Mike Sandler
1000 New Jersey Ave SE, Apt 819
Washington, DC 20003
www.carbonshare.org

For the Public Record

February 22, 2013

To: California Air Resources Board, Department of Finance, and Office of the Governor

Re: Comments on the Cap-and-Trade Auction Proceeds Investment Plan Concept Paper

Thank you for accepting these comments on the Cap-and-Trade Auction Proceeds Investment Plan Concept Paper. I am submitting these comments as a private citizen, not on behalf of any organization. Since 2006 I have attended and commented at public hearings on AB32 market mechanisms. My comments have consistently encouraged the California Air Resources Board (ARB) to auction the maximum amount of allowances to upstream emitters, include a rising price floor, and return most of the auction proceeds to the public following the Cap & Dividend model.[1] The comments below include the following sections:

I. **Dividends are the Best Use of Proceeds**

II. **Political Considerations: The Skocpol Paper and National Carbon Pricing**

III. **Problems with Investments**

IV. **The EAAC recommendations of 75% Dividend, 25% Investments**

I. Dividends are the Best Use of Proceeds

Regarding the investment of Cap-and-Trade auction proceeds, the best use of revenues is returning them to the public through a dividend. Dividends accomplish the AB32 goals relating to equity, and maximizing additional environmental, economic, and overall societal benefits.

Although rebates are already being contemplated for the electricity sector, consumers will be facing costs from the carbon price in the industrial and transportation sectors as well as indirect costs from other goods and services that are passed through as energy costs rise. Electricity sector rebates will not compensate consumers for those additional costs. When the transportation sector enters the program in 2015, consumers will see a very visible hit to their pocketbooks.

[1] An archive related to this work is at http://www.carbonshare.org/californiaAB32.html#advoc

The best way to defuse the resulting potential political backlash is to **include a dividend for transportation sector and indirect costs in the Investment Plan**.

While dividends are not specifically named in AB1532 (Perez), the bill says that the Air Pollution Control Fund expenditures "may include" the categories named "but are not limited to" them, so dividends are still a viable option.[2] Dividends are also feasible within the *Sinclair Paint* constraints.[3]

Additionally, two named categories in AB1532 could feature dividends. The first of these reads:

> *Funding to reduce greenhouse gas emissions through investments in programs implemented by local and regional agencies, local and regional collaboratives, and nonprofit organizations coordinating with local governments.*

In this case, the State could send funds to local collaboratives to administer dividends. In fact, the original Cap and Dividend proposal developed by author and Marin County resident Peter Barnes in his book *Who Owns the Sky?* called for an new entity named a "Sky Trust" to be created to administer dividend calculation and distribution. The creation of local or regional Sky Trusts, perhaps in cooperation with local or regional governments, Air Districts or the California Public Utility Commission's new Regional Energy Networks, would be compatible with AB1532.

The second category in AB1532 where dividends could play a role reads:

> *Funding in research, development, and deployment of innovative technologies, measures, and practices related to programs and projects funded pursuant to this part.*

The State could fund research into cost-effective dividend distribution and the potential for resulting behavioral change. For example, the State could fund an effort to determine how the California Public Utilities Commission can best accomplish its stated goal of moving from on-bill dividends toward off-bill dividends.[4] The State could pilot a debit card system, or work with existing debit card programs to assess how dividends could be best delivered at low cost to recipients. This may include incorporating dividends from a future national carbon price or from other "feebate" programs. It also could test special offers such as private public partnerships that entice consumers to spend their dividends on home energy upgrades and energy efficient products or services.

Universal dividends should be the goal. However, given the constraints on spending the revenues from the State Legislature, it may be possible to devote a specific dividend to

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[2] http://www.leginfo.ca.gov/pub/11-12/bill/asm/ab_1501-1550/ab_1532_bill_20120930_chaptered.html

[3] The EAAC, CPUC, and others have analyzed this issue, and the CPUC's Decision in Proceeding R1103012 sided with the Division of Ratepayer Advocates and other consumer groups.

[4] http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M040/K631/40631611.PDF (see pages 122-123)

disadvantaged communities, and a separate dividend to the state as a whole. Members of those communities would likely see additional benefit, and could spend dividend funds on health care or other necessities depending on each family's needs. At the very least, a survey of members of those disadvantaged communities should be conducted to see what the response is to dividends versus government investments in their area. This should be analyzed in the Investment Plan.

