

Redefining Progress
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May 22, 2006

Staff Working Group
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RE: RGGI Model Rule Comments

Thank you for the opportunity to comment on the Regional Greenhouse Gas Initiative model rule. Redefining Progress is a leading national think tank focusing on the intersection of economics, the environment, and social issues, with more than a decade of experience in policy design, modeling and analysis.

Redefining Progress applauds participating states for their stated commitments to implement significant, measurable, and mandatory reductions in greenhouse gas emissions from electricity generation. If successful, the region will take a leading role in helping the United States confront this serious issue.

Though the model rule and memorandum of understanding that preceded it address a wide range of topics, Redefining Progress has identified two critical issues that will help determine the ultimate success or failure of the Initiative to meet its stated goals while enhancing the region's economy, and protecting its most vulnerable residents.

Integrity of the Cap:

If attained, the carbon emissions cap proposed in the model rule will make measurable progress toward lowering greenhouse gas emissions in the region. Based on our analysis of this and other climate policy proposals, we feel that the stated goal is attainable, and can be met without large negative economic consequences. If designed well, it may actually enhance the region's economy. In fact, in relation to other policies we have analyzed, the goals laid out in the model rule appear to be somewhat modest. At the same time, there are several elements to the model rule which serve to weaken the stated target.

Principal among them is the fact that there is insufficient treatment of the leakage problem. Modeling assessments of the RGGI proposal indicate that well over a third of the carbon reduction targets may be met not by reductions from emitters within the region, but rather by importing carbon-intensive electric power from non-RGGI states, merely shifting the carbon emissions from within the RGGI region to other areas. As a global pollutant, carbon dioxide emissions cause the same amount of environmental harm regardless of where they are emitted. Reducing regional emissions by increasing emissions elsewhere does little environmental good, but can do potentially significant economic damage to electricity generators, their workers and communities.

A relatively straightforward solution to the leakage issue is to institute border adjustments, whereby electricity importers are required to hold emissions permits for the electricity they import, while simultaneously exempting electricity exporters from the same requirement. Alternately, requiring permits to be held by load serving entities would achieve essentially equivalent results.

Sale of Emission Allowances:

Cap and trade systems, such as the one contemplated by the model rule, are often lauded for their ability to achieve a given environmental goal at a minimum economic cost. While this is certainly appropriate, it is incomplete. In our work, we have discovered that it is possible to design climate policies in such a way as to enhance economic growth. At the same time, it is possible design them in economically harmful ways. One of the critical factors in determining whether or not policies promote or hinder overall economic growth is how emission allowances are distributed. A survey of the current economic literature shows that assessments of climate policies based on market mechanisms, like a cap and trade system, hinge in large part on whether allowances are issued for free or sold via auction or some other means.

Because the impact of a given carbon cap on energy prices is identical under free distributions and auctioning, the main difference between the two methods arises from how the resulting revenues are treated. If allowances are issued for free, the value of higher energy prices flows directly to the shareholders of polluting energy companies. Setting aside the view that polluters should not be rewarded for imposing environmental risks on society at large, a free distribution of allowances represents a lump-sum shift of wealth from energy consumers to energy company shareholders. To the extent that the shareholders live outside of the RGGI region, this represents a pure and direct economic leakage out of the region, much like a rise in imports, with a depressing effect on the regional economy. Even for those shareholders who live within the region, this windfall payment to owners of polluting assets is not contingent on concurrent or future behavior, and thus represents a pure transfer from consumers with no incentive effects on economic behavior.

An economically well-designed policy would put this revenue stream toward some productive use. Several options exist, including lowering taxes on productive activity like labor, and increasing spending on productive investments like education and infrastructure. Another productive use of the revenues would be to invest in energy efficiency and renewable energy projects. Not only do these have the benefit of reducing current and future costs of meeting any given environmental target, but they also stimulate economic activity and job growth in the region. Our research has shown that policy approaches that sell carbon permits and put the revenues to productive uses such as, but not limited to, those outlined here can help accelerate economic and job growth. Conversely, nearly all assessments of policy approaches that do not auction or otherwise sell pollution allowances, find at least some macroeconomic cost to meeting the environmental goal.

Further, a free distribution of allowances would have distributional impacts similar to a regressive income or other tax. As an economic necessity, energy prices represent a larger share of household budgets for low income households. The further down the income scale a household is, the larger the relative burden any increased energy prices tend to be. At the same time, lower income households are less responsible for carbon dioxide emissions than those further up the income distribution. To avoid placing an undue economic burden on potentially vulnerable households, climate policies such as those contemplated by RGGI must contain mechanisms to at least partially offset costs to low income households and working families. Free distributions of allowances eliminate any possibility of funding to provide the necessary

stream of revenues for these purposes. By selling allowances, however, RGGI could generate the funding necessary to avoid these adverse distributional impacts. Options to avoid such impacts include direct rebates to households and investments in energy efficiency technologies, particularly those aimed at low-income households.

While we are encouraged by the fact that the model rule specifies the auctioning of at least 25% of allowances, economic efficiency and distributional fairness demand that all of the allowances be auctioned with the revenues dedicated to encouraging economic growth, enhancing energy efficiency, and eliminating adverse distributional impacts.

Thank you,
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