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Panel Recommends Auctioning, "Household Friendly" Approach to Carbon Regulation

EAAC Recommendations Depart from Existing European, Proposed Federal Cap-and-Trade Designs

SACRAMENTO – Today, the 16-member Economic and Allocation Advisory Committee (EAAC) adopted their report of recommendations to California officials on a range of economic issues related to the possible design of a cap-and-trade system to reduce greenhouse gas emissions.

Today's report includes key recommendations to help inform the development of a cap-and-trade program by the California Air Resources Board pursuant to the Global Warming Solutions Act of 2006 (AB 32). The Committee embraces auctioning, as opposed to free allocation, as the principal vehicle for putting valuable emissions allowances in private hands. In addition, it calls for giving households a large majority of the allowance value (auction proceeds). These are significant departures from most federal proposals, as well as the existing Emissions Trading System employed by the European Union.

"The issue of allocation strategy is one of the most important elements of a cap-and-trade program. I am encouraged that this diverse group of experts, with a broad range of perspectives, was able to reach consensus. I am hopeful that the analysis in this report will be useful to the California Air Resources Board as well as decision makers at the regional and national levels," said Larry Goulder, Chair of the EAAC and Shuzo Nishihara Professor in Environmental and Resource Economics at Stanford University.

"California policymakers have made a cap-and-trade program an integral part of its strategy to implement AB 32. The Committee's objective is that the recommendations contained in this report will assist the Air Resources Board in developing a cap-and-trade program that is both effective and fair," said Rick Frank, Vice Chair of the EAAC and Executive Director of the Center for Law, Energy & the Environment at the University of California, Berkeley School of Law.

The EAAC recommends a "household friendly" approach to carbon regulation by suggesting that the majority of allowance value derived from California's cap-and-trade program be returned to households. The Committee, which was split on the mechanics of providing allowance value to households, suggested two different options in their report. Allowance value could be provided either in the form of tax cuts or avoided tax increases, or in the form of a lump-sum payment directly to households.

Particular attention is recommended for low-income and disadvantaged communities to ensure they are not disproportionately affected by the program. Remaining allowance value is recommended to be used to ensure a level playing field for California’s workers and industries and for public purposes that will also
benefit consumers, including energy efficiency programs, research on clean technologies, climate change adaptation measures, and environmental remediation.

Cal/EPA and ARB asked the Committee to look at the allocation of emission allowances and the various options for distributing allowance value. It employed four criteria from AB 32 in developing the recommendations: fairness, cost-effectiveness, environmental effectiveness and simplicity.

The recommendations from the Committee will be considered for possible inclusion in the draft regulation for California’s greenhouse gas cap-and-trade program, due out this spring. A cap-and-trade program is part of a broad based, multi-sector approach to reducing greenhouse gas emissions outlined in the AB 32 Scoping Plan, adopted by the ARB in December 2008. The Plan, which serves as California’s roadmap for reducing greenhouse gas emissions calls for a mix of complementary measures along with the creation of a cap-and-trade program. The proposed cap-and-trade program would cover 85% of California’s largest emission sources including electricity generation, large industrial sources, transportation fuels, and residential and commercial use of natural gas.

The Committee’s final report makes the following key recommendations:

- **Return nearly 75% of the allowance value to households, through direct financial transfers or tax decreases.** The report recommends that 75% of the monetary value of allowances received, after low-income assistance and some industry protections are accounted for, be returned to households with the other purposes accounting for the remaining 25%.

- **Avoid disproportionate adverse economic impact to low-income households.** The report recommends giving low-income households, which spend proportionately more of their income on energy, some of the allowance value, to balance possible increases in costs. EAAC recommends financial transfers rather than subsidized energy prices.

- **Use an auction as the primary method for distributing allowances.** EAAC finds that almost any purpose that could be achieved through free allocation could also be achieved through auction, and that auctions would be more transparent and provide additional advantages including price discovery and market liquidity.

- **Prevent leakage, through “border adjustments” or allocation.** Firms that rely most heavily on carbon-based energy, and that compete directly with firms that do not face carbon regulation, should be provided assistance to avoid loss of market share that doesn’t result in emissions benefits. Where possible, California should account for the carbon in imported products so that in-state producers and out-of-state producers face the same costs. Where that is not possible, allowance value should be given to affected California firms to reduce their costs**.**

- **Do not give allowance value to firms for other reasons.** The report does not recommend that value be given to firms for any other reasons than those cited above. The Committee recommends against freely giving allowances to utilities to reduce the price impacts on their consumers, which would remove the incentive for consumers to invest in energy efficiency, and raise the societal cost of the program.

- **Invest in a low-carbon economy; create an independent board to advise and screen investments.** The report offers principles to choose among investments and lists many categories of targets. In addition, the report recommends the creation of an independent Investment Advisory Board to help ARB choose specific proposals.

- **Create an air pollution contingency fund.** The report recommends that if air pollution increases in disadvantaged communities as a result of AB 32—considered to be an unlikely outcome given safeguards built into the law—funds should be available for remediation. If air pollution does not increase, the funds should go to other recommended purposes.

- **Adopt an auction design very similar to that of the Regional Greenhouse Gas Initiative (RGGI).** RGGI, a collaboration of ten Northeast and Mid-Atlantic states to reduce carbon dioxide emissions from electricity, has held six cap-and-trade allowance auctions. Its auction design is relatively simple, and the report recommends emulating it with one addition: allowing the public to sell allowances in its auctions along with the state.

Next month, members of the Committee will present the key findings of their report before members of ARB at their February hearing in Sacramento. In addition to today's report, Committee members also will help inform the ARB on its revised economic analysis due to be released next month.

The EAAC has met publicly ten times since it was created on May 22, 2009 by Linda Adams, Secretary for Environmental Protection, and Mary Nichols, Chairman of the Air Resources Board. This independent panel of experts is comprised of economic, financial and policy experts with various backgrounds and experiences.

For more information on the EAAC and to view the full report, go to http://www.climatechange.ca.gov/eaac/.