AB 32 Implementation Group

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

June 12, 2012

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FR: AB 32 Implementation Group

RE: AB 32 Implementation Group Comments on Mandatory Reporting Workshop

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Thank you for the opportunity to comment on the California Air Resources Board's (CARB) May 30, 2012 workshop to discuss potential revisions to the California Mandatory Greenhouse Gas Reporting Regulation.

The AB 32 Implementation Group is a coalition of employer and taxpayer groups advocating for policies to achieve greenhouse gas emission reductions in a manner that will protect jobs and the economy. Our comments are focused on slides 21 through 23 relating to Emissions Leakage in the Cap-and-Trade Program.

We believe that leakage minimization is a crucial element of AB 32, for environmental as well as economic reasons and must be aggressively readdressed. Leakage is a failure to actually reduce global emissions, and has been, and still is reflected in job loss, reduced investments, and lower tax receipts for California. More importantly, leakage has and will continue to hurt the fragile state economy, will further weaken the fiscal health of the state, and will impede any hope for future economic recovery.

The AB 32 Implementation Group (AB 32 IG) has the following concerns with the proposal:

1. Staff notes that CARB's obligation under AB 32 is to "design measures to minimize leakage to the extent feasible." The focus is appropriately on the design of the measures, to get ahead of the "leakage problem" and prevent it from happening. Yet, CARB failed to satisfy this obligation when the CARB Board adopted a cap-and-trade regulation that withholds allowances from regulated entities and puts them up for auction without having conducted thorough and sufficient studies on leakage and its impact on California businesses and industry to determine whether such design elements contribute to the problem. The impacts of leakage will be compounded by this illegal design feature which raises the cost of the program much higher than necessary. Furthermore, under this design leakage is assured, and it will not be forestalled through ineffective, pointless, and overreaching monitoring and data collection as discussed at the Workshop. Other design elements, including limitations on offsets, buyer liability, and non-obligated purchasers of allowances will also drive up costs and contribute to leakage. We have commented on these and other flawed design features of cap-and-trade program in prior comments.

2. This failure to minimize leakage cannot be remedied by simply monitoring the exodus of jobs and investment and trying to fix it later. Leakage will happen if entities that operate in regional and global markets suffer higher costs than competitors in other states or countries and CARB should focus on correcting these design elements to prevent this inevitable outcome. The Pew Center on Global Climate Change issued a 2008 study that modeled up to 44% of emissions from a federal cap-and-trade program could leak to other countries. It is readily acknowledged that any state only program is at greater risk of leakage, especially a trade dependent economy like California's. CARB cannot ignore the fact that no other neighboring state will participate in the cap-and-trade program leaving California vulnerable to this increased risk of leakage. The burden of proof is on CARB to show that leakage is minimized through the correct design of the program, and CARB has failed to satisfy this burden in a spectacular manner.

3. There is little CARB will be able to do to minimize leakage after the program is underway as the damage to businesses and industry will have already taken its toll. And no amount of staff "timely monitoring… allow[ing] for refinement or development of policies to minimize leakage" will undo the damage or return lost companies, lost production, or lost jobs to California. The monitoring will be of no value except to record for historical purposes all the jobs and investment the state lost during the period measured, with no ability to change policies to prevent the loss or regain the jobs and investment back.

4. The leakage monitoring recommended by Staff during this workshop is intended to address leakage from cap-and-trade for the covered entities only. Staff plans to annually update the Board on "shifts in business activity that may result in emission leakage and changes in market share for covered entities and sectors as a result of the cap and trade program." But this limited perspective of the possible sources and causes of leakage fails to take into account many possible leakage scenarios such as could result from higher costs and burdens associated with all elements of the AB 32 Scoping Plan, not just the cap-and-trade program, and not just for the companies directly regulated under the cap. This recommendation is far too narrow and limited to constitute a leakage monitoring program.

