

Climate regulation drama! Sen. Darrell Steinberg is floating a proposal that would change California law to take transportation fuels out of the cap-and-trade program, and to enact a new fuels tax instead. As background, distributors of those fuels are slated to join the cap-and-trade program in 2015, meaning they would need allowances to cover their greenhouse gas emissions starting in January of that year, through 2020.

I have no idea what the politics of the proposal are. It seems to be stumbling out of the gate a bit, with some business groups and environmentalists opposed. (See an early LA Times story with those reactions [here](#).) Steinberg's party is at best divided, with Sen. Pavley, who authored AB 32, publicly opposing the move. As a tax, the legislation would need a 2/3 majority of the Legislature — a hurdle AB 32 itself didn't pass.

But on the substance, would Californians be better off with a fuel tax instead of cap-and-trade? My first blush answer is No, and certainly not at this stage. Here's why.

Generally speaking, a tax provides more cost certainty to emitters and (sometimes) fewer administrative implementation burdens than a cap-and-trade system. Cap and trade, by contrast, provides more certainty about the emissions reductions it would achieve (via a cap), but less certainty about cost. Given AB 32's mandate that California return to a known level of emissions by 2020, a hard cap is attractive from a regulatory perspective, despite its challenges. It also provides more flexibility to regulated entities than would more prescriptive, traditional environmental regulations requiring reductions. A cap-and-trade program seems like a reasonable fit for reaching AB 32's mandates and achieving GHG reductions.

But even if you believe that a fuels tax would have been better from the get-go for California, there's a path-dependency to these questions. We are now years into development and deployment of a cap-and-trade program that is working as designed, and well. The administrative burdens of its development are largely sunk costs. We have linked with another jurisdiction, Quebec, to join markets. Allowance prices are stable, not far above the floor but also not so low as to suggest that companies aren't buying them or taking the program seriously. Companies know the program and know what to expect. And, importantly, the market was designed with an expectation about how many entities would participate, and how many allowances they would demand. Fuel distributors will be a large segment of the market starting in 2015. Taking fuels out of the cap now would inject considerable uncertainty into the market. It would also affect its liquidity by reducing the

demand, which economists say makes prices more manipulable and less predictable. At this point, I don't see much gain from disrupting what's working well or dividing up large emitters into those who pay taxes, versus those under the cap.

It appears that one of the primary motivations for the proposal is to allow the state to return tax dollars to some of those who would be hit hardest by any rise in fuel prices that may result from a tax or from cap and trade. The LA Times writes:

About half the money would be put back into the pockets of low- and moderate-income people in the form of a tax credit, similar to the earned income tax credit for the federal income tax. The rest would fund transit projects to give commuters an incentive not to drive their cars, as well as some environmental projects.

Even here, however, the fuels tax doesn't seem to me to hold much of an advantage. As I testified to the Senate Budget Committee last week, the State has a fair amount of flexibility about how to spend its auction revenue. It likely couldn't create a tax credit, or at least not without altering existing statutory law, but it can certainly use the revenue to benefit low- and moderate-income people, and to fund transit projects. In fact, California has already committed to using at least 25% of auction revenue in ways that benefit disadvantaged communities (a floor, not a ceiling), and Governor Brown's budget proposal invests heavily in transit with these monies. So, again, I don't see much gain here.

I'll write more about spending auction revenue in a bit, drawing from my testimony at last week's hearing.