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Cap-and-Trade Extension: Issues for Legislative Oversight

L E G I S L A T I V E   A N A L Y S T ' S   O F F I C E

Presented to:
Joint Legislative Committee on Climate Change Policies
Hon. Eduardo Garcia, Chair

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Background

☑ **State Greenhouse Gas (GHG) Goals and Policies**

- The Global Warming Solutions Act of 2006 (Chapter 488 [AB 32, Núñez/Pavley] established a statewide GHG emissions limit of 1990 levels by 2020. Chapter 249 of 2016 (SB 32, Pavley) established a GHG limit of at least 40 percent below 1990 levels by 2030.
- 2017 Scoping Plan Update developed by the California Air Resources Board (CARB) includes a variety of policies to meet 2030 targets, including a 50 percent renewable portfolio standard, a low carbon fuel standard, energy efficiency, and cap-and-trade.

☑ **Chapter 135 of 2017 (AB 398, E. Garcia) Extended Cap-and-Trade From 2020 to 2030.**

- Provides new direction regarding certain cap-and-trade design features, but significant discretion on key implementation decisions left to CARB.

☑ **CARB Held Informal Workshops on AB 398 Implementation in Early 2018.**

- CARB staff presented initial thinking on various AB 398 implementation issues in March and April workshops.
- Formal regulatory proposals and hearings expected to begin later in 2018.

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Background *(Continued)*

Major Differences Between Current CARB Cap-and-Trade Regulation and AB 398[a]

Design Feature	Current Regulation	AB 398 Extension (2021 Through 2030)
Setting Post-2020 Emissions Caps	Establishes the number of allowances issued each year through 2030.	When setting post-2020 caps, directs CARB to evaluate and address concerns related to a large number of banked allowances.
Banking	No expiration date for allowances; limits on the number of allowances an entity can hold at a time.	Directs CARB to adopt banking rules that "discourage speculation, avoid financial windfalls, and consider impact on complying entities and market volatility."
Price Ceiling	"Soft" price ceiling of about $60 per allowance in 2017, increasing gradually in future years.	Directs CARB to establish "hard" price ceiling and consider various factors when setting the level of ceiling.
Price Containment Points	None.	Directs CARB to establish two price containment points (also known as speed bumps) between the price floor and the price ceiling.
Offset Limits	Maximum of 8 percent of a covered entity's emissions.	Maximum of 4 percent in 2021-2025 and 6 percent in 2026-2030, with no more than half from projects that do not provide direct environmental benefits in California.
Industry Assistance	Different IAFs for high- (100 percent), medium- (75 percent) and low- (50 percent) risk industries from 2018 through 2020; not specified from 2021 through 2030.	100 percent IAFs from 2021 through 2030.

[a] Chapter 135 of 2017 (AB 398, E. Garcia).
CARB = California Air Resources Board and IAF = industry assistance factor.

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Summary of Key Issues for Legislative Oversight

Key Issues for Legislative Oversight

- ✓ **Setting Post-2020 Caps and Banking Rules to Ensure State Meets Its GHG Targets**
- ✓ **Setting Hard Price Ceiling at Level That Balances Emissions and Costs**
- ✓ **Setting Level and Size of Two Price Containment Points to Limit Price Spikes**
- ✓ **Implementing New Offset Limits Consistent With Legislative Intent**
- ✓ **Determining Industry Assistance Factors Through 2020**

GHG = greenhouse gas.

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Setting Post-2020 Caps

☑ CARB Estimates 150 Million Allowances Could Be Banked Into Post-2020 Program

- Last year, we estimated that 100 million to 300 million California allowances could be banked into the post-2020 program, with the most likely scenario roughly 200 million.
- CARB estimates 150 million California allowances could be carried into the post-2020 program. This amount is based on our office's estimate, plus various downward adjustments for regulatory provisions that we did not incorporate into our prior estimates.
- Most of CARB's adjustments appear reasonable. However, CARB makes no adjustments to account for the lower than estimated emissions in 2016. Based on this new data, our estimate of oversupply increases by a few tens of millions, all else equal.
- Based on these various factors, we continue to think a central estimate of roughly 200 million allowances is reasonable, but the actual amount could be at least several tens of millions higher or lower.

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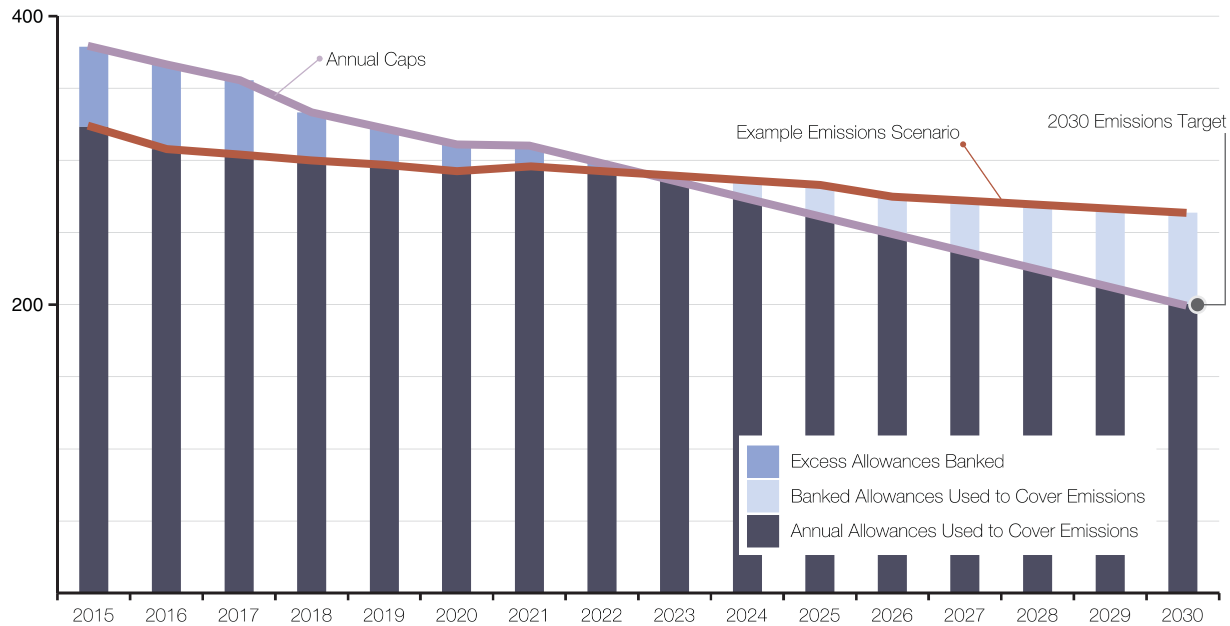
Setting Post-2020 Caps *(Continued)*

Large Number of Banked Allowances Increases Risk of Exceeding GHG Target

Million Metric Tons



GHG = greenhouse gas.

Setting Post-2020 Caps *(Continued)*

☑ **CARB Has Not Described How Program Would Ensure the State Meets Its 2030 GHG Limