

## Massachusetts Climate Coalition

Governor Mitt Romney  
State House, Room 360  
Boston, MA 02133

Dear Governor Romney:

Under the Regional Greenhouse Gas Initiative (RGGI), the northeast states are collectively developing a system for capping greenhouse gas (GHG) emissions, and allowing permits (also called credits or allowances) to be traded on the open market. The system would focus initially on carbon dioxide emissions from power plants. In addition, under the 2001 Climate Change Action Plan reached by the New England Governors and Eastern Canadian Premiers, each New England state is developing a climate action plan; an important component of which could be a carbon emissions cap.

We write to you concerning one important aspect of such a system: whether the permits will be provided at zero cost to existing polluters, or will be auctioned off at whatever price the market yields. This is one among many critical issues that will need to be resolved as the RGGI process moves forward. We strongly urge that the permits be **auctioned, not allocated at zero cost based on historical emissions or any other allocation system (“free allocation”)**, for the reasons discussed below.

**1) Auctions are likely to be more efficient and more equitable than a free allocation:** There is widespread agreement among economists and other analysts of plans for carbon caps that auctions are more efficient than allocations. An auction, along with a fair and sensible distribution of the proceeds, will achieve a substantial reduction in carbon emissions while minimizing the financial costs to consumers and taxpayers (see point 5 below). An allocation of free permits to polluters based on their historical emissions has higher societal costs and would therefore unnecessarily add to the challenge of implementing emission reductions.

**2) In deregulated markets, auctions and allocations will have similar effects on energy prices:** The level of an emissions cap will determine the market value of permits, whether they are given to current emitters or auctioned off. Because the cap will be below current emission levels, the demand for permits will exceed the supply, making them a valuable commodity. To some degree, the cost of permits will be incorporated into market prices for energy, and this will take place regardless of whether the initial permits (prior to trading) are given out free or auctioned. (Cramton and Kerr; Burtraw *et. al*)

**3) Free allocation is likely to create large new profits for some producers:** New producers, who are not provided the allocations given to existing polluters, will need to buy permits, and will incorporate those costs into their electricity prices. Since the Northeast and mid-Atlantic markets set electricity prices according to the "marginal" generator, existing producers may be able to raise their prices also, even though they have received permits for free. Thus, some grandfathered producers could receive additional profits through higher energy prices.

In addition, owners of power plants who receive free permits will be able to trade them for whatever price the market sets. Since owners will be capable of reducing their emissions over time, through making their plants more efficient, switching to lower-carbon fuels, building new plants, and converting to non-fossil means of generation, they will sell many of their permits to other generators. As a result, some existing generators stand to gain many millions of dollars in profits net of investments through permit sales.

**4) There is no right to pollute:** Historically emitters of carbon dioxide and other pollutants have been allowed to pollute our air for free. There is no justification for continuing to allow “incumbent” emitters to have a greater right to pollute than others. The atmosphere, and the earth's climate are common property. All emitters of pollution should pay for contributing to air pollution and global warming.

**5) Auction revenues should be used to minimize impacts on the general public:** Free allocation to power plant owners means that the entire value of permits goes to the owners, while the costs are imposed on the general public. To the degree that electricity prices rise, all customers (including commercial, industrial, residential, and the public sector) will pay. In contrast, with an auction, the government will receive the revenues, which can then be used to minimize impacts on the public, particularly lower-income households. This can be done, for example, through returning funds to all residents of the state; supporting energy efficiency and renewable energy programs; and/or providing transitional assistance for any workers who lose their jobs in fossil-fuel based industries.

**6) Free allocation is likely to be highly inequitable, especially to low-income consumers:** Because allocations would benefit plant stockholders, one analysis found that free allocations ("grandfathered permits") would benefit the wealthy and harm the poor: "...using grandfathered permits to reduce U.S. carbon emissions by 15% would reduce annual real income for the lowest income quintile [the bottom 20% of the population] by around \$500 per household but *increase* that for the top income quintile by more than \$1,500 per household." (Dinan and Rogers)

**7) Auctions are far better for the economy than allocations:** Particularly in the Northeast, energy consumption is a drain on the economy, as virtually all our fossil fuels are purchased from outside the region. The carbon cap itself will reduce this drain, as our consumption of coal, oil, and natural gas is reduced. However, if producers are allowed to take the permit revenues as windfall profits, this money will go largely to company stockholders, who are just as likely to live anywhere in the country (and the world) as in the Northeast. Thus, these funds will flow out of the region, causing a drag on our economy. In contrast, an auction could return the revenues in one form or another to all households, who will spend most of it within their communities and the region. This will help to stimulate the economy and to create jobs.

For all these reasons, it is vital that the carbon cap-and-trade system being set up under RGGI utilizes an auction rather than an allocation. To do otherwise would cause a large degree of unnecessary harm to all residents, taxpayers, and energy consumers in the Northeast.

Yours truly,

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