

Backgrounder: AB 32's Economic Analysis Tens of Billions in Hidden Costs

The AB 32 Scoping Plan represents perhaps the most far-reaching regulatory policy initiative ever attempted in our state's history, imposing new costs on virtually every product and service used by Californians. Yet the agency's economic analysis for this transformational policy initiative finds that it won't cost consumers a dime. We are skeptical about the rosy prediction partly because large government regulatory programs often cost dramatically more than initial estimates suggest. In addition, there are problems with the agency's economic analysis.

Hides tens of billions in higher costs.

The economic analysis hides tens of billions in higher costs for electricity, fuel, food and other products resulting from the AB 32 scoping plan.¹ It does this by assuming that these near-term costs will be more than offset by future savings from energy efficiency improvements. But CARB wrongfully assumes all these benefits are a direct result of the scoping plan and wouldn't otherwise occur.

CARB's estimates of cost savings from many of the energy efficiency measures are speculative. Even if CARB is right, its assumption that these measures can only be realized through the scoping plan flies in the face of the fact that Californians have, and will continue to, voluntarily invest in energy efficiency because of the high costs of natural gas and electricity. For example, as gasoline and diesel costs have increased, Californians have begun purchasing more fuel efficient cars. Yet, CARB's analysis implies that, absent the Scoping Plan, Californians would spend 20% more than they need to on energy (in 2020) as a result of failing to take advantage of many cost-saving energy efficiency improvements. CARB counts all of these energy efficiency savings as billions of dollars of assumed economic benefits, which cancel out the real, indisputable costs of the proposed AB 32 regulations.

Without a compelling analysis of why these savings can only be realized through policy intervention, CARB's analysis cannot be considered an assessment of the economic impact of the *policies* that it proposes to implement. Instead, if you believe CARB's estimates about opportunities for energy efficiency improvements, its analysis simply assesses the economic impact of various future changes in the economy, many of which would occur without the Scoping Plan.

Billions in higher electricity and natural gas costs.

CARB's own economic analysis found that the 33% RPS alone would increase electricity costs by \$3.7 billion in gross annual costs or \$1.8 billion in net costs.² The RPS and CARB's other proposals would collectively increase electricity prices by 11% and natural gas prices by 8% over and above the high costs California businesses and consumers already pay.³ These higher prices will be very challenging for companies and families, and particularly for low income families. The economic analysis tries to hide these certain and substantial impacts on electricity and natural gas prices by giving the Scoping Plan credit for speculative savings from energy efficiency improvements that may happen even without that Plan.

¹ For example, CARB's analysis indicates that its cap-and-trade program and the RPS would together increase energy costs in California by more than \$5 billion *every year*.

² Economic Analysis Appendix I-7

³ Economic Analysis Table IV-2, page IV-3

Billions in higher gasoline prices.

The CARB analysis found that it would cost \$11 billion a year to make the fuels necessary to meet the low carbon fuel standard (LCFS),⁴ which would likely result in higher gasoline and diesel prices. In fact, based on past experience with California fuel formulation changes, consumers should expect far higher fuel costs resulting from the AB 32 scoping plan. According to the Energy Information Administration (EIA), California's unique gasoline and diesel fuel formulations are a major reason why our gasoline and diesel fuel prices typically have been far higher than the rest of the country, equaling many billions of dollars in higher costs for consumers. The LCFS proposed in the scoping plan will require an even more extreme fuel formulation, which if history is any indication will have a similar if not greater impact on the price of fuel. Moreover, there is far more uncertainty about how the LCFS will impact fuel supplies because the low carbon fuels it relies on have either not yet been invented or are not commercially viable. In fact, EIA concluded that the federal renewable fuel standard would be unachievable in 2020, raising serious questions about the achievability and cost of California's LCFS. In light of all this uncertainty, it's simply not credible to discount the \$11 billion a year price tag attached to low carbon fuel production and assume these costs would ultimately be equivalent to conventional fuel production.

