

# California's carbon market reaches an inflection point

With ramifications for the West Coast and beyond

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IT WAS THE equivalent of a warning siren. The results of California's latest auction of carbon allowances, released on May 29th, showed that prices had hit the floor. Each quarter companies shell out for credits that cover their greenhouse-gas emissions. Demand is weak, and lower revenues from the auction are bad news for lawmakers who are already trying to plug a \$12bn budget deficit. The poor showing is also a signal that firms are not confident that California's cap-and-trade programme, the fourth-largest carbon market in the world, will continue to exist.

America is a laggard when it comes to putting a price on carbon. The last time Congress seriously considered (and declined to adopt) a federal cap-and-trade scheme, Barack Obama had just been inaugurated and Lady Gaga was headlining her first tour. Some states, mostly Democratic, have been more aggressive. A consortium of east-coast states created an emissions-trading programme for their power sectors back in 2005. California implemented its economy-wide carbon market in 2013; Washington followed in 2023. But California's plummeting prices portend trouble. New policies hashed out (or not) in West Coast legislatures over the next few months could determine whether more states move towards an integrated carbon market or the markets that do exist fall apart. The outcome could affect America's emissions levels.

California's cap-and-trade problems began at the programme's birth. Rather than authorising the system for as long as it would take to reach net-zero emissions—the state reckons it can do this by 2045, though that is up for debate—lawmakers gave the green light only until 2020. Eventually they extended the programme until 2030. Firms that stockpiled allowances when prices were cheaper are skipping auctions while they wait to see if cap-and-trade persists. “The state kicked the can down the road for the better part of a decade,” says Danny Cullenward, who sits on California's Independent Emissions Market Advisory Committee.

Gavin Newsom, the state's governor, wants to reauthorize cap-and-trade via the annual budget bill, which must pass the legislature by mid-June. His sense of urgency is needed. But there are questions about how well the programme works that would not be solved by a blanket reauthorisation, which leaves most of the details to the California Air Resources Board (CARB), the air-pollution regulator. What price ceiling would fill the state's coffers without pushing excessive costs onto consumers? What should the state spend its auction winnings on? How to deal with carbon offsets? Lawmakers are working on their own proposal. If no one acts, CARB can try to save the programme. But a quirk in California's constitution requires a two-thirds majority vote in the legislature to enact a new tax. Without that, the scheme could be vulnerable to legal challenges.

What happens in California matters elsewhere in the country. Washington is exploring whether to link its carbon market to California's, which is already connected to Quebec's. Because California has a glut of allowances, a link would drop Washington's price, leaving the Evergreen State poorer. But a report from Resources for the Future, a think-tank, suggests that overall emissions in the

region would decline. Washington is also looking for stability. Last year a ballot measure to repeal cap-and-trade was rejected, but it spooked the state's climate hawks. Linking with California "will ensure that if we do have more attacks on the programme, that prices won't dip", says Altinay Karasapan of Climate Solutions, a non-profit in Seattle.

Oregon is the slowpoke on the Left Coast. In 2019 and 2020 Republicans literally fled the Capitol building in Salem to avoid voting on a cap-and trade bill. State agencies began enforcing an emissions cap in 2024 but the programme has less staying power than it would if it were enshrined in law. Last month several lawmakers resurrected the idea.

Squint hard and it's just possible to envision an integrated West Coast carbon market. New Yorkers are fighting over whether to implement their own scheme, and could one day join ranks. The more states that join, the less those places have to worry about leakage—firms and jobs moving to other states that don't have a price on carbon. Before any of that can happen, though, California needs to decide if its carbon market will lead the country, or languish. ■