July 31, 2024

California Air Resources Board
1001 I Street
Sacramento, CA 95814

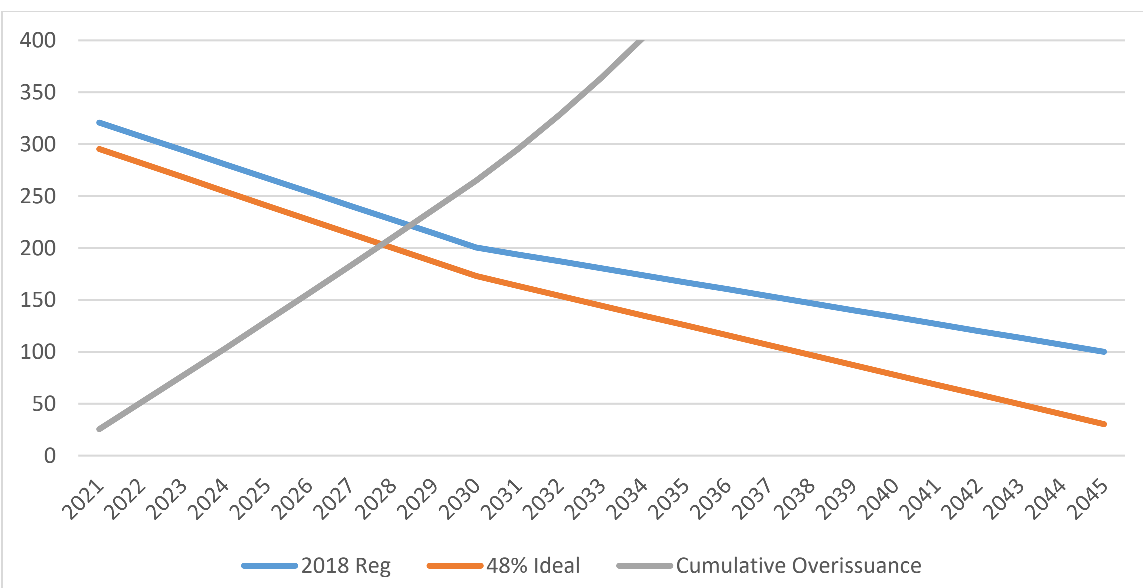
Re: July 10, 2024 California Public Workshop: Potential Amendments to the Cap-and-Trade Regulation

Firstly, I would like to recognize and thank the Air Resources Board for its efforts to implement a more ambitious Cap-and-Trade program. I would also like to commend its willingness to engage with interested parties and solicit feedback on proposed amendments.

Although I am an authorized representative of a general market participant, I write today on my own behalf as a native Californian specifically to address the potential 2025-2045 allowance budgets outlined in the Standardized Regulatory Impact Assessment (SRIA Proposed Scenario A) and the July 10th workshop (Smoothed Options 1 and 2).

From the perspective of an outside observer, it appears that any budget adjustment should satisfy the following conditions:

- Budgets move towards the "ideal" long-term budget targets (173 $MMTCO_2e$ in 2030 and 30.3 $MMTCO_2e$) and the linearly interpolated points between them as quickly as practical
- Budgets decrease annually
- Budgets remove, again as quickly as practical, the "oversupply" created by issuing allowances using budgets from the 2018 Regulation rather than the budgets that would have been in place had the 2017 Scoping Plan Reference Scenario GHG Inventory revisions and 48% 2030 target been in effect at the start of the decade. The following chart illustrates this cumulative overissuance, which will be approximately 103 million at the end of 2024 and 130 million at the end of 2025, if no changes are made.



None of CARB's three budget scenarios fully satisfy the above conditions.

