December 12, 2008

Hon. Roger Niello
Assembly Member, 5th District
Room 6027, State Capitol
Sacramento, California 95814

Dear Assembly Member Niello:

I am writing you to confirm that we have received and reviewed (1) the response of the Air Resources Board (ARB) (dated November 26, 2008) to the questions we asked about the proposed scoping plan to reduce greenhouse gas (GHG) emissions on October 3 of this year and (2) ARB's response to the peer review of the scoping plan. After reviewing both sets of documents, our office generally maintains the same observations and concerns about the scoping plan and ARB's economic analysis of the plan that we raised in our November 17, 2008, letter to you.

As noted below, ARB's letter newly informed us that ARB conducted some further economic analyses in September, subsequent to the release of supplemental documentation containing its economic analysis. The ARB letter describes these subsequent analyses as including a "sensitivity analysis" of ARB's economic modeling and an evaluation of capital investments required by the scoping plan for both the near- and mid-terms. However, in the case of each of these subsequent analyses, ARB has mainly asserted its findings while providing us with few details of its methodology or its analysis. It appears that these subsequent analyses were very preliminary and far from comprehensive. Accordingly, the analyses ARB has completed to date do not significantly address the concerns we raised in our first letter to you. We continue to conclude that ARB's economic analysis of the AB 32 scoping plan lacks a sensitivity analysis and fails to lay out an investment pathway for the scoping plan.

In each of the paragraphs that follow, we list in ***bold italic text*** the main observations or concerns made in our first letter to you. Then, following each observation or concern, we very briefly summarize how, if at all, ARB's latest responses affect our findings.

The scoping plan's overall emissions reductions and purported net economic benefit are highly reliant on one measure—the Pavley regulations. The ARB does not dispute this finding. The ARB agrees with us that the assumptions most critical to the outcome of its economic modeling of the scoping plan are those concerning costs and savings of individual scoping plan measures. The other critical assumption identified by ARB relates to energy price forecasts for conventional fuels, such as petroleum products.

The plan's evaluation of the costs and savings of some recommended measures is inconsistent and incomplete. The ARB does not dispute that the evaluation of the costs and savings of some recommended measures is incomplete. That leaves the issue of the inconsistency regarding ARB's treatment of the costs and savings associated with certain recommended measures we saw in its evaluation of the scoping plan. Specifically, we saw inconsistencies in the way the ARB analysis accounted for measures required by statute or policy other than AB 32 that were explicitly undertaken to reduce GHG emissions (such as Chapter 200, Statutes of 2002 [AB 1493, Pavley]) versus other measures that could reduce GHG emissions but that were undertaken for other reasons.

The ARB justifies its treatment of these costs and savings as "appropriate." We note that ARB indicates that it conducted additional macroeconomic analysis in which it included the so-called Pavley regulations as part of the so-called "business as usual" scenario, thereby no longer attributing to the scoping plan the emissions reductions, costs, and savings associated with the Pavley regulations. The ARB indicates that this additional macroeconomic analysis diminished the positive economic effect it had previously found for the scoping plan. However, ARB still found that the plan had a largely positive net effect on California's economy.

However, as we mentioned in our first letter to you, the Pavley regulations were not the only GHG reduction measure required by a statute or a policy other than AB 32. The additional analysis conducted by ARB did not change the way ARB accounted for these other measures in the macroeconomic modeling. In our view, therefore, the plan's evaluation of the costs and savings of some recommended measures remains inconsistent and incomplete.

Macroeconomic modeling results show a slight net economic benefit to the plan, but ARB failed to demonstrate the analytical rigor of its findings. As noted above, the ARB indicates that it has conducted additional macroeconomic modeling to test the sensitivity of its findings to alternative scenarios and that the result of this additional modeling is a positive, though somewhat diminished, net economic benefit. However, based on ARB's limited description of the additional macroeconomic modeling it conducted, we conclude that ARB's sensitivity analysis has, thus far, been very rudimentary. For example, ARB describes its sensitivity analysis as considering the macroeconomic effects of alternative estimates of costs and savings to be realized by the scoping plan's recommended measures. But ARB's sensitivity analysis appears not to have considered the macroeconomic effects of alternative assumptions, such as changing the mix of measures included in the scoping plan. As a result, we continue to conclude that ARB's macroeconomic findings lack analytical rigor.

Economic analysis played a limited role in development of scoping plan. The ARB's response to our questions confirms that economic analysis played a very limited role in both the selection of the measures recommended in the scoping plan and the amount of GHG emissions reductions sought from each measure. The ARB included measures in the scoping plan that it considered "feasible" and calculated the cost-effectiveness of each. While ARB indicates that the result of its macroeconomic modeling "shows that the overall approach is sound," it confirmed that the macroeconomic findings did not influence the composition of the measures recommended by the scoping plan, either individually or as a whole.

The plan fails to lay out an "investment pathway." The ARB indicates that it has conducted additional analysis that shows that (1) most measures would require little up-front capital investment; (2) because those capital investments that would be required would be financed to spread the cost over many years, annual savings from implementation of the measures would outweigh annual costs; and (3) those measures that did require major capital outlays would require them of large industrial entities. Despite these claims, ARB has not shared the details of its analysis with us or its interpretation of the significance of some of its new findings. The ARB states that it will later develop detailed, year-by-year estimates of capital costs as each measure is implemented.

To summarize, ARB's response to our questions and to the peer review have generally not altered our observations and concerns about the AB 32 scoping plan and ARB's economic analysis of that plan as we expressed them in our letter to you dated November 17, 2008.

If you have any additional questions, please feel free to contact Mark Newton of my staff at 319-8323.

Sincerely,

Mac Taylor
Legislative Analyst