

Approaches for adjusting allowance supply

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Background for the Independent Market Advisory Committee

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Cap reductions during program review or renewal to achieve ongoing environmental progress have been implemented widely (CA, RGGI, EU). This presentation provides background on the ways allowance supply has been or could be adjusted to reduce the number of allowances in circulation (the bank).

1. Adjustments based on the number of allowances in circulation
2. Program design for allowance supply
3. Other approaches
4. Additional considerations

1. Adjustments based on the number of allowances in circulation

- Cancellation of allowances held in government accounts (RGGI)
- Forward-supply adjustment to absorb the privately-held bank (RGGI, twice)
- Back-loading (delay) of allowance distribution (EU)
- Delay of allowance issuance based on quantity of allowances in circulation (EU market stability reserve)
- Invalidation (cancellation) of allowances in market stability reserve (EU)
- Progressive flow control (NO_x budget program)

2. Program design for allowance supply

- Price floor (RGGI, WCI)
 - Prevent allowances unsold at the price floor from re-entering the market (RGGI)
 - Increase price floor level
 - Increase price floor rate of change
 - A rate of change greater than the opportunity cost of capital could invite speculative acquisition of allowances, pushing up prices at an even greater rate. ARB discretion to make ongoing/future adjustments could mitigate such activity.
- Emissions containment reserve, with cancelation (RGGI)
- Cost containment reserve
 - Populated inside the cap (WCI)
 - Populated additional to the cap (RGGI)
- Price ceiling
 - Additional emissions would be made up with out-of-program emissions reductions (CA)

3. Other approaches

- Vintage differentiated compliance value
 - Cross State Interstate Rule (evolving *allowances-per-ton* compliance value)
 - Depreciation of value of allowances in holding account
- Change in eligible offsets
 - Clean development mechanism (EU)
 - Change in offset limits and protocols (CA, RGGI)
- Enable use of allowances for compliance in other programs
 - Linking
 - One way linking protocol (CA)
 - Cost containment for other companion regulations by enabling allowances to be used at an appropriate conversion rate (LCFS)
 - Allowance cancellation if out-of-market reductions identified in the Scoping Plan are not achieved

4. Additional considerations

- If the quantity of allowances sold in auction is reduced there might be a decrease in revenues
- The current allowance price might jump in expectation of future scarcity
 - Formal ARB or legislative consideration of these options might invite speculation to take advantage of an anticipated potential jump in prices. ARB's discretion to make further program changes or issue companion regulations might mitigate such activity.
- The expected increase in allowance price
 - Could offset the reduction in allowances sales and maintain or increase auction proceeds
 - Could create a windfall profit for entities holding allowances currently
 - Vintage differentiating the compliance value of allowances in the bank would offset this as their reduced compliance value would be accompanied by an increase in price per unit of compliance.
 - A reasonable goal would be to protect the *value* of banked allowances, not their quantity (Waxman-Markey). Policy measures listed here might be combined to achieve this.
 - The sector-specific value of free allocation would be enhanced relative to other sectors
- Administrative (ex post) adjustments might increase perceived regulatory risk with respect to early action in achieving emissions reductions. A rule-based approach might be more predictable and avoid this.
- The allowance bank in the WCI provides allowance price stability for other (smaller) programs that might consider linking.