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Thanks, it's great to be back in Oregon and back at the Portland City Club.

There are people in this room who may not be old enough to remember that there was a time in America when our rivers caught fire. The Cuyahoga River caught fire in 1969; others may not remember that the Willamette River was an open sewer in the late 1960s.

In response, Congress passed the Clean Water Act in 1972. The Clean Water Act established a regulatory scheme to prohibit unauthorized discharges of pollution into our waterways. The approach was very straightforward: we went out and inventoried the pollution, we gave polluters targets, monitored them, and if polluters didn't meet those targets, we fined the heck out of them.

It worked. In fact, it's one of the most successful environmental programs in the history of the United States. We cleaned up our rivers, streams, and waterways with extraordinary success and without imposing unreasonable costs on business and industry.

There are certainly new challenges with clean water, but the Clean Water Act is alive and well and evolving now to deal with non-point source pollution threats and concerns. So, it's still a very viable act.

But, today, we face the greatest environmental challenge of all time. It's a problem that is global in nature but with the potential for dire and unpredictable regional and local impacts: climate change.

Since the beginning of the industrial era, the U.S. has emitted far more greenhouse gases than any other country. Today, we are surpassed by only China.

But during the eight dark years under the Bush administration, we had a government that refused to acknowledge there was a problem with climate change and an administration that certainly didn't take any leadership in resolving this issue.

Well, all that changed with the election of Barack Obama. Now we are finally confronting the problem. Just this week the Obama administration released a report in collaboration with "The United States Global Change Research Program," a joint scientific venture of 13 federal agencies and the White House, warning that the U.S. will not be able to stop some climatic changes even with immediate and dramatic action. This is a very real challenge.

I'm not here to give Al Gore's "Inconvenient Truth" presentation. But because of my outspoken opposition to a cap-and-trade, there has been some confusion about my views on global warming. I want to make it clear that I am now, and have been for a number of years, convinced by the science that global warming is happening, human activity is substantially responsible for rising temperatures, and the United States of America must take immediate and effective action and lead the world in dealing with this problem.

Basically, we've got three options:

* The Clean Water Act model -- cap, regulate, reduce, monitor;

* A carbon tax; and

* A market-based, cap-and-trade system as planned in the American Clean Energy and Security Act (ACES) or the "Waxman Bill."

I'm going to spend a good deal of time talking about cap-and-trade and then discuss what I think is a more viable alternative. You had a brief discussion here of how cap-and-trade works. The government sets a cap on greenhouse gas emissions,; then the government would give participants "allowances" to pollute up to the established cap. Participants may buy, sell, and trade these allowances in the market to meet their emission targets. In theory, emissions will drop as we issue fewer allowances.

There is also another component of a cap-and-trade that is less known called "offsets." Offsets are really at the crux of my most dire concerns about where a cap-and-trade would lead the U.S. and where it would lead the world.

There is already documentation of widespread abuse of offset projects approved under something the Kyoto Protocol established, which Europe is using, and which the United States would mimic. It's called the Clean Development Mechanism.

I will digress for a moment here. Twelve years ago I came to the City Club and gave a speech against something that was very current, everyone was really excited about, and that the NRDC, Wall Street, and big business all thought was the way to solve major problems in this country. It was called energy deregulation. I came here as one of the very few in the House of Representatives to vote against Ed Markey's proposal to deregulate energy and predicted what a disaster it would be.

I wish I had been wrong. It turned out to be an extraordinary disaster. In just two years under deregulation, electricity rates in California jumped from \$30 per MWH average to \$300 per MWH average, and the state had spikes as high as \$1,900 per MWH.

There was a lot of money to be made in a deregulated electricity market- and ENRON made a lot of money manipulating and gaming that market. ENRON is now gone, but their legacy - and the legacy of deregulation - lives on. We have paid more than \$1 billion in the Pacific Northwest for our power unnecessarily. That money could have been better spent had it not been for the inflated contracts that we entered into and that couldn't be rolled back.

Now, Ed Markey, the father of energy deregulation, and Henry Waxman, have taken a page from the ENRON playbook. That page is cap and trade.

As far as anyone can tell, the first major and most persistent proponent of cap-and-trade was ENRON. They spent millions of dollars and hundreds of hours lobbying the Clinton Administration in the 1990's for a market-based approach to deal with carbon emissions.

