



## HARMONIZING STATE AND FEDERAL CLIMATE PROGRAMS



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Determining the appropriate ***respective roles*** of the states and the federal government on climate policy requires considering the ***appropriate balance*** between the efficiency of the ***national program*** and ***state autonomy*** in ***environmental and energy policy.***

*WITHOUT DIMINISHING THE IMPORTANCE OF STATE EFFORTS, MOST OBSERVERS WOULD AGREE THAT THESE PROGRAMS ARE NOT AN EFFECTIVE SUBSTITUTE FOR A NATIONAL APPROACH.*

## INTRODUCTION

States are at the forefront of U.S. efforts to address climate change. Many states have shown extraordinary leadership as they have designed and implemented a variety of pioneering approaches. For example, states have adopted or proposed renewable energy portfolio standards (RPS), energy efficiency programs, automobile emission standards, bio-energy programs, and land-use initiatives. Perhaps most importantly, states in the Northeast, West, and Mid-West are at various stages of implementing or developing cap-and-trade programs that will directly limit greenhouse gas (GHG) emissions. The development of these programs has created important innovations and models that have had a significant impact on federal approaches to climate change. These state initiatives have added political momentum to legislative efforts to pass a national cap-and-trade program.

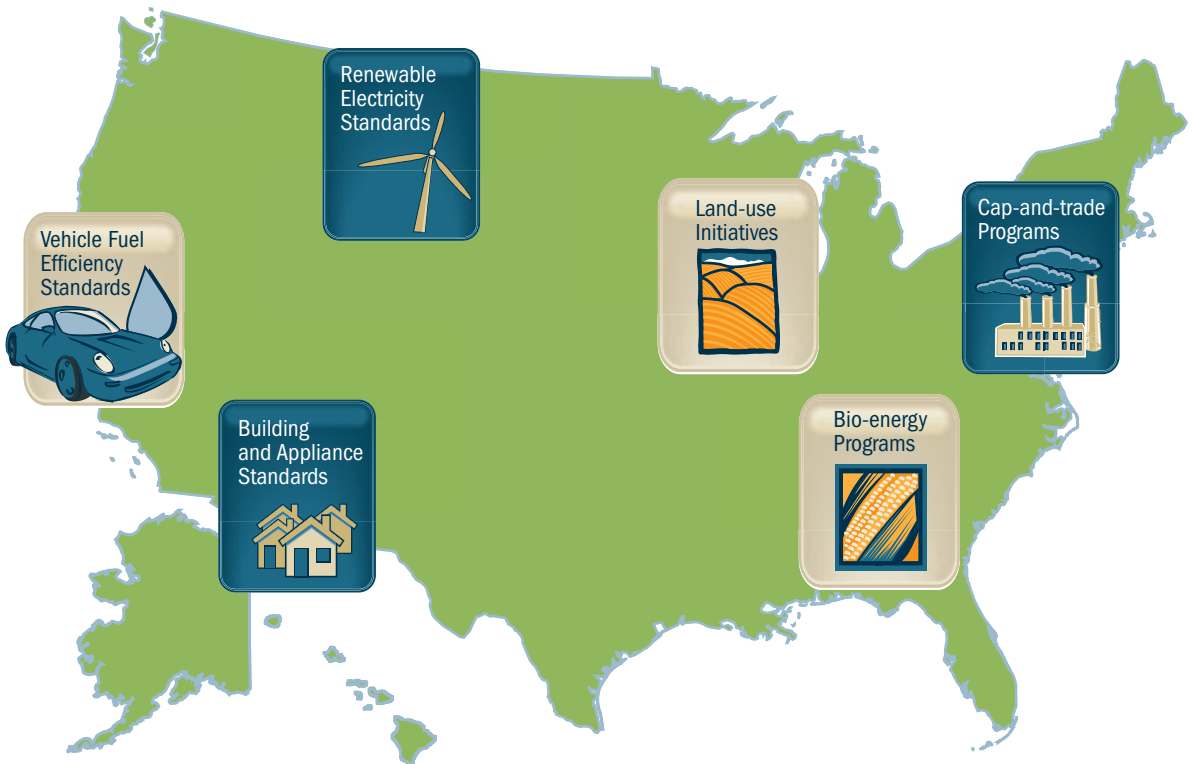
It is also true that state or regional greenhouse gas cap-and-trade programs complicate the design of a federal policy because state climate policies often reflect the particular goals, values, and characteristics of the states that have pursued them. A state's energy resources, economy, and political culture often indicate where it will stand on climate change. Each of these characteristics could affect the overall stringency of state emission caps as well as specific design features of a state program. As state cap-and-trade efforts develop, there are potential conflicts between what is workable or desirable at the state or regional level and what

