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California Air Resources Board

1001 I Street, Sacramento, California 95814

IETA COMMENTS TO CALIFORNIA AIR RESOURCES BOARD (CARB) PROPOSED AMENDMENTS TO CALIFORNIA CAP AND TRADE REGULATION POST-2020

The International Emissions Trading Association (IETA) appreciates this opportunity to provide comments on California Air Resources Board (CARB)'s Initial Statement of Reasons (ISOR), posted on 24 September 2018, regarding proposed amendments to California's cap and trade regulation.

An active and transparent cap and trade program, which empowers and drives market efficiencies, is essential in mobilizing private investment while unlocking the most cost-effective solutions across the multi-jurisdictional program. We take this opportunity to stress that California's existing cap and trade program is working and should continue to be the instrument of choice for California policy-makers in reducing greenhouse gas (GHG) emissions both to and past 2020.

In response to the ISOR, we encourage CARB to consider the following key considerations while moving forward with potential cap and trade amendments:

1. Cap and Trade in the Policy Mix;
2. Cost Containment Provisions; and
3. Carbon Offsets

1. CAP AND TRADE IN THE POLICY MIX

IETA encourages using the cap and trade program as a "workhorse" rather than a "backstop" for meeting the state's ambitious climate goals. Overlapping policies impose a greater burden on regulated entities, in terms of costs per ton of abated carbon emissions, than the cap and trade program, which delivers climate goals at least cost. The overuse of overlapping policies unnecessarily reduces demand for allowances and the resultant dampening of allowance prices creates a cycle of dependency that "requires yet more regulation to achieve long-term emissions goals".¹ This unfortunate dynamic persists because cap and trade communicates underlying costs by way of a price signal, while overlapping policies masks underlying costs.

IETA therefore emphasizes the importance of answering the following two questions posed by the Chair of the Independent Emissions Market Advisory Committee (IEMAC), Dallas Burtraw, and a Member of the IEMAC, Ann Carlson, in their recently posted report: (1) are there estimates of the [abatement] cost of various overlapping policies, and (2) are there estimates about the degree to which overlapping policies put downward pressure on allowance prices? We urge CARB to estimate (and do so frequently) the abatement achieved by overlapping policies at entities regulated by the cap and trade program as well as the cost of abatement for those overlapping policies. Further transparency is needed to begin understanding the interaction between overlapping policies and the cap and trade program, including implications for allowance prices and overall compliance costs.

¹ Burtraw, Dallas, and Ann Carlson. 2018. "Subcommittee Report on Overlapping Policies". Report for the Independent Emissions Market Advisory Committee. Released on 18 September 2018. Available [here](#).

IETA understands that it is unlikely for significant changes to be made to California's current climate policy mix in response to this specific set of proposed amendments. We need to highlight that California continues to increase the assertiveness of its climate goals and underline that there is increasing need for future restraint from the overuse of overlapping policies, which will better serve to ensure a rational and robust pathway to achieving these goals at least cost.

2. COST CONTAINMENT FEATURES

ROLE OF A PRICE CEILING

CARB's proposed price ceiling escalation rate post-2021 of 5% plus the Consumer Price Index (CPI) per year does not effectively reflect the legislative direction from AB 398. IETA is concerned that CARB discounts the possibility of reaching the price ceiling.

A recently published paper from prominent economists reveals that levels of abatement from overlapping policies and the uncertainty associated with business-as-usual emissions implies that allowance prices in California could plausibly hit the proposed price ceiling (Borenstein, Bushnell, Wolak and Zaragoza-Watkins, 2018). A related paper, broadly-based on CARB's proposed amendments, confirms this conclusion, showing that the allowance price will potentially either land on the price floor (47%) or hit the price ceiling (34%) (Borenstein, Bushnell, and Wolak, 2017). These two academic articles comport with recent tailored analyses that find the price ceiling will be reached in approximately the late 2020s (NERA 2018; NERA and PG&E 2018).

While there is significant uncertainty around macroeconomic trends and market dynamics, this body of research underscores the possibility that allowance prices will hit the price ceiling before 2030. Even if this probability were quite low, a robustly designed mechanism and an expertly-executed response to avoid excessively high allowance prices would be paramount to the political success of California's cap and trade program.

LEVEL OF A PRICE CEILING

In our previous comments, IETA suggested a range of \$60/tonne to \$80/tonne reaching roughly \$95/tonne nominally (at maximum) in 2030. In contrast, CARB's proposed price ceiling level reaches roughly \$120/tonne nominally in 2030. Contention continues to exist on this issue. IETA therefore strives to offer a new perspective, leveraging our unique international experience with linkage and leakage concepts.

IETA supports the notion of broad linkages with other jurisdictions, as such links lower overall compliance costs and drive efficiencies and cross-border compatibilities. Fortunately, there are an increasing number of potential linkage partners with 25 cap and trade programs in operation or scheduled for operation (World Bank and Ecofys, 2018). That said, there are certain prerequisites that must occur ahead of linkage in order to ensure success.

Leading academics have shown that aligning price ceiling levels could be important for the political economy and technical functioning of a linked cap and trade program (Burtraw, Palmer, Munnings,

Weber, and Woerman, 2013). **Specifically, in a linkage setting with two jurisdictions with different price ceiling levels, the lower price ceiling level might propagate to the other jurisdiction by way of allowance exports (e.g., Haites and Wang, 2009).**

The average allowance price among the world's operating cap and trade programs – outside of WCI – is approximately \$7/tonne. **IETA is therefore concerned that a price ceiling level exceeding an order of magnitude higher than this average allowance price will discourage potential partners from considering linking with California.** All else equal, a lower price ceiling level would facilitate linkages with potential partners and therefore lower overall compliance costs.

