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C O L U M N

Dwelling in the Details

by Tom Mounteer

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Among the complex aspects of the recently passed Waxman-Markey climate change legislation (H.R. 2454) is its formula for distributing emission allowances. Beyond the sectoral allocation of free allowances for the first few years of the cap-and-trade system's operation, what else does the bill entail for allowance allocation?

Where the bill ended up might, or might not, seem predictable—depending on your cynicism (or realism) about congressional politics. If you took candidate Barack Obama at his word, you may have expected greenhouse gas (GHG) emission allowances to be allocated entirely by auction. Candidate Obama was quite definite in his endorsement of this approach.

What's more, President Obama, in the first months of his presidency, seemed to stick to candidate Obama's position. While committing to spend vast sums under his stimulus package, President Obama forecast the federal government's collection of substantial revenues from the auction of GHG emission allowances, though not substantial enough to offset all the stimulus spending.

But President Obama is not doctrinaire. Or put less charitably, President Obama is willing to accept political compromise if such compromise results in legislative success. In the case of climate change legislation before the U.S. House of Representatives, such success resulted in a hybrid of free and auctioned allowances, with more free allowances in the early years of implementation and moving to a greater proportion of auctioned allowances over time.

The compromise should have come as no surprise. Among the available regional analogues, the Regional Greenhouse Gas Initiative (RGGI) allows each of the 10 participating northeastern states to independently decide on the percentage of allowances to auction versus to freely allocate. Each RGGI participating state, however, has chosen to go the auction route. The Midwestern Greenhouse Gas Reduction Accord, to begin in 2012, takes a hybrid approach that phases into full auctioning, though not specifying what proportions of available allowances should be auctioned versus allocated for free.

Even closer to home, the Lieberman-Warner bill (S. 3036), which reached the floor of the U.S. Senate in the fall of 2008, allocated some allowances without charge while auctioning others. That Waxman-Markey took a comparable hybrid approach, therefore, may not be so unexpected.

Despite its seeming precision in terms of sectoral allocation, precisely what Waxman-Markey means for specific GHG emitters remains something of a mystery. That's because, like other comprehensive federal environmental statutes, the bill tends to paint in broad brushes, while the U.S. Environmental Protection Agency (EPA), at times in concert with other federal regulators, is left to fill in the details.

Waxman-Markey's "precision" lies in its sectoral allocations. Waxman-Markey specifies the percentage of the allowances to be freely distributed to various sectors of the economy—beginning in 2012 and then being phased out in 2025 to 2026—for what appears to be three general purposes: consumer assistance to utility ratepayers; direct support of capped industries; and advancing certain public-policy goals.

For example, electric utilities are to receive 43.7% of the allowances in 2012 and 2013, which declines to 35% during the period from 2016 to 2025. From 2016 through 2025, the natural gas industry receives 9% of the allowances. This allocation declines gradually starting in 2026 from 7.2% down to 1.8% in 2029. While the bulk of emission allowances are allocated directly to the electricity and natural gas distribution sectors, the allocation is conditioned upon local electricity and natural gas distribution companies using these allocations for some form of consumer benefit. Other economic sectors, such as petroleum refiners, who receive only 2% of allocated emission allowances under Waxman-Markey, would take their allocations with no such strings attached.

God, or the devil (depending on one's perspective), dwells in the details within these sectors. Here, the details are swept under a broad rulemaking command. Waxman-Markey tasks EPA, in consultation with sister federal agencies, with further refining this broad sectoral division among sources.

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For example, Waxman-Markey provides for allowances dedicated to local electricity or gas distribution companies to benefit retail ratepayers but provides that these free allowances may only be given to a gas or electric distributor—not to a stand-alone retailer or generator. State regulators will, in turn, determine whether the distributor has actually used the allowances to its consumers' benefit.

Once allowances begin to be auctioned, another policy overlay involves the dedication of 15% of auction revenue from each year's auctioned allowances to monthly cash payments to qualifying families to offset any economic impact or potential utility rate increases. Again, states will be tasked with ensuring eligibility of applicant households, issuing refunds, and overseeing the program.

Congress likes to set broad policy objectives in federal environmental legislation and to leave the hard work of applying these broad objectives to EPA. Think about the Clean Water Act's "fishable, swimmable" objective for the nation's river and streams. Thus far, the case of climate change seems no different. For this reason, understanding how, precisely, specific emitters will secure GHG emission allowances might be a few years away.