Impacts of a \$4 billion carbon fee and \$500 million water tax.

The scoping plan promised to compare the costs and benefits of approaches other than the preliminary recommendations, including two carbon fees that CARB states would be designed to increase the costs of energy in order to discourage its use.⁵ The first is an annual \$4 billion carbon fee and the second is a \$500 million water fee. While market-based policies such as a cap-and-trade system or well-designed carbon fees are preferable to inflexible, prescriptive regulations, there should be no doubt that, with costs of this magnitude, they will result in lower economic activity and lost jobs. It is hard to accept the economic analysis conclusion that there would be no negative economic consequences of a \$4 billion energy tax. Higher energy costs are particularly challenging for low income families that use a greater percentage of their income for energy.

Fails to account for today's difficult economic climate, and assumes business has unlimited capital to invest.

Many California businesses, like many California families, are hurting badly from the sluggish economy, increasing costs for diesel and gasoline and higher costs for electricity and natural gas. The economic analysis fails to take the existing economic challenges into account. Even if one believes CARB's assumption that its plan will bring about substantial cost saving energy efficiency improvements, the Scoping Plan will require already strapped families and businesses to pay billions in higher energy costs and make tens of billions of dollars in near-term investments, with the hope that those investments will yield speculative returns from energy efficiency in the future. In reality, these increased near-term costs will have significant impacts on small businesses, as they will reduce the capital that is available to hire new employees and expand business and may in fact force cutbacks in jobs and production.

Phantom new jobs versus real lost jobs.

The economic analysis finds there will be new jobs in an expanding economy as a result of AB 32 implementation. This finding depends on the flawed assumption that little energy efficiency will occur

⁴ Economic Analysis page I-6

⁵ Scoping Plan Appendix C-181

in the business as usual baseline. The analysis does not describe the additional “green” jobs promised when AB 32 passed. New green jobs may result from AB 32 regulations, but there is no guarantee those jobs will be based in California. The state’s high tax rates already have pushed many manufacturers out of the state, and there’s absolutely no justification for assuming that any new manufacturing jobs resulting from AB 32 regulations would be based here.

What is far more likely is that the higher costs imposed on California companies will result in reduced economic activity and lost jobs here as employers close down or move operations elsewhere. The economic analysis should calculate not only the lost jobs, but also the dislocation costs of these lost jobs on the economy. It should also not wish away job losses the model predicts by assuming that facilities in the state will continue to operate.

Fails to compare the costs of command and control regulations to market-based approaches.

CARB staff has recommended that 80% of the scoping plan’s emission reductions be derived from command and control regulations versus 20% under market mechanisms. To help decision-makers choose between these alternative regulatory approaches, the economic analysis was supposed to compare the costs of a command and control regulations versus market mechanisms. Unfortunately, the economic analysis provides no real comparison of the many regulations it proposes to the alternative approach of relying more heavily on market-based strategies like cap and trade and offsets to lower implementation costs. At best, the analysis only indirectly shows that a cap and trade program would cost about eight times less than the proposed 33% RPS.

Fails to calculate higher costs for food and other products.

Higher energy costs for electricity, natural gas and transportation fuels will directly result in higher food costs. Energy is typically are 10% to 15% of the cost of food production and additional costs are incurred for transportation. However, the economic analysis fails to calculate how much these higher costs will impact the cost of food, but instead incorrectly indicates food prices will drop.

Omits critical questions from the charge to peer reviewers.

There are two additional points that peer reviewers should be asked to consider:

- Assess the sufficiency of CARB's analysis for addressing whether it would be more or less costly to subject particular emission sources to prescriptive regulations, versus the alternative of including them under a broad California-wide cap-and-trade system.
- Assess the sufficiency of CARB's analysis for addressing the economic implications of other key policy design choices, such as whether to allow for offsets in a cap-and-trade system and whether to adopt particular cost-containment measures.

In addition, CARB should make the peer reviewers’ comments public, and should also make public its response to those comments.