is feasible at the national level. There is also increasing pressure from the business community to reconcile inconsistent state approaches with a unified federal approach.

Determining the appropriate respective roles of the states and the federal government on climate policy requires considering the appropriate balance between the efficiency of the national program and state autonomy in environmental and energy policy. First, many in industry raise concerns that multiple state programs—particularly state cap-and-trade programs—that overlap with a federal program would burden industry with redundant compliance requirements, and therefore support preemption of such programs. On the other hand, should federal preemption extend beyond cap-and-trade to the full range of state climate programs, states might be prevented from adopting aggressive approaches on climate change that are consistent with the goals and values of their populations. This could create a barrier to important state efforts to reduce greenhouse gases and it would be inconsistent with past precedent in environmental policy. If federal climate legislation cannot establish common ground between state and federal approaches, the likely result is a political impasse that will make federal legislation more difficult. Although it is possible that states could subsequently “go it alone,” this outcome would limit the scope and the effectiveness of a U.S. approach to climate change.

State and federal goals on climate change, however, need not collide. The American Clean Energy and Security Act of 2009 (H.R. 2454,

## STATE AND REGIONAL POLICIES TO ADDRESS CLIMATE CHANGE



the “Waxman-Markey” bill) has a number of provisions that help reconcile state and federal approaches and provide an appropriate division of labor between state and federal governments. This paper explores the key issues involved in harmonizing state and federal approaches, examines options for harmonization, and makes recommendations for how best to utilize the comparative advantages of national, regional, and state climate programs.

### KEY ISSUES

States have cited a number of reasons for developing greenhouse gas programs. First, some states have adopted programs to address public or other stakeholder concerns about the impacts of climate change.<sup>1</sup> Second, states

have expressed a desire to influence national policy or regulations in ways that benefit their companies or other stakeholders. For example, Rabe argues that some U.S. states enacted greenhouse gas policies to facilitate recognition of emission reductions by companies in the event of future national regulations. Finally, some states have developed programs to spur innovative technologies, encourage economic development benefits, or create environmental co-benefits.<sup>2</sup>

On the other hand, state greenhouse gas cap-and-trade programs raise a variety of issues that have not been raised by state environmental policies in the past because of the global nature of climate change. Although states or regional governments may adopt emission reduction programs to address “their share” of the global problem, their

<sup>1</sup> Rabe, B.G. 2004. *Statehouse and Greenhouse, The Emerging Politics of American Climate Change Policy*. Washington, DC: Brookings Institution Press.

<sup>2</sup> Peterson, T. D. 2004. *The Evolution of State Climate Change Policy in the United States: Lessons Learned and New Directions*. *Widener Law Journal* 14(1): 81-120.

efforts may be futile if other states or national governments do not adopt similar programs. Second, state actions raise the potential problem of “leakage” if mandatory requirements in one jurisdiction cause a shift in economic activity and emissions to another jurisdiction without mandatory requirements. For example, limits on power plants emissions in one state or region may simply shift power generation to other regions of the country. Finally, solutions developed at the state or local level may not create the institutions necessary for a robust national trading program. Thus, without diminishing the importance of state efforts, most observers would agree that these programs are not an effective substitute for a national approach.

