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COMMITTEE ON
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Chairman and Ranking Member Statement: Climate Change Conference

On April 4, 2006, the Senate Committee on Energy and Natural Resources held a conference to discuss critical issues involved in the design of a mandatory greenhouse gas (GHG) program. More than 300 people attended the event and over 160 organizations and individuals submitted detailed written comments.

Although the issue of climate change continues to elicit a diverse array of opinions, we are encouraged that a number of general themes are emerging that could form the basis of eventual solutions to reducing greenhouse gas emissions.

The following discussion reflects our perception of key areas where there appears to be a narrowing of disagreement and in some cases an emerging consensus. Of course it is not our intent to imply that there is now or will ever be an absolute unanimity of opinion on issues related to climate change, especially on a greenhouse gas regulatory mechanism. Nevertheless, we remain committed to exploring the development of solutions consistent with the requirements set forth in the June 22, 2005, Sense of the Senate Resolution. We continue to work together with our colleagues on the Committee on Energy and Natural Resources and throughout the Senate to fashion reasonable policy solutions to the key issues identified at the April 4, 2006, Workshop and look forward to ongoing input and engagement from interested stakeholders.

Conceptual Direction for Reducing Greenhouse Gas Emissions

In both the written submissions and comments at the workshop, many participants and respondents expressed the view that the risks associated with a changing climate justified the adoption of mandatory limits on greenhouse gas emissions. While opinions varied on the stringency of initial limits, there was support for the notion that a program should begin modestly and strengthen gradually over time. Consistent with the success of the acid rain program and other market-based approaches, most participants supported a market-based approach that would set a "forward price" on greenhouse gas emissions in order to provide both the flexibility and incentive needed to accelerate technology development and deployment.

Most participants recognized that if the price signal initially imposed under a domestic regime is modest, it is unlikely to be strong enough to motivate the development and deployment of the key technologies that will ultimately be needed to eventually eliminate GHG emissions. In order to speed technology deployment, there was general agreement that some portion of the proceeds of a permit auction should be used to enhance current technology incentives. Again

there was disagreement about the appropriate size of a permit auction and the means of directing these resources toward technology innovation. Ultimately, we perceive agreement that a GHG policy should provide a combination of a market signal and increased incentives for technology innovation.

In addition to general support for the overall goals of the Sense of the Senate Resolution, we are encouraged by the similarity of views with respect to several of the key questions raised in the White Paper:

Economy-wide approach: A threshold decision in designing a mandatory GHG emission reduction program is whether the program should address GHG's on an economy-wide basis or whether the program should focus on the GHG emissions of just one or more sectors of the economy. In general, there was agreement on the need for economy-wide action to address the wide diversity of sources of GHG's. Many participants argued that an economy-wide program is the most equitable and efficient approach

Upstream or hybrid point of regulation: Most participants supported either an entirely upstream or a hybrid approach for point of regulation. In an "upstream" regulatory approach, the point of regulation is placed closer to energy producers and suppliers than to end-use consumers. Specifically, a requirement to acquire permits or allowances for emissions associated with fossil fuel use might apply to coal mining companies, petroleum refiners, and natural gas shippers, processors or pipelines rather than to the "smokestack" entities (e.g., electric utilities, large industrial plants). Under a "hybrid" approach, major stationary sources that burn coal would be regulated at the point of combustion, while natural gas and petroleum related emissions would be addressed upstream (at refineries for petroleum and at either shippers, processors, or pipelines for natural gas). Regulating the carbon content of fuels at the point in which energy enters the economy was described by many as providing the most complete coverage through the most manageable regulatory approach. However, several participants noted that the efficiency of an upstream program would not be diminished if only major stationary sources were carved out for regulation at the source of combustion. They note that these sources are limited in number and already have the monitoring and knowledge in place necessary to implement such requirements due to participation in the acid rain program.

