AB 32 Implementation Group

Working Toward Greenhouse Gas Emission Reductions
And Enhancing California's Competitiveness

October 23, 2008

Ms. Mary Nichols
Chair, California Air Resources Board
1001 I Street
Sacramento, CA 95814

RE: Comments on the Economic Analysis Supplement to the Draft Scoping Plan

Dear Ms. Nichols:

Now more than ever, it's important for the California Air Resources Board to understand the consequences of their climate policy decisions on consumers and business in California. Many California companies are hurting badly from the sluggish economy and increasing costs for fuel, food and energy. The potential cost increases from AB 32 could dramatically worsen these difficult times.

California should also take note that even the European Union is taking a more cautious approach to climate policy due to concerns from several of their member states that meeting the EU's goal of reducing GHG emissions 20% by 2020 would be too expensive, cause economic turmoil and would increase unemployment. [i] A recent EU Summit amended its climate change policy to require a comprehensive cost-effectiveness analysis before any binding climate laws are enacted. The EU amendment also requires that climate policies must be cost-effective to all sectors of the economy. [ii]

Prudent implementation of AB 32 requires that we conduct economic analyses to guide CARB and policymakers to the most beneficial approaches, to highlight cost impacts that should be mitigated, and to garner support from the public for the most appropriate policies. The process of analysis should be ongoing, should provide a range of outcomes based on likely scenarios, and it should be adjusted to reflect reality over time. It is not necessary, nor is it appropriate, to conduct an analysis simply to prove a pre-determined conclusion that a particular package of measures will be beneficial by 2020 if our cost estimates are correct. If the main focus of the economic analysis is to show a positive economic analysis outcome in 2020, rather than determining the real risks and opportunities between now and then, we are masking the information CARB needs to make wise decisions on the scoping plan and regulations to be adopted in coming years.

We believe that the economic analysis falls short of fulfilling the purpose of informing policymakers about how best to approach AB 32 implementation. Regrettably, it also fails to give a reliable or useful snapshot of the economic impacts in 2020.

Judson Jaffe and Jonathon Bork of the Analysis Group have reviewed CARB's Economic Analysis. The Jaffe Report identified three major weaknesses in the Economic Analysis all of which are relevant to your Board's consideration of the AB 32 Scoping Plan in December.

Overly Optimistic Findings Result from Flawed Methodology

The CARB Economic Analysis asserts that the Scoping Plan will save consumers money, but their analysis relies on existing laws to promote vehicle fuel efficiency (Pavley) which are already on the books, independent of AB 32. The cost savings anticipated by (Pavley) hide the reality that other measures in the Scoping Plan will cause electricity rates to increase by 11%, natural gas rates by 8%. Additionally, gasoline costs would go up by $11 billion a year under the plan. The Jaffe report provides a more detailed discussion of these methodological flaws.

CARB's Economic Analysis Underestimates Impacts on California Businesses

CARB recognizes that the Scoping Plan will increase energy prices (electricity prices up 11% and natural gas prices up 8%), but implies that all California companies will be better off with higher energy prices because of increased efficiency. In reality, these energy price hikes will adversely impact the competitiveness of California businesses relative to out-of-state competitors. The most energy intensive businesses in this state, most of whom are already very energy efficient, will be put at a competitive disadvantage by higher energy costs. The consequences of higher energy costs deserve a much more rigorous analysis to fully inform the Board about the consequences of going forward with the Scoping Plan.

In addition, the CARB Economic Analysis does not discuss the billions of dollars in upfront costs the Scoping Plan will impose on California businesses. CARB has not addressed questions about the near-term magnitude of these investments, the impact of today's economic climate and the demand that such investments will place on capital markets, businesses and households.

No Analysis of Lower Cost Emission Reduction Options

A major Scoping Plan issue the Board will consider is the relative role of low cost options such as a cap-and-trade program and the use of offsets to reduce greenhouse gas (GHG) emissions. The Scoping Plan relies on traditional command and control regulations for 80% of the GHG emissions to meet AB 32's 2020 goal with marketplace strategies accounting for just 20% of the emission reductions.

The CARB Economic Analysis recognizes the merits of a cap-and-trade program. For instance the Scoping Plan's 33% Renewable Portfolio Standard (RPS) is estimated to cost $133 per ton of GHG emission reduction compared to CARB's estimate of $10 per ton of GHG emission reduction under a cap-and-trade system. Unfortunately, despite these strong endorsements, CARB has not offered any analysis of the relative economic costs of direct regulations versus cap-and-trade and offset programs. Even if a definitive quantitative comparison is not feasible by December, additional economic analysis should be conducted to highlight the difference in costs between the two approaches.

Recommendations for Additional Analysis:

The Jaffe Report provides several avenues for future research we believe should be pursued:

- CARB should place higher priority on evaluating the relative cost of alternative approaches to achieving AB 32 emission reduction targets. In particular, research should focus on quantifying how more reliance on cap-and-trade and offset programs could reduce the costs of implementing AB 32.

- CARB should analyze the marginal costs of emission reductions of the various Scoping Plan regulations.

- CARB should develop more rigorous and informative assessments of competitiveness impacts.

- CARB should develop an internally consistent baseline that reflects the best forecast of how the economy will evolve in the absence of the Scoping Plan, but with all existing state and federal policies in place.

If you have any questions or need further information, please don't hesitate to contact either one of us.

Sincerely,

Dorothy Rothrock
Vice-President
California Manufacturers &
Technology Association

Amisha Patel
Policy Advocate
California Chamber of Commerce

[i] Under AB 32, California is required to reduce emissions by nearly 30% by 2020, compared to the EU goal of 20%.
[ii] Financial Post, October 21, 2008