Enron executive John Palmisano wrote in a private memo in 1997 that stated the Kyoto Protocol treaty and a cap-and-trade system would be "good for Enron stock." The memo went on to predict that an under-regulated market "would do more to promote Enron's business than would almost any other regulatory initiative outside of restructuring, [that is deregulating,] the energy and natural gas industries in Europe and the United States."

Enron is gone; but the excitement lives on on Wall Street. Here's a quote from Chris Leeds, head of emissions trading at Merrill Lynch, "Carbon could become one of the fastest-growing markets ever, with volumes comparable to credit derivatives inside of a decade."

Credit derivatives? Anyone remember that?

This is a quote from Simon Glossop, founder of CF, a hedge fund designed to track and make money off the price movements in carbon, "Carbon has now become an [investible] asset class in its own right instead of a compliance tool... The volatility around the market's

policy risk is actually good for us from an investor point of view, so we encourage it." [\[1\]](#)

Of course it's not good for us as consumers or for those who are truly concerned about carbon emissions reductions.

Europe implemented a cap-and-trade system in 2005. The downturn in the economy has changed things a little but for the first two years Europe emitted more carbon and added \$60 billion in costs trading carbon. Let me say that again, Europe emitted more carbon and spent \$60 billion under a cap-and-trade.

We don't have emission figures for last year, but initial estimates show emissions may be down a little. But that's not due to cap-and-trade, it's more likely due to the tanked economy. US emissions were also down for last year about 2.8 percent - the biggest drop in 30 years in the United States. Of course we haven't adopted any changes in policy. It's just merely because plants have been shut down, people are travelling less, and the global economy is in recession.

Europe has a deregulated carbon market. In other words, anyone can buy, sell, and trade carbon allowances including speculators, hedgers, and sovereign wealth funds. That's why Wall Street is so excited about this cap-and-trade proposal. The Markey-Waxman Bill being considered by Congress would create a thinly regulated carbon market. But we don't exactly have a good track record of regulating derivatives and other exotic financial instruments in this country. The President has proposed something that hopefully will be adopted, it should be stronger, but it will start to put a stop to this type of gaming in energy markets.

Europe also allows polluters to use offsets. As I mentioned earlier, offsets allow polluters to forego any meaningful change in behavior by investing in projects in developing countries. There are some good offsets out there that are legitimate. But most studies show offsets are dubious and difficult to verify. For example, a report by David Victor, the head of Stanford University's Energy and Sustainable Development Program, found that "between

a third and two-thirds" of offsets used in the European cap-and-trade do not represent actual emissions cuts.

Offsets are a little abstract, so let me give you some examples.

Every year, China and India refrigerant gas manufacturers produce a gas called HCFC-22. The production of HCFC-22 gas produces HFC-23 gas, which is an unbelievably horrible greenhouse gas; it is 12,000 times more virulent than regular carbon dioxide. In the U.S., Europe, and Japan - or anywhere else where refrigerant gas is produced - our law requires that the byproduct gas HFC-23 be destroyed during the manufacturing process. Well, China and India don't do that. They collect the gas and pipe it to another plant where the gas is destroyed for a profit.

Here's how it works: Deutsch Bank enters into an agreement with Chinese and Indian companies who are storing this really bad greenhouse gas, which costs about \$1 a ton to dispose of. Deutsche Bank pays \$8 a ton to buy the offset generated by the destruction of the HFC-23 gas, giving the Chinese and Indian companies a \$7 profit margin per metric ton. Deutsch Bank then sells the offsets to European companies that don't want to cut their emissions for \$20 a ton.

It's estimated that if all the Chinese and Indian companies were to install the proper equipment to destroy the gas during the production process, it would cost about \$157 million. But last year Chinese and Indian companies got paid \$7.3 billion to destroy the toxic gas.

Meanwhile, European companies don't have to meet their emission caps because they bought the destroyed gas in Asia. There's no net decrease in carbon. That's why emissions are up in Europe.

I'll give you one more example because a lot of environmental groups believe this is how we're going to save the rainforests. They expect that U.S. companies will go down and invest in offsets to save the Amazon rainforest in Brazil. But that may not be the most profitable thing going on down there. Brazil has some of the strongest environmental laws in the world. But these laws have not prevented illegal logging and the rapid deforestation of the rainforest.

Much of the continued illegal logging and deforestation is attributable to Brazil's drive towards industrialized agriculture. There's a company called Plantar that owns about 57,000 acres of rainforest in Brazil. They clear cut it - having the usual catastrophic effects on the flora and fauna and neighboring people. They then plant a monoculture of eucalyptus trees.

