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Global Climate Solidarity

MONETIZING GLOBAL SOLIDARITY ALLOWANCES FOR THE BENEFIT OF THE GLOBALLY POOR AND VULNERABLE

Technical Options Paper for a California Pilot Scheme[1]

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1. Executive Summary

Global Climate Solidarity

The idea of the Global Climate Solidarity (GCS) initiative is to assist (sub-national) governments in providing predictable innovative funding – i.e. from outside government budgets – for the poorest and most vulnerable across the globe, in support of the Paris Agreement.

Why California? A case of enlightened self-interest.

We need developing countries fully on board if we are to overcome the climate emergency. They will not join (wholeheartedly) if they think people in the developed world do not care about the plight of the poorest and most vulnerable among them. We all need to show solidarity, and do so globally, not just in our back yard.

As befitting the world's fifth largest economy, by adopting the GCS pilot California would set a gold standard for emission trading schemes, which, when adopted worldwide, could raise significant innovative finance for the global poorest and most vulnerable.

The preferred modalities to achieve this are:

a) for sources: shares of proceeds of carbon pricing instruments, i.e. carbon taxes, or emission allowance sales; and
b) for dissemination: Enhanced Direct Access (EDA)[3], in particular and primarily through the multilateral climate funds serving the Paris Agreement.

The scope of the initiative is ultimately all jurisdictions, national and sub-national, in charge of carbon pricing instruments. Following Quebec's lead in using part of its emission trading auction revenue to fund its Paris contribution to the UN Least Developed Countries Fund, the idea is to focus the on the regional 'home' of the Quebec emission trading system, that is the Western Climate Initiative (WCI), as initial GCS catchment area.

The aim is to establish a pilot GCS scheme in California, to be replicated in and linked to similar schemes of their partners in the WCI[4] and the members of RGGI, and after that, to go global.

The California GCS pilot scheme.

The proposal is to set-aside annually a number of allowances of the California Cap and Trade Program as 'Global Solidarity Allowances' to be sold ('monetized') by a suitable non-governmental organisation on behalf of the designated recipients of the scheme, namely:

- the multilateral climate funds (receiving a proportionate majority share);
- eligible Californian civil society organization EDA-programmes for the benefit of local vulnerable communities.

[3] Enhanced Direct Access is a programmatic access modality under which the ultimate recipients of the funding (such as impacted local communities) have a say in how the funding is to be used.
[4] The trans-national character of this 'catchment area' is important as it would guarantee that the schemes are not perceived as competing with national support, but as genuinely complementary to it.

2. The California pilot: Technical Summary

This technical options paper is about setting up a GCS pilot in the context of California's Cap-and-Trade Program (CTP), managed by the California Air Resources Board (CARB), focusing on the idea to set aside a small share of allowances as 'Global Solidarity Allowances' (GSAs), to be monetized by a third party on behalf of the multilateral climate funds of the Paris Agreement and designated local CSO programmes.[5] Three key questions are being addressed in this context:

- Who would have the power to create such a fundraising scheme?
- Would there be legal/regulatory problems with the proposed use of the funds raised: to support out-of-state activities?
- How should the GSAs be set aside, and how many?

All three questions are answered by reference to precedents.

1. Given that the mechanics of the proposed fundraising scheme are based on the monetization of allowances on behalf of ratepayers, the paper looks at the history of how this scheme was set up and concludes that the CARB would have powers to establish the proposed scheme *suo motu*, i.e. on its own initiative, provided there are no legal/regulatory obstacles as regards the use of the revenue.

2. As regards this issue, and more specifically the legal/regulatory feasibility of using the funding to provide (indirect) financial support for out-of-state activities, the paper cites the fact that the California cap-and-trade regime already accepts offset credits created by, and thus financially supporting, out-of-state projects.

3. As concerns the size and origin of the proposed GSA set-aside, the paper refers to the *Clean Development Mechanism* which sets aside 2 per cent of the generated credits to be monetized for supporting adaptation projects in developing countries, and suggests setting aside allowances from the (not state-owned) *Price Containment Reserve* allowances, equivalent to 2 per cent of the state-owned ones, for the benefit of the multilateral funds, with an additional 1 percent for local beneficiaries.

