

TESTIMONY

May 24, 2012

Public Consultation on Investment of Cap- and-Trade Auction Proceeds

Dallas Burtraw

Prepared for the California Air Resources Board

1616 P St. NW
Washington, DC 20036
202-328-5000 www.rff.org



Public Consultation on Investment of Cap-and-Trade Auction Proceeds

California Air Resources Board May 24, 2012

Comments of Dallas Burtraw
Senior Fellow and Darius Gaskins Chair, Resources for the Future

An emissions cap-and-trade program is different from previous regulations that allowed emitters to pollute for free as long as they met regulatory standards. Under cap and trade, emitters surrender an emissions allowance for each unit of pollution. Since these allowances are limited and can be bought and sold, they have a price, which reflects their value in the market. Ultimately, consumers and some businesses will pay for the costs of these allowances through higher prices. However, the allowance revenue generated by the trading of emissions allowances does not disappear—this value will cycle through the economy.

In 2010 the Economic and Allocation Advisory Committee reported to the Air Resources Board on options for the use of allowance value.¹ The issue was taken up in an idealized context, cognizant of but not constrained by legal and political issues. The committee's recommendation was first to dedicate what was anticipated to be a small share of allowances to prevent leakage of emissions or jobs from California and protect potentially vulnerable communities - objectives that are explicitly mentioned in AB 32. The committee anticipated that a relatively small share of the total allowance value would be needed for these purposes.

The Committee found that the more substantial portion of allowance value should be allocated to two major uses: (1) returning allowance value to households, potentially through reductions in other taxes or as direct payments, and (2) financing investments to reduce emissions and other public expenditures.

In 2012, the state is making decisions in the practical context where it is constrained by state law. The state has already decided to direct most of the value associated with industrial sector emissions back to that sector to protect against unregulated competition from out of state. Value associated with the electricity sector emissions is returned to that sector and designated "for the benefit or ratepayers," partly justified by the early action already taken in that sector to reduce emissions. The third and largest portion of allowance value is associated with transportation, which enters the program in 2015. In the next year the advance auction of allowances associated with the transportation sector will generate \$0.6–\$1.8 billion, and that auction revenue will grow fivefold in 2015. The designation of this value is the main question facing the state now.

Returning value to households through reductions in other taxes or direct payments, despite its appealing features, is viewed as legally risky. In lay-person terms, the legal test is the strength of the link between the source of the allowance revenue (fees) and the way the resulting revenues

¹ http://www.climatechange.ca.gov/eaac/documents/eaac_reports/2010-03-22_EAAC_Allocation_Report_Final.pdf

are used. In contrast, a low legal risk is associated with the use of allowance value to make investments to reduce emissions. In addition, a recent study by Next10 illustrates the substantial contribution such investment can make to the California economy (www.Next10.org).

The focus for today's conversation is: How is the state legislature, with help from the Air Resources Board, going to authorize the expenditure of funds toward investments with a primary goal of reducing greenhouse gas emissions in the state?

A fundamental dimension to the choice is whether to consider options incrementally or to envision bigger efforts. On one hand, the state could continue to pursue measures that build on many existing efforts to improve efficiency in various sectors of the economy such as appliance standards, efficiency standards, and promotion of renewable fuels. These types of measures have proven effective in reducing emissions and additional efforts could be expected to produce additional emissions reductions. Eventually, one would expect to see diminishing marginal returns to these efforts as they are developed further, but that knee of the cost curve may still be some ways off, and the process of adopting incremental measures is likely to identify unforeseen additional opportunities.

One should note that incremental measures in sectors covered by the cap and trade program may reduce allowance costs under the program, but they are unlikely to reduce emissions, because emissions are governed by the cap. If a measure lowers emissions at one source, it frees up an allowance that is available for another source to use.

On the other hand, the state could consider transformative investments that achieve emissions reductions in 2020 but are geared to put the state in the position to achieve long run goals for the middle part of the century. These types of investments might, for example, put in place new infrastructure in electricity, transportation or land use.

About this option, one should note that not all transformative-type investments need to be large. Expanded investment in research and development can contribute to a transformation of the economy, with spillover benefits for the rest of the country. This could be part of a portfolio that also involved investments in physical infrastructure.

Many economists would add to this discussion an expression of concern about the proper role for government. Incremental policy measures are justified by evidence that individuals often do not have the information or means to make decisions that meet broader social goals such as reducing greenhouse gas emissions. But typically we want to leave investment decisions where sizable financial risks are involved to the private sector. However, government is the only agent in the position to determine and develop the skeletal infrastructure that enables private sector investment in the transforming economy. The instantiation of allowance value by the introduction of the cap-and-trade program represents a rare situation when funds of substantial magnitude will be available for such a purpose.

The California cap-and-trade program is the best designed that we have seen. The fact that decisions about how to allocate the allowance value under the program are taking place in an open setting with public consultation is an important illustration of the program's success thus far. This deliberative process continues that effort.

Public Consultation on Investment of Cap-and-Trade Auction Proceeds

May 24, 2012
1:30 p.m. to 5:00 p.m.

Byron Sher Auditorium
Cal/EPA Headquarters Building, 2nd floor
1001 "I" Street in Sacramento, CA

Note: The Byron Sher Auditorium at Cal/EPA Headquarters has limited seating. The meeting will be webcast (www.cal-span.org). Overflow seating will be available in the Coastal Hearing Room.

AGENDA

1:30 p.m. **Opening Remarks and Introductions**

Mary D. Nichols, Chairman, California Air Resources Board

1:45 p.m. **Panel One:** *How California can 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?*

- Dallas Burtraw, Senior Fellow, Resources for the Future
- Ellen Hanak, Senior Policy Fellow, Public Policy Institute of California
- Grant Davis, General Manager, Sonoma County Water Agency
- Lester A. Snow, Executive Director, California Water Foundation
- Mike Mielke, Senior Director, Environment, Silicon Valley Leadership Group
- Frances Keeler, President of the Board of Directors, FuturePorts
- Jim Earp, Executive Director, California Alliance for Jobs

2:50 p.m. **Panel Two:** *What criteria should be prioritized in the development of an investment plan for auction funds and why?*

- Dr. Barry R. Wallerstein, Executive Officer, South Coast Air Quality Management District
- Leonard E. Robinson, Board Member, California Black Chamber of Commerce
- Dorothy Rothrock, Vice President & Government Relations, California Manufacturers & Technology Association
- Ruben Guerra, Chairman & CEO, Latin Business Association
- Daniel M. Dooley, Senior Vice President of External Relations, University of California
- Michelle Passero, Senior Climate Policy Advisor, The Nature Conservancy
- Emily Rooney, President, Agricultural Council of California
- Nidia Bautista, Policy Director, Coalition for Clean Air

4:00 p.m. **Public Comment**

Written comments are welcome at <http://arb.ca.gov/cc/capandtrade/revenue/publicinputdetails.pdf> from Friday May 25, 2012 until Friday June 22, 2012.