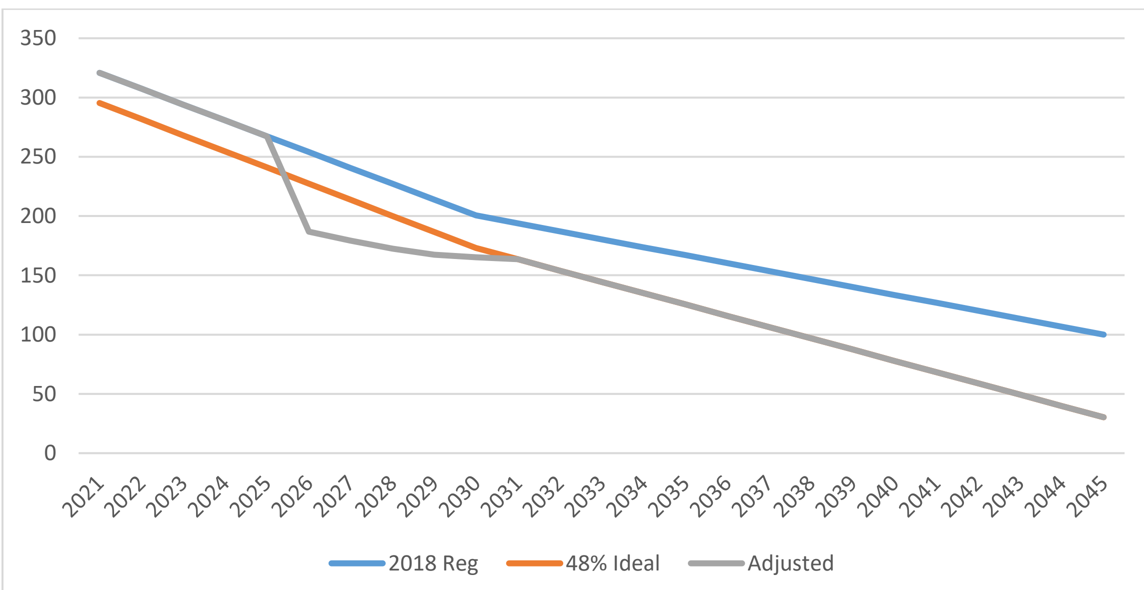
SRIA Proposed Scenario A: Although the SRIA Proposed Scenario A completes its adjustments by the end of this decade and attains a 2031 budget consistent with ideal long-term budget targets, its budgets do not decrease monotonically, as there is an increase in budgets between 2030 and 2031. Furthermore, this scenario includes budget adjustments in 2025, which are no longer viable given CARB's decision to delay adjustments until 2026.

Smoothed Option 1: This scenario fails to withdraw allowances as quickly as practical by shifting 85 $MMTCO_2e$ in withdrawals to the next decade. Further, it does not complete the 85 million withdrawal until 2045.

Smoothed Option 2: Although this scenario does implement a full 265 million adjustment this decade, it produces eight years of non-declining budgets in the subsequent decade. Additionally, in many of those years, the allowance budget is below the "ideal" straight-line targets. This downwardly biases all aspects of the program that are linked to the annual budgets, including holding limits.

Alternative Proposal

It is possible to select allowance budgets that satisfy all three conditions. The following, for example, withdraws 265 million allowances this decade, has allowance budgets that decrease annually, and has allowance budgets that match the "ideal" budgets starting in 2031.



This approach has a large initial decline in 2026 followed by additional non-linear decreases in 2027 through 2030. The budgets for 2026-2030 shown above are 186.9, 179.2, 172.6, 167.4, and 163.5 million allowances, although there are other combinations that would work.

The most significant objection to this proposal is likely to be its steep initial decline. The revised 2026 budget is 67.1 million below the 2018 Regulation's budget and 40.5 million below the 48% ideal budget.

We should note, however, that this reduction only corrects a portion of the 130 million overissuance between 2021 and 2025.

Reducing the Impact of a Large Decline in Issuance

Even after this large adjustment, the market would remain 90 million allowances oversupplied at the end of 2026 relative to the 48% ideal budgets. Therefore, one can contend that even if allowance prices should rise materially between now and then, they should nevertheless be lower than the prices we would have otherwise observed if the 48% ideal budgets had been in effect since the beginning of the decade.

That is not to say, however, that such a large adjustment would not have many meaningful impacts unrelated to price. Perhaps the most significant would be that to holding limits, which would be approximately 26.4% lower in 2026 in this scenario than they would have been under the 2018 Regulation, and 30.1% lower than they will be in 2025 if no other changes are made.

This may be too significant a change to comfortably bear. One way to address this, however, would be to decouple the budget adjustments from the official budget. An official budget, perhaps matching the 48% ideal budgets, could be used for setting holding limits and other quantities that are linked to annual budgets. The adjusted budgets could then be used for allocation and auction purposes. There is precedent for this approach in other programs. RGGI, for example, bases its Cost Containment Reserve quantities on its official budget, but issues quantities in line with a lower, adjusted budget.

By incorporating both a large initial decline and an alternative reference budget, CARB may be able to achieve its goals in a manner that strikes a healthy balance between speed and impact.

A Final Note on Timing

During the workshop CARB repeatedly emphasized that all three of its proposed scenarios remove the same number of allowances between 2026 and 2045, thereby implying that all scenarios were more or less equivalent in the long-run.

I wholeheartedly disagree with this sentiment. Just as there is a time value of money, where one dollar in the future is worth less in present value terms than one dollar today, there is a time value of emissions. Due to a number of factors, including both externalities and the compounding effect of CO_2 in the atmosphere, one ton reduced today has greater value than one ton reduced in the future. The market today is oversupplied relative to CARB's revised goals. This oversupply depresses prices, which in turn disincentivizes abatement. CARB should make every effort to bring budgets and cumulative supply in line with its new targets as soon as it can.

Sincerely,
Will Simmons