Central to the state/federal climate policy debate is whether states may undertake greenhouse gas reductions that exceed the reductions required under a national cap. To the extent that state or regional programs are more stringent than the federal program, there are implications for both the emission reductions that will be achieved and the overall costs of a national effort on climate change. The following section discusses design factors that could affect both cost and emissions where there are overlapping state and federal caps.

**EMISSIONS ISSUES:** A key factor in reconciling regional programs with a federal one is whether the federal program covers the same sources as the state or regional cap. Where state or regional programs cover sources of emission not included in the national cap, emission-reduction obligations at these sources will clearly lead to net reductions in emissions. However, a more complicated case arises when state and federal mitigation obligations overlap. For example, in an economy-wide federal program, state efforts will not reduce overall

emissions if they are implemented at sources (or downstream from sources) that are already covered under the national cap. In such cases, states with stricter standards will demand fewer allowances and these allowances (and associated emissions) will shift to states without stricter standards. As will be discussed below, to impose an absolute emission reduction beyond the national cap, a state would have to “retire” federal emission allowances equal to the increment of additional emission reductions from a state cap. This retirement would remove allowances from the national market and would reduce total emissions.

**COST ISSUES:** If states have tighter caps but do not retire federal allowances, costs would increase only in those states. At the same time, these states would decrease their emissions more than they would have under the national cap alone. This would make it easier for other states to meet their obligations under the national cap-and-trade program and would therefore lower costs in these other states. In other words, there would be more allowances available in states without tighter caps, so allowances prices would be lower.<sup>3</sup>

On the other hand, when a state retires federal allowances, it effectively takes them out of the trading system. Essentially, it represents a tightening of the national cap and allowance prices for all participants increase. The extent to which a state would need to retire federal allowances to meet its own cap will depend upon a number of factors, including the stringency and coverage of the national and

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<sup>3</sup> See McGuinness, M. and Ellerman, A.D., 2008. “The Effects of Interactions between State and Federal Climate Policies,” Working Paper 08-004, Center for Energy and Environmental Policy Research, May. In addition to shifting costs between states, the authors note that marginal costs would not be equalized across all states and the overall costs of the program would be higher than they would be with one national cap.

state caps, the geographic distribution of least-cost emission reductions in the federal program, and a variety of other design features. Overall, the increased national costs from allowance requirements would depend on the number of allowances retired and the resulting increase in the stringency of the national cap.

## IMPACTS OF ALLOWANCE RETIREMENT

Retiring a small number of allowances out of hundreds of millions of tons is unlikely to have a significant impact on the stringency of a national greenhouse gas cap. However, if states were to retire tens or hundreds of millions of tons of carbon allowances to meet their more stringent emissions targets, then the impact on the costs of the national cap could be significant.

To get a sense of the possible magnitude of retirement on the national cap, NCEP analyzed the possible retirement of federal allowances that might be necessary to meet targets in three states in the Western Climate Initiative (WCI)—California, Washington, and Oregon—if a national target similar to an earlier version of the Lieberman-Warner bill (S. 2191) was implemented.<sup>4</sup> The WCI has proposed an economy-wide approach to reduce GHG emissions in several western states. The emissions targets in the WCI are more stringent than those proposed in federal legislation given that they cover 100 percent of the economy's emissions, in contrast to the 75-85 percent coverage seen in recently proposed federal legislation.

The analysis found that under the federal cap analyzed, the WCI states in the Pacific

Census region are estimated to make modest emission reductions that would fall short of the WCI emissions goal.<sup>5</sup> In order to meet the WCI goal, we estimate that these states would have to implement additional emission-reduction measures (and retire a corresponding number of allowances) totaling 473 to 658 million tons over the period from 2012 to 2020. WCI allowance retirements for the Pacific Census region range from 1.0 to 1.4 percent of the total national cap proposed in recent federal climate legislation. In effect, these states would have to retire up to 1.4 percent of the total national allowance pool in order to meet state targets.

