**Michael J. Sandler**
**1000 New Jersey Ave SE, Apt 819**
**Washington, DC 20003**

**For the Public Record**

June 15, 2012

To: California Air Resources Board (ARB)

Re: Input on Investment of Cap-and-Trade Auction Proceeds following May 24, 2012 workshop

Thank you for accepting these comments on the ARB's Plan for Investment of Cap-and-Trade Auction Proceeds. I am submitting these comments as a private citizen, not on behalf of any organization. Since 2006 I have attended dozens of public hearings on AB32 market mechanisms, and provided comments on behalf of the public interest. My comments have consistently encouraged 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. The comments below are divided into the following sections:

I. Why dividends (rebates) are the best use of revenues
II. Problems with the "laundry list of investments" approach, especially large infrastructure such as high-speed rail
III. Suggested framework for an Investment Plan based on the EAAC recommendations: 75% Dividend, 25% investments

**I. Returning revenues to households as a dividend**

The best use of revenues from an auction of permits under the AB32 cap-and-trade program is to return auction proceeds to the public through a dividend, perhaps on a debit card. The ARB has divided the carbon market into three sectors: industrial, electricity, and transportation. The electricity sector will likely see rebates to electricity customers, based on the proceeding currently held at the California Public Utility Commission. However, the other two sectors should also include rebates to California households, since costs from the carbon price will be passed down to them in those sectors as well.

UCLA issued a report on legal risk of various uses of cap-and-trade revenues due to the *Sinclair Paint* nexus issues related to a fee.[1] The report concluded that projects resulting in direct GHG reductions are most likely to be seen in court as advancing the objectives of AB32. Next in line are expenditures that accomplish the additional goals of AB32 relating to equity, and maximizing additional environmental,

[1] Horowitz, Cara et al. "Spending California's Cap-and-Trade Auction Revenue: Understanding the Sinclair Paint Risk Spectrum" March 2012, available at http://cdn.law.ucla.edu/SiteCollectionDocuments/Centers%20and%20Programs/Emmett%20Center%20on%20Climate%20Change%20and%20the%20Environment/Spending_CA_Cap_and_Trade_Revenue_March_2012.pdf

economic, and overall societal benefits. For some reason, the UCLA report considered those additional goals to apply to expenditures in environmental justice communities, but overlooked how they could apply to universal dividends. AB32 explicitly requires that the Air Resources Board:

- Design the regulations in a manner that is equitable;
- Maximize additional environmental and economic benefits for California;
- Consider overall societal benefits, including reductions in other air pollutants, diversification of energy sources, and other benefits to the economy, environment, and public health.

Dividends help accomplish those goals and more.

There has also been a presumption that the state legislature would be unable to pass any bill that allocates revenues with a two-thirds vote, even one that gives money to three-thirds (all) of Californians, as a universal dividends bill would. As a result, big projects such as high speed rail (aka "cap and rail") may be incorrectly perceived as low legal risk under *Sinclair*, but returning funds as dividends to the public is incorrectly assigned as high risk. I disagree with this analysis, and I ask ARB to include dividends within its investment plan. **I urge the ARB to work with the Governor to ask Assembly Speaker Perez and State Legislators to amend bill AB1532 (Perez) to include dividends as a potential category for the Air Pollution Control Fund.**

Recent experiences in the Regional Greenhouse Gas Initiative (RGGI) provide a cautionary tale for what could happen if allowance value is used for opaque 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 new Governor from withdrawing his state from the program a few months ago. A per capita dividend could help California avoid this fate.

The moral basis for distributing proceeds of a sale of pollution rights to the Commons must be grounded in justice and equity, and the simplest formula to accomplish this is a per capita dividend.

**II. Problems with the "laundry list of investments" approach, especially large infrastructure such as high-speed rail**

The panelists at the May 24, 2012 ARB workshop on this topic expressed support for a long list of programs including local government programs, research and development, and projects in sectors such as energy and water, transit, environmental education or health studies in disadvantaged communities, and natural resources such as urban forests or in the Bay Delta. 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 is what derailed the U.S. Congress' attempt at a climate bill in 2009-2010, and it will turn proponents against each other, and possibly against ARB and cap-and-trade in 2013 if ARB does not step in with a plan that minimizes pet projects. Dividends provide a solution to this issue for ARB.

The problem with multi-billion dollar infrastructure projects such as high-speed rail is that 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.

The State needs to use public money to mobilize private money, and it needs to get climate change and carbon pricing into the public's brains. It can do this by addressing the psychological, economic, and justice issues that underlie climate change in the minds of most people. Big infrastructure is visceral, while charts of supply and demand are abstract. However, to address climate change, society needs an invisible hand to encourage low carbon activities, make externalities more expensive, and provide a price signal for remaking our electricity and transportation systems. A key concern is if the costs fall on consumers, or if they are perceived to do so, it could result in an anti-tax revolt like California's Prop 13 and set back climate protection efforts by decades. ARB and state legislators should take care not to spend cap and trade revenues in a way that results in an anti-tax backlash. Once again, dividends provide the best solution to this problem.

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.

Another problem with investments that seek to reduce emissions under the cap is that they simply create space for more emissions by "freeing up" emissions in other sectors under the cap. **I request that the ARB include a discussion of this problem in the Investment Plan.**

There are better sources of funding for investments in renewables and efficiency. Proceeds from the Cap & Trade program are not a good source of funding. The amount will fluctuate, and we don't know how much it will be. A better source for the investments would be to reroute fossil fuel subsidies or existing subsidies for activities that cause emissions. In California, money is being continually invested in parking structures, new highway lanes and widening roads, resulting in higher GHGs.

### III. Suggested framework for an Investment Plan based on the EAAC recommendations: 75% Dividend, 25% investments

Despite the concerns above, it is still reasonable to devote 25% or 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".[2]

Within that 25%, reasonable priorities include local government activities that reduce GHGs, financing programs that leverage private capital for energy efficiency (i.e. PACE 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, and web-enabled transportation information and networking systems). When choosing among these options, questions ARB may ask are: Are these investments already being made by other funding sources? How will the ARB's choices impact the potential renewal of the Public Good 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?[3] I strongly discourage the use of funds for large infrastructure, especially high-speed rail.

The State of California is desperate for revenue. But so are the people of California. The good news for state legislators is if they do it in the right order, they can get both by sending the money directly to the people with dividends, and making the dividends taxable. This would result in a portion coming back to the State, 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 revenue-neutral program that reimburses the 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 rewards the people of California.

These comments are my own and do not reflect those of any organization with which I am affiliated. Thank you for your consideration.

Sincerely,

Mike Sandler

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

[3] 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