

Question 1. Point of Regulation

Submitter's Name/Affiliation: Eileen Claussen/Pew Center on Global Climate Change

Who is regulated and where?

Clarifying Question 1a:

- Is the objective of building a fair, simple, and rational greenhouse gas program best served by an economy-wide approach, or by limiting the program to a few sectors of the economy?

Please begin your response HERE. (no page limit)

Pew Center Response

The Pew Center's responses to these questions draw from two sources:

- An extensive body of analysis, conference and workshop proceedings, and other work undertaken by the Pew Center from 1998 to the present with input from the Center's Business Environmental Leadership Council¹ (BELC), leading scholars, policymakers, and stakeholder groups. This work provides the foundation for the Pew Center's positions on these design questions. Documentation of this work is available at the Pew Center website www.pewclimate.org. Information about the BELC and its 41 member companies can be found at: http://www.pewclimate.org/companies_leading_the_way_belc/.
- Opinions expressed to the Pew Center in dozens of hours of discussion over several years with over 30 large corporations regarding design elements of a greenhouse gas (GHG) cap-and-trade program. The companies include several large utilities as well as companies in other sectors, ranging from primary fuels to manufacturing to retail. Although the Pew Center and the companies with which the Center has discussed design elements agree on the broad outlines of a cap-and-trade program, individual company opinions may or may not agree with the Center's positions on particular issues.

As reflected in the Center's 15-point "Agenda for Climate Action," the Pew Center believes that mandatory GHG mitigation measures must cover the economy as a whole, equitably spreading responsibility for reducing emissions among large emitters, the transportation sector, and households. The companies surveyed unanimously supported this position.

Because emissions from electricity generation and transportation make up approximately 40% and 30% of U.S. GHG emissions respectively, it is critical to address these sectors sooner rather than later. However, these emissions need not be covered through the same system.

¹ The BELC is the largest U.S. based association of corporations focused on addressing the challenges of climate change, with forty-one members representing \$2 trillion in market capitalization and over 3 million employees.

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Large stationary sources should be addressed through a cap-and-trade program.² A cap on emissions would send an economy-wide signal favoring reductions, and emissions trading would ensure that reductions are achieved at the lowest cost possible. Such a program should cover all GHGs in all major emitting sectors and include all measurable, verifiable reductions and offset measures, without restrictions on trading. An absolute cap for the national program should be set to achieve a modest level of emission reductions and announced sufficiently far in advance to allow for planning (e.g., a return to current levels within a five- to ten-year period). Further reductions should be phased in over time as new technologies come online and capital stock turns over. Because individual sectors have different sensitivities to the price of carbon and are growing at different rates, sector-specific emission limits or allowance allocations within the overall cap could be established.

At the end of a year, each emitter would be required to surrender allowances equal to its emissions. Emitters whose cost of abating emissions was lower than the allowance price could sell allowances or “bank” them for future use. Emitters whose cost of reducing emissions was more than the price of an allowance could buy allowances. This flexibility would allow for the most cost-effective emissions reductions.

The transportation sector is difficult to incorporate into a downstream cap-and-trade program, and should be addressed through requirements on vehicle manufacturers, for example by converting the Corporate Average Fuel Economy (CAFE) program into strengthened, tradable corporate average CO₂ (or GHG) standards. Average fuel economy standards under the current CAFE program could be replaced by corporate average CO₂ emission standards for each manufacturer's combined sales of cars and light trucks. A manufacturer that “overachieves” (whose average emissions are below the standard) in a given year would earn allowances based on the reduction in projected lifetime emissions from vehicles produced in that year. These allowances could be banked, sold to other manufacturers or sold into the broader, economy-wide GHG cap-and-trade program. A manufacturer that does not meet its CO₂ standard would purchase allowances to cover its shortfall.

In order not to penalize any vehicle manufacturer at the start, efforts of those who invested early and exceeded standards would be recognized (for example, through credit allocation) with adequate time provided for other companies to catch up, recognizing the time needed to develop and market new vehicles. Concerns about a lack of price-responsiveness within the transportation sector driving up costs of allowances for stationary sources could be addressed by keeping this program separate from the stationary source cap-and-trade program, or by requiring a certain amount of reductions from within the sector.

² See also: Claussen, E., and R. Fri, co-chairs. 2004. A Climate Policy Framework: Balancing Policy and Politics. Ed. J. Riggs. Report of an Aspen Institute Climate Change Policy Dialogue, November 14-17, 2003. Washington DC: The Aspen Institute. Nordhaus, R., and K. Danish. 2003. Designing a Mandatory Greenhouse Gas Reduction Program for the U.S., Arlington, VA: Pew Center on Global Climate Change.

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Since the energy services required by residential, commercial and industrial buildings produce approximately 43% of U.S. CO₂ emissions,³ a comprehensive climate program must address this sector. Measures such as upgraded building codes and appliance efficiency standards are an important complement to a large-source cap-and-trade program. Incentives for technologies such as combined heat and power could move the country toward net zero-energy buildings.

While it is important to cover all major emitters, policies may address some sectors first – for example, by implementing cap-and-trade for the electric power sector before other sectors. Some of the utilities surveyed indicate a willingness to consider such an approach, provided the design of regulations is sensible and fair, in exchange for the regulatory certainty that a program would provide. Similarly, some companies state that, although GHG legislation ultimately needs to cover the economy as a whole, a cap-and-trade program initially needs to be as straightforward and easy to implement as possible. At least two major utilities, however, say they oppose a bill that excludes buildings and transportation. They state that the program otherwise would create a distortion that moves electricity generation away from the sector most able to make low-cost reductions to captive generation by large electricity users. Almost all the utilities note they have extensive experience and internal capacity gained over many years of compliance with other air regulations and, in many cases, are also experienced in emissions trading of other air pollutants, so they are well prepared to work within a GHG cap and trade system.

Finally, while the objective is to build “a fair, simple, and rational” program, it is important to recognize possible tensions between “fair” and “simple.” The Pew Center and all of the companies with which we have discussed design elements agree that fairness calls for all sectors to bear a fair share of the emissions reduction burden. However, implementing a cap and trade bill for large emitters could be a simpler first step than covering other sectors in the same bill. Establishing a large emitter cap and a U.S. GHG trading market could provide a simple, effective platform for integrating transportation, buildings, and other sectors into a GHG regime over time, rather than undertake measures for all sectors simultaneously.

³ Brown, M., Southworth, F., Stovall, T. 2005. Towards a Climate-Friendly Built Environment, Arlington, VA: Pew Center on Global Climate Change.

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Clarifying Question 1b:

- What is the most effective place in the chain of activities to regulate greenhouse gas emissions, both from the perspective of administrative simplicity and program effectiveness?

Pew Center Response

The Pew Center and most of the companies surveyed believe that allowance submission should be required “downstream” at the point of emission from large stationary sources, rather than “upstream” (e.g., on producers of coal, oil, and natural gas). To many, a program that applies a cap and trade to upstream producers functions for all practical purposes like a carbon tax, rather than a robust market. Moreover, some research suggests that carbon taxes must be very high and continuous to motivate a significant market response. It is more useful to apply regulation to those in a position to alter the behavior that results in emissions, rather than to apply a tax on firms that have no technology or process options to reduce emissions.

Regarding the special case of transportation emissions, the Pew Center recommends a focus on vehicles – changing the CAFE standard to a tradable emissions approach, as discussed in response to the Question 1a.