These retirements are projected to have a material impact on allowance prices in the federal program. By 2020, allowance prices are projected to increase by up to \$4 per ton of CO<sub>2</sub>, or roughly 12 percent. These higher allowance prices are projected to lead to greater increases in electricity and natural gas prices for consumers.

It should be noted that this analysis is limited in ways that may overestimate or underestimate the impact of state allowance retirement on national allowance prices. First, the analysis only looks at the possibility that three WCI states would retire allowances. If other states with caps retire allowances, it could increase the impacts on national allowance prices. On the other hand, the analysis did *not* include the possible impacts of new state energy efficiency and other state programs that would reduce emissions. These programs would be expected to reduce the

<sup>4</sup> See U.S. Department of Energy, Energy Information Administration, "Energy Market and Economic Impacts of S.2191, the Lieberman-Warner Climate Security Act of 2007," SR-OIAF/2008-01, Apr. 2008.

<sup>5</sup> NCEP examined regional National Energy Modeling System (NEMS) outputs for this analysis. Note that NEMS does not provide state specific results, but does provide results on a regional basis. The Pacific Census region, comprised of Alaska, California, Hawaii, Oregon, and Washington, was therefore used as a proxy for the three WCI states. Note that the Pacific Census region is an imperfect proxy for the WCI because Alaska and Hawaii are not members of the WCI, while other members of the WCI (e.g., Arizona, New Mexico, Montana, and Utah) are not included in the modeling region.



impacts on national energy and allowance prices. Finally, it is far from certain that states would actually *choose* to retire significant numbers of federal allowances because this would entail forfeiting potentially significant financial resources that could be used for emissions mitigation and other purposes.

## OPTIONS FOR HARMONIZATION

Although several different models are possible for the coexistence of state and federal cap-and-trade programs, consensus at the federal level has emerged around having just one national cap-and-trade program.<sup>6</sup> Under Waxman-Markey, states would be precluded from having their own cap-and-trade programs for the first five years of the national program. In contrast, Boxer-Lieberman-Warner, the Substitute Amendment to S. 2191, did not explicitly preclude states or regions from having cap-and-trade programs. However, the bill provided an incentive structure designed to entice states to give up their programs. Only states without cap-and-trade

programs or states that phase out existing programs were eligible to earn a pool of incentive allowances.

Although both proposals anticipate one national cap-and-trade program, neither precludes states from implementing more stringent state targets through policies such as transportation planning measures or facility-specific standards. For example, Waxman-Markey does not preclude states from adopting their own greenhouse gas target, nor does it preclude any other standard, limit, or regulation, as long as it is not implemented through a cap-and-trade program. Further, Waxman-Markey does not prevent states from retiring federal allowances; states can choose to retire federal allowances that they had received for free under the legislation.

State retirement of federal allowances would represent the expenditure or forfeit of potentially significant resources. States would be required to make a tradeoff between reducing emissions and foregoing revenues that could be used for a variety of purposes, including energy efficiency, adaptation, economic development, and reduction of consumer energy costs. Alternatively, states could require in-state sources to surrender federal allowances at a compliance ratio that was more than 1 allowance for 1 ton. For example, sources within a state with a tighter cap might be required to submit 1.1 allowances for every ton of CO<sub>2</sub>. Under this option, costs would rise for sources

<sup>6</sup> For example, affected sources in a state with a cap-and-trade program could be required to turn in two sets of allowances, one to meet the Federal requirements and one to meet state requirements. Under another option, states could be exempt from Federal requirements if their programs were at least as stringent. A variation on this option would be that states or regional cap-and-trade programs could link to a national program through the negotiation of an MOU. For further discussion of options, see Litz, Franz and Kathryn Zyla, "Federalism in the Greenhouse: Defining a Role for States in a Federal Cap-and-Trade Program," World Resources Institute, September, 2008.

that had the tighter compliance requirement. National allowances prices would also rise as the effect on prices would reflect a higher demand for allowances. The impact on national allowance prices would be the same under this option as under an option whereby states retired a comparable amount of allowances.

