June 5, 2002

Ms. Jean Vernet
U.S. Department of Energy
Office of Policy and International Affairs,
Office of Electricity and Natural Gas Analysis,
PI-23, Attention: Voluntary Reporting Comments

Dear Ms. Vernet:

I am writing on behalf of the Competitive Enterprise Institute (CEI), a non-profit free-market public policy group based in Washington, D.C. This letter responds to the Department of Energy's "request for comment"[1] on the Voluntary Reporting of Greenhouse Gases Program, established under section 1605(b) of the 1992 Energy Policy Act.

On February 14, 2002, President Bush directed the Secretary of Energy, in consultation with other department and agency heads, to propose improvements in the 1605(b) program to enhance its "accuracy, reliability, and verifiability." The President also directed the Secretary to recommend reforms "to ensure that businesses and individuals that register reductions are not penalized under a future climate policy, and to give transferable credits to companies that can show real emission reductions."

Although the Department's *Federal Register* notice devotes only one paragraph to the topic, the crediting scheme is the key driver of the President's proposal. It is only when voluntary reductions generate credits that potentially confer competitive advantage on some firms at the expense of others that it becomes urgent to agree upon accounting details. The perceived need for greater "accuracy, reliability, and verifiability" derives solely from the President's directive to transform the 1605(b) reporting program into a crediting program.

Almost four years to the day before the President announced his proposal, the Natural Resources Defense Council (NRDC) clarified the underlying logic: "Flexible reporting guidelines may have been appropriate to encourage reporting actions under the various voluntary programs that do not award credits, but are not acceptable as the basis for awarding real credits."[2]

The President should reconsider this proposal. A crediting program would energize and expand the "greenhouse lobby" – the coalition of politicians, advocacy

[1] *Federal Register* Vol. 67, No. 87, May 6, 2002, pp. 30370-30373.
[2] Dan Lashof and Jeff Fiedler, *Incentives for Reducing Greenhouse Gas Pollution: Principles for Environmentally Credible Early Reduction Credit Legislation*, Natural Resources Defense Council, February 1999, available at http://www.nrdc.org/globalwarming/pearly.asp.

groups, and companies supporting the Kyoto Protocol and kindred energy rationing policies.

Comment Writer's Background

During the 106th Congress, I served as staff director for Rep. David M. McIntosh, Chairman of the House Government Reform Subcommittee on National Economic Growth, Natural Resources, and Regulatory Affairs. The Subcommittee's investigations were instrumental in challenging three Kyoto-inspired agendas. These were: (1) the Environmental Protection Agency's (EPA's) attempt to interpret the Clean Air Act (CAA) as authorizing regulation of carbon dioxide (CO2); (2) Senator James Jeffords' (R-VT) and Rep. Henry Waxman's (D-CA) "multi-pollutant" bills,[3] with their mandatory CO2 reduction targets; and (3) the Chafee-Lieberman-Lazio legislation to provide regulatory credits for "early voluntary" greenhouse gas reductions.[4]

To expose EPA's misreading of the CAA, the Subcommittee held a joint hearing with the House Science Subcommittee on Energy and Environment,[5] solicited a legal opinion from former CAA conference committee chairman Rep. John Dingell (D-MI),[6] and, in four oversight letters, developed the case that the plain language, structure, and legislative history of the CAA all contradict EPA's claims.[7]

To stop "multi-pollutant" regulation of CO2, the Subcommittee, in June 2000, commissioned the Energy Information Administration (EIA) to examine the impacts of such policies on consumers and energy markets.[8] In December 2000, EIA published a 76-page report responsive to the Subcommittee's request. Among other findings, EIA estimated that a "multi-pollutant" strategy with a requirement to reduce CO2 emissions 7 percent below 1990 levels during 2008-2012 would, in 2010, increase utilities' production costs by $86 billion, reduce coal consumption for electric generation by 50 to 52 percent, and increase consumer electricity prices by 30 to 43 percent.[9]

In March 2001, President Bush disavowed an ill-advised campaign proposal to regulate CO2 as part of a "multi-pollutant" strategy. Pro-Kyoto Democrats and environmental lobbying groups fiercely denounced the President's action, which remains a topic of controversy to this day. White House spokesman Ari Fleischer gave two reasons for Mr. Bush's decision: (1) "describing CO2 as a pollutant is not in accordance

