

## **Carbon Pricing and Other Economy-wide Strategies**

**Report Date – July 1, 2022**

**By The Utility Consultation Group<sup>1</sup>**

### **Key Insights**

- Chapter 17 of the Climate Action Council’s draft Scoping Plan identifies options for public input related to economy-wide strategies generally aimed at introducing a price for carbon emissions (i.e., “carbon pricing”) or a clean energy supply standard to help achieve emissions reductions to meet CLCPA targets. The plan states that “a well-designed program could support economic development and innovation in New York and reduce existing disproportionate burdens of GHG and other emissions in Disadvantaged Communities,” and also recognizes that “a poorly designed program could increase economic burdens on New Yorkers and New York businesses, reducing New York’s competitiveness.”<sup>2</sup>
- The success of carbon pricing programs depends on many factors. An appropriately designed carbon pricing mechanism could leverage market signals to drive needed carbon emissions reductions, and do so in a way that is cost-effective and efficient. Revenues from carbon pricing could be used to fund the investments needed to achieve the clean energy transition, improve infrastructure resiliency, and address environmental justice needs. Implementing carbon pricing at the economy level could also ease pressure on utility customer bills by appropriately spreading the costs across all sectors of the economy. The impacts of carbon pricing to low- and moderate-income (LMI) customers must be considered and addressed.
- Similarly, an appropriately designed clean energy supply or related standard could result in reduced emissions and/or emissions intensity while stimulating the advancement of technologies that promote energy reliability and enable customer choice.
- Given the complexity of the State’s energy transformation, involving multiple existing and new energy systems and technologies, and directly impacting residents, businesses and industries, the design and implementation of any of the strategies identified in Chapter 17 should be preceded by significant analysis and consideration. If adopted in New York, such strategies must be complementary to other policies or programs so the *overall* suite of initiatives is cost-effective and efficient.

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<sup>1</sup> The Utility Consultation Group (UCG) was formed in December of 2020 in connection with the Climate Action Council (CAC or Council) to provide expertise to the Council and act as a resource for its Advisory Panels as they develop recommendations for the Council. The participating utilities include: Consolidated Edison Company of New York, Inc.; Central Hudson Gas and Electric, Inc., The Municipal Electric Utilities Association of New York State; National Fuel Gas Distribution Corporation; National Grid; New York State Electric and Gas, Inc.; Orange and Rockland Utilities, Inc.; and Rochester Gas and Electric, Inc.

<sup>2</sup> DSP at 252.

## **Guiding Principles for Carbon Pricing**

If adopted, any carbon pricing program should be designed to:

### **Maximize geographic scope**

Generally, the broader the geographic scope, the more effective the program - national is better than regional, and regional is better than state-specific. Mandatory carbon prices that are not uniform across regions or economic sectors may cause economic dislocation and may increase overall emissions relative to their efficient level. A New York-only program could increase burdens on state residents and businesses who already will be bearing costs of other elements of the energy transition, and could increase economic and emissions leakage. As noted in the Draft Scoping Plan, any mechanism adopted should be designed “in a way that does not unduly burden New Yorkers and create disadvantages to New York’s competitive position – with other states, with the nation as a whole, or with the global economy.”<sup>3</sup>

### **Maximize economic reach**

A well-designed carbon pricing program should encourage cost-effective decarbonization across the *entire economy* by embedding an appropriate cost of carbon in business and customer decisions. The burden to reduce emissions should be fairly distributed across all sectors. Sector-specific programs that impose carbon pricing on one or a small handful of sectors generally do not fairly represent the value of carbon in society. A narrow application of carbon pricing could raise significant concerns with inter-sector leakage and equity, distort consumer decision-making, and/or lead to inefficient and undesirable outcomes especially where sector substitution is possible (e.g., imposing carbon pricing on gas but not delivered fuels (like oil or propane)). Similarly, if carbon pricing is focused only on the power sector, commuters or commercial enterprises who use electricity as fuel for electric vehicles would be penalized, while those who use gasoline or diesel for conventional internal combustion vehicles would not see a price signal to shift to cleaner alternatives.