## TRANSITIONING TO ONE FEDERAL PROGRAM

The transition from state or regional programs to a federal program raises a number of questions. For example, if allowances are banked in a state program, can they then be used in a national program? If so, should there be limitations on the use of these banked state allowances? Similarly, will offsets generated in state or regional program be available for use in a national program? As discussed below, the resolution of these questions will determine the incentives of companies that participate in state and regional programs during the period between the phase out of these programs and the phase in of a national program. The resolution of these issues could also affect the overall cap level of a national program. Finally, the transition issue also raises equity questions because if it is not handled correctly, companies and states that acted early to reduce emissions could be penalized for their efforts rather than rewarded.

The MIT analysis notes the dilemma with the transition from a state program to a federal program:

If the federal program does not provide credit for or recognize state program allowances, the value of existing state program allowances will fall toward zero to the extent that a bank of state allowances has been accumulated. This price decline could begin to occur well before

the federal program is finalized as expectations about preemption become stronger. Sources within the state that have banked allowances will be expected to draw down their banks as the program is phased out, and statewide emissions will increase.<sup>7</sup>

In other words, once the market determines that state allowances will be worthless in the future, the price will drop and participants would have an incentive to use up their allowances and increase their emissions.

In contrast, if state allowances are fully bankable and fungible with a federal program, allowances would reflect the expected future prices of the national program. To the extent that future prices for federal allowances are expected to be greater than the prices in the state program, prices in the state program would rise and emission abatement would increase. These banked state allowances could be considered credits for early emission reductions, but they could also essentially expand the cap of the future national program and lower allowance prices. Alternatively, any banked state allowances could be deducted from the future federal cap, thereby keeping the number of allowances and the allowance price under the national cap constant.

Waxman-Markey directs EPA to distribute federal emission allowances to any entity holding Regional Greenhouse Gas Initiative, California, or Western Climate Initiative (WCI) emission allowances as of the commencement date of the federal cap-and-trade program. This provision was designed to compensate entities only for costs incurred in obtaining and holding non-federal allowances prior to the inception

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<sup>7</sup> McGuinness, M. and Ellerman, A.D., 2008. "The Effects of Interactions between State and Federal Climate Policies," Working Paper 08-004, Center for Energy and Environmental Policy Research, May.

of the federal program. Thus, it is not a 1-1 replacement of allowances but would be based on the cost of allowances purchased in the state or regional program.

One unfortunate aspect of the allowance compensation proposal in Waxman-Markey is that the WCI, CA, and RGGI allowance trade-ins come directly out of the low-income protection that the state in question would otherwise receive. This puts states in the awkward position of either protecting consumers to the greatest extent practicable using the resources the bill provides, or protecting the integrity of the investments they and their covered entities have made in a regional program by the time of the allowance exchange. Rather than lowering the number of allowances allocated to states for low-income protection, reducing the number of allowances that are allocated to deficit reduction is a more fair approach.

Similar issues exist for offsets allowed under a state program. Federal programs will have to decide whether approved projects would be allowed to generate offsets that would be fully fungible with federal allowances. This issue is could be more complicated if there is concern about the compatibility of state methods with federal methods or the overall rigor of state offset approaches. Waxman-Markey includes provisions that would allow offset credits earned under state programs to be exchanged for federal allowances from a limited set aside (0.75 percent of 2012 allowances.) The exchange rate would be based on the average monetary value of the offset credits between January 1, 2006 and January 1, 2009.<sup>8</sup>

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<sup>8</sup> The provision also applies to voluntary offset programs and would include activities undertaken between January 1, 2001 and January 1, 2009.

## STATES' ROLE IN A NATIONAL PROGRAM

Even with an economy-wide, cap-and-trade program at the federal level, states should be active partners in addressing climate change. A rule of thumb could be that state governments should have a lead role on programs and activities where they have a comparative advantage over the federal government. Following are some types of activities in which this might be the case.

**TECHNOLOGY DEPLOYMENT:** Some states have strong records on programs to deploy energy efficiency and renewable energy technologies. Thirty states have established clean energy funds (CEFs), which are dedicated to building markets for renewable energy and clean energy resources (including energy-efficiency technologies and on-site, small-scale renewable energy generation). Most state CEFs are funded through system-benefits charges imposed by public utility commissions and administered through utilities, NGOs, state energy offices or other public regulatory agencies.<sup>9</sup> Each state focuses its CEF on a variety of program areas depending on the specific needs of its communities and statewide goals for increased energy efficiency and renewable energy production. Programs include (but are not limited to) residential heating equipment rebates and home energy analysis, commercial and industrial demand-side management and peak load reduction, and municipal-scale and distributed solar and wind installations.

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<sup>9</sup> US EPA, Combined Heat and Power Partnership. "State Clean Energy Funds Fact Sheet." April 12, 2007 [http://www.epa.gov/CHP/state-policy/funds\\_fs.html](http://www.epa.gov/CHP/state-policy/funds_fs.html)



Waxman-Markey would allocate 9.5 percent (roughly \$6.5 billion assuming an initial allowance price of \$15 in 2012) of allowances for State energy efficiency and renewable energy activities in 2012 and would gradually phase down this amount to 4.5 percent of allowances in 2050.<sup>10</sup> These allowances would be distributed among states in a manner intended to level the playing field between large states and small states and between higher emitting states and lower emitting states. Specifically, the formula would allocate one third of the allowances equally between all states, one third proportionally divided by population, and one third proportionally divided by energy consumption.<sup>11</sup>

States that receive allowances may use them for a variety of specified purposes:

- ▶ 20 percent must be used for several specified energy efficiency programs;

- ▶ 20 percent must be used for several specified renewable energy programs;

- ▶ 12.5 percent must be distributed to local governments for use on energy efficiency or renewable energy programs.

- ▶ 47.5 percent may be used for the specified energy efficiency and renewable energy programs or for additional efficiency programs for end-use consumers of electricity, natural gas, home heating oil, or propane. Funds may also be used for the development of smart grid projects or for providing the no-federal share of support for certain surface transportation projects.

**ADAPTATION:** An increasing amount of attention is being directed towards ways that uniquely vulnerable states can adapt to, or adjust to, some of the changes that are expected to occur as a result of climate change. A number of studies have documented the multiple types of impacts from climate change, including sea level rise, increased intensity for hurricanes, and impacts on water and forest resources. Although a full discussion of the potential costs of adapting to the impacts of climate change is beyond the scope of this paper, it is clear that these costs could be staggering. For example, a recent study conducted by researchers at four North Carolina universities found that over the next 75 years, the impacts from climate change on the North Carolina Coast could lead to lost

<sup>10</sup> The EPA allowance price estimate for 2012 is between \$11-15, while the EIA estimates are much broader and range from about \$11 up through about \$50 in 2012, but the “Basic Case” and the “High Cost Case” both show a 2012 price of about \$19. Assuming that there will be about 4,581,000,000 allowances available in 2012 (after taking out the strategic reserve allowances), using an allowance price range of \$11-\$19 would mean that the 9.5% allocation for State energy efficiency and renewable energy activities would be worth roughly \$4.8-\$8.3 billion, with a \$15 allowance price resulting in \$6.5 billion distributed to States for these activities in 2012.

<sup>11</sup> For analysis of how allowances are distributed to states, see Zyla, Kate, Pacyniak, Gabriel, and Larsen, John, “Allowance Distribution to States and Energy Consumers under the American Clean Energy and Security Act (H.R. 2454, Waxman-Markey), Georgetown Climate Center and World Resources Institute, July 28, 2009, available at: [http://www.law.georgetown.edu/gcc/documents/WRI\\_GCC\\_Allocations\\_to\\_states\\_and\\_LDCs.pdf](http://www.law.georgetown.edu/gcc/documents/WRI_GCC_Allocations_to_states_and_LDCs.pdf)

recreational and tourism benefits totaling \$3.9 billion. The study also found that the property risk from sea level rise in four coastal counties to be \$6.9 billion.

