AB 32 Implementation Group

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

January 7, 2010

Dr. Lawrence Goulder
Chair, Economic and Allocation Advisory Committee
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Comments on "Allocating Emission Allowances Under California's Cap and Trade Program – January 2, 2010 Draft

Dear Dr. Goulder and Committee Members:

The AB 32 Implementation Group thanks the members of EAAC for their tremendous effort to inform CARB and stakeholders about the options available for allocation and auction revenue distribution, as well as to help the California Air Resources Board (CARB) complete a valid and useful economic analysis of the Scoping Plan.

Your mission was to help answer specific questions, and we've provided comments on those tasks in previous letters. At this time we would like to offer further comments on those questions, and raise questions that you were not directly asked to address, but which nevertheless will greatly impact the success of the cap-and-trade program and the impact on the California economy. To the extent possible, we urge you to communicate your thoughts on these additional issues to CARB.

<u>ECONOMIC ANALYSIS</u>

We support many of the observations and recommendations of the economic analysis subcommittee. CARB should at least study the first-order impact of each measure by running simulations of the Scoping Plan with each measure removed from the Plan. It is disappointing that the sub-committee had not seen such simulations as of December 17, nearly a year since CARB was asked to improve the analysis.

In addition, each major measure, such as the Low Carbon Fuel Standard (LCFS), cap-and-trade, renewable energy standard and energy efficiency measures, includes a range of design options and/or assumptions about costs that justify a few more simulations to test the relative impact of those design choices. For example, in the cap-and-trade program, the availability of offsets will likely be a big cost driver. At this time, CARB recommends only 4% offsets should be allowed, yet a range of alternatives to this choice has not been tested for economic impact, as requested in the board resolution adopted along with the scoping plan in December 2008. Until that is done, CARB will have a difficult time justifying this or any other level of offsets, and other design choices that might relate to that analysis will also be uninformed.

The subcommittee notes that input cost estimates may be optimistic. During 2009 CARB has been investigating the potential costs of emission reductions for various industries and has heard from many affected parties in workshops. For the next analyses, CARB should be able to use more realistic cost estimates, or a range of estimates where greater uncertainty prevails. Transparency will be crucial, and we look forward to reviewing those inputs.

As noted in Section 3.2 of the draft report, there will likely be little consumer demand response in reaction to energy price increases caused by carbon prices less than $115 per ton (electricity and natural gas) or less than $150 per ton (gasoline). A well-designed cap-and-trade program with offsets and trading will achieve reductions based on the lowest costs anywhere in the world. A well-designed cap-and-trade program should never allow costs to reach the level where demand reduction is the only option. But the PDR (with its potentially limited offsets and minimal linkage and with CA's already energy efficient industry) could lead to demand reduction being the only viable scenario to achieve the reductions and therefore should be evaluated in the economic analysis so that if such prices prevail, that we fully understand the broader economic impact of the higher energy prices.

The subcommittee acknowledges that identifying trade exposed industries is very difficult. Yet providing fair treatment for those industries that are exposed to import competition or are solely exporters without import competition is extremely important for the success of the cap-and-trade program. We look forward to more specifics about the industries that will be included in this category to overcome concerns about cost burdens and encourage investment in the state.

We also support the recommendation that the baseline against which the scoping plan is measured should be transparent and also consistent. Existing law prior to AB 32 should be considered the baseline for study purposes.

To the extent possible, the economic analysis should look at the types of jobs we will lose, how many, which sectors, what wage rates, etc and also determine what jobs we will create, how many, which sectors, what wage rate, etc. This will highlight the job impacts beneath the surface of the “net” job impacts, and perhaps show where green jobs growth may be costing more than expected due to high-wage job loss in other sectors. The Legislature requests this level of analysis in the ACR 77 passed unanimously last year. In addition, the recommendation to use some allowance value for job training and transition assistance for displaced workers will require such analysis to direct resources wisely.

<u>CAP-AND-TRADE – AUCTION OF ALLOWANCES</u>

As we have stated previously, the recommendation that CARB rely principally on an auction of allowances is of great concern. Depending on CO2 prices, many billions of dollars will be paid by large industries over the timeframe of the program. The goal to use allowance value for cost-effective reductions, to compensate for leakage or achieve other AB 32 goals is commendable, but not likely to convince employers and investors to expand production and employment in the state. In fact, the likely outcome will be decisions to limit exposure to California auction charges as much as possible. This will apply to employers who are subject to leakage as well as others who are technically capable of passing along costs to consumers but who have options to produce at lower cost in other prices combine with auction payments to create an ever more uncompetitive cost burden in the state.

AB 32 GHG REDUCTION PROGRAM– CALIFORNIA ONLY

Since EAAC began work in Spring 2009, the outlook for federal and international carbon policies has changed. A federal cap-and-trade bill that would include California is not likely to pass due to concerns about the economy and political pressures leading up to mid-term elections. Nearer to home, California is the only member state of the Western Climate Initiative to adopt an enforceable cap on its economy. California is now developing a California-only GHG reduction program, including a cap-and-trade program.

Economic risks for a California-only program are many, beyond the leakage potential described above. The risks include a worsening of the overall business climate while the economy is still fragile and far from recovery from the recent recession. Even though the cap-and-trade program does not start until 2012, the prospect of multi-billion dollar auction taxes along with a new bureaucracy to distribute the monies to new entitlement groups will discourage the capital investments and associated jobs we need in the next few years to create new wealth and restore tax revenues in the state.

California must show both environmental and economic success to lead the nation and encourage others to adopt our stringent climate policies. As we have heard from CARB Chair Mary Nichols, the scoping plan is a "blueprint" for AB 32 compliance, and CARB should regularly update the plan, taking a hard look at whether all its elements remain reasonable and timely given current realities. To that end, we urge EAAC to recommend that CARB adjust the scoping plan as needed to reflect the improved economic analysis and the political and economic changes since 2008. As part of that review, CARB should determine how elements of the entire AB 32 plan, including the timing, design and scope of the cap-and- trade program, could be adjusted to better fulfill the needs of AB 32 and serve as a model for the country.

The AB 32 Implementation Group represents large and small businesses, taxpayers and consumers and we appreciate all the dedication EAAC has demonstrated in crafting its recommendations to CARB. We hope you will take our comments under advisement as you continue your efforts. We would be happy to further discuss these issues with you.

Sincerely,

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