**Response to ARB Request for Public Input on Investment of Cap-and-Trade Auction Proceeds**

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**Background**

At the recent public consultation on investment of cap and trade auction proceeds, ARB staff asked for public comment on two questions:

* How can California effectively invest the auction funds to meet the goals of Assembly Bill 32 (AB 32) including support of long-term, transformative efforts to improve public health and develop a clean energy economy?
* What criteria should be prioritized in the development of an investment plan for auction funds and why?

This comment provides preliminary observations on the overall structure of the evaluation process, i.e. how to frame the discussion to best address the various competing priorities. In brief, it recommends that the evaluation process (at ARB and/or the Legislature):

1. Start by defining a clear, limited set of desired objectives for the use of the funds,
2. Determine the criteria that are appropriate to apply for each objective (which, notably, need not be the same across all objectives), and
3. Apply the appropriate criteria to candidate funding proposals for each objective.

**1. Define Desired Objectives**

The comments provided at the recent public consultation focused almost entirely on inputs--the speakers recommended a variety of possible uses of the auction proceeds that would support their particular projects of interest. To better organize the discussion and facilitate the necessary debate on overall priorities, ARB and/or the Legislature should first of all define and impose a limited set of desired objectives that the state hopes to achieve through the investment of these new resources. In the absence of such an up-front overall hierarchy it will be very difficult to have a coherent discussion.

There are several existing and forthcoming analyses that can help inform the identification of priority objectives. At the June 28th Board meeting ARB staff will present a Status Report on "Vision for Clean Air: 2012-2050". Although the Status Report is not yet released, based on conversations with staff it appears that the report will identify several overarching strategies, such as widespread electrification of transport, that are necessary in order to simultaneously achieve long term climate and criteria pollutant goals. This analysis will highlight possible strategies that are consistent with the "long-term, transformative efforts" called out in the ARB question above.

Less recent, but still relevant, is the March 2010 report from the Economic and Allocation Advisory Committee on "Allocating Emissions Allowances Under a California Cap-and-Trade Program". That report provided a detailed examination of possible uses of auction proceeds, and recommended that the funds be used to:

1. Prevent disproportionate adverse impacts,
2. Finance public and private investments "oriented towards achieving low-cost emissions reductions (both directly and through investments in clean tech RD&D), adaptation to climate impacts, environmental remediation, improvements to disadvantaged communities, and job training", and
3. Return to households a significant fraction of allowance value through rebates or reduced taxes.

In addition to the programmatic investments outlined above, in the current fiscal climate there is strong interest in using auction proceeds to offset General Fund expenditures that are consistent with the purposes of AB 32.

Taking into account all of the above, and also the need to maintain a clear "nexus" between the source and use of the funds in order to avoid legal challenges, the following are preliminarily identified, in priority order, as candidate objectives:

1. Offset legitimate General Fund expenditures,
2. Prevent disproportionate adverse impacts to individuals, communities, and California businesses,
3. Achieve low cost GHG reductions from sources not easily reached by existing regulations and/or the emission cap:
* Sources within the cap that have structural impediments (e.g. rental housing energy efficiency, sources with financing issues, federally regulated sources)
* Sources outside the cap, and
1. Enable strategic transformations that can achieve future deep GHG reductions:
* Transport electrification
* VMT reduction/land use

**2. Determine Appropriate Criteria**

A variety of possible evaluation criteria have been suggested. The Economic and Allocation Advisory Committee report recommended the use of cost-effectiveness ("an expanded measure of cost effectiveness...that accounts for environmental co-benefits"), fairness, environmental effectiveness, and simplicity, transparency and accountability.

Meanwhile, as noted above it is not necessary that the same criteria be applied to all categories of objectives. Rather, it is possible that the desired objectives are best reached by applying different criteria to each situation. For example, transformative measures to achieve deep reductions are perhaps better judged in terms of the magnitude of the potential reduction, and long-term cost-effectiveness, rather than attempting to force them through the filter of near-term cost effectiveness.

An initial set of proposed criteria that captures the range of considerations appropriate for the various objectives includes:

* Near term GHG cost effectiveness ($ per ton)
* Near term criteria pollutant cost effectiveness ($ per ton)
* Long term GHG cost effectiveness ($ per ton)
* Additionality (would the project proceed even in the absence of funding),
* Nexus (the linkage between the project and AB 32 purposes),
* Economic and job creation benefits
* Magnitude of the potential reduction, and
* Certainty/uncertainty of the expected outcome.

Table 1 below provides an initial attempt to lay out how the recommended criteria might best fit the identified objectives.

**3. Apply Criteria to Candidate Funding Proposals**

The final step involves using the defined criteria to evaluate proposed uses of the funds. Although this is straightforward, a few caveats are in order:

Although this comment (and the ARB/legislative process in general) does not address the ongoing Public Utilities Commission proceeding regarding the use of utility auction revenues, the results of that decision will affect deliberations here. For example, the "additionality" of energy efficiency measures must take into account the impact of the PUC decision.

Given the wide variety of proposals that will be submitted and the very different source categories to be addressed, it is critical to have in place a consistent evaluation methodology. This methodology should ensure to the extent possible that key parameters such as the scope of the analysis, the impacts considered or excluded, the time period covered and the discount rate employed are consistent across the various proposals. More specific suggestions will be provided on this dimension as work proceeds.

The evaluation of cost-effectiveness is complicated by the presence of the cap and trade program. As has been pointed out by other commenters, funding a measure that achieves additional reductions from a source within the cap does not reduce net emissions overall; rather it redistributes the emission reduction among the various sources. Given this situation, from one perspective the cost-effectiveness in terms of dollars per ton is infinite--money is spent but no net reduction is achieved. On the other hand, by reducing emissions within the cap such a measure would (provided that its cost is less than the marginal cost of compliance) reduce the overall cost of meeting the cap and thus provide a societal benefit. More work is needed to fully explicate these complex interactions.

**Other Considerations**

Finally, the evaluation process should explicitly take into account any uncertainties regarding the timing and magnitude of revenues to be received. This might best be accomplished via a "staged" expenditure plan that first addresses the use of revenues stemming from the initial allowance distribution methodology, and then separately considers the additional revenues that will be generated when free allocation declines and additional sources such as transportation fuels and smaller natural gas users are included under the cap.

Table

Possible Evaluation Framework for Distribution of Auction Revenues

|  |  |
| --- | --- |
| Objective | Evaluation Criteria |
|  | Near term GHG $/ton[[1]](#footnote-1) | Near term criteria pollutant $/ton | Long term GHG $/ton | Additionality (would not happen without this funding) | Economic and job creation impact | Magnitude of potential reduction | Nexus with AB 32 purposes | Certainty of expected outcome |
| Offset legitimate General Fund expenditures | X |  |  |  | X |  | X | X |
| Prevent disproportionate adverse impacts to individuals, communities, and California businesses | X | X |  | X | X |  | X | X |
| Achieve low cost GHG and reductions from sources not easily reached by existing regulations | X |  |  | X | X |  | X | X |
| Enable strategic transformations that can achieve future deep reductions |  |  | X | X | X | X | X | X |

1. Where this criterion is relevant the state should only pursue measures with a dollar per ton cost that is lower than the allowance price. [↑](#footnote-ref-1)