One potentially effective use of auction proceeds or allowances would be to direct funding to state adaptation efforts. These efforts would be best employed in programs to enhance the resilience of state infrastructure, communities, and natural systems. A few states are already beginning to develop plans to engage in these types of efforts. For example, Florida recently issued a report that laid out a state policy framework for adapting to climate change.

Waxman-Markey provides allowances for a variety of state adaptation activities. This includes activities to address infrastructure and public health needs as well as to address climate change impacts on wildlife habitats. The bill allocates 1 percent of allowances for infrastructure and public health adaptation in 2012, and increases the allocation to 4 percent of allowances in 2050 for these activities. Similarly, 1 percent of allowances would be distributed for wildlife and natural resource adaptation in 2012, increasing to 4 percent by 2050.

**CONSUMER PROTECTION:** Ultimately, one of the most important state roles in a national climate program could be played by State public utility commissions (PUCs) if climate legislation distributes a significant portion of allowances to electric and gas local distribution companies (LDCs). State PUCs would be responsible for determining how the allowance value would be used to address the impacts of climate legislation on ratepayer bills. Under Waxman-Markey, 44.25 percent of total allowances are distributed to electric power

sector in 2012. Most of this amount will go to LDCs.<sup>12</sup> The legislation distributes 9 percent of total allowances to gas LDCs in 2016. The amounts to both gas and electric LDCs are slowly reduced over time. Waxman-Markey directs LDCs to use these allowance values “solely for the benefit of ratepayers,” provides requirements for how to divide allowance between different classes of ratepayers, and gives guidance on how to provide consumer rebates without diminishing the price signal of a cost on carbon. In the case of natural gas LDCs, no less than one-third of allowance value must be used for energy efficiency programs.

## HOW SHOULD STATE PROGRAMS BE FUNDED?

Waxman-Markey would allocate allowances directly to states. A direct allocation to states would allow states that want to be more stringent than the federal program to retire federal allowances without going into the market to purchase allowances. States would have to auction off the allowances to get the revenues necessary to pay for technology deployment or other activities. One possible downside of a direct allocation to states would come if there were delays in making these allowances available to the market. Such a delay could temporarily increase allowances prices, and more generally, could create greater uncertainty and volatility in the allowance market.

A second option would be for the federal government to disburse auction revenues to states rather than allowances. This type of

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<sup>12</sup> Note that some of this amount includes allowances that will be distributed to merchant coal units and holders of long-term power contracts. The bill notes that up to 14.3% of electricity allowances could be distributed for this purpose. In this case, electricity LDCs would receive about 38% of total allowances.

# “ THE NEED FOR A CONSISTENT NATIONAL MARKET FOR GREENHOUSE GASES ARGUES FOR ONE NATIONAL CAP-AND-TRADE PROGRAM RUN BY THE FEDERAL GOVERNMENT. ”

mechanism is more consistent with traditional methods by which the federal government funds state activities. A block grant program might create less uncertainty for the allowance market. However, like other Federal revenues, it might increase uncertainty for states if revenues were subject to the annual Congressional appropriation process.

## CONCLUSIONS

The scale of the climate change challenge argues for engaging the problem at all levels of government and for experimentation with different approaches. At the same time, the almost overwhelming size of the task requires harnessing the comparative advantages of state and federal programs to design a harmonized and efficient program. With this in mind, we propose the following recommendations for the harmonization of federal and state programs in climate change legislation:

► **One national cap-and-trade program.**

The need for a consistent national market for greenhouse gases argues for one national cap-and-trade program run by the federal government. The Commission believes a temporary moratorium on state and regional cap-and-trade programs, as required in the Waxman-Markey bill, is a sensible way to proceed and will provide greater certainty to industry during the early years of a climate program. This moratorium would ultimately become permanent or, as is more likely, states will repeal their separate programs as the federal program becomes operational.

