AB 32 Implementation Group

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

July 24, 2007

Ms. Mary D. Nichols
Chair
California Air Resources Board (CARB)
1001 "I" Street
P.O. Box 2815
Sacramento, CA 95812

Dear Ms. Nichols,

We submit the following comments in reference to the Market Advisory Committee report for your review. We are the AB 32 Implementation Group, a coalition representing companies employing millions of California workers. More information about the AB 32 IG, as well as a list of members, can be found at www.ab32ig.com.

The Market Advisory Committee (MAC) members deserve positive recognition for a job well done as they gave careful consideration to many of the issues related to the design and implementation of a cap-and-trade program to help reduce greenhouse gas (GHG) emissions as targeted under AB 32, the Global Warming Solutions Act of 2006.

The committee's recommendations should prove to be a valuable base from which to build a workable cap-and-trade system in California that is both cost-effective and technologically feasible. In our effort to constructively participate in the development of rules, we offer the following:

- Economic analysis shows reducing GHG emissions results in real economic costs to the state and its residents;
- A broad, market-based cap-and-trade program can provide a level of costs savings that command-and-control regulations cannot equal while assuring environmental integrity;
- To reduce high implementation costs and economic uncertainty, a safety valve offers a reasonable way to help achieve emission reductions under certain circumstances;
- The broader the trading market, the more likely real emission reductions occur, opposed to a narrow market where leakage of emissions outside the state become more likely; and
- Finally, the pursuit of an auction system will ultimately disadvantage California, devaluing business investments here while encouraging the expansion of jobs and the investment of capital outside the state.

California must keep its eye on economic costs

AB 32 recognizes that any reduction of GHG emissions will likely result in costs to California. Hence, it requires that regulations to implement the reductions must be "cost-effective." Clearly, it is advantageous to the economy and the state's residents to choose regulations that achieve the environmental integrity desired with a program design that is less costly than a program with a more costly design.

In a study by the Electric Power Research Institute, "Economic Analysis of California Climate Initiatives: An Integrated Approach," the conclusion is reached that "all forms of policies to restrict California's GHG emissions will entail economic cost." The authors of the study write: "California's new laws will reduce GHG emissions relative to business-as-usual for most of the State's major industrial sectors, depress real wages, negatively affect the state's terms of trade, and diminish consumption."

The study refers to one scenario that concludes the "decrease in consumption can be translated as a financial cost of $1,170 per household in 2020 and $1,600 per household in 2030."

While economists may disagree over modeling and the precise cost projections, it is our position that the ultimate cost of implementing AB 32 must be watched closely, and where one option likely produces costs savings over another, that option should be favored.

A cap-and-trade system to reduce GHG will be more cost-effective than command-and-control regulations

While we understand that the choice is not necessarily between an exclusive cap-and-trade system versus a system of command-and-control, and that a combination of programs may best suit California, it is worthwhile to note that when the choice arises, a cap-and-trade system holds near-universal advantages.

First, a cap-and-trade program holds advantage because it covers all sources and sectors. A command-and-control regulation, by its nature, is sector specific. The more specific it is designed, the greater will be the administrative costs and the oversight required by government. Meanwhile, a cap-and-trade program guarantees achievement of real emission reductions because it provides economy-wide coverage to match the economy-wide emissions of CO2.

Next, cap-and-trade has a proven track record. When leaded gasoline was phased out during the 1980s, the phase out was achieved through a trading program designed by the U.S. Environmental Protection Agency. The reduction of lead in gasoline was realized quicker than anyone anticipated and the savings of the program amounted to approximately $250 million a year. Similarly, the ongoing sulfur dioxide (SO2) allowance trading program has achieved significant cost savings (approximately $1 billion a year), a savings of at least 30 percent when compared to the cost of conventional standards.

Lastly, a cap-and-trade program encourages those who can reduce emissions to maximize the reduction even further than the levels required under a command-and-control rule. A command-and-control rule, on the other hand, fails to assure that a "cap" on emissions is truly achieved.

A safety valve would limit economic costs and help achieve the desired GHG emissions reductions

The MAC report fails to support the concept of a "safety valve," yet we see a safety valve – a maximum price for emission credits -- as an integral part of cost-containment for the program.

Given the premise that any regulation designed to reduce GHG emissions will be "cost-effective," the use of a safety valve would only happen when emission reduction costs are higher than expected. It is at these unexpected moments when the safety valve effectively contains unreasonable costs, and if the revenue generated by the safety valve is dedicated to reducing emissions elsewhere in the market, the overall reduction goal can still be achieved.

Leakage beyond the California state line must be reduced to truly achieve the goals of AB 32

While the MAC report discusses the importance of preventing leakage specifically in the electricity sector, we encourage a broader, ongoing evaluation to assure emissions simply don't shift to a place outside the California border.

If in-state compliance costs are high, and out-of-state costs are significantly lower, competition will favor those facilities outside California. As a result, emissions could migrate to those more competitive facilities. To avoid "leakage" from California to elsewhere we support a program that has few, if any, geographic boundaries. GHG emissions are a global issue and our response must be global by design.

The broad use of auctions will disadvantage California

We strongly disagree with MAC members who "favor a 100 percent auction from the outset" and others who favor a "full auction over time."

An auction penalizes companies that chose to invest, operate and create jobs in California by devaluing those investments. An auction would give those facilities outside the state an immediate cost advantage over California companies. An auction will also divert capital away from beneficial uses, such as efficient growth opportunities or projects that reduce GHG emissions at the facility.

Ultimately, an auction is a carbon tax with a price tag of nearly $10 billion. In 2002, California generated about 500 million metric tons of CO2 equivalent GHG emissions. If

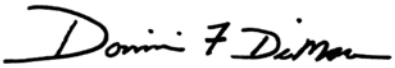
all sources and emissions were to be included, at the $20/ton EU price, it would cost the California economy about $10 billion. If an auction was instituted “only” for the industrial and electric utility sectors, the cost of CO2 equivalent allocations would cost California industries and utilities about $4 billion.

This tax, again, is a cost only California companies would pay, making them less competitive with their counterparts in other states and countries. In addition, when comparing use of an auction to a market system with free allocations, the same goals can be achieved, but free allocation achieves the goals without the competitive disadvantages.

We thank you for considering our comments.

Sincerely,

Dorothy Rothrock
Vice President
California Manufacturers &
Technology Association



Dominic DiMare
Vice President
California Chamber of Commerce

cc: Board members