Price Containment in the California Cap & Trade Market

Emissions Market Assessment Committee
November 14, 2013
Price Containment

• CARB sets minimum price at which it will sell permits in auction
  – Economic reasoning: net benefits of additional reduction is unlikely to be less than $X so set that as minimum cost of emitting even if there would be an excess supply of allowances at $X

• CARB doesn’t set maximum price, but stands ready to sell limited additional allowances from a reserve
  • Limited quantities at prices of $40, $45, $50

• If all reserve quantities at these prices were sold and the reserve were exhausted, what would happen?
  – Is unrestricted price rise politically credible?
    • RECLAIM during CA electricity crisis

• EMAC recommends a maximum price at which CARB will sell unlimited additional permits
  • Economic reasoning: \( \text{NET benefits of additional reduction} \) is unlikely to be greater than $Y so set that as maximum cost of emitting even if there would be an excess demand for allowances at $Y
Benefits of Defending a Price Cap

• Limits the possible price and economic impacts from volatility in supply or demand
  – allowance demand (abatement supply) likely to be very inelastic

• Avoids possible market disruption if shortage occurs near end of market period (2020)

• Eliminates price increase that incorporates low probability of skyrocketing price

• Reduces incentive to push price above current reserve levels through market manipulation
Costs of Defending a Price Cap

• Reduces predictability of California GHG reductions
  – Only if alternative is true commitment to reduction regardless of cost
  – A smooth functioning C&T market is more likely to be expanded to other states and countries

• Administrative costs of establishing rules
  – EMAC view is that risk is small but not insignificant – and disruption would be large – so it merits the costs