The fact that the GSAs are taken out of the Price Containment Reserve means, for one, that they are not infringing on the environmental integrity of the cap-and-trade program. It also means that they are not taken away from set-asides for other stakeholders, such as industry or ratepayers, or from the state-owned allowances monetized through auctions for the state Greenhouse Gas Reduction Fund (which supports the California Climate Investment programs).

The mechanism proposed here provides a means for California to show the globally poorest and most climate-vulnerable countries and communities that they have not been forgotten (even if the size of the contributions are symbolic) and to do so without relying on state auction revenue.

3. 1. Who could operationalize it?

A key question concerning the operationalization of the proposed GCS pilot is: who would have the power to introduce such a scheme? Given that it is based on the existing allowance allocation schemes for the benefit of rate payers, one way of arriving at an answer is to have a look at how these schemes were introduced.

The 'California Global Warming Solutions Act of 2006', also known as 'Assembly Bill 32' (AB 32), authorizes CARB "to achieve the maximum technologically feasible and cost-effective greenhouse

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[5] As such, this proposal is based on the Allowance Allocation to Electrical Distribution Utilities on Behalf of Ratepayers, where the utilities in question are allocated allowances to sell, with the proviso that the funds generated be used in a specified manner for the benefit of their customers.

gas emission reductions from sources or categories of sources"[Section 38560]. It instructs CARB to prepare and approve a Climate Change Scoping Plan (Scoping Plan), which was to identify and make recommendations, *inter alia*, on market-based compliance mechanisms. AB 32 authorizes CARB to "to adopt market-based compliance mechanisms" and also explicitly allows it to develop relevant regulations [38570]. But there are no specific design stipulations on issues such as the issuance of allowances for the benefit of ratepayers. AB 32 instructs CARB to "convene an environmental justice advisory committee [EJAC] to advise it in developing the scoping plan"[38591.a] and "appoint an Economic and Technology Advancement Advisory Committee [ETAAC]"[38591.d].

In December 2008, CARB publishes the AB 32-mandated Scoping Plan. It took into account an ETAAC Report (February 2008) suggesting that allowance auction revenue be used, *inter alia*, for direct payments to ratepayers, as well as the recommendations by the California Energy Commission (CEC) and the California Public Utilities Commission (CPUC) that "revenue generated from the electricity sector under a cap-and-trade program be used for the benefit of that sector to support … customer utility bill relief."[Scoping Plan, p.70] The final Scoping Plan recommendations on "possible uses of allowances and of the revenue generated under the program" included both proposals (p.71):

- *Consumer rebates* – Utilities and other businesses could use revenues to support and increase rebate programs to customers to offset some of the cost associated with increased investments in renewable resources and to encourage increased energy efficiency.
- *Direct refund to consumers* – Revenue from the program could be recycled directly back to consumers in a variety of forms including per capita dividends, earned income tax credits, or other mechanisms.

However, note that while discussing the use of 'set-asides' of allowances (p.35), these recommendations were about the use of state auction revenue, that is to say, revenue derived from the sale of state-owned allowances, *not* about allocating other (i.e. non-state-owned) allowances for monetization by utilities on behalf of rate payers.

Building on the Scoping Plan, CARB staff developed the regulatory proposal in 2009/10, involving public consultations through more than 30 workshops. The Initial Statement of Reasons was posted on 28 October 2010, including the proposal for a Regulation Order ('California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms').

The regulatory proposal specifies how allowances are to be used and introduced, among other things, the *Allowance Price Containment Reserve*, as well as reserves for direct allocations to electrical and gas distribution utilities to protect the relevant ratepayers. Each of the covered utilities was to open a holding account to receive a predetermined share of the relevant reserve. The proposal also specified how the utilities are to monetize these allowances, and how the proceeds are to be used for the protection of the ratepayers. The final Regulation Order, with the electrical distribution utilities scheme [95892], was posted on 22 December 2011.

The genesis of this scheme thus clearly demonstrates that introducing allowance set-asides such as the proposed *Global Solidarity Reserve* and third-party monetization programs of such set-asides, is fully in the gift of CARB, which could introduce the proposal as part of the regular amendments of the CTP regulations.