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[3] S. 1369, the Clean Energy Act; H.R. 2900, the Clean Smokestacks Act.
[4] Rep. Rick Lazio's (R-NY) H.R. 2520 was the House companion to Senator John Chafee's (R-RI) and Joseph Lieberman's (D-CT) S. 547, the Credit for Voluntary Reductions Act.
[5] http://www.house.gov/reform/neg/hearings/index.htm, see hearing of 10/6/99, "Is CO2 a Pollutant, and Does EPA Have the Power to Regulate It?"
[6] See Attachment on page 13, also available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=106_house_hearings&docid=f:62900.pdf.
[7] http://www.house.gov/reform/neg/oversight/gcc/gcc_index.htm, see letters of 10/14/99, 12/10/99, 3/14/00, and 5/10/00.
[8] Ibid., see letter of 6/29/00.
[9] EIA, *Analysis of Strategies for Reducing Multiple Emissions from Power Plants: Sulfur Dioxide, Nitrogen Oxides, and Carbon Dioxide*, December 2000, pp. xvii-xix.

with the terms of the Clean Air Act," and (2) "in December of 2000, the Clinton administration Department of Energy [i.e., the EIA] came out with a study that said, to have mandatory reductions of CO2 would lead to large increases in the price of electricity."[10] The Subcommittee's investigative actions provided a solid foundation, in legal and economic analysis, for the President's courageous retraction of the errant campaign proposal.

To counter early action crediting, the subcommittee conducted oversight,[11] introduced and marketed counter-legislation,[12] and held a hearing, at which then EIA Administrator, Jay Hakes, testified as a key witness.[13] Through these actions, the Subcommittee exposed early action crediting as a strategy to jump-start implementation of the non-ratified Kyoto treaty, and build a pro-Kyoto business clientele. Rep. Lazio's bill quickly became radioactive among Kyoto opponents in the House,[14] and Senator Lieberman's bill lost steam without a viable House companion. In the 107th Congress, Senator Lieberman did not reintroduce his bill, nor did Senate Majority Leader Tom Daschle (D-SD) reprise the concept in the climate-related provisions of S. 1766, the Senate energy bill, introduced December 5, 2001. In short, early action crediting was politically defunct – until President Bush revived it in his February 14th speech.[15]

It is my hope that the Subcommittee's work may again prove useful to the Administration. This comment will summarize the Subcommittee's investigation of early action crediting, supplemented by other relevant information. It will explain why early action crediting is inimical to the President's goal of securing plentiful, affordable, reliable energy supplies for the American people.

Son of Kyoto Returns – Again

Early action crediting began as a strategy to overcome S. Res. 98, the Byrd-Hagel resolution, which the U.S. Senate, in July 1997, passed by a vote of 95-0. Byrd-Hagel stipulated that the United States should not be a party to any climate treaty that exempts developing countries from binding limits on carbon emissions. The Kyoto Protocol, negotiated by some 160 countries in December 1997, does exempt all developing countries from binding limits. Thus, when the Senate approved Byrd-Hagel, it preemptively rejected the Kyoto Protocol.

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[10] http://www.whitehouse.gov/news/briefings/20010315.html.
[11] http://www.house.gov/reform/neg/oversight/gcc/gcc_index.htm, letters of 5/27/99 and 7/22/99.
[12] http://www.house.gov/reform/neg/hearings/legis/Default.htm, see information on H.R. 2221, the Small Business, Family Farms, and Constitutional Protection Act.
[13] http://www.house.gov/reform/neg/hearings/index.htm, see Hearing of July 15, 1999, "Early Action Crediting: Win-Win or Kyoto through the Front Door?"
[14] McIntosh "upstaged" Lazio, introducing H.R. 2221 – a measure to prohibit funding for early action crediting – just days before Lazio had planned to introduce H.R. 2520. Lazio postponed introducing his bill until a month later. McIntosh's bill eventually gained 32 cosponsors, compared to Lazio's 15.
[15] The proposal resurfaces as "baseline protection" in the April 25, 2002 version of the Senate energy bill (H.R. 4, Title XI, section 1104).

Byrd-Hagel, however, was neither a law nor a formal vote on ratification but a "sense of the Senate" resolution. Consequently, Kyoto supporters set about to change the Senate's "sense." Early action crediting seemed ideally suited to the task, because lawmakers respond to business lobbyists, and a crediting scheme would fuel pro-Kyoto corporate lobbying.

The basic idea was simple: Award credits to companies that "volunteer" to reduce their CO2 emissions before required to do so by Kyoto or a comparable domestic program, and allow those companies to sell or use the credits to comply with future regulation. In effect, participating companies would acquire Kyoto stock that would bear dividends if – but only if – Kyoto or a comparable domestic program were ratified or enacted. Credit-holders would thus acquire an incentive to support ratification of Kyoto and/or lobby for domestic restrictions on CO2.

