



ON POINT

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Early Action Crediting: Growing the Kyoto Lobby at Small Business' Expense

By
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“Credit for early action” – a policy proposal developed by the Environmental Defense Fund and warmly embraced by the Clinton-Gore Administration – is the latest ploy in the Kyoto lobby’s strategy to divide and conquer the American business community. Like the President’s Climate Change Technology Initiative (a \$4 billion package of targeted tax breaks and subsidies), early action crediting is designed to jump-start implementation of the non-ratified UN global warming treaty while expanding the number of companies favorable to ratification of the Kyoto Protocol.² Although touted by proponents as a “win-win” environmental program, early action crediting would benefit participants *at the expense* of non-participants. The losers would include most small businesses, which lack the discretionary capital and technical expertise required for participation.

Background. Although early action crediting is the subject of much technical analysis and discussion,³ the basic concept is fairly straightforward. Companies that reduce their energy-related emissions before 2008 – the year when a ratified Kyoto Protocol would go into effect – earn credits they could later use during the first (2008-2012) Kyoto emission budget period.

Early action crediting would not only encourage implementation of a non-ratified treaty, it would also give companies a cash incentive to support ratification. Credits earned under the program, although *potentially* worth millions or billions of dollars, are *actually* worthless unless Kyoto, or a comparable regulatory program, is ratified or adopted.

There’s also a strong likelihood that EPA would be the administering agency. Through tacit threats of permitting delays, burdensome information requests, or aggressive enforcement actions, EPA has the means to make companies “volunteer” – and, thus, to swell the ranks of companies with a cash stake in ratification.

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² For additional background, see Marlo Lewis, Jr., “Credit for Early Implementation: Kyoto Through the Front Door,” CEI *On Point* No. 23, January 25, 1999.

³ See, e.g., United States General Accounting Office, *Climate Change: Basic Issues in Considering a Credit for Early Action Program*, GAO/RCED-99-23.

The Fixed-Pie Problem. Even if not administered by EPA, an early reduction program would put the squeeze on many companies to “volunteer,” because participants would profit *at the expense* of non-participants. The latter would not merely forgo benefits – they would be penalized.

Here’s why. Under the Kyoto Protocol, every industrial nation is allocated an emissions budget – a fixed quantity of emission allowances or credits it may lawfully use during 2008-2012. Industrial nations can earn emission credits, and thus increase their budgets, through early reduction projects completed before 2008 *in developing countries*, under the Clean Development Mechanism (CDM). But *domestic reductions* achieved before 2008 do not create credits that can be banked and later added to a nation’s budget.

This “early action discontinuity” – the fact that early reductions overseas generate bankable emission credits but not identical reductions achieved at home – may seem unfair or irrational. Nonetheless, it is built into the Kyoto Protocol. Where, then, would the credits to fund an early action program come from? They can only come from one place – the U.S. budget allocation for 2008-2012. If we are not to break our budget cap, every credit awarded to companies for early domestic action must be subtracted (“drawn down”) from the total U.S. allocation in the compliance period. In other words, for every company that gains a credit for early action, there must be another company that loses a credit in the compliance period.

An Illustration. Suppose 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 equivalent, for a national total of 100 mt. Suppose further that the U.S. Kyoto budget is 80 mt, or 80 allowances (1 allowance or credit being an authorization to emit 1 metric ton). Absent an early reduction program, each company would receive 20 allowances during 2008-2012, 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 2008. That reduces each company’s budget period allocation from 20 credits to 15 (4 companies X 15 credits each = 60 + 20 early action credits = 80, the total U.S. budget). Finally, suppose Companies A and B make early reductions and each earn 10 credits. In the compliance period, A and B will have 25 credits apiece (10 + 15). Thanks to the early action program, A and B will each have five credits more in the budget period (25 instead of 20) than they otherwise would – but C and D will each have five fewer credits (15 instead of 20). C and D must make deeper reductions than Kyoto itself would require – or they must purchase credits from A and B. Either way, the early reducers gain at the non-participants’ expense.