Such regulatory changes generally involve both an informal and a formal process. Thus, starting in October 2017, the CARB held a series of informal workshops where proposed changes to the regulations were presented for feedback from stakeholders. In September 2018, the CARB released its formal regulatory package for public comment, which was ultimately approved by CARB in

December 2018 and then entered into force in April 2019. In general, the formal process can take anywhere from eight months to more than a year from start to finish.

4. 2. Financial support for out-of-state activities?

Having established that CARB has the power to create such third-party allowance-monetizing schemes *suo motu*, there is another key question that needs to be addressed, namely whether using funds thus raised to contribute to the multilateral climate funds would be a (legal/regulatory) issue? Are there legal or regulatory obstacles to supporting out-of-state activities in the proposed manner?

AB 32 & the Climate Change Scoping Plan

In Section 38501 of AB 32, "the Legislature finds and declares" that:

- "national and international actions are necessary to fully address the issue of global warming";
- California "has long been a national and international leader on energy conservation and environmental stewardship efforts";
- the "program established by this division will continue this tradition of environmental leadership by placing California at the forefront of national and international efforts to reduce emissions of greenhouse gases"; and
- "action taken by California to reduce emissions of greenhouse gases will have far reaching effects by encouraging other states, the federal government, and other countries to act."

CARB's original (2008) Scoping Plan, in turn, contains a section on international collaboration with a number of statements also pertinent to the question discussed here [emphases added]:

- "California hopes to engage developing countries to pursue a low-carbon development path. With developing nations expected to suffer the most from the effects of climate change, California and others have an *obligation to share information and resources on cost-effective technologies and approaches for mitigating both emissions and future impacts* as changes in climate and the environment occur."
- "California recognizes the 'common but differentiated responsibilities' among developed and developing countries (as articulated in the Kyoto Protocol)".
- "[I]t is critical for California to help support the adoption of low-carbon technologies and sustainable development in the developing world."
- "California recognizes *the importance of establishing mechanisms that will facilitate global partnerships and sustainable financing mechanisms* to support eligible forest carbon activities in the developing world."[Chapter V: "A Vision for the Future"]

The proposed GCS pilot scheme would clearly be consistent with this CARB 'manifesto' on international engagement, as well as with the relevant views of the Legislature as expressed in AB 32. However that, in itself, does not necessarily mean that the use of funds collected to support out-of-state activities would be consistent with the existing laws and regulations.

It is important, in this context, to note that the proposed scheme is deliberately designed so as not to involve state revenue subject to state appropriations. In other words, the support provided through the scheme would not be direct state support, in the same way in which the support provided to utility ratepayers is not a (direct) state subsidy.

A Precedent

As it happens, there is already a scheme used in the CTP which provides (indirect) financial support for out-of-state activities: the Compliance Offset Program.

The use of ‘offsets’, that is to say project-based emission reduction certificates *in lieu* of allowances in complying with emission caps, is a well-established, albeit not always uncontroversial, practice. Probably the best-known example is the Clean Development Mechanism (CDM) under the Kyoto Protocol, which uses *Certified Emission Reductions* (CERs) as offsetting units. Developed country emitters purchase CERs to reduce compliance costs. However, the fact that *only* projects in developing countries were allowed to generate CERs, and the very name of the scheme, reflect the intention that it was seen as a tool to transfer value from developed to developing countries, not only in the form of funding but also technology. At the same time, it was also realized from the outset that given the market-based distribution of this support, the poorest and most vulnerable countries would be left out by virtue of having, relatively speaking, no emissions to reduce (this is why the CDM was sometimes referred to as the ‘China Development Mechanism’). This led to the adoption of an additional ‘pro poor’ measure, a ‘share of proceeds’ to “to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation.”[Art. 12.8, Kyoto Protocol]. This was operationalized by ‘charging’ 2 per cent of the CERs generated by a project and depositing them with the newly founded multilateral Adaptation Fund, to be monetized for the purpose specified in Art. 12.8, on behalf of, as it were, not ratepayers but the poorest and most vulnerable countries and communities around the world.