To sell the concept to the business community, supporters tirelessly repeated the warning that, without credits for "voluntary" reductions, "good corporate citizens" will be "penalized" under a future climate treaty – forced to make reductions from lower baselines than their less "environmentally responsible" competitors.[16] The fear that early actions will be punished by lower emission baselines under an eventual compulsory program, supporters argued, discourages companies from taking voluntary action now to reduce emissions.[17]

Environmental Defense (then known as Environmental Defense Fund, or EDF) was the strategy's chief architect.[18] The Clinton-Gore Administration began promoting the idea in October 1997 as part of its climate change policy initiative.[19] The Pew Center on Climate Change, headed by former Clinton-Gore Kyoto negotiator Eileen Claussen, took the lead in marketing early action crediting to corporate America. In October 1998, these efforts coalesced in a multi-pronged political campaign. The Administration, via the President's Council on Sustainable Development, formulated and promoted "principles" of early action crediting.[20] The Pew Center published a major report advocating a credit

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[16] See, for example, Eileen Claussen's testimony at the March 24, 1999 Senate Environment and Public Works Committee hearing, available at http://www.senate.gov/~epw/cla_3-24.htm.

[17] Testimony of Kevin Faye, Executive Director, International Climate Change Partnership, July 15, 1999, available at http://www.house.gov/reform/neg/hearings/071599/fay.htm.

[18] At the July 15, 1999 McIntosh Subcommittee hearing, EDF Executive Director Fred Krupp claimed EDF "developed" early action crediting "in early 1997." See http://www.house.gov/reform/neg/hearings/071599/krupp.htm. As far as I can determine, EDF's first published writing on the subject is Daniel J. Dudek and Joseph Goffman, "Spurring Early Greenhouse Gas Reductions in the United States," EDF Letter, April 1998, p. 4, available at http://www.environmentaldefense.org/documents/24_Apr98.pdf.

[19] President Clinton, Remarks to the National Geographic Society, October 22, 1997: "Second, we must urge companies to take early actions to reduce emissions by ensuring that they receive appropriate credit for showing the way." Available at http://frwebgate.access.gpo.gov/cgi-bin/multidb.cgi.

[20] Press Release, October 17, 1998, "U.S. Environmental and Business Leaders Agree Early Action Is Needed to Reduce Greenhouse Gas Emissions and Present Principles for Early Action to Vice President Gore." Available at http://clinton3.nara.gov/PCSD/tforce/cctf/cpress.html.

for early action program.[21] Most importantly, Senators Joseph Lieberman (D-CT), John Chafee (R-RI), and Connie Mack (R-FL) introduced S. 2617, the "Credit for Voluntary Early Action Act." This was the first Son of Kyoto bill.

With ten internal references identifying the end of the "early action" period as the day before the start of the Kyoto compliance period (January 1, 2008), the bill was a transparent effort to begin implementing a non-ratified treaty. Senator Chafee was upfront about the Kyoto connection in his floor statement on the bill: "The credits would be usable beginning in the first five-year budget period (2008-2012) under the Kyoto Protocol, if the Kyoto Protocol is ratified."[22]

Enron was a prominent member of the Pew Center's Business Environmental Leadership Council, and lobbied aggressively for the Kyoto Protocol. Enron was a major natural gas distributor, and Kyoto would suppress coal as a fuel source for electric power generation, boosting demand for natural gas. In a December 12, 1997 internal memorandum, John Palmisano, Enron's senior director for environmental policy and compliance, described Kyoto as "exactly what I have been lobbying for," adding: "This agreement will be good for Enron stock!!"[23]

However, in an email dated October 14, 1998 — four days after the bill's introduction — Palmisano criticized S. 2617. First, he worried that early reduction credits would relieve the "pressure" Kyoto would put on other companies to purchase Enron's natural gas, solar, wind, and energy management services. But he also worried that the bill was too "blatant":

> This proposal, if adopted, would start implementing Kyoto. And while I support that outcome (personally), I question the likelihood of this initiative having political traction and the wisdom of being blatant vis-à-vis implementing Kyoto. The bill is not incremental. They are going for almost the "whole enchilada."[24]

Alluding to the debate in Congress over whether Clinton-Gore's EPA was trying to implement Kyoto through the regulatory "backdoor," Palmisano characterized S. 2617 as an attempt to implement Kyoto through the legislative "front door."