### **Set an Appropriate Price**

Setting the “right” level of carbon price is very important and not obvious. In theory, a carbon tax or price that is economically efficient should be set equal to the marginal cost of the environmental harm – if the tax is too high, economic actors (regulators, producers and consumers) will divert more money and resources to abatement than is necessary, and if the tax is too low the same actors will divert too little. In other words, a fee that is set so high as to attempt to eliminate all or most emissions will be very expensive and inefficient and a fee that is set very low will be ineffective. A properly designed program should set the price at an economically

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<sup>3</sup> Draft Scoping Plan, at p. 252.

efficient level that achieves material emissions reductions but does not result in unintended financial, reliability or other consequences.

### **Properly Time Implementation**

Generally, all sectors participating in carbon pricing should commence as closely in time as possible to avoid inter-sector leakage based on timing rather than emissions impacts. The right time to implement these types of strategies, whether economy-wide or sector-specific, must be weighed carefully with regards to 1) customer outcomes 2) cross-sectoral or regional interactions that may result from a staggered or targeted implementation, 3) significant economic and emissions leakage concerns, and 4) continuing reliability and resiliency of the State's energy systems. The timing of usage of funds to mitigate customer impacts also should be carefully weighed before any recommendations are adopted.

### **Protect Vulnerable Sectors**

A well-designed program should send clear economic signals, but create protections for vulnerable parties and sectors. Carbon pricing generally should provide market signals that drive efficient behavior and discourage carbon-intensive activities or products. Funds from carbon pricing should be utilized to further support equitable and affordable decarbonization through investment in infrastructure needed to advance CLCPA requirements, alternative fuel/energy technologies, mitigation of equity concerns, and additional funding for customer end-use investments that promote decarbonization. Revenues from the program could also be directed to those entities least capable of avoiding or absorbing the costs (e.g., disadvantaged communities, energy-intensive, trade-exposed industries) without muting the market signal created by the carbon price. If carbon pricing is adopted for the energy sector, customer protections can be provided either through adjustments to the existing energy affordability programs or similar programs administered by the Public Service Commission (PSC). If carbon pricing is implemented in other sectors, care should be taken to mute the economic impacts on disadvantaged communities.

### **Complement Other Programs**

Any carbon pricing program should complement non-market policies and programs. A well-designed carbon pricing program must coexist alongside non-market based policies aimed at reducing carbon emissions. For example, carbon pricing schemes should consider existing emissions-related taxes, surcharges, or subsidy collections already built into energy rates. Price signals resulting from the sum total of emissions reduction programs should be consistent with each fuel's lifecycle emissions and not distorted by additive or compounding programs. It also is possible that a carbon pricing program might more efficiently reduce carbon emissions than traditional command and control program structures; in which case, the State should be prepared to move promptly to eliminate or simplify redundant or ineffective programs that absorb

administrative resources and potentially increase the burden on the State's businesses and residents.

Policy makers should consider strategies that focus on reducing emissions intensity or emissions themselves. These differ from carbon taxes or carbon pricing because such programs establish an emissions limit or low carbon fuel standard to be met, and the market determines the price of measures of achieve emissions allowances or the low-carbon product in response to the limits or standard. Such initiatives could catalyze clean energy supply markets, leverage competition to deliver efficient emissions reduction opportunities and facilitate consumer choice while lowering emissions. As with carbon taxes or carbon pricing, setting appropriate emissions limits or product standards is key to avoiding inefficiencies or distortions, and minimizing leakage between regions and sectors.

**In conclusion**, as a precursor to development and implementation of a carbon price or other pricing or emissions reduction strategy, the State should quantitatively study these initiatives in a holistic manner to fully understand the environmental benefits, economic impacts and energy industry outcomes (e.g., resource mix, reliability, resiliency, etc.). The UCG stands ready to work with State leaders and stakeholders to consider the economy-wide programs identified in the draft Scoping Plan that could help New York reach the CLCPA's goals more quickly, efficiently, and equitably.