The California Compliance Offset Program also allows for emission reductions outside the state emission cap, indeed, outside the state boundaries, to be used as offsets, while at the same time geographically restricting the provenance of such offsets by stipulating that only projects carried out in the US can generate ‘offset credits’. The main reason for introducing offsets into the CTP program was, no doubt, economic efficiency, that is to say to reduce the cost of compliance for the covered emitters – indeed, it stands to reason this was the *only* motive. What is clear, given the said geographical restriction, is that offsetting was not introduced to show solidarity with vulnerable developing countries. However, the fact is that establishing the Compliance Offset Program did create value and provide the basis for the sort of (indirect) financial support of out-of-state activities envisaged under the GCS pilot scheme. So it stands to reason that since the former was not seen to be legally problematic, neither should the latter.

This is not to say that there have not been issues with offsetting in California – far from it. But the issues that have been raised are different ones: they are about the *environmental integrity* of offsetting in general, and about *moral injustice*, particularly in the context of out-of-state offsets.

The concern that offsets could violate the environmental integrity of emission caps, that is to say increase the level of permitted emissions, is by no means restricted to California. It has, in part, to do with the ability to overstate fraudulently the emission reductions that have been achieved by an offsetting project, and the ability of the regulator to take legal action against such fraud. This may well have been a reason why out-of-state offsetting was restricted to the sovereign territory of the US.

The push-back on out-of-state offsets – particularly strong in the Environmental Justice community – was taken up in the 2017 legislation (Assembly Bill 398) that extended the CTP program to 2030, by:

- requiring CARB “to develop approaches to increase offset projects in the state”; and
- essentially limiting the use of out-of-state offsets to not more than half the offsets permissible to comply.

As to motivation, Jonah Kurman Faber put it like this: “let’s be abundantly clear – there are major environmental justice concerns regarding the legitimacy of offset projects … the moral injustice of

allowing the polluting facilities … to send money and resources to other solutions, rather than investing in the local people their pollution is actively harming."[6]

There is indeed a justice imperative – sometimes referred to as the 'polluter pays principle' – which demands that polluters make good the harm they have caused by polluting. The problem is that – unlike air pollution – 'greenhousegas pollution' does not just harm the people near the source. The 'local people' that are being harmed are spread across the globe, and it would be wrong to ignore them just because they are not California residents. Having said this, greenhouse gas emitters are, more often than not, also polluting the surrounding air and the people living in their vicinity, particularly the poor, do need to be protected – as is happening under CARB's Community Air Protection Program,[7] funded through California Climate Investments state allowance auction revenue. The point is that from an environmental justice perspective, both concerns should be treated as equally valid.

The mechanism proposed here provides a means for Californians to show solidarity with the poorest and most vulnerable countries and communities across the globe, to show that they have not been forgotten (even if the contributions are symbolic), and to do so without relying on state auction revenue that should be the source of support for California's local poor and vulnerable.

5. 3. How much, how many, and where from?

A contribution by California to the climate funds serving the Paris Agreement must be seen to be fair, both within and outside California. It must be of a size that is proportionate with California's rightful claim to international climate leadership, but it also must avoid being disproportionate relative to competing domestic demands. Finding California's 'fair-share contribution' in this context is absolutely key for the viability of the GCS pilot idea.

As regards the primary source of GCS pilot income, the question is: what would be a fair-share of CTP proceeds to be earmarked for the GCS pilot? Fortunately, there is an internationally established precedent, namely the share of proceeds of the CDM, which has also been included in the trading mechanism established in Art 6.4 of the Paris Agreement. In the case of the CDM, the figure adopted was 2 per cent, and it is likely that the Paris mechanism will follow that precedent. Following that precedent, the use of 2 per cent of California's CTP proceeds as benchmark for the GCS pilot contribution could not only be defended as fair internationally, but it would have the added benefit of aligning the CTP with the Paris Agreement.

The basic idea here is that allowances corresponding to 2 per cent of state-owned allowances allocated for the period of 2021 to 2030 – that is approximately 23 million tCO2e[8] – would be set aside as 'Globas Solidarity Allowances' (GSAs), to be monetized by a third party on behalf of the climate funds serving the Paris Agreement and channelled through the WCF.

