

November 18, 2009

Via: e-mail to goulder@stanford.edu

Larry Goulder
Chairman, Economic and Allocation Advisory Committee
Stanford University
Stanford, California 94305

Re: Recommendations on Draft Report for November 18th Public Meeting

Dear Chairman Goulder and EAAC Committee Members,

It has been a privilege working with the members of the Committee and I look forward to finishing our important work. I apologize that I am unable to attend today's meeting, but I ask the Committee to consider the following four recommendations from me, and to read them at the public meeting in my absence.

1. **Allowances should be auctioned.**

I join my colleagues in recognizing that auctioning offers the elegant solution to distributing allowances. As other members of the Committee have eloquently explained in previous meetings, auctioning allowances provides the most equitable and efficient means of allocating allowances. In evaluating allocation methods, it is important to remember the objectives laid out in AB32 that this Committee has distilled into four key criteria: cost-effectiveness, environmental effectiveness, fairness, and simplicity. Compared to free allocation, I believe auctioning provides the superior method of distribution under each criterion:

- In terms of **cost-effectiveness**, auctions ensure allowances are directed toward their highest valued use in an efficient manner. Revenues from auctions also provide a key resource to lower the overall cost of meeting AB32's reduction target.
- In terms of **environmental effectiveness**, auctions reward early innovators that have already reduced their emissions through investments in low-carbon technologies, rather than reward past polluters.
- In terms of **fairness**, auctions provide a transparent process of distribution that puts all market participants on an equal footing.
- In terms of **simplicity**, auctions eliminate the need to adjust the allocation scheme to deal with sources entering and exiting the market, making them easier to administer than free allocation systems.

I recommend auctioning 100% of allowances.

2. **Allowance value should be used to ensure agencies and local governments can fully implement AB 32-related measures.**

State, regional, and local agencies tasked with implementing AB 32-related measures must have the staff and resources necessary to carry out their jobs. I know from experience how critical operational capacity is to ensuring that an organization can fulfill its mission. Unfortunately, I believe there are significant shortfalls in agency and local government capacity that will severely hamper their ability to achieve the goals of AB 32.

In particular, the California Public Utilities Commission (CPUC) has been unable to increase staff for implementing AB 32 over the past three budget cycles. This leaves the California PUC today with fewer staff dedicated to clean energy initiatives (35) than the New York Public Service Commission (40), even though California's initiatives are more than double the size of New York's as measured in dollars and megawatt-hours.

Similarly, local governments tasked with implementing ambitious land use planning and public transit programs under AB 32 and SB 375 are woefully unprepared. As a member of the Strategic Growth Council, I see both the potential that improved land use planning has in reducing GHG emissions and the present lack of funding for this critical effort. Forty percent of California's GHG emissions come from the transportation sector. Better land use planning and public transit are necessary to reduce these emissions. Reductions in vehicle miles travelled will also result in reductions in other air pollutants. Eighteen Metropolitan Planning Organizations in California are ready to take on this task, but currently have nowhere near the \$20 to \$60 million that the League of California Cities estimates will be needed to implement the measures required by AB32 and SB375 in the first 2-3 years.

If agencies and local governments tasked with implementing AB 32-related measures are not properly funded, I believe the work of this Committee might be a grand but futile exercise.

I urge the committee to recommend using allowance value to ensure that state, regional, and local agencies implementing cost-effective GHG-reduction measures are properly funded.

3. **A portion of allowance value should be used to kick-start other cost-effective GHG emission reduction solutions.**

California must transition to a low-carbon economy to meet AB32's reduction target. Because of the presence of market barriers, however, a price signal alone will not facilitate investments in many GHG reduction solutions that are already cost-effective (such as energy efficiency). Accordingly, in the initial years of cap-and-trade, a portion of allowance revenue should be directed toward institutions with the capacity to overcome these market barriers. Once programs are in place to allow these markets to develop, the full amount of allowance value could return directly to taxpayers. But it is vital that we kick-start the cost-effective measures other than cap-and-trade that CARB is relying on to meet AB32's reduction goal. Foregoing these opportunities now will unnecessarily increase the overall cost of this venture.

I recommend using allowance value to fund cost-effective GHG reductions, such as energy efficiency.

4. **The remaining allowance value should be used to reduce taxes**

Once our transition to a clean energy future is on track, allowance value should be used to finance cuts in existing taxes or to reduce California's budget deficit (thereby reducing the need for future taxes). Both dividends and tax relief provide a use of allowance value that directly benefits the public, but using allowance value to reduce the marginal rates of distortionary taxes like California's state income tax is much more cost-effective than direct dividends.

Barring a contrary recommendation from the Legal Issues Subcommittee, I support using allowance value to reduce other taxes, once agencies are fully funded and our transition to a clean energy future is on track.

Thank you for considering my recommendations.

Bob Fisher