

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,

Frank Gorke
Massachusetts Public Interest Research Group
MassPIRG, 29 Temple Place, Boston, MA 02111
617-292-4800, frank@masspirg.org

Cindy Luppi
Massachusetts Clean Water Action
36 Bromfield St., #204, Boston, MA 02108
617-338-8131, cluppi@cleanwater.org

Marc Breslow
Mass Climate Action Network
86 Milton St., Arlington, MA 02174
781-643-5911, marc@mbreslow.org

Seth Kaplan
Conservation Law Foundation

Michelle Manion
Deborah Donovan
Union of Concerned Scientists

Larry Chretien
Mass Energy Consumers Alliance

Kathy Moyes
Lawrence Environmental Action Group

Nancy Hazard
Northeast Sustainable Energy Association

Rebecca MacLachlan
Middlesex Clean Air Association

Derek Murrow
Environment Northeast

Amy Goldsmith
New Jersey Environmental Federation

Sheila Dormody
Rhode Island Clean Water Action

Doug Bogen
New Hampshire Clean Water Action

Brooke Suter
Connecticut Clean Water Action

Sue Jones
Natural Resources Council of Maine

Josh Irwin
New Hampshire Public Interest Research Group

Kate Canada
Rhode Island Public Interest Research Group

Chris Phelps
Connecticut Public Interest Research Group

Azur Moulart
Vermont Public Interest Research Group

Emily Rusch
New Jersey Public Interest Research Group

Gigi Kellett
Maryland Public Interest Research Group

Nathan Wilcox
PennEnvironment

Matthew Davis
EnvironmentMaine

Ken Kipen
Hilltown Anti-Herbicide Coalition

Paul Beaudette
Environment Council of Rhode Island

Erich Stephens
People's Power & Light

Linda Pease
Appalachian Mountain Club, Narragansett Chapter

Jim Celenza
RI Committee on Occupational Safety and Health

Mary Hitt
Environment Committee, Episcopal Diocese of Rhode Island

Brad Hyson
Apeiron Institute for Environmental Living

Marti Rosenberg
Ocean State Action

Margaret Kane
American Lung Association, Rhode Island Chapter

Letitia R. Naigles
St. John's Episcopal Church
Vernon, CT

Sister Suzanne Brazauskas, CSJ and Sister Mary Alice
Synkewecz, RSM
The Collaborative Center for Justice

Sam Mekrut, Executive Director
NH Citizens Alliance

Rabbi Andrea Cohen-Kiener
Interreligious Eco-Justice Network

John Friede, Executive Director
Worldview, Ltd.
Peterborough, NH

Tom Sevigny
Green Party of Connecticut

Social Responsibility Department
NH Unitarian Universalist Church

Oliver Barton
New Haven Ecology Project, Inc

John Blake
Sierra Club, Connecticut Chapter

Barbara Bacon
Earth Ministries, St. Mark's Church

Andy Burt
Environmental Justice Program
Maine Council of Churches

Karen Schneider
Health Systems Consultants, Inc

Raina Rippel
Maine Physicians for Social Responsibility

Jara Burnett
League of Women Voters of Connecticut

Saskia James
Chair, Environmental Health Committee
Maine Public Health Association

Tom Swan
Connecticut Citizen Action Group

Don Hudson
Chewonki Foundation

Judi Friedman
People's Action for Clean Energy

Sally Davis, President
NH League of Women Voters

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