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Cap-and-Trade:
Budget Conference Issues
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LEGISLATIVE ANALYST'S OFFICE

Presented to:

Budget Conference Committee

Hon. Mark Leno, Chair

LAO

70 YEARS OF SERVICE

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Cap-and-Trade Expenditure Plan

(In Millions)

	Governor	Senate	Assembly
Continuously Appropriated Funds (60 Percent of Revenue)	**$1,200**	**$1,200**	**$1,200**
Discretionary Expenditures	**1,037**	**1,532**	**1,217**
Agreement Between Houses			
Incentives for low-carbon transportation	350	350	350
Energy efficiency for low-income households	140	140	140
Forest management and urban forestry	92	92	92
Wetlands and watershed restoration	65	65	65
Transit and intercity rail capital projects	65	65	65
Energy efficiency and renewable energy for UC and CSU	60	60	60
Energy efficiency for public buildings	40	40	40
Rebates for water efficient appliances	30	30	30
Differences Between Houses			
Disproportionately affected communities program	—	500	—
Agricultural water and energy efficiency	40	105[a]	40
Urban water-energy efficiency	20	—[a]	20
Water and energy technology research and development	30	—[a]	30
Agricultural operations and efficiency	25	50	30
Green Bank for energy efficiency financing	—	25	—
Waste diversion	60	10	75
Active transportation grants and expanded transit passes	—	—	50
Biomass power generation grants	—	—	50
Biodiesel refining and biomethane grants	—	—	20
Improved agricultural soil management practices	20	—	20
Property Assessed Clean Energy financing	—	—	10
River revitalization and greenway development	—	—	10
Community outreach to assist disadvantaged communities	—	—	8
Climate change research and outreach	—	—	6
Mosquito vector control activities	—	—	4
Climate adaptation activities	—	—	3
Total Expenditures	**$2,237**	**$2,732**	**$2,417**

[a] Senate plan combines water efficiency programs and adds $15 million to May Revision amounts.

- ☑ ***Additional Spending Relative to Governor's May Revision.*** Relative to the Governor's May Revision, the Assembly plan adds $180 million in cap-and-trade funds, including $50 million for biomass power generation grants and $50 million for active transportation grants and expanded transit passes. The Senate plan adds $495 million, largely driven by a $500 million increase for a new program that would allocate funding to counties for greenhouse gas (GHG)-reducing programs that benefit disadvantaged communities.

- ☑ ***Both Houses Make Changes to Eligible Uses of Funds.*** In addition to differences in funding amounts, both houses make changes to the eligible uses of funds for certain programs. These changes include:

  - Senate adds alternative fuels as an eligible use of low-carbon transportation funds.
  - Senate broadens use of low-income energy efficiency and renewable energy funds to include low-income communities and individuals.
  - Senate funding for agricultural and operational efficiency places an emphasis on sequestration.
  - Assembly includes sustainable disposal of biosolids as an allowable use of funds in the waste diversion program.
  - Senate adds energy- and water-efficient housing as a criteria for the Affordable Housing and Sustainable Communities Program and dedicates a share of funding to farmland preservation.
  - Senate expands use of energy efficiency funds for public buildings to include locally owned buildings.
  - Senate expands use of funding going to forest health to include mountain meadows, estuaries, coastal watersheds, and biomass.

☑ ***Senate Changes Departments Administering Programs***. Relative to the Governor's May Revision, the Senate changes the departments administering some programs. These changes are:

- Maintaining energy efficiency for state buildings at the Energy Commission instead of shifting to the Department of General Services as proposed in the May Revision.
- Shifting non-urban forestry activities from the California Department of Forestry and Fire Protection to the Wildlife Conservation Board.
- Combining funding for water and energy efficiency programs proposed by the Governor to be administered by the Department of Water Resources and Department of Food and Agriculture and shift administration of these activities to the Energy Commission and State Water Board.

Issues to Consider

☑ ***Fund Balance.*** Based on preliminary results from the recent cap-and-trade auctions, the amount of 2014-15 revenue will likely be about $140 million higher than the May Revision assumes. Under the Governor's 2015-16 $2 billion revenue assumption, the Assembly expenditure plan would maintain a $460 million fund balance at the end of 2015-16, and the Senate expenditure plan would maintain a $145 million balance. It is appropriate to maintain a prudent fund balance to account for future revenue uncertainty. However, based on our analysis, the Governor's May Revision 2015-16 revenue assumptions are at the low end of our range of estimates. Therefore, it is likely not necessary for the Legislature to also maintain a large fund balance to protect against revenue uncertainty.

- The 60 percent continuous appropriation also reduces the need for a significant fund balance because a significant portion of lower revenues, should they occur, would automatically result in less funding for continuously appropriated programs, rather than a reduced fund balance.
- If the Legislature adopts the Governor's May Revision 2015-16 revenue assumptions of $2 billion, the Legislature could spend about $420 million more than the Governor proposes and still maintain a fund balance of $220 million, which would be about 15 percent of discretionary expenditures.
- If the Legislature assumes our 2015-16 moderate revenue estimates of $2.3 billion, the Legislature could spend about $530 million more than the Governor proposes and maintain a fund balance of about $230 million, which would be 15 percent of discretionary expenditures.

Issues to Consider *(Continued)*

☑ ***Administrative Complexity.*** Both plans create new programs. Creating new programs at state agencies and allocating funds to local governments to create their own programs will increase the amount of administration and oversight needed to ensure the funds are being spent in a way that is consistent with legislative direction. For example, the Air Resources Board will have to assess whether the new programs are meeting statutory goals, including reducing GHG emissions. On the other hand, creating new programs, rather than adding to existing programs, might give the Legislature an opportunity to evaluate the effectiveness of a more diverse set of programs prior to making future funding decisions.

☑ ***Legal Risk.*** The Legislature will want to consider the level of legal risk associated with different types of spending. There are likely legal restrictions on the use of cap-and-trade funds that require the funds be used in a way that advances the goals of AB 32. For example, the primary goal of AB 32 is to reduce GHG emissions. Climate change adaptation and mitigation are not goals identified in AB 32. Therefore, there might be greater legal risk using funds on activities that focus on mitigating or adapting to the effects of climate change, rather than activities intended to reduce GHG emissions.

☑ ***Interaction With Existing Programs.*** The Legislature may want to consider how each plan interacts with existing energy and GHG-related programs. For example, the biomethane grants included in the Assembly plan appear to be similar to existing alternative energy programs. The Legislature may want to ensure new programs are coordinated with, not duplicative of, and build on the expertise available in existing programs. In addition, under the Senate's disproportionately affected communities program, the Legislature may want to consider how local programs would complement, supplement, or overlap with existing state programs targeted at reducing GHG emissions to ensure overall resources are being used in a way that maximizes benefits.