AB 32 and Global Climate Change: The National Context of State Policy for a Global Commons Problem

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California’s Climate Change Policy: The Economic and Environmental Impacts of AB 32
The Giannini Foundation of Agricultural Economics
The University of California Issues Center
Sacramento, California
October 4, 2010

Why talk about the national context of a state policy?

- Climate change is a global commons problem
  - Any jurisdiction taking action – a country, state, or city – incurs the costs of its actions
  - But the benefits (averted climate change) are distributed globally
  - Hence, for virtually any jurisdiction, the benefits it reaps from its actions will be less than the costs it incurs ….
    - despite the fact that the global benefits may be greater – possibly much greater – than the global costs
- This presents a classic free-rider problem, ….
  - which is why the highest levels of effective government should be involved, i.e., sovereign states (nations), ….
  - and this is why international, if not global, cooperation is essential.
The National Context

- **Federal Climate Policy**
  - Pricing Instruments
    - Cap-and-Trade, Cap-and-Dividend
    - Carbon Taxes, Subsidies
  - Other Instruments
    - Regulation Under the Clean Air Act
    - Energy Policies Not Targeted Exclusively at Climate Change
    - Public Nuisance Litigation, and Other Interventions

- **Sub-National Climate Policy**
  - Interactions of Regional & State Policies with Federal Policies
  - Sub-National Policies in the Absence of Federal Policy
    - Future Linkage of Sub-National Policies as *de facto* National Policy

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National Carbon-Pricing Policy

- **Most economists & other policy analysts favor this approach. Why?**
  1. No other feasible approach can provide truly meaningful emissions reductions (such as an 80% cut in national CO₂ emissions by 2050)
  2. It’s the least costly approach in short term (heterogeneous abatement costs)
  3. It’s the least costly approach in the long term (incentive for carbon-friendly technological change)
  4. It’s a necessary – but not sufficient – component of sensible climate policy

- **But, carbon-pricing is a hot-button political issue**
  - It makes the costs transparent (unlike conventional policy instruments), and is easily associated with the T-word: indeed, in Washington, cap-and-trade has been *demonized* as “cap-and-tax”
  - A meaningful, national, economy-wide carbon-pricing policy is unlikely to be enacted before 2013

- **Does that mean there will be no Federal climate policy? No.**
Other Federal Regulations in Place or On the Way

- **U.S. Supreme Court decision, EPA endangerment finding, & CAA**
  - Mobile source standards
  - Stationary sources (January 2, 2011, with or without “tailoring rule”)

- **Air pollution policies for correlated pollutants under CAA**
  - Five rules in the regulatory pipeline – SO$_x$, NO$_x$, Hg, & PM
  - Could shut some coal plants (w/o any CO$_2$ requirements)

- **Energy Policies** (variety of standards & subsidies, not targeted at CO$_2$)
  - National renewable electricity standard
  - Federal financing for “clean energy” projects
  - Energy efficiency measures

Other Legal Mechanisms

- **Public Nuisance Litigation**
  - Lawsuits pursuing injunctive relief and/or damages
  - In flux – recent court decisions

- **Other Interventions**
  - Intended to block permits for new fossil energy investments
    - Power plants
    - Transmission lines
  - Some NIMBY, some strategic

- **But, with delay in Congressional action on carbon-pricing, attention is increasingly turning to the states …**
Sub-National Climate Policies

- Regional, state, & local policies continue to emerge
  - Regional Greenhouse Gas Initiative (RGGI)
  - California’s Global Warming Solutions Act (AB 32)
  - Western Climate Initiative
  - In fact, more than half of 50 states are contemplating, developing, or implementing climate policies

- In presence of Federal policy, …. 
  - Will state efforts achieve their objectives?
  - Will state efforts be cost-effective?
  - Answer: interactions can be problematic, benign, or positive, …
    - depending on relative scope and stringency, and policy instruments used (Goulder & Stavins, NBER Working Paper 16123, June 2010)

Problematic Interactions

- If Federal policy limits emissions quantities or uses nationwide averaging of performance, …

- Then, emission reductions accomplished by “green state” (more stringent policy than Fed) reduce pressure on other states,
  - thereby freeing – indeed, encouraging (such as through lower allowance price) – emission increases in other states

- Result: 100% leakage, and loss of cost-effectiveness nationally

- Potential examples (can depend upon details of regulations)
  - AB 32 cap-and-trade and Federal cap-and-trade (HR 2454) or some U.S. Clean Air Act performance standards
  - State limits on GHGs/mile and Federal CAFE standards
  - State renewable fuels standard and Federal RFS; or state renewable portfolio standard and Federal RPS

- Partial solution: carve-out from Federal policy (but not c/e)
**Benign Interactions**

- Example #1: Regional Greenhouse Gas Initiative (RGGI)
  - RGGI (state) policies are less stringent than assumed Federal policy
  - Result: state policies become non-binding and largely irrelevant

- Example #2: Federal policy sets price (not quantity)
  - A carbon tax, or a binding safety-valve/price collar in cap-and-trade
  - More stringent actions in green states *do not lead* to offsetting emissions in other states induced by a changing carbon price.
  - *However*, there will be *different* marginal abatement costs across states, and so aggregate reductions are *not* achieved *cost effectively*.

**Positive Interactions**

- States can address market failures not addressed by a Federal “carbon-pricing” policy
  - Example: principal-agent problem re. energy-efficiency investments in renter-occupied properties \(\rightarrow\) state or local building codes

- States can be “laboratories for policy design
  - Can provide useful information for development of Federal policy
  - But will state authorities allow their “laboratory” to be closed after the experiment has been completed and the information delivered?

- States can create pressure for more stringent Federal policy
  - Example: Pavley I standards and subsequent change in Federal CAFE
  - Desirable if previous Federal policy is insufficiently stringent, … but that is an empirical question
Sub-National Climate Policies in Absence of Federal Action

- In the absence of meaningful Federal action, sub-national climate policies could become the core of national action

- Problems
  - Legal obstacles: possible preemption
  - Not national in scope
  - Not cost-effective (if there are different carbon shadow-prices)

- Is there a (partial) solution?
  - Yes, state & regional carbon markets can be linked
  - Linkage reduces costs, leakage, price volatility, and market power
  - A possible future for U.S. climate policy: linkage of state & regional cap-and-trade becomes the de facto post-2012 national climate policy

- So, Sacramento could take the place of Washington as the center of national climate policy.

For More Information

Harvard Project on International Climate Agreements
www.belfercenter.org/climate

Harvard Environmental Economics Program
www.hks.harvard.edu/m-rcbg/heep/

www.stavins.com