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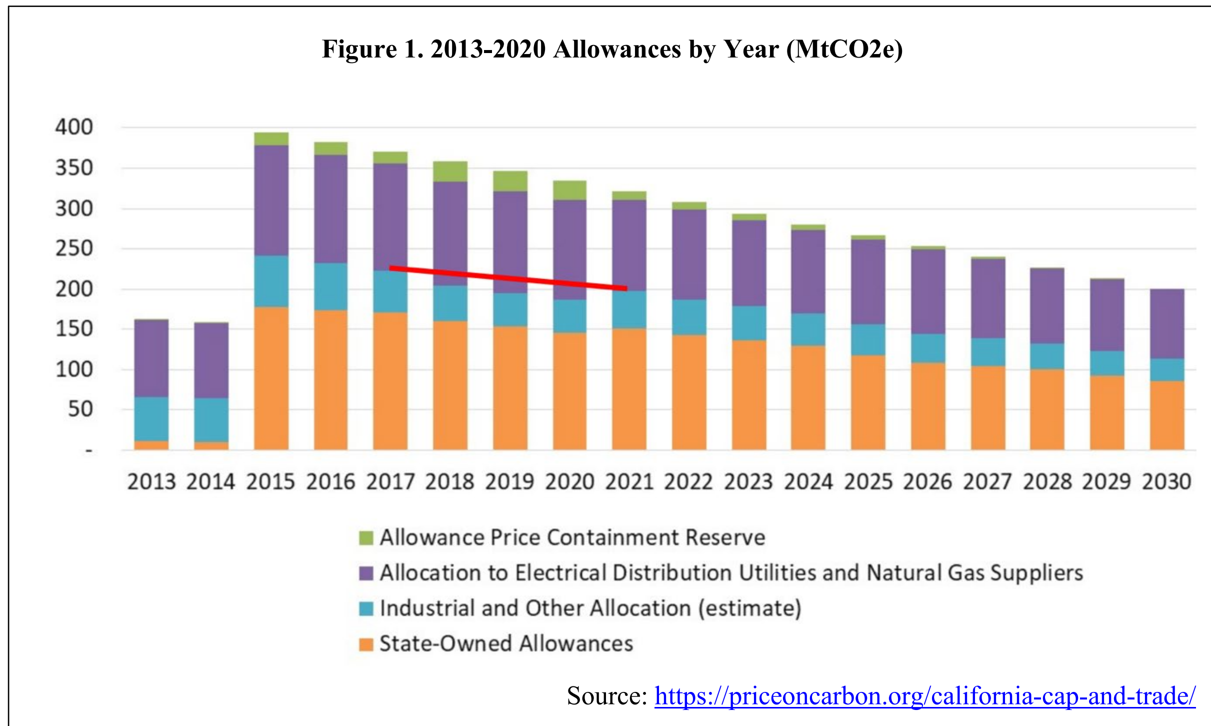
[6] "The (other) problem with offsets in California"
[7] In response to Assembly Bill 617, CARB established the Community Air Protection Program, whose focus is to reduce exposure in communities most impacted by air pollution.
[8] According to Figure A, the sum total of state-owned allowances over the period of 2021-30 is 1,150 million tCO2e.

Introducing such a category of allowances is, in principle, in the gift of the CARB and would be carried out through a change of the CTP regulations (although there may be a need for some legislative changes, depending on the 'provenance' of the GSAs). Before turning to the different possible provenances, let us consider how much funding could be generated by monetizing these 23 million allowances over the period 2021 to 2030. Assuming they are sold in annual lots proportional to 2 per cent of the respective annual state-owned allowances at the auction floor price, this would generate on average **$48 million per annum.**[9]

Figure 1. 2013-2020 Allowances by Year (MtCO2e)



Source: https://priceoncarbon.org/california-cap-and-trade/

Returning to the provenance question, GSAs could be introduced as a new category, or taken from the existing four categories, illustrated in Figure 1

A. New Category. The 23 million GSAs could simply be added as a new allowance category. This would reduce the ambition of the CTP for that period by increasing the total GHG Allowance Budget for the period, but only by 0.9 per cent.

One way in which this could be addressed is by making a compensating adjustment in out-of-state offsets credit limits, but that would require legislative action, as they are stipulated in (AB 398) Section 38562 c.2.E

Alternatively, there is of course the option to reduce one (or several) of the other four allocation categories. For simplicity's sake, let us focus on the 'pure' provenances.

