August 6, 2009

Honorable Members of the Economic and Allocation Advisory Committee
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Dear Members of the Economic and Allocation Advisory Committee:

Thank you for your commitment to working on some of AB 32's most critical implementation components: the economic analysis and the allocation mechanism with regard to AB 32's cap-and-trade system. As the Resolution from the December 2008 California Air Resources Board meeting specifies, it is our understanding this Committee:

> *"[w]ill provide advice on allocation of allowances and use of their value. It will evaluate the implications of different allowance allocation strategies such as free allocation, auction or a combination of both. The committee members also will help inform the ARB on its revised economic analysis. . . .*[1]*"*

Recognizing that the Economic and Allocation Advisory Committee (Committee) has an aggressive timeline to present its findings by the end of the year, the AB 32 Implementation Group, a coalition of more than 185 business and consumer organizations, would like to offer the Committee its perspective on a few components under consideration as they relate to the Committee's mission.

There's a threshold question for the Committee and the state which is important for this Committee to address:

## Should California establish a state or regional cap-and-trade program that may duplicate or perhaps be inconsistent with a federal program?

The state's Air Resources Board (CARB) is moving forward with a variety of regulations intended to reduce emissions associated with climate change, and its proposals will cost billions of dollars in higher energy costs, fuel prices, building costs and other expenses. And if these programs aren't part of a well-thought-out, practical strategy fully integrated with the rest of the nation and the world, they won't make a dent in global warming. They will, however, deal a serious blow to the ability of California businesses to compete in a global market place and on our state's economy, which is already on the critical list.

CARB has traditionally justified its stand-alone environmental policies by pointing to a federal government unwilling to take action on challenges like global warming. But times have changed, and CARB's approach needs to change along with them. The Obama Administration has moved swiftly to craft a national policy on global warming. It recently announced groundbreaking nationwide, low-emissions standards for cars and trucks, and Congress may soon adopt a sweeping climate change law to reduce our carbon footprint, produce cleaner and more efficient energy, and encourage the development of innovative green technologies.

Now that the federal program is on the move, California should revisit its own climate change blueprint to make sure it's compatible with nationwide policy. We need to be sure that we are not

[1] *CARB Website/Advisory Committees: http://climatechange.ca.gov/eaac/index.html*

imposing rules that will duplicate – or worse, contradict – federal initiatives, and to avoid burdening our businesses and families with costs that exceed those of national programs and jeopardize jobs and economic growth in California.

As the Analysis Group suggested in its June 29th letter to the Committee, CARB should be asking: What are the implications of overlap between the various AB 32 policies and existing or future federal policies? How should CARB alter the design, implementation, or timing of its program in light of the developing federal climate policy? This Committee should also consider whether industry in California will be subject to duplicate, overlapping or more stringent requirements in light of the Governor's goal to design a program that will achieve emissions reductions "without impairing robust economic growth."[2]

A cap-and-trade program, setting a ceiling and putting a price on greenhouse gas emissions, should be national or international in scope. A California-only program is unnecessary and potentially dangerous for our state. If a federal cap is more stringent, the California program becomes irrelevant. If less stringent, California's economy would be disproportionately burdened with emissions reduction requirements, thus subsidizing the rest of the nation, without any additional climate benefit. A recent analysis indicates that overlap between state cap-and-trade programs and a federal cap-and-trade program could increase economic cost to the state while providing minimal environmental benefits.[3]

In order to maintain a level playing field and keep California industry competitive, any emissions reductions that would be covered by a federal cap-and-trade program should not be separately regulated by the state.

The bottom line is this: global warming is a worldwide challenge that must be addressed, well, "globally." There is no scientific rationale for California to adopt policies far more aggressive than the rest of the nation and the world; indeed CARB acknowledges that such policies would not by themselves do anything to mitigate global warming.

## Improved Economic Analysis Needed

If the Committee and CARB choose a state-only approach, CARB must revise and update its initial economic analysis to reflect developments in federal climate change policy. The revised economic analysis should also help inform, identify and design specific state level policies that both meet AB 32 emissions reduction targets and minimize the adverse impacts on California's struggling economy. Unlike the initial economic analysis, the revised analysis should compare alternative policy choices including the use of tools to reduce costs.

For example, offsets are the single most effective means of reducing costs. Offsets are individual projects that can be developed to achieve the reduction of emissions from activities not otherwise regulated, covered under an emissions cap, or resulting from government incentives. These projects can generate "offsets," i.e., verifiable reductions of emissions whose ownership can be transferred to others.[4] The broad use of offsets will ensure emissions reductions are achieved at least cost. Since greenhouse gas (GHG) emissions have the same impact no matter where they occur, an arbitrary limit is not justified.

