



Allowance Price Containment

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Root of the Issue

Goal	Instrument(s)	Advantages	Risks	Address risk
Price certainty	Tax	Guaranteed price	Undermine emissions target	Re-evaluate or re-set emission targets?
Emissions certainty	Cap and trade with firm cap	Guaranteed long-term emissions target	Price/Cost uncertainty	Flexibility: Banking, borrowing, and offsets Intervention (price ceiling, price floor, allowance reserve)



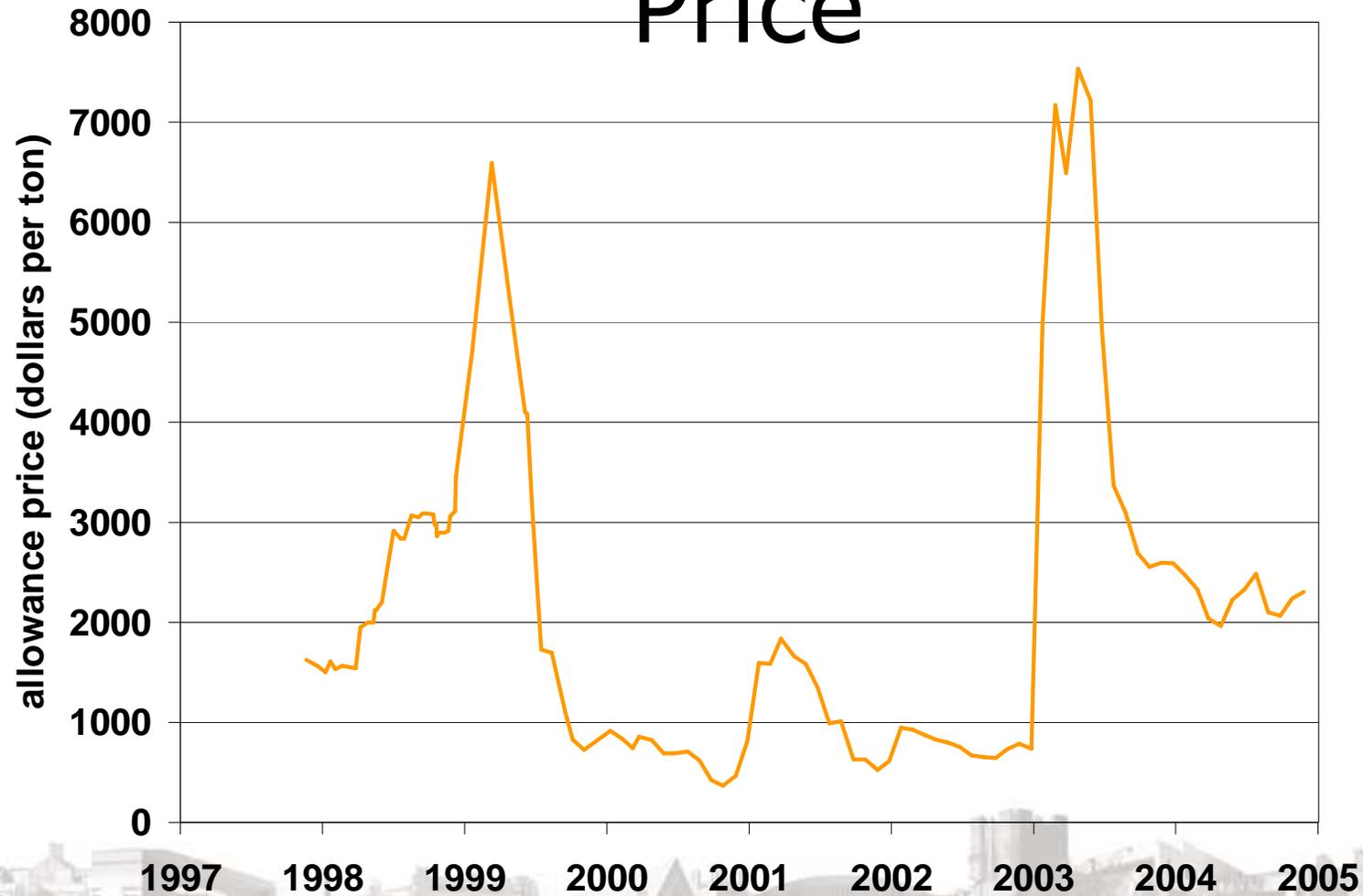
Cap-and-Trade: Price Uncertainty Implications