► **States should be able to surpass national targets and to implement greenhouse gas programs that exceed federal standards.**

Even though there should be only one national cap-and-trade program, states and regions would still have the right to implement control requirements that are effectively more stringent than federal standards. Further, states should not be preempted from implementing building and appliance standards, renewable energy portfolio standards, automobile fuel efficiency standards, land use requirements, and other types of programs that would reduce greenhouse gases. Federal legislation should preserve all state programs not explicitly pre-empted by the federal cap-and-trade regime, including but not limited to consumer protection, antitrust, and financial institution regulatory programs.

► **States should be able to retire a limited number of federal allowances.** NCEP's analysis finds that although there are a number of uncertainties, retirement of federal allowances by states *could* have a noticeable impact on national allowance prices. This impact could vary based on the ultimate stringency of the national cap and on various design features such as cost containment measures and offsets. Therefore,



legislation would limit state retirements of federal allowances to, for example, between 5 and 10 percent of a state's annual emissions. A variation on this provision would be to impose this limit only for ten years or some other time period. Ultimately, retiring federal allowances would yield a relatively small amount of incremental emission reductions while potentially forfeiting significant revenues that could be used to address various important aspects of climate change or other issues at the state level. For these reasons, NCEP believes that most states will decide not to retire significant numbers of allowances.

► **Transition from state cap-and-trade to federal cap-and-trade.** For cap-and-trade programs that are up and running by the time federal legislation is enacted, there should be provisions to make a smooth transition to a federal program and to avoid penalization of early action by states and regions. Several features should reward the innovations of state programs and ensure that states are not penalized for being first movers. These should include:

- Ensuring that federal allowances or auction revenues substitute fully for the revenues from state auction that would be discontinued after a federal program begins.
- Ensuring that baselines for any free allocation in federal legislation are based on years *prior* to the start of state programs.
- Ensuring that allowances and offsets from state programs are bankable into the federal program. If necessary, these allowances and offsets should be discounted to reflect roughly the levels of stringency of the state

programs. When states exchange regional program allowances for federal allowances, compensation for low-income residents of those states should not be compromised. Instead, the number of allowances allocated to deficit reduction should be reduced.

Recent Senate climate proposals and the Waxman-Markey bill indicate that Congress may ultimately decide to provide states with significant resources, either in the form of allowances or auction revenues, to implement key aspects of a climate change program. If this is the case, we recommend the following features for funding state climate initiatives:

► **Allowance formulas to states should balance the interests of both lower and higher emitting states.** There are several factors that must be balanced when designing formulas to provide allowances or auction revenues to states. For states that have been leaders on cap-and-trade programs, there will be lost revenues from giving up their own programs. Many of these states have already begun effective programs to deploy no- and low-carbon technologies and these efforts should be rewarded. For higher emitting states, there may be greater economic and political pain in moving forward with a federal cap-and-trade program.

► **States should be given discretion on how they spend revenues.** States have a variety of different priorities on climate change and should be given discretion on how they spend auction revenues or allowances. Allowable activities should include low- and no-carbon technology deployment, adaptation, green-job programs, and programs to address higher energy costs.

“THE SCALE OF THE CLIMATE CHANGE CHALLENGE ARGUES FOR ENGAGING THE PROBLEM AT ALL LEVELS OF GOVERNMENT AND FOR EXPERIMENTATION WITH DIFFERENT APPROACHES.”



# HARMONIZING STATE AND FEDERAL CLIMATE PROGRAMS



The savings below are achieved when PC recycled fiber is used in place of virgin fiber. Your project uses 903 lbs of paper which has a postconsumer recycled percentage of 25%.

2 trees preserved for the future	71 lbs solid waste not generated
4 lbs waterborne waste not created	140 lbs net greenhouse gases prevented
644 gallons wastewater flow saved	1,074,570 BTUs energy not consumed



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