II. Political Considerations: The Skocpol Paper and National Carbon Pricing

The insider politics of giving away pieces of the allowance revenue pie to special interests failed to get a climate bill through in Congress in 2009-10. But an equal rights/Commons-based approach could unify diverse constituencies through a more inclusive political strategy. Harvard Professor Theda Skocpol's paper "Naming the Problem" describes the failure of the previous round of national climate legislation in 2009-2010.[5] Although a climate bill passed the U.S. House (the Waxman-Markey bill), companion legislation failed to pass the Senate. Skocpol believes this was in part due to an "inside the Beltway" strategy that failed to engage a variety of stakeholders around the country. The strategy also neglected to counter the anti-tax rhetoric of the Tea Party.

Skocpol writes:

> Politically speaking, the cap and dividend route has a number of advantages [over the strategy used by the Waxman-Markey proponents]. Instead of building political support by bargaining with industrial interests about how many permits they may get cheaply or for free, the cap and dividend approach makes it possible to speak with average citizens about what they might gain as well as pay during the transitional period of increasing prices for energy from carbon sources. Cap and dividend is simple to spell out (the Collins-Cantwell bill was 39 pages, compared to over a thousand pages for cap and trade) and it is also relatively transparent. Citizens could understand and trust this policy. Like Social Security, taxes or proceeds from auctions are collected for a separate trust fund – and the revenues are used to pay for broadly valued benefits for each citizen and every family. No opaque, messy, corrupt insider deals. The dividend payments also deliver a relatively greater economic pay-off to the least-well off individuals and families, precisely the people who, as energy prices rise, would have to spend more of their incomes as home heating, electricity, and gasoline.
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> Popularly rooted organizations like labor unions, churches, and old people's associations might rally behind such an approach, because it is economically just in its impact. Indeed, for some years after it started, a cap and dividend system would reduce the expanding income inequalities that have plagued American society and politics in recent decades. Some environmentalists speak as if social benefits and economic fairness are not "their issues"… But all U.S. environmentalists should recognize that they have a stake in combating income inequality. Environmentalism has a reputation for appealing mostly to white, upper-middle-class educated citizens, even as stagnating wages for less privileged Americans have made it easy for right-wing forces to demonize carbon-

[5] http://www.scholarsstrategynetwork.org/sites/default/files/skocpol_captrade_report_january_2013_0.pdf

> capping as a new tax that will burden already hard-pressed families. Cap and dividend would allow antiglobal warming advocates to say – loud and clear, and very truthfully – that promoting cleaner energy will also boost the economic fortunes of average Americans. The claim would not have to rest only on pie-in-the-sky green energy jobs. Those jobs will appear, indeed are already appearing in the tens of thousands, but the promise of future jobs for some people is not going to be enough to counter right-wing scare campaigns that stoke the well-founded economic anxieties of the majority. Reformers who want to remake energy use in the United States need to deliver concrete economic help to ordinary families along the way, and ideally they should do it in easy-to-understand, transparent ways. (pgs. 125-126)

It may be tempting to ignore Skocpol's political warnings since California currently has a super-majority of Democrats in the State Legislature. But it is prudent to ask: How long will that last? A program that spends all funds on new government programs with few dividends may become vulnerable when Republicans re-gain some legislative seats or the governorship.

The withdrawal of New Jersey from the Regional Greenhouse Gas Initiative (RGGI) is a cautionary tale for what could happen if allowance value is used for well-intentioned efficiency programs that are invisible to most consumers. Funds that were supposed to be set aside for energy and environmental uses were raided to plug state budget deficits. Because consumers did not see a direct connection to the use of revenues, the lack of consumer support failed to prevent New Jersey's Governor from withdrawing his state from the program. A per capita dividend could help California avoid this fate.

Dividends are moving to the center stage in the national climate debate. A recent bill announced by Senators Barbara Boxer (D-CA) and Senator Bernie Sanders (I-VT) would impose an upstream fee on carbon emissions, with three-fifths of revenues refunded to residents as a Family Clean Energy Rebate.[6] In 2009-10 dividends were supported by Republican Senator Susan Collins (R-ME), who co-sponsored a bill called the CLEAR Act with Senator Maria Cantwell (D-WA) in 2009 that would have returned 75 percent of revenues to consumers as a dividend.

Climate change is a multi-decade, multi-generational challenge. Rather than spending revenues on projects that attract support from only one party, California needs a bi-partisan approach that attracts public support from non-environmental constituencies.

III. Problems with Investments

The Draft Concept Paper noted that "One of the planning challenges is drafting an investment plan when the amount of auction proceeds to the State each year is unknown" (pg 11). The RGGI recently reduced its number of auctioned permits by 45 percent.[7] The European Trading

[6] http://www.sanders.senate.gov/imo/media/doc/0121413-ClimateProtectionAct.pdf
[7] http://www.bloomberg.com/news/2013-02-07/u-s-northeast-cap-and-trade-program-reduces-emissions-limit-45-.html

System (ETS) is proposing to withhold 1.4 billion permits due to an oversupply.[8] Such ongoing fluctuations of supply and demand in a tradable permit system make it an inappropriate source of funding for long-term large-scale projects.