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[2] *Governor Schwarzenegger letter to the AB 32 Economic and Allocation Advisory Committee, May 22, 2009.*

[3] *Goulder, Lawrence, Mark Jacobsen, and Arthur Benthem,"Impacts of State-Level Limits on Greenhouse Gases per Mile In the Presence of National CAFE Standards," 2009.*

[4] *ARB Proposed Scoping Plan, October 2008, Page 36*

Offsets are an important cost-containment mechanism for the cap-and-trade program. Cost containment is vital, particularly because it is widely recognized that there is substantial uncertainty about the cost of reducing greenhouse gas (GHG) emissions to meet the ambitious emissions targets of AB 32. Those costs will be incurred by the economy generally, resulting in higher costs for energy and infrastructure providers that would be passed along to consumers.

Studies support this conclusion: At a CARB workshop on offsets, a study concluded that high quality, geographically broad and unlimited qualities of tradable offsets for AB 32 implementation could save California more than $20 billion in GSP by 2020 and reduce cost by 80% for California.[5]

Additionally, a recent economic study prepared by the United States Environmental Protection Agency (EPA) demonstrated the effectiveness of offsets in containing costs. Here, EPA analyzed the Low Carbon Economy Act of 2007 (S. 1766 or Bingaman-Specter cap-and-trade bill), and concluded that limiting the types of eligible offsets projects undermines emissions reductions and makes the cap-and-trade program more expensive.[6]

In fact, a recently released study conducted by experts from California State University, Sacramento concluded that when AB 32 is fully implemented, the average annual loss in gross state output from small businesses alone would be $182.6 billion, translating into nearly 1.1 million lost jobs in California. Lost labor income is estimated at $76.8 billion, with nearly $5.8 billion lost in indirect taxes.

Electricity costs are estimated to increase by up to 60% in some parts of California[7], and transportation fuel costs by $4 billion per year[8], according to other analyses. And according to both the California Building Industry and California Business Properties Associations, housing and commercial building costs would also increase significantly.

Limiting offsets dramatically increases the threat of emissions and job leakage. It is important that California, as a leader in the fight against climate change, crafts a plan that gets it right the first time and anticipates – and mitigates -- issues related to jobs and the economy, as supported by a recent University of California, Berkeley Center for Labor Research and Education Policy study – *Addressing the Employment Impacts of AB 32, California's Global Warming Solutions Act*[9].

## Allocations and Auctions

Determining how allowance allocations should be distributed is certainly a large task for the Committee. The AB 32 Implementation Group believes distributing the allowances through an auction program would put the state at a competitive disadvantage. Auction revenues would add from $760 million to $39 billion in defacto taxes per year on California companies that wish to continue operating in this state depending upon the scope of the cap-and-trade program and the per ton cost of carbon ($39 billion in auction revenues represents an economy-wide cap with carbon trading at $100 per ton). These billions of dollar in hidden taxes will wind up being paid for by California consumers.

Further, California government has a poor track record of using earmarked dollars for the purpose they were intended. These new taxes would represent a government windfall with no guarantee the funds would be used to reduce greenhouse gas emissions or for research & development.

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[5] *CRA Presentation, ARB Workshop on Modeling Offsets. April 4, 2008*
[6] *US EPA, EPA Analysis of the Low Carbon Act of 2007 (January 15, 2008) at 11, 40, and 96.*
[7] *Tri-Cities (Glendale, Burbank, Pasadena) AB 32 Forum, May 14, 2009*
[8] *Preliminary Review of the CARB Staff Analysis of the Proposed Low Carbon Fuel Standard, Sierra Research Inc., April 8, 2009*
[9] *http://laborcenter.berkeley.edu/greenjobs/AB32_policy_brief09.pdf*

In these economic times, remaining mindful of the economic hardships AB 32 will place on California is especially important. With that said, we encourage the Committee to review the objectives of AB 32 and evaluate the outcomes of a California-only market system in light of a federal program. Doing so will assure California is not faced with any regulatory duplication or overlap. Moving forward, it is also essential the Committee guides CARB to develop an accurate economic analysis of the true costs of implementing AB 32. And finally, if the Committee continues along the path of a California-only cap-and-trade system, we urge the Committee to recommend a broad use of offsets as a way to keep California's economy strong, competitive and growing while still reaching the real GHG emissions reduction goals set forth in AB 32.

Thank you for your consideration of these issues that are critical to California's climate change policy and the future of our state's economy.

Sincerely,

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