- Policymakers: A rational decision (ex ante)
 - “Trusted” economists estimate the allowance prices and economic impacts in advance
 - Congress chooses target/options with highest expected efficiency (or with “acceptable” cost)
 - Program is implemented
- Problem (ex post)
 - Even “trusted” estimates are likely to be off once program takes off
 - Mean/trend
 - Un-modeled fluctuations
- Adaptive measures needed?

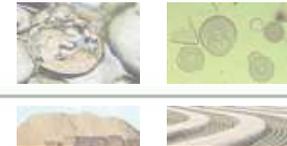




NO_x OTC Current Vintage Price



Source: Presentation, Billy Pizer RFF



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From Point Carbon June 17, 2010

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Market Data

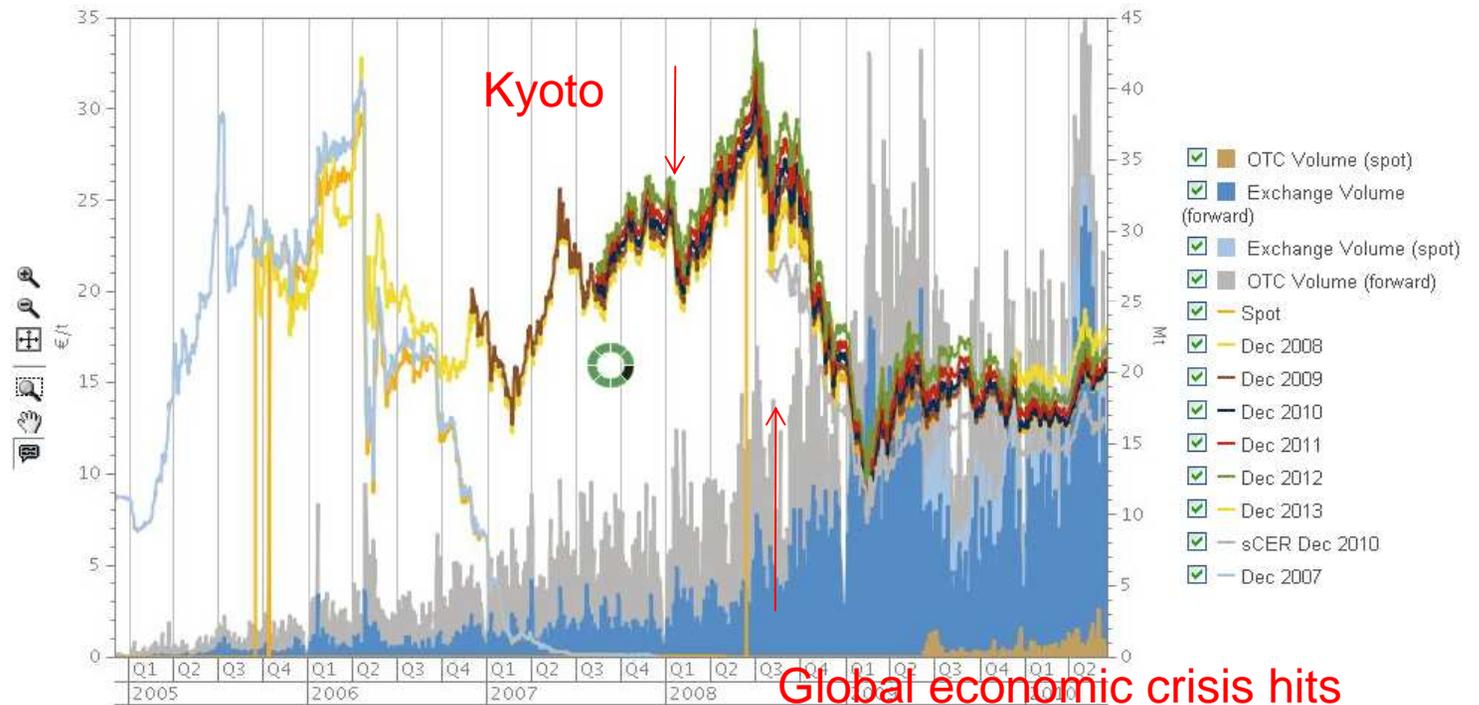
EU ETS

- CDM & JI
- RGGI
- Methodology

Features

- CITL search

Point Carbon EUA OTC assessment





Why do allowance prices vary?

- Fundamentals
 - Allowance demand uncertainty
 - Economic growth
 - Pace and cost of low carbon technology
 - Supply uncertainty
 - Offsets
 - Policy shifts
- Fluctuations
 - Weather
 - Macroeconomic factors (growth, exchange rates,...)
 - Energy markets
- Hedging/speculation ?





Goldilocks Paradox

- Don't want prices "too high"
 - Excessive cost burden on households and businesses
 - Trade flow disruption
- Don't want prices "too low"
 - May not generate sufficient investment
 - Foregone cheap reductions
- Want it "just right"

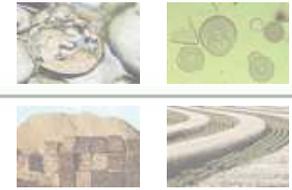




“Getting it Right” options

- Rein in high prices
 - Safety valve: hard price ceiling
 - Allowance Reserve Auctions: flexible price ceiling
- Prop-up low prices
 - Hard price floor
- Price “collar” tries to do both