Whether due to Palmisano's behind-the-scenes criticism or to free market groups' public criticism of S. 2617 as "Kyoto Lite,"[25] the sponsors performed minor cosmetic surgery before re-launching their bill in the 106th Congress. They stripped out all internal references to the Kyoto compliance period, and deleted the word "early" from the title, which in the original version visibly meant earlier-than-Kyoto. On March 4, 1999, the

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[21] Robert R. Nordhaus and Stephen C. Fotis, *Analysis of early action crediting proposals*, October 1, 1998, available at http://www.pewclimate.org/projects/pol_early.cfm.
[22] *Congressional Record*, October 10, 1998, S-12310.
[23] Marc Morano, "Enron: Courting Clinton and the Environmentalists," CNSNews.Com, March 19, 2002, available at http://www.newsmax.com/archives/articles/2002/3/19/83215.shtml.
[24] Personal copy of Palmisano email.
[25] Marlo Lewis, Jr., "Credit for Early Implementation: Kyoto through the Front Door," CEI On Point, January 25, 1999.

sponsors offered S. 547, the "Credit for Voluntary Reductions Act." The Son of Kyoto returned.

President Bush's proposal to convert the 1605(b) reporting program into a crediting program unwittingly resurrects the EDF-Pew-NRDC-Clinton-Gore-Chafee-Lieberman strategy. The President even employs the same rationale as the plan's inventors: to ensure early reducers "are not penalized" under future climate policy. The Son of Kyoto returns — again.

Coercive Zero-Sum Game

In his opening statement at the July 15, 1999 hearing, Subcommittee Chairman McIntosh offered several reasons for concluding that early action crediting was the "centerpiece" of a Clinton-Gore strategy to "divide and conquer business opponents of the Kyoto Protocol."

First, as already noted, early action crediting would reward companies for doing today what they later would have to do under a ratified Kyoto treaty. In the original Chafee-Lieberman bill, the early action period ends December 31, 2007 – one day before the start of the Kyoto compliance period. Thus, said McIntosh, a more honest title for such proposals would be "credit for early implementation."

Second, as also noted, early reduction credits have no value apart from the threat or enactment of a future mandatory program. Thus, participating companies would acquire financial motives to support the Kyoto Protocol or similar regulatory controls on CO2.[26]

Third, although touted as "voluntary" and "win-win" (good for business, good for the environment), early action crediting would create a coercive zero-sum game. It would put the squeeze on many companies to "volunteer," because participants profit at the expense of non-participants. The latter would not merely forego benefits, they would be forced to make deeper emission reductions, or pay higher credit prices, under a future regulatory program.

Here's why. The Kyoto Protocol, like the Jeffords-Waxman "multi-pollutant" bills, would establish an emissions trading program. The economic and environmental integrity of such programs absolutely depends on strict enforcement of an overall emissions reduction target or "cap." If companies "break the cap" (if they exceed the national or industry-wide emissions "budget"), then the credits lose value and the program fails to achieve its environmental objective. Early action programs create credits

[26] Resources for the Future puts the point more delicately but nonetheless clearly: "Proponents of voluntary early credit approaches also point to potential political benefits: if a broad cross section of business, environmental groups, and others could come together behind such a program, it would provide some political impetus for more ambitious goals, including eventual ratification of the Kyoto Protocol." See Ian Parry and Michael Toman, *Greenhouse Gas "Early Reduction" Programs: A Critical Appraisal*, July 2000, Climate Change Issues Brief No. 21, p. 2, available at http://www.rff.org/CFDOCS/disc_papers/PDF_files/0026.pdf

companies can later use to offset their obligations under a future cap. If the cap is not to be broken, then every credit awarded to companies in the early action period must be subtracted from the total allocation available in the mandatory period. For every firm that gains a credit in the early action period, there must be another that loses a credit in the mandatory period.

The zero-sum nature of early action crediting is easily illustrated. Assume for simplicity's sake that there are only four companies in the United States (A, B, C, and D), each emitting 25 metric tons (mt) of CO2, for a national total of 100 mt. Also assume the U.S. emission reduction target is 80 mt, with the government issuing 80 tradable allowances or credits (1 credit being an authorization to emit 1 mt). Absent an early action program, each company would receive 20 allowances during the compliance period, and have to reduce its emissions by 5 mt.

Now assume there is an early action program that sets aside 20 allowances for reductions achieved before the compliance period. That reduces each company's compliance period allocation from 20 credits to 15 (4 companies X 15 credits each = 60 + 20 early action credits = 80, the total U.S. emissions "budget"). Finally, assume Companies A and B each earns 10 credits for early reductions. In the compliance period, A and B will have 25 credits apiece (10 + 15) – 5 more (25 instead of 20) than they otherwise would. But, C and D will each have 5 fewer credits (15 instead of 20). C and D must make deeper reductions than the cap would otherwise require – or they must purchase additional credits from A and B. Either way, the early reducers gain at the expense of non-participants.