Nearby there is a low-grade iron-ore smelting plant which uses coal. Plantar receives credits for destroying the rainforest and planting eucalyptus trees which will be used to produce charcoal to run the iron smelter. An offset is created because the eucalyptus trees were used instead of coal.

I would argue that we've just lost another 57,000 acres of rainforest and these people are not providing a net-benefit or helping reduce greenhouse gas emissions. I'm very skeptical that this will somehow be the salvation of the rainforests.

In the U.S., the Waxman Bill would allow U.S. polluters to use up to 2 billion metric tons of offsets - that's about 1/3 of what we emit - and they can do it in offsets. A recent report by the Congressional Budget Office predicts U.S. polluters will use offsets to meet up to 61% of emission targets. So if the offsets aren't real, they don't reduce carbon emissions in the U.S., and in fact add costs to consumers, why would we want to incorporate them into a cap-and-trade system? Do offsets help us achieve our objective of reducing emissions? No.

There's one think tank, called the Breakthrough Institute that has completed an analysis of the Congressional Budget Office report. In the report, they found that there's another unique feature of Markey-Waxman: we're going to give away allowances to polluters for free. President Obama originally said all allowances should be auctioned. The Europeans said they made a big mistake by giving them away and should have auctioned them. But in order to get agreement to move the bill forward, the Waxman Bill had to water things down by giving polluters allowances for free.

They came up with another great idea: you don't have to use allowances right away; in fact, you can keep them forever. This allows polluters to go overseas and buy an offset when allowances are expensive at home. It also allows polluters to bank allowances so when the price of offsets overseas goes up, they can draw on their banked allowances to keep polluting.

Breakthrough Institute estimates that a combination of the bankable allowances and the offsets could result in a total reduction of a mere one-half of one percent in the U.S. by 2020 in capped industries. You might quibble with their analysis, but you can see how this can be gamed and that's very much a problem.

Then there's the potential problem with the carbon bubble itself. In Europe, they've already developed carbon futures, carbon offset futures, carbon derivatives, and now they are slicing and dicing them into special investment vehicles like tranches of carbon. Traders call these complex financial tools "gourmet carbon" and "junk carbon." Does any of this sound familiar? Having something to do with mortgages in the U.S.? But Wall Street is going to do this with carbon and they think it's going to be an even bigger market than the mortgage market was here in the United States of America.

In the back of the room I've got a copy of a report by Friends of the Earth, a well regarded environmental group, except by some of their colleagues right now, who put out a report called "Subprime Carbon." It makes very interesting reading. I recommend it to you; you can pick up a copy on the way out, or access it from my website.

Ok, what's my alternative? You shouldn't complain about something unless you've got an alternative. It's kind of out of fashion.

One more digression: the Obama Administration has started to regulate carbon dioxide. There was a Supreme Court decision in 2007 validating the EPA's authority to regulate carbon dioxide under the Clean Air Act. However, the Bush administration wouldn't implement it. Under the Obama Administration, the EPA has filed a notice that they are going to regulate carbon emissions because of the pollutant's impact on public health. This ruling establishes the beginning of a regulatory process. The Waxman Bill would prohibit - prohibit - the EPA from going forward with its regulatory approach. Instead, we are being asked to put all our eggs into the market-based approach basket.

But here's the irony: if you're going to have a market-based approach you first have to establish a regulatory system. For a cap-and-trade to be viable the government will have to establish a cap, then government will inventory our pollution sources; next government regulators would provide all polluters with individual caps; Finally, a monitoring mechanism must be created.

Next, a cap-and-trade superimposes a market-based system on top of the regulatory structure. Proponents of the bill claim the market will make the system more efficient, more effective or as the *Oregonian* editorialized, less expensive.

How is it less expensive? A regulatory program provide certainty and predictability where potential investors can look out 20 years and say, I can make an investment because the emission targets are clear and the price of allowances is stable.

By comparison, a market-based cap-and-trade system brings volatility and uncertainty to reducing emissions. For example, in Europe the price of carbon allowances has fluctuated between \$30 a ton to \$1 a ton - and it's currently trading at somewhere around \$8 a ton. If you invested in technology last year at \$15 a ton, you're probably broke and out of business. If you're a utility, and you want to plan for the future, you've got no certainty because it impossible to predict what's going to happen in a volatile carbon market.

I recently met with the head of one of America's largest utilities who works for Warren Buffet at Mid-America. He told me "give me a cap, give me a plan. I might build nukes and you may not like it, but I'll meet that demand; I'll meet that schedule." But he said, "Don't trade."