5. The monitoring approach recommended by CARB is not sufficient to provide a reliable tracking of leakage, even for the narrow group of regulated entities. Furthermore, it fails to justify the need for a vast majority of the information and data, some clearly confidential, CARB seeks for the purpose of leakage monitoring. Confidentiality and trade secrets aside, the proposal displays a fundamental misunderstanding about how businesses operate and make investment decisions. For example, CARB's monitoring process assumes that leakage is not happening if monitoring shows little change in behavior in the prior year of data. But companies make plans for investment, product development, hiring, etc, years in advance of such data points revealing themselves. Plans for capital investments and site locations are particularly long term, with three- to ten-year time horizons for major decisions. This means that projected costs of AB 32 have already been included into investment decisions being made in the years since 2006. A record of "no leakage" in 2012 ignores the losses that occurred in 2007 through 2010 before monitoring began but when costs were initially incorporated in decision making. On the flip side, the same "no leakage" result in 2012 could represent the last year of full production before significant changes are predestined to occur in 2013 and beyond. In the best case scenario, it would likely take two or more years of data to draw any conclusions about the extent or cause of leakage, and each year of delay is another year of losses CARB will not have prevented.

6. One of the biggest flaws in the CARB proposal is that it does not include a plan to measure economic activity by competitors in other states. Business and industry in the U.S. does not operate in a vacuum. States will not remain neutral nor idle once cap-and-trade commences, but will actively seek to lure business away from California. In effect, leakage will occur when California fails to obtain its proportionate share of investment and hiring, while other states get more than their proportionate share. Therefore it is critical that CARB consider not only the short-term impacts but also how proposed regulations are already effecting growth and investment in energy intensive sectors and businesses that provide services to them. The California Manufacturers & Technology Association (CMTA) tracks manufacturing investment trends in California compared to the rest of the country. Between 1977 and 2000, California attracted 5.6% of U.S. manufacturing investment, but the rate has plummeted to 1.9% since 2001. The leakage represented by this lack of growth has been happening for years, right under our noses, and it will likely ramp up in surrounding states in order to take advantage of the competitive burden that CARB is placing on California industry. If a flat yet disproportionately low level of investment occurs in future years, the monitoring proposal will neither recognize nor remedy such leakage.

7. When evaluating leakage, CARB needs to consider the added costs not only of the cap-and-trade program but also the complementary measures contained in AB 32. Leakage originates when sources in California face additional regulatory costs that sources in other states or countries do not. All of the programs under AB 32 and additional programs related to other GHG reduction programs (RPS) contribute to these additional regulatory costs. CARB needs to evaluate the combined effects of all regulations, including complimentary measures.

8. Finally, the CARB proposal does not address the all but certain possibility that emissions leakage is happening for many reasons, not just AB 32. Sorting out the actual causes will be difficult, expensive, politically sensitive, and time consuming, – and, if past actions are any measure, far, far too late. Any monitoring proposal needs to acknowledge the limitations to effectively deal with leakage due to the failure of the CARB to address and thoroughly understand the issue of leakage BEFORE implementing the cap-and-trade program.

Conclusion:

Rather than burdening regulated parties with a new reporting requirement that seeks confidential information without a guarantee of providing useful information in return, the AB 32 IG recommends that any leakage analysis should be based on models and surveys that attempt to predict what market or economic situations exist that may foster or encourage leakage. The scope of this analysis should go far beyond the snapshot of behaviors from regulated parties under cap-and-trade and include the economies of other states and nations that may prove attractive havens for businesses that finally tire of the regulatory assault of California government. In 2015 the entire economy will be incurring cap-and-trade related costs in natural gas, electricity and transportation fuels. CARB should use data that is readily available from CMTA, the US Census Data, and many other sources that demonstrates that leakage is already happening. CARB must engage a highly qualified firm to survey regulated and unregulated entities to determine how AB32 policies are impacting business decisions, market share, product pricing, etc.

Only comprehensive, meaningful and accurate information and firm, aggressive action will prevent leakage, and if leakage is prevented, a healthy growing economy will be the obvious result. Should you have any questions or need anything further please contact Shelly Sullivan at (916) 858-8686.

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