That one company's gain will be another's loss is widely recognized by proponents as well as critics. The Center for Clean Air Policy writes: "Credits earned should be subtracted from the pool of allowances given out in the binding program, rather than added to it. *This means that early reducers will be rewarded at the expense of those who don't participate*."[27] As one CCAP scholar put it, "This is the essence of an early reductions program – it reallocates first budget period allowances from those who don't take early action to those who do."[28] The Pew Center's monograph also acknowledges that early action credits must be "drawn down" from the compliance period budget.[29] Similarly, Resources for the Future concludes: "If the United States were to implement an emissions control program during that [2008-2012 Kyoto compliance] period with tradable carbon allowances, holders of early reduction credits would be allocated a share of the allowances, implying fewer allowances for others."[30] Enron's John Palmisano opined that S. 2617 could "transfer substantial wealth to so-called early actors while imposing substantial penalties upon those companies that are neither good nor bad but merely choose, for whatever reasons, to wait to control emissions until a regulatory control program goes into effect." As more companies participate, Palmisano cautioned,

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[27] Center for Clean Air Policy, *Key Elements of Domestic Program to Reward Early GHG Emissions Reductions*, January 1999 (emphasis added). available at http://www.ccap.org/.
[28] Tim Hargrave, personal communication, February 2, 1999.
[29] Nordhaus and Fotis, *Analysis of early reduction crediting proposals*, p. 21.
[30] Parry and Toman, *Greenhouse Gas "Early Reduction" Programs: A Critical Appraisal*, p.1.

"more and more pain will be imposed on fewer and fewer non-participating companies."[31]

Growing the Greenhouse Lobby

Since companies that do not act early will be hit with extra burdens in the compliance period, many businesses that otherwise would never dream of investing in carbon reduction projects may do so for purely defensive reasons. Proponents view the coercive aspect of early action crediting as a virtue, because it guarantees many companies will "volunteer" just to avoid getting stuck in the shallow end of the credit pool. The political effect is to grow the mass of companies holding Kyoto stock that derives its entire value from the threat or imposition of a cap.

Unsurprisingly, Clinton-Gore's EPA, EDF and other proponents denied that early action crediting was a strategy to foster pro-Kyoto lobbying. To explore this topic, Rep. McIntosh, in a letter dated July 22, 1999, asked EPA whether, under a well-designed early action program, the credits would be valuable enough to motivate companies to make energy-efficiency, carbon reduction, or carbon sequestration investments beyond those they otherwise would make. Responding on August 12th, EPA stated that, "a well-designed early action credit program could motivate companies to make substantial investments in energy efficiency, carbon reduction or carbon sequestration beyond those that would occur anyway." But, as the Subcommittee pointed out, "if early action credits are valuable enough to change a company's economic behavior, how could they not be valuable enough to change its lobbying behavior?"[32]

Corporate Whining

According to early action proponents, fear of having to do double duty under a future climate policy discourages companies from investing in voluntary emission reductions. Only a crediting program, they contend, can remove the "perverse disincentive" to voluntary action created by the "current legal vacuum."[33] This rationale fails on two counts.

First, there has been no lack of genuine (un-coerced) voluntary action under the 1605(b) program. Since the program's inception in 1994, participation has grown steadily, year-by-year. The number of entities reporting voluntary reductions grew from 105 in 1994 to 222 in 2000 – a more than 100 percent increase. Similarly, the number of greenhouse gas reduction projects reported rose from 634 in 1994 to 1,882 in 2000 – an almost 300 percent increase. Year 2000 projects "included 187 million metric tons carbon

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[31] John Palmisano, "What Are the Economic and Environmental Benefits from 'Early Crediting'?" draft Enron position paper, March 8, 1999, p. 5.

[32] *Report of the Activities of the House Committee on Government Reform*, H. Rpt. 106-1053, Subcommittee on National Economic Growth, Natural Resources, and Regulatory Affairs, Hon. David. M. McIntosh, Chairman, One Hundred Sixth Congress First and Second Sessions 2000, available at http://www.access.gpo.gov/congress/house/house07cr106.html.