Warren Buffet has been one of the leading and lone voices opposing derivatives and other bizarre financial instruments. He warned Wall Street that they had no idea what they'd created. Mr. Buffet predicted that there would be no certainty for anyone and the potential for an unbelievable bubble and collapse in the future would be enormous. Mr. Buffet was right.

I want to get back to my alternative proposal. I'm a cosponsor of a bill written by Jim McDermott from Washington state which is based on the Clean Water Act. Under the McDermott approach the government would inventory all sources of greenhouse gas pollution, we'd set a cap; we'd give everyone a schedule to reduce; we'd make them pay for their permit (which ought to raise a fair amount of money); and, finally, if polluters don't meet the schedule - just like under the Clean Water Act -we'd fine the heck out of them. The Clean Water Act levies serious fines - up to \$50,000 a day. That's a pretty good stick. Most people tend to comply to avoid that.

Some people say a regulatory program is way too complicated. I find this argument amusing. Under the Clean Water Act the government already regulates 500,000 sources -- 50,000 of them are major sources, the others are more minor. Under the Clean Air Act, the government already regulates 250 million sources: 84,000 of them are major industries, and 2,000 power plants. By comparison the Waxman Bill would cover 7,400 entities. Since we are already regulating millions of point sources under existing environmental laws, it's simply not a viable argument to say that regulating the 7,400 major U.S. greenhouse gas polluters is preventatively complex or burdensome.

I prefer the McDermott regulatory approach because of its certainty. Under this alternative we will reduce emissions here in the United States of America; we won't be engaged in buying phony offsets offshore; and we won't create new exotic financial vehicles like "carbon default swaps" and "carbon tranches."

Unfortunately, we face a powerful, unholy alliance of Wall Street, big business and some major environmental groups who are lobbying for a "market-based" approach at all costs. Does that sound familiar? It should: it's the same alliance that supported energy deregulation twelve years ago. They were wrong then, and they're wrong now and this time it could be much more catastrophic for our economy.

Even if this bill passes, it wouldn't be implemented until 2012. I don't think we should wait. And unfortunately, all our energy is being diverted into this debate over cap-and-trade instead of real taking steps we can - and should - take to make an actual difference.

The U.S. as a country should adopt the same renewable portfolio standards that we have here in Oregon. They're trading away real gains for the American people -- the Waxman Bill mandates a renewable portfolio standard in this bill -- but in order to get votes, they keep compromising on the standard. We'll be lucky if we end up with 17, 16, or 15 percent nationally. We have 25 percent here in Oregon. The country could get there. That would spur a huge growth in green energy and green jobs, make us less dependent on foreign oil, and do something real about our carbon footprint. That's one thing we could do.

Another thing we could do, now that we own some of the auto companies, is to require a really tough CAFE standard.

We could also have a major national program to invest in renewable energy, clean technologies, more efficient bio-fuels. I'm not talking about ethanol, which I think is a loser, but we need to look to the next generation of bio-diesel fuels that could have net energy gains and burn much cleaner.

Finally, I'm spending most of my time in Congress to deliver a 21st century transportation plan. More than one-third of our carbon emissions are from mobile sources, so I want to do is get the American people out of congestion and traffic snarls. We waste 4 billion gallons of gasoline and diesel fuel by people sitting in traffic. If we could eliminate one-half of that, it would be an incredible contribution to reducing our greenhouse gases. It is estimated added fuel costs due to traffic congestion costs Americans and businesses \$80 billion each year.

Our road surfaces are rated very poorly. We have 160,000 bridges that are either structurally obsolete or they are load limited and have to be replaced on the national system. So we have huge legacy costs and maintenance needs. The City of Chicago alone has \$6 billion in deferred maintenance on their transit system. Some of their trains have to run at two miles an hour over tracks that are propped up with two-by-fours. I'm glad they're using wood products but it's probably not great, especially if we're going to host the Olympics there.

We need to be making these investments. We need a transformative transportation plan, one that puts us on a path to reducing emissions, reducing congestions, gives people more transit options, more fuel efficient options, and incorporates the kind of planning we've done here in Oregon into a national model. We can do all those things and all those things are embodied in the bill that I've been working on with Chairman Oberstar now for two and a half years. I hope to pass that bill out of my subcommittee next Wednesday, and begin to contribute something very real to the quality of life of all Americans and a real contribution toward lowering our carbon footprint.

And with that, thank you very much and I would be happy to take questions.