January 19, 2010

Hon. Edmund G. Brown Jr.
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Krystal Paris
Initiative Coordinator

Dear Attorney General Brown:

Pursuant to Elections Code Section 9005, we have reviewed a proposed initiative relating to the California Global Warming Solutions Act of 2006, commonly referred to as "Assembly Bill 32" (A.G. File No. 09-0094).

Background

Assembly Bill 32 establishes the goal of reducing, by 2020, the state's emissions of greenhouse gases (GHGs) to the level those emissions were in 1990. The law requires the state Air Resources Board (ARB) to adopt rules and regulations to achieve the targeted reduction in emissions and to monitor and enforce this program. As required by law, the ARB in December 2008 released its scoping plan for AB 32 implementation. This plan is a blueprint for meeting the statutory GHG emission reduction goal, and it encompasses a range of GHG emission reduction measures. These include, as allowed under AB 32, traditional regulatory measures to directly order reductions in emissions, market-based compliance measures (namely, a "cap-and-trade" system), and voluntary measures. Regulations have already been adopted for some of these measures. For others, regulations are either currently under development or will be developed in future years.

As allowed under AB 32, the ARB has adopted a regulation with a schedule of fees to be paid by parties that emit GHGs to fund state agency administrative costs to implement AB 32. Under current law, revenues from the AB 32 administrative fee are also to be used to repay various state special funds that have made loans totaling $83 million to the AB 32 program. These loans have staggered repayment dates that run through 2014.

Other Statutes Have Been Enacted That Could Reduce GHG Emissions. In addition to AB 32, a number of other state statutes have been enacted that could reduce GHG emissions. In some cases, the main purpose of the statute is to reduce GHG emissions, such as in the case of legislation enacted by Chapter 200, Statutes of 2002 (AB 1493, Pavley), that requires the ARB to adopt regulations to reduce GHG emissions from light-duty vehicles. Other statutes authorized various energy efficiency programs that could have the effect of reducing GHG emissions.

State Currently Has High Unemployment Rate. Each month, the state Employment Development Department (EDD) publishes an estimate of the unemployment rate for California. The preliminary non-seasonally-adjusted unemployment rate for November 2009, as found in EDD's *Monthly Labor Force Data for Counties* report, is 12.2 percent.

Proposal

This measure would suspend the implementation of AB 32 until such time that the unemployment rate in California is 5.5 percent or less for four consecutive calendar quarters. During the suspension period, state agencies would be prohibited from proposing or adopting new regulations, or enforcing previously adopted regulations, implementing AB 32.

Fiscal Effects

Some Regulatory Activities Would Likely Be Suspended. California's current unemployment rate is much higher than the 5.5 percent level, and is forecast to remain so for the next several years. In fact, some economists are concerned that unemployment could remain a problem even longer. Given this, it is probable that the measure's suspension mechanism would go into effect immediately and stay in effect for at least several years thereafter. The specific fiscal impacts of this measure on state and local governments, therefore, would depend largely on the particular regulatory activities that would be suspended during this period. These would likely include:

- The proposed cap-and-trade system.
- A low carbon fuel standard that would require a significant reduction in the carbon intensity of, and thus the GHG emissions from, the state's transportation fuels.
- A requirement that all retail sellers of electricity procure at least 33 percent of their electricity by 2020 from "renewable" sources, such as solar or wind power. (A current standard that renewable sources constitute 20 percent of the electricity procured by investor-owned utilities by 2010 would still apply.)
- The fee to recover state agency costs of administering AB 32.

However, the majority of activities related to addressing climate change and reducing GHG emissions would probably not be suspended by this measure. That is because certain regulations, such as the light-duty vehicle emission regulations adopted under AB 1493, implement statutes enacted separately from AB 32. We estimate that more than one-half of the emission reductions intended from implementing the scoping plan are scheduled to come from programs that derive their authority outside of AB 32.

As discussed below, the suspension of AB 32 regulatory activities would have several impacts. These include potential effects on the California economy and related impacts on state revenues, as well as effects on the administrative costs of state regulatory agencies.

Potential Impacts on California Economy and Government Revenues. A suspension of AB 32 would have various economic impacts. Generally speaking, the suspension of regulatory activity under the measure means that business would avoid costs required to comply with the suspended regulations. For example, the suspension of AB 32 regulations might allow some businesses to avoid significant investments they might otherwise be mandated to make in new energy technologies. This could potentially lead to larger net profits for these firms, at least in the short term, than would otherwise occur. To the extent that such impacts occurred, the state could collect greater state corporate tax revenues than would otherwise be the case.

Similarly, the suspension of the proposed cap-and-trade regulations could result in lower energy prices for consumers, including state and local government agencies that are large consumers of energy, than would be the case if AB 32 regulations were allowed to take effect. These lower energy prices, in turn, also would have positive economic impacts on the state. As a result, the measure would likely have a positive impact on state and local government revenues, at least in the near term.

The longer-term economic impact of the measure is less certain. This is because the suspension of AB 32 could also have some negative impacts. For example, it could delay investments in energy technologies reaping longer-run savings or dampen additional investment in clean energy technologies or in so-called "green jobs" by private firms, thereby resulting in less economic activity than otherwise would be the case.

State Administrative Cost Savings. During the likely suspension of AB 32, state administrative costs to develop and enforce regulations pursuant to AB 32 would be reduced significantly. We estimate that the resulting state administrative cost savings—and ultimately lower fees—could be in the low tens of millions of dollars annually. Once the suspension was lifted because of an improvement in the state's unemployment rate, these savings would end. (The state might, however, incur some additional costs to reevaluate and update work which had been underway prior to the suspension.)

During any period that AB 32 would be suspended, the ARB would lack the authority to collect the administrative fee authorized under AB 32. As a result, there would no longer be a dedicated funding source to repay loans that have been made from certain state special funds to support the operation of the AB 32 program. This would mean that other sources of state funds, potentially including the General Fund, might have to be used instead to repay the loans. These state costs could amount to tens of millions of dollars.

Other Fiscal Effects. There are other potential fiscal effects of the measure that relate specifically to a suspension of ARB's proposed cap-and-trade regulation. One feature of this proposed regulation that is currently under discussion relates to whether, and to what extent, emission allowances are allocated free of charge or instead auctioned by state government to emitters of GHGs. The AB 32 scoping plan developed by ARB provides for the auction of at least some emission allowances initially, with this proportion increasing over time. Depending upon the specific approach ultimately determined by ARB, the resulting state revenues from the auction of emission allowances could be up to billions of dollars annually. (These revenues could be used to reduce other state taxes or increase state spending—either related to GHG emissions or not.) If this measure suspends the future implementation of such a cap-and-trade regulation, the state would therefore forego these revenues, at least until the state's unemployment rate dropped to the level specified in this measure for four consecutive quarters.

Summary

In summary, the initiative would likely have the following major fiscal effects:

- Potential positive, short-term impacts on state and local government revenues from the suspension of regulatory activity, with uncertain longer-run impacts.
- Potential foregone state revenues from the auctioning of emission allowances by state government, by suspending the future implementation of cap-and-trade regulations.

Sincerely,

Mac Taylor
Legislative Analyst

Ana J. Matosantos
Director of Finance