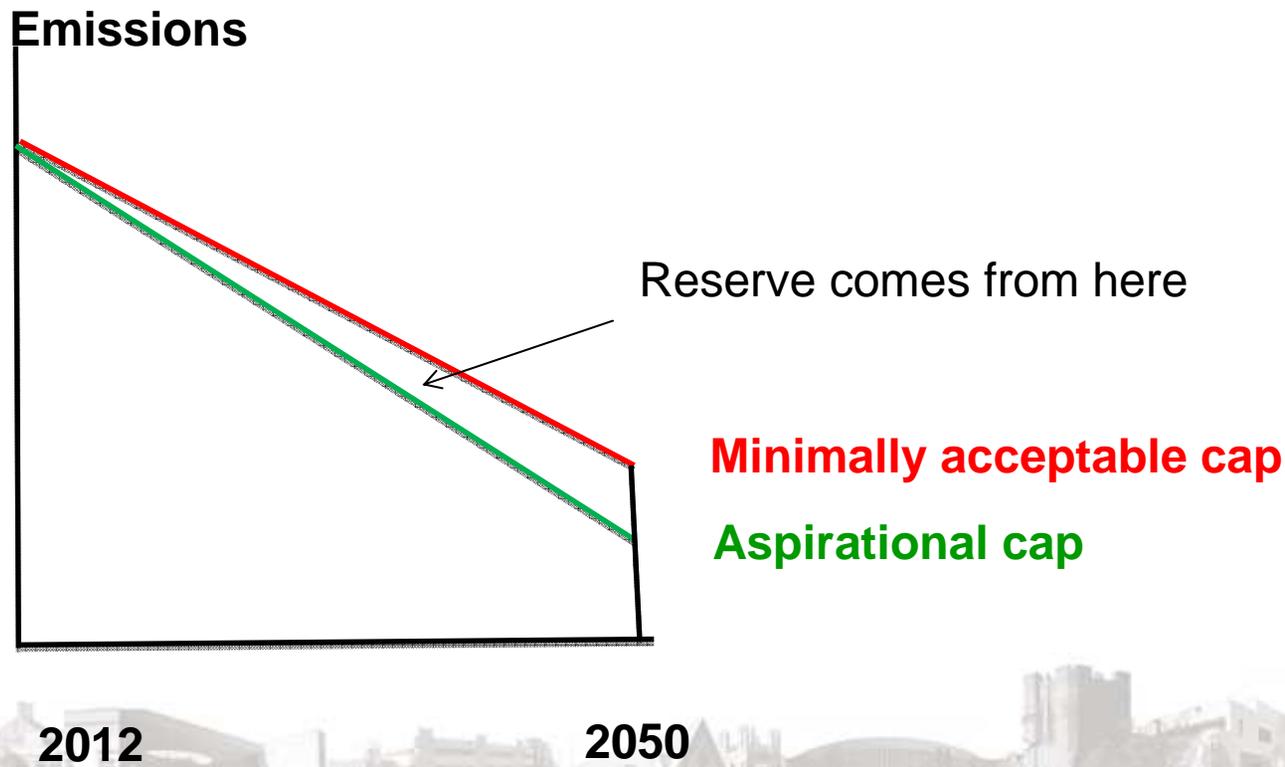
Waxman-Markey: Flexible collar

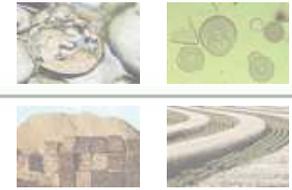
- Hard price floor
 - Regular auction will set a reservation price of at \$10
 - Government will not sell allowances for less than this
 - Rising at 5% per year
- Flexible price limit: Strategic reserve
 - Initial: ~ 2.5 billion tons set aside within long-term cap
 - Cost containment auction at a “reserve” price
 - 2012: \$28, Rising at 5% (double the projected price)
 - 2015 -> 36 month rolling average of market price
 - Annual limits on use (5%, 10% of cap)
 - Replenishable with international offsets (REDD),...
 - Flexible? Price not absolutely guaranteed





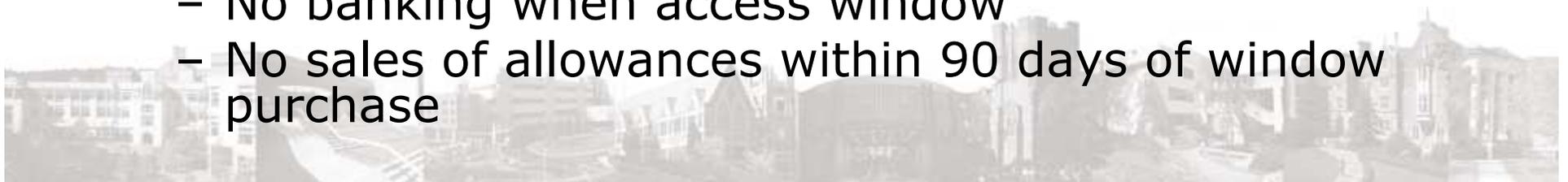
A View of the Waxman/Markey Reserve





Kerry/Lieberman: Discount Window

- Hard price floor
 - Regular auction will set a reservation price of at \$12
 - Rising at 3% per year
- Discount Window to access strategic reserve
 - Initial: 4 billion tons set aside within long-term cap
 - Right to purchase up to 15% of compliance at set price
 - 2012: \$25, Rising at 5%
 - Replenishable with government purchased offsets, 80% ratio
 - No banking when access window
 - No sales of allowances within 90 days of window purchase





Refinement options

- Reserve Modifications
 - Size of reserve
 - Reserve price points
 - Change initial reserve price
 - Drop rolling average approach
 - Move decisions to discretionary board
 - Triggered by something else other than a price spike.