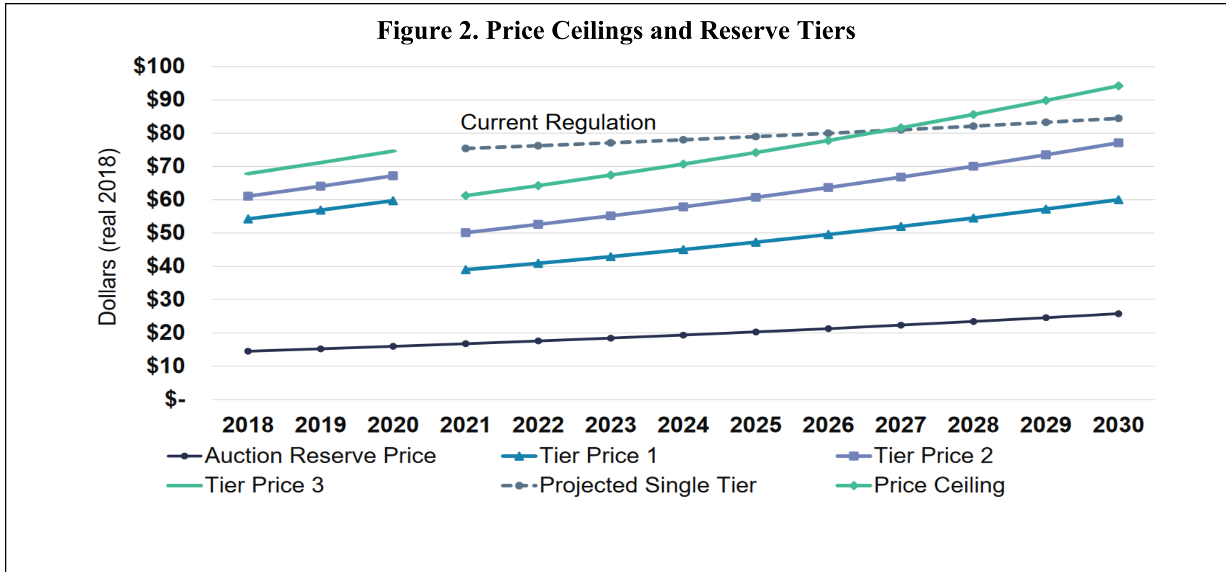
B. State-owned Allowances. Re-designating 2 per cent of State-0wned Allowances as GSAs would, on the one hand, remove the GSA revenue from the budget appropriation process, but it would also reduce the state auction revenue, albeit by only a small fraction, which might lead to a push-back from the beneficiaries of the revenue of state allowance auctions.

C. Industrial Allocations, Allocations on Behalf of Rate Payers, and Other Allocations. It stands to reason that the designated recipients of these categories would push back against such a reduction

[9] Starting with $52 million in 2021 (assumed floor price $17.2) end ending with $40 million in 2030 (assumed floor price $26.7).

of their allocation, not least because it might be seen as being unfair: "Why should we pay for a scheme for the benefit of the state's international standing?"

D. Allowance Price Containment Reserve (APCR). Finally, the GSAs could be taken from the APCR, which to date has remained untouched and has grown considerably over time. Indeed, if that trend were to continue, the APCR would, in 2020, contain 159 million allowances. Moreover, the fact that, thus far, no-one has made user of the APCR means that at present there are no actual beneficiaries that would be impinged by this.



Moreover, given that according to AB 398[10] the current APCR regime is to be superseded in 2021 by a price ceiling which, in the regulatory amendments approved in 2018, is operationalized as three Reserve Tiers, the CARB has decided to re-allocate one third of the APCR and divide it into three equal-sized pre-2021 Reserve Tiers (see Figure 2), all at prices below the current APCR benchmark, with the remaining two-thirds of APCR (106 million) allowances not to be made available as reserve sales until 2021 [Section 95913]. It thus stands to reason that CARB could also reallocate the required 23 million GSAs from the remaining two-thirds of APCR allowances, at least if this is done **before 2021** when, according to AB 398, all remaining APCR allowances "shall be utilized solely for the purpose of sale at the price ceiling".[11]

[10] Section 38562. C.2.A.
[11] Ibid.

6. Literature

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