[33] See testimony of Kevin Faye at the July 15, 1999 McIntosh Subcommittee hearing, http://www.house.gov/reform/neg/hearings/071599/fay.htm.

dioxide equivalent of direct project-level reductions, 61 million metric tons of indirect project-level reductions, 9 million metric tons of reductions from carbon sequestration, and 12 million metric tons from unspecified project-level reductions."[34] The direct project-level reductions alone represent over 33 percent of the 558 million metric ton U.S. average annual reduction target under the Kyoto Protocol.[35] These numbers speak for themselves. The 1605(b) program is robust, and provides no evidence of significant barriers to voluntary action.

Second, if there is a disincentive to voluntary action, it is the *presence* of the Kyoto Protocol and other CO2-control initiatives like the Waxman and Jeffords bills, not the *absence* of a crediting program. Kyoto-style regulation is what threatens to "penalize" companies that take voluntary action to reduce emissions. Those seriously committed to promoting *voluntary* reductions should lobby *against* Kyoto, not *for* Son-of-Kyoto crediting schemes.

The 1605(b) program was never intended to provide political risk insurance for voluntary reductions, whether through offsetting regulatory credits or any other form of "baseline protection." Participants (mainly utilities and large manufacturing concerns) knew from the start that, under a future regulatory regime, they might have to reduce emissions from lower baselines than non-participants. But, for whatever reasons – environmental, economic, public relations – they nonetheless chose to participate. It is unseemly for any to complain now and pretend they are entitled to a retroactive reward that disadvantages their competition.

Moreover, some participants – notably American Electric Power, Dupont, Entergy, PG&E, and BP[36] – are corporate members of organizations (Pew's Business Environmental Leadership Council, Clean Energy Group, International Climate Change Partnership[37]) that spread climate alarmism and advocate Kyoto-style regulation. They are demanding "baseline protection" from the very policies they promote! Early action crediting would reward such deviousness.

Baseline Manipulation

There is no fair way to select baselines for 1605(b) participants prior to setting industry-wide or national baselines in the context of properly developed, duly enacted regulation. Far from being fair, "protecting" regulatory baselines for a particular group of companies before policymakers have even decided to develop regulation is preferential treatment. Such cart-before-the-horse rulemaking has no precedent under the Clean Air Act.

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[34] Energy Information Administration, *Voluntary Reporting of Greenhouse Gases 2000*, February 2002, p. ix, available at http://www.eia.doe.gov/oiaf/1605/vrrpt/pdf/0608(00).pdf.

[35] Author's calculation, based on Energy Information Administration, *International Energy Outlook 2001*, p. 14.

[36] EIA, *Voluntary Reporting of Greenhouse Gases 2000*, Table B11: Reporting Entities and Sectors, Years Reported, and Form Type, Data Years 1994-2000, available at http://www.eia.doe.gov/oiaf/1605/vrrpt/pdf/0608(00).pdf.

[37] For more information about these groups, see footnote 41, below.

Consider the Title IV sulfur dioxide (SO2) cap-and-trade program – a program early action advocates misleadingly invoke as a model for their proposals. Title IV allowed companies to bank and use SO2 reduction credits earned during 1995-1999 (Phase I) to offset the more stringent reductions required in 2000 and beyond (Phase II). The banking provision encouraged "early action" to reduce emissions below the level required in Phase I. However, companies received SO2 allowances after – not before – Congress and the President enacted Title IV, specified the program's emission reduction targets, determined the number of allowances to be distributed, defined the rules for emissions trading, and established the baseline years for measuring reductions. The program was fair because everyone operated under the same rules, from the same baselines. In stark contrast, early action crediting would allow a collection of insiders to bias future regulation by locking in their baselines before policymakers have even given notice of a proposed rulemaking.

All kinds of creative environmental accounting become possible under early action crediting. For example, many U.S. companies made investments in energy efficiency following the OPEC oil embargo in 1973-74. Presumably, some could document how those investments lowered their emissions baselines. Why shouldn't these companies be eligible for early reduction credits, if any company is?

The Kyoto Protocol shows how critical it is to avoid baseline manipulation in the context of greenhouse gas regulation. The Conference of the Parties adopted the Kyoto Protocol in 1997, and they expected it to enter into force in 2002. Yet Kyoto negotiators picked 1990 as the baseline year from which to measure emission reductions, not 1997 or 2002. Why? The answer has nothing to do with climate, and everything to do with economic advantage.

