

FOREWORD

As the California Air Resources Board (CARB) completes the final preparations for distribution of CO₂ allowances to the State's largest industries, including an auction of about 10% of the allowances in the first compliance period under a broad cap and trade regulation, opponents of climate action are converging on Sacramento. Some object to having to buy allowances; others want to eliminate or expand the ability to use offsets; a few even question the need for action, citing continued challenges to the science of climate change or the perceived unfairness to California residents of placing a price on carbon when other states and countries are doing nothing.

In the face of a new round of well-funded efforts to overturn the program, renewed efforts are underway to educate policymakers, businesses and consumers about what to expect and why cap and trade makes sense. This is no easy task. While most voters understand that climate change is a real threat, and many are willing to support action, few people can explain cap and trade and even fewer believe it's the best way to reduce greenhouse gas emissions. So how do we go about building and maintaining the support necessary to carry us through the start-up of this new venture?

First and foremost, we are working on our own and with our partners in the Western Climate Initiative to make sure that when the (imaginary) bell rings for opening day there are no administrative glitches. We have carefully studied the experience of RGGI and the EU ETS, both good and bad, as well as the cautionary tale of California's disastrous experiment with deregulating electricity markets. Every aspect of allowance creation, tracking and use has been designed to deter fraud. We are retaining an independent market monitor whose job is to be on constant lookout for any symptoms of irregularity or problems in the trading of allowances that might be symptoms of abuse or market manipulation. A blue-ribbon market oversight committee will review and advise if action needs to be taken to correct problems.

Our goal, of course, is to launch a system that runs smoothly, that achieves the stipulated reductions in greenhouse gas emissions at a cost that is acceptable to the general public and that fits well within a set of policies designed to encourage investment in energy efficiency, renewable electricity generation, and rapid adoption of advanced technology vehicles and fuels.

Looking ahead, I see three major areas where we will

need the help of creative business and financial thinkers.

1. Compliance-grade offsets. The demand for fully verified offsets developed under approved CARB protocols will grow quickly. The Board is eager to find offset types that fit our rigorous criteria. While there are no current plans to relax the geographic boundaries or numerical limits on offsets, these aspects will be under close scrutiny and may be revised if need be.

2. Voluntary offsets. As forward-looking businesses and state and local permitting agencies with responsibility for environmental impact review and mitigation begin to incorporate assessment of GHG emissions in all kinds of plans, project developers will need to find and lock in emissions reductions. Such offsets will be required both by law and public scrutiny to demonstrate that they are real, enforceable and exceed any current or likely future regulatory requirements.

3. Investment. Making sure that the benefits of free allowances and the proceeds of auctions are used wisely is emerging as a major political issue. Without losing the benefit of a price signal to those who can choose to reduce GHG emissions cost-effectively while at the same time protecting the general public against rate shocks requires careful calibration. For the public sector, the temptation to seize any new revenue to fill general budget holes may be irresistible. Any diversion of proceeds from the cap and trade program to non-AB32 purposes risks a judicial stop to the rule. But there are ample opportunities to think creatively about using the robust new revenue stream that will start flowing when transportation fuels and natural gas come under the cap in 2015.

By then, we are hopeful that an improving economy and increased public awareness of the visible impacts of climate change will combine to give politicians in other states and regions the encouragement to move forward with their own climate plans. Following the lead of Gov. Edmund G. Brown Jr., who is constantly spreading the good news about the benefits of investing in California's clean energy economy, there are indications that other leaders may be willing to re-engage in the climate debate. When they do, we will be ready with the case studies to show that using market instruments can play an important role in solving the global climate crisis.

Mary D. Nichols,

Chairman, California Air Resources Board

The foreword reflects the personal opinion of the writer and does not constitute an official view of the California Air Resources Board.