A key part of California's climate policy has always been its cap and trade system. Because the regulations aren't very transparent, there have been a lot of misconceptions about the system. I've been digging into the rules, the explanatory website set up by the California Air Resources Board (CARB), and secondary sources to try to figure some of these things out.

Despite complexities, the basic idea behind the trading system is simple. The state sets an annual cap on emissions, distributes allowances (permits to emit a ton of carbon), and then allows the recipients to trade those allowances amongst themselves. The idea is to allow the private market to figure out the cheapest way of reducing emissions. An important side-benefit is that allowance auctions have generated $4 billion for the state to spend on carbon reduction projects.

Here are some half-truths and outright myths about the trading system.

"The cap and trade system is insanely complicated."

> **Half-Truth.** It's definitely complicated — just take a look at CARB's 400+ pages of regulations. The reason I'm calling this a half-truth, however, is that regulating big industries is inherently complicated. It's not clear that the cap and trade regulation is any more complicated than the federal EPA's major emissions regulations.

"The cap and trade system is California's only carbon reduction strategy."

> **Myth.** Far from true! For instance, the primary pressure on electric utilities to cut emissions comes from regulations issued by the California Public Utility Commission, not CARB. In fact, because other California laws were cutting emissions so much, it has only been in the last few years that the allowances prices have risen above the floor level set by CARB.

"In practice, the cap and trade system is just a carbon tax."

> **Half-truth.** In practice, California's system is a hybrid, with some aspects of a tax and some of an emissions cap. Until the last few years, there have been more allowances than emitters had any immediate need for. For that reason, CARB's minimum price has functioned like a tax.
>
> It's also true that there's a price ceiling, which is again something like a carbon tax. Yet the regulations do attempt to preserve the integrity of the annual

emission caps. When the state runs out of allowances in a given year, emitters can pay the ceiling price in order to comply — but the state must then use the funds to procure verifiable and equivalent reductions in emissions outside the trading system. Thus, the intent is that the quantity caps will remain controlling in terms of the state's total emissions. That's different from a tax.

"Carbon prices are passed on to utility ratepayers."

Myth. The regulations provide an elaborate system in which utilities are given free allowances which the state then sells at auction. But the proceeds must be used either to benefit utility consumers or for additional emissions reductions. In the past, utilities have heavily favored rate reductions as the choice.

"Cap and trade keeps coal plants alive."

Myth. For understandable reasons, environmental justice advocates were very worried about this when California first adopted its cap and trade system. It hasn't proved to be a problem. Of the coal plants in operation when the cap and trade system was adopted, only one remains in operation.

It remains to be seen how effective the system will be as California tries to ramp down emissions more quickly. It could well require some modifications to get the desired results. To date, however, the regulation seems to have worked as advertised.