In the Kyoto negotiations, the Europeans insisted on a 1990 baseline because they believed it would impose minimum sacrifices on Europe while inflicting maximum economic pain on the United States, their chief competitor in global trade.[38] The U.S. economy performed strongly during 1993-97, the European economy did not. Thus by 1997, U.S. energy emissions were significantly higher than 1990 levels, whereas Europe's were close to 1990 levels. For that reason alone, a requirement to reduce emissions below 1990 levels would be more costly for the United States than for Europe. In addition, using a 1990 base year, Britain would reap a windfall in CO2 reduction credits because, after that date, Britain's electric power sector switched from heavy reliance on subsidized, high-sulfur coal to burning cleaner, non-subsidized North Sea natural gas. Germany would achieve a similar windfall for shutting down obsolete factories and power plants in the former East Germany.[39] If climate negotiators had instead selected a 1997 or 2002 baseline, the European Union would be less zealous

[38] The 1990 baseline was also critical for securing Russia's participation in Kyoto. The Russian economy – and, hence, Russia's energy-related emissions – collapsed after 1990. The 1990 baseline ensured that, under Kyoto, Russia would become the world's leading supplier of hot air credits.

[39] Tom Randall, Ten Second Response: Recess Notes on Kyoto and CO2 – May 8, 2001, National Center for Public Policy Research, available at http://www.nationalcenter.org/TSR50801b.html.

about Kyoto, and less hostile to President Bush's energy policies. The politics of climate change would be milder than what we observe today.

Just as countries should not be allowed to manipulate regulatory baselines for competitive advantage, companies too should not be allowed to do so. Awarding regulatory credits outside the context of a duly enacted regulatory program is an open invitation to insider manipulation and gamesmanship.

Risky Insurance

As we have seen, some early action proponents are in the odd position of demanding baseline protection from policies they promote. When this fact is carefully considered, the case for transforming 1605(b) into a political risk insurance program collapses. The U.S. Senate would never ratify the Kyoto Protocol, nor would Congress enact CO2 controls, unless pushed to do so by many of the same policymakers,[40] companies,[41] and activist groups[42] that support credit for early reductions. All Senator Lieberman, Pew, EDF, BP, etc. need to do to ensure that "good corporate citizens" are not "penalized" under a future climate policy is cease and desist their agitation for the Kyoto Protocol. Those advocating credits for baseline protection might as well plead, "We have met the enemy, and it is us."

Furthermore, as Rep. McIntosh pointed out, there is something odd about an insurance policy that makes the insured-against event more likely to happen:

> It would not be smart to purchase fire insurance that virtually guarantees your house will burn down. By the same token it would not be smart to purchase Kyoto insurance that increases the odds of the Protocol being ratified.[43]

An early action credit program would not only expand the coalition for energy suppression policies, it would also demoralize the friends of energy abundance. The

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[40] In the 106th Congress, Senator Jeffords co-sponsored Chafee-Lieberman's S. 547, the Credit for Voluntary Reductions Act, even as Sens. Chafee and Lieberman co-sponsored Jeffords' S. 1369, the Clean Energy Act. In the 107th Congress, Senator Lieberman is an original co-sponsor of Jeffords' S. 556, the Clean Power Act. Of course, former Vice President Gore advocated both CO2 controls and CO2 early reduction credits. See http://www.igc.org/wri/climate/scsb_vicepres.html.

[41] The "Clean Energy Group" – a coalition of electric generating and distribution companies – advocates both "multi-pollutant" regulation of CO2 and an "early credit program" for CO2 reductions. Member companies are: Connectiv, Consolidated Edison, Inc., Entergy Corporation, Exelon Corporation, KeySpan, Northeast Utilities, PSEG, and Sempra Energy. See http://www.mjbradley.com/documents/Briefing_Packet.PDF. Additional corporate supporters of CO2 caps and/or credits include various members of Pew Center's Business Environmental Leadership Council (http://www.pewclimate.org/belc/index.cfm), President Clinton's Council on Sustainable Development (http://clinton2.nara.gov/PCSD/Members/index.html), and the International Climate Change Partnership (http://www.iccp.net/membership.html#memberlist).

[42] E.g., Pew Center on Global Climate Change, Environmental Defense, World Resources Institute (http://www.igc.org/wri/climate/ccji-04.html), and Natural Resources Defense Council (http://www.nrdc.org/globalwarming/pearly.asp).

[43] Opening Statement, "Credit for Early Action," July 15, 1999, available at http://www.house.gov/reform/neg/hearings/071599/dmm.htm.

program would be interpreted far and wide as a signal that the Bush Administration believes some kind of CO2 regulation is inevitable, or at least probable. After all, if the President does not think such regulation is likely, then why bother offering credits to "insure" against it? The implicit message – the smart money is betting on Kyoto – could easily become a self-fulfilling prophecy. Few corporations will forthrightly oppose climate alarmism and energy rationing if they suspect the White House plans to throw in the towel.