The Experts Agree. This zero-sum problem is widely recognized by proponents of early action crediting. 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.*”⁴ 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.”⁵

The Pew Center’s monograph on early action proposals is similarly up front about the fixed-pie problem:

However, as a general matter, the Kyoto Protocol does not provide credit for ghg [greenhouse gas] reductions that occur before the first budget period. The only two exceptions are the CDM and

⁴ Center for Clean Air Policy, *Rewarding Early GHG Emissions Reductions*, p. 1 (emphasis added).

⁵ Tim Hargrave, personal communication, February 2, 1999.

certain afforestation credits. As a result, any U.S. program to provide credit for early reductions...will have to provide participants credit solely out of the credits available to the U.S. in the first budget period. For that reason, the credits needed to “fund” the early action crediting program will have to be taken out of (or “drawn down” from) the U.S. allocation for the first budget period.⁶

Concerned that an early reductions program might leave too few credits available to non-participants in the budget period, the Center for Clean Air Policy and Niagara Mohawk Power Corporation recommend limiting the amount of early action credits to 5 percent of the total U.S. emissions budget.⁷ Robert Friedman of the John Heinz III Center, noting that “Domestic reductions before 2008 cannot offset post-2008 requirements,” concludes that the politics of domestic early action “will focus on who gains from credits and who ‘pays’ for them.”⁸

Resources for the Future views the zero-sum problem as so serious that it advocates amending the Kyoto Protocol so that early domestic reductions will create internationally recognized bankable emission credits.⁹ But as the Pew report points out, the Kyoto Protocol cannot be amended until it has been ratified and enters into force. If amending Kyoto is a prerequisite to establishing an early reduction program, then the program will not be adopted quickly enough to encourage early action.¹⁰

Growing the Kyoto Lobby. Since early reducers will be rewarded at the expense of those who do not participate, many businesses that otherwise would never dream of “volunteering” may be constrained to do so for purely defensive reasons. Companies that see no particular benefit in early reductions may participate just so they won’t be stuck in the shallow end of credit pool in 2008-2012. This dynamic is exactly what Kyoto partisans desire, as it would build up a large mass of companies holding costly paper assets that are completely valueless unless Kyoto is ratified.

At Small Business’ Expense. Since early reduction programs penalize those who do not act early, it is worth asking who the non-participants are likely to be. The answer is really quite obvious. Only the big boys – utilities and major manufacturing firms – have the legal and technical expertise and the discretionary capital to invest in “voluntary” emission reduction projects. Most small businesses simply will not be players in the early credit game. But in a Kyoto world, small businesses will have to pay higher energy costs and many will have to reduce their energy-related emissions. Indeed, meeting the U.S. Kyoto target will be far more difficult if EPA does not regulate the one million or so small to mid-sized manufacturing companies, farms, medical and educational facilities that individually generate at least 100 metric tons of fossil fuel emissions per year.¹¹ Credit for early reduction would not only make Kyoto more likely to be ratified, it would also make Kyoto more costly to small business.

Conclusion. Credit for early action may seem at first glance to be a benign, voluntary, market-oriented program. It is actually a political strategy to implement a non-ratified treaty, fuel pro-Kyoto business lobbying, and penalize companies that don’t jump on the global warming bandwagon. Far from a “win-win” environmental program, it would produce a zero-sum game in which small business can only lose.

⁶ Robert R. Nordhaus and Stephen C. Fotis, *Analysis of early action crediting proposals*, Prepared for the Pew Center on Global Climate Change, October 1, 1998, p. 21.

⁷ *Ibid.*, p. 22.

⁸ Capitol Hill briefing, sponsored by Northwest Midwest Institute, February 5, 1999.

⁹ *Analysis of early action crediting proposals*, p. 42.

¹⁰ *Ibid.*, p. 43.

¹¹ Mark P. Mills, *A Stunning Regulatory Burden: EPA Designating CO₂ As A Pollutant*, Mills McCarthy & Associates, Inc., 1998.

Early action crediting is a staking horse for the Kyoto Protocol. Policy makers and business leaders cannot consistently profess to oppose Kyoto and support early action crediting.