentalists also warn that these trading systems hurt minorities and the poor.

"We're skeptical of how efficient and just a cap-and-trade system can be because RECLAIM resulted in the concentration of pollution in low-income communities," said Philip Huang, a staff lawyer for Communities for a Better Environment, a statewide group that represents working-class and poor urban areas.

Huang noted that the older industries that are frequently located in poor communities tend to have high emissions of both greenhouse gases and conventional pollutants. As a result, he said, a trading system would allow large industries to reduce their emissions in newer factories located in more affluent areas while maintaining the high emissions in their older facilities.

Officials at the California Air Resources Board, the agency that is drawing up the state's new rules, say they won't repeat the mistakes of Europe and Southern California.

"Yes, there are environmental justice issues to consider with RECLAIM, and there's no shortage of other possible issues that have to be worked through," said Chuck Shulock, climate change coordinator for the agency. "But we're confident that a market-based system can be created successfully."