Multi-billion dollar infrastructure projects such as high-speed rail are problematic investments because they could easily swallow up all the revenues from cap and trade, yet still be unable to contribute significantly to the state's GHG reduction goals by 2020. Investing solely in such projects will not broaden bipartisan public support for a continuously increasing price on carbon. Big projects will not counter the attack that a carbon price is a regressive tax. As mentioned above, spending billions of dollars of revenues on infrastructure projects that offer long-term emission reductions but short term costs to taxpayers is a risky political gamble that could jeopardize the entire AB32 effort.

Panelists at the May 24, 2012 ARB workshop on this topic expressed support for a long list of programs. Suggestions often conflicted as one speaker recommended focusing on "shovel ready" programs and the next on long-term research and development. The extensive laundry list of pet projects is a result of the perception that this is "free money" which can substitute for needs being de-funded by budget cutting of the General Fund, etc. Competing interests were friendly towards each other because no one knows how much money there will be, so there is a presumption that everyone will get funded. The politics among these players will change the instant a specific number is known, and some interests realize they are below the funding line. The resulting in-fighting will turn proponents against each other, and possibly against ARB and cap-and-trade if the Investment Plan does not strictly limit pet projects. Dividends can help address this issue.

Once politicians see revenues being spent, it will be tempting to "borrow" from those funds and what looks like "free money" to legislators will be a visible target for opponents to make the entire AB32 program vulnerable to an anti-tax backlash. High-speed rail is the most egregious of these, because the "boondoggle" attack would be tough to fight during the years or decades until it is fully operational.

There are better sources of funding for investments in renewables and efficiency, including rerouting fossil fuel subsidies or existing subsidies for activities that cause emissions. The transportation sector in California is investing millions of dollars in policies and programs that increase fossil fuel use, such as parking structures, new highway lanes and widening roads, resulting in higher GHGs. Such funds could go toward the investments described in the Concept Paper, while auction proceeds are reserved for per capita dividends.

[8] http://www.reuters.com/article/2011/12/20/us-eu-carbon-idUSTRE7BH0DZ20111220

IV. The EAAC recommendations of 75% Dividend, 25% Investments

Despite the concerns listed above, it is still reasonable to devote 25% of proceeds to investments from cap-and-trade funds, as long as 75% goes back to consumers as climate dividends. This follows the advice from the experts of the Economic and Allocations Advisory Committee (EAAC), who recommended that "the largest share (roughly 75%) of allowance value should be returned to California households… through lump-sum payments…" and "roughly 25% of this value used to finance socially beneficial investments and other public expenditures".[9]

Within that 25%, reasonable priorities include local government activities that reduce GHGs, financing programs that leverage private capital for energy efficiency (i.e. PACE financing for building energy efficiency and on-bill financing), activities that reduce the carbon content of water treatment and delivery, projects in disadvantaged communities (i.e. school bus retrofits), market transformation and R&D programs (i.e. distributed generation, micro-grids, web-enabled transportation information and networking systems), and biochar carbon sequestration in the agricultural sector.

When choosing among these options, questions ARB should ask include:

- Are these investments already being made by other funding sources?
- How will the ARB's choices impact the potential renewal of the Public Goods Charge that the Legislature let expire?
- How do these public funds relate to private sector investment for research or product development (i.e. Silicon Valley venture capital)?
- Will these funds "choose" technology winners and losers, or dissuade private firms from investing in R&D?[10]

The State of California is desperate for revenue. But so are the people of California. The good news for the State is if it is done in the right order, both will benefit if the money is sent directly to the people with dividends, and **dividends are made taxable**. This would result in a portion of funds coming back to the State through taxes, and those funds would now be free of the *Sinclair* restrictions. However, if the money is spent on programs first, then the public will see climate change as one more budget item, floating in a sea of eroding social services. The State can still seize this prime opportunity to create a nearly revenue-neutral program that reimburses the

[9] http://climatechange.ca.gov/eaac/

[10] See study by UC Berkeley Professor Margaret Taylor, "Cap and Trade Programs Do Not Provide Sufficient Incentives for Energy Technology Innovation," described at http://www.solardaily.com/reports/Cap_and_Trade_Programs_Do_Not_Provide_Sufficient_Incentives_for_Energy_Technology_Innovation_999.html

public for their share of revenues from the Commons. At the same time, it would create a new psychological, economic, justice framework for understanding that the solution to climate change is a carbon price that compensates the people of California. The Investment Plan can provide a template for national and international climate policy by providing equal dividends or shares to all Californians. Thank you for your consideration.

Sincerely,

Mike Sandler