The best insurance – the kind that emboldens rather than demoralizes advocates of energy abundance – is a clear and unequivocal "never-on-my-watch" rejection of CO2 regulation, whether of the international (Kyoto) or domestic (Jeffords-Waxman) variety, and of any policy that would legitimize or build political support for such regulation.

Conclusion

In March 2001, President Bush honored his campaign promise to oppose the Kyoto Protocol and pulled the plug on an ill-advised campaign proposal to regulate CO2. As the energy debate in Washington builds to a climax, the President again needs to act with courage and consistency. He should bury early-action crediting, not bring it back from the dead.

Sincerely,

Marlo Lewis, Jr., Ph.D.
Senior Fellow
Competitive Enterprise Institute

U.S. House of Representatives
Committee on Commerce
Room 2125, Rayburn House Office Building
Washington, DC 20515–6115

October 5, 1999

The Honorable David M. McIntosh
Chairman
Subcommittee on National Economic Growth, Natural Resources, and Regulatory Affairs
Committee on Government Reform
Room B-377 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

I understand that you have asked, based on discussions between our staffs, about the disposition by the House-Senate conferees of the amendments in 1990 to the Clean Air Act (CAA) regarding greenhouse gases such as methane and carbon dioxide. In making this inquiry, you call my attention to an April 10, 1998 Environmental Protection Agency (EPA) memorandum entitled "EPA's Authority to Regulate Pollutants Emitted by Electric Power Generation Sources" and an October 12, 1998 memorandum entitled "The Authority of EPA to Regulate Carbon Dioxide Under the Clean Air Act" prepared for the National Mining Association. The latter memorandum discusses the legislative history of the 1990 amendments.

First, the House-passed bill (H.R. 3030) never included any provision regarding the regulation of any greenhouse gas, such as methane or carbon dioxide, nor did the bill address global climate change. The House, however, did include provisions aimed at implementing the Montreal Protocol on Substances that Deplete the Ozone Layer.

Second, as to the Senate version (S.1630) of the proposed amendments, the October 12, 1998 memorandum correctly points out that the Senate did address greenhouse gas matters and global warming, along with provisions implementing the Montreal Protocol. Nevertheless, only Montreal Protocol related provisions were agreed to by the House-Senate conferees (see Conf. Rept. 101-952, Oct. 26, 1990).

However, I should point out that Public Law 101-549 of November 15, 1990, which contains the 1990 amendments to the CAA, includes some provisions, such as sections 813, 817 and 819-821, that were enacted as free-standing provisions separate from the CAA. Although

the Public Law often refers to the "Clean Air Act Amendments of 1990," the Public Law does not specify that reference as the "short title" of all of the provisions included the Public Law.

One of these free-standing provisions, section 821, entitled "Information Gathering on Greenhouse Gases Contributing to Global Climate Change" appears in the United States Code as a "note" (at 42 U.S.C. 7651k). It requires regulations by the EPA to "monitor carbon dioxide emissions" from "all affected sources subject to title V" of the CAA and specifies that the emissions are to be reported to the EPA. That section does not designate carbon dioxide as a "pollutant" for any purpose.

Finally, Title IX of the Conference Report, entitled "Clean Air Research," was primarily negotiated at the time by the House and Senate Science Committees, which had no regulatory jurisdiction under House-Senate Rules. This title amended section 103 of the CAA by adding new subsections (c) through (k). New subsection (g), entitled "Pollution Prevention and Control," calls for "non-regulatory strategies and technologies for air pollution prevention." While it refers, as noted in the EPA memorandum, to carbon dioxide as a "pollutant," House and Senate conferees never agreed to designate carbon dioxide as a pollutant for regulatory or other purposes.

Based on my review of this history and my recollection of the discussions, I would have difficulty concluding that the House-Senate conferees, who rejected the Senate regulatory provisions (with the exception of the above-referenced section 821), contemplated regulating greenhouse gas emissions or addressing global warming under the Clean Air Act. Shortly after enactment of Public Law 101-549, the United Nations General Assembly established in December 1990 the Intergovernmental Negotiating Committee that ultimately led to the Framework Convention on Climate Change, which was ratified by the United States after advice and consent by the Senate. That Convention is, of course, not self-executing, and the Congress has not enacted implementing legislation authorizing EPA or any other agency to regulate greenhouse gases.

I hope that this is responsive.

With best wishes,

Sincerely,

JOHN D. DINGELL
RANKING MEMBER

cc: The Honorable Dennis J. Kucinich
Ranking Minority Member, Subcommittee on National Economic Growth, Natural Resources and Regulatory Affairs
Committee on Government Reform