Offsets and set-asides: There was general agreement about the benefits of emission reduction projects at sources outside of a cap on GHG emissions. However, there was some disagreement about how to ensure the environmental integrity of these types of projects. Some panelists argued that offsets could provide low-cost emission reductions and could create incentives for new technologies and approaches. In particular, a few panelists specifically mentioned the potential for offset opportunities in the agricultural sector. Others noted that offsets could dilute the environmental benefit of a mandatory program unless they are accompanied by rigorous and standardized baseline and measurement protocols. An additional option would be to dedicate a percentage of allowances from within a program's overall allowance allocation for offset activities that are less easily verified.

Links to other trading programs: Ultimately, GHG emissions cannot be reduced absent an effort that includes meaningful participation from all nations with significant GHG emissions. An emission reduction program in the U.S. could be designed to leave open the possibility of trading with GHG systems in other countries. Most panelists at the conference agreed that linking to other domestic emissions trading programs is theoretically more efficient. However, a few panelists also noted that differences in the design of domestic trading programs (e.g., different target levels, different monitoring and verification systems) may complicate linking programs and make it politically difficult in the near-term.

Developing country action: Many participants agreed that an important component of a U.S. GHG program should encourage major trading partners and large emitters of GHG's to take actions that are comparable to those taken by the U.S. Panelists noted that ultimately, action by major developing countries like China and India is critical to address climate change. There was also discussion of the competitive implications if the U.S. takes action to address climate change and other major trading partners do not. Not all, but many panelists said that the U.S. should not wait for developing countries to act. Rather, the U.S. should take a cautious first step toward mandatory action with additional action conditioned on an evaluation of the efforts of major developing country emitters. There was debate about how to measure progress when different countries have different national circumstances. There was also discussion about the best process for evaluating the actions of developing countries and about how much discretion there should be in this process.

Allowance distribution: Multiple views were expressed at the conference on the best approach to allowance distribution. However, a significant number of panelists emphasized that not all allowances need be distributed for free at the point of regulation. For example, several panelists endorsed the concept of using cost burden as a principle for allocation. In other words, even if a sector is not at the point of regulation, it still might receive some allowances to mitigate the cost impacts of a mandatory program. In addition, some panelists argued for the benefits of allowance auctions. According to this view, auctions can level the playing field for new facilities, and can create an incentive for lower-carbon technology. Auctions may also avoid the need for complex allocation rules that might result in unintended competitive advantages, including windfall profits, for certain market participants. On the other hand, some panelists noted the political difficulties of an auction approach and suggested a gradual transition to an auction. Finally, the discussion on allowance distribution highlighted the diverse economic, regulatory, social, and political considerations associated with this issue. There were a number of creative suggestions at the conference on how to accommodate these different considerations.

Based on the discussion at the conference, we believe the following principles for allocation are emerging;

- Allowances should be allocated in a manner that recognizes and roughly addresses the disparate costs imposed by the program.
- Allowances should not be allocated solely to regulated entities because such entities do not solely bear the costs of the emissions trading program.

- A portion of the allowances should be auctioned (or used for “set-aside” programs), with revenues used to advance climate-related policy goals and other public purposes.
- Over time, an allowance distribution approach should transition from approaches that attempt to fairly compensate sectors for past investments in carbon intensive technologies to approaches that create incentives for energy efficiency and lower carbon technologies. In practice, this means a gradual transition over an extended period of time from a largely free allocation of allowances to the use of an auction as the predominant method for distribution of allowances.

Next Steps

The Committee intends to continue soliciting comments on the major points that have been summarized from the conference and on the emerging allowance allocation principles that have been described. The Committee recognizes that any proposals for a mandatory GHG program will deserve further input from affected stakeholders and Members of Congress. We encourage stakeholders and congressional offices to provide the Committee with ideas and suggestions for expanding general findings to the next level of specificity. Please contact John Peschke or Jonathan Black if you have further thoughts or input.

A transcript of the April 4, 2006, Climate Conference can be found at:
<<<http://www.access.gpo.gov/congress/senate/senate08ch109.html>>>

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