IETA generally supports the minimization of economic and environmental leakage as California pursues its ambitious climate goals, a criterion outlined for consideration in setting the price ceiling level in Assembly Bill 398. IETA is concerned that, at the excessively high price ceiling level proposed by CARB, leakage rates will undermine the achievement of California's targets.

CEILING PRICE AND ESCALATION RATES

IETA disagrees with CARB's justification for the price ceiling escalation rate. **CARB's objective of maintaining distance between the price ceiling and the post-2020 Reserve tiers does not require consistent escalation rates for the floor and ceiling prices.** Rather, CARB can maintain distance between the price ceiling trajectory and the post-2020 Reserve tiers by using its proposed approach for determining the post-2020 Reserve tier values in 2021 (i.e., X% of the distance between the floor and ceiling) in all other years through 2030.

CARB maintains this escalation proposal for the price ceiling is consistent with its past practices for this program. However, IETA notes that CARB made an important change to its approach in 2017 in moving from the 2013-2020 program to the post-2020 program, switching from consistent escalation rates in the earlier years of the program (which results in divergence in the dollar gap between the floor and the ceiling) to a fixed adder in the post-2020 program (which avoids divergence in the dollar gap between the floor and ceiling). CARB explained the new approach from 2017 as *"this approach would maintain a fixed difference between the two prices in terms of real value as it would be adjusted for inflation. In contrast, the existing schedule of increases in the Auction Reserve Price and the Reserve tier prices would lead to a divergence of these prices. With each annual increase, the Reserve would afford less protection against high prices, although with a correspondingly smaller potential to interfere with market price signals."*² We are concerned that CARB's current proposal will result in exactly the type of divergence between the floor and ceiling, and corresponding concern about high prices, that CARB recognized as a concern in 2017.

IETA recommends a fixed real adder above the floor price to establish the price ceiling, which would avoid convergence or divergence between the floor and ceiling, as recognized as an issue by CARB in 2017. Based on the existing floor price and escalation rate, IETA recommends a fixed real adder to the floor price no higher than \$60 in 2021-30 in 2021 dollars. This would result in a price ceiling that does not converge with the price floor, is in the range under consideration by CARB in this rulemaking and was used in the 2030 Scoping Plan, and is consistent with the other criteria established by AB 398.

² 2016 ISOR, p.15 (available at <https://www.arb.ca.gov/regact/2016/capandtrade16/isor.pdf>)

SPEED BUMPS

IETA supports a spacing of speed bumps that is one-third and two-third between the price floor and price ceiling as well as a greater number of allowances in the first, rather than the second, speed bump. Such a placement provides the maximum cushioning against price volatility. It also provides reasonable time for CARB and IEMAC to review market dynamics that might lead to rapidly increasing prices.

3. CARBON OFFSETS

DIRECT ENVIRONMENTAL BENEFITS

IETA generally supports many amendments proposed by CARB pertaining to direct environmental benefits, including the automatic designation of in-state offsets as well as the process outlined for out-of-state offsets to achieve such designation.

OFFSET PROTOCOL TASK FORCE

AB 398 recognizes the value of offsets in several ways. One such reaffirmation of offsets is the creation of the Offset Protocol Task Force. This entity is charged with finding *more* offset protocols to use in the program. IETA is supportive of its creation and its work to find additional protocols that provide direct in-state GHG reductions. Such an entity would benefit from having technical and real-world experience in offset development, accounting, verification and trading amongst its members.

PRICE CEILING UNITS

Offsets are also a key component in the concept of a Ceiling Price Unit (CPU). These CPUs need to be real, quantifiable, enforceable, and additional GHG reductions to ensure the environmental integrity of the Program. Such requirements are the definition of offsets. IETA supports the use of offsets as CPU currency. We also support efforts by CARB to initiate processes to secure CPU in advance to the ceiling price being hit in the marketplace. Failure to provide sufficient lead-time could lead to a delayed supply of issued offsets to mitigate prices from rising to and above the ceiling. The stated goal of the CPU construct is fully satisfied with the use of CARB-approved offsets.

ODS OFFSETS

With regard to Section 95973(b)(1)(E)(3), IETA supports the provision to remove from offset eligibility only those days during which a forest carbon project is in regulatory non-compliance. However, IETA suggests that CARB allow ODS destruction projects the same type of protections against undue loss of offsets accorded to livestock and mine methane projects in Section 95973(b)(1)(E)(1) and forestry projects in Section 95973(b)(1)(E)(3). Voiding all ODS destruction that occurs under a Certificate of Destruction, as stated in Section 95973(b)(1)(E)(2) is overly punitive and unnecessary. Destruction facilities retain detailed records that would enable only ODS destroyed during a non-compliance event to be discounted from a project.

CONCLUSION

Once again, IETA appreciates this opportunity to comment on CARB's ISOR.

While moving forward with cap and trade amendments and stakeholder engagement in 2018, we look forward to closely engaging with Staff.

If you have questions about IETA's comments, please contact Katie Sullivan, Managing Director, at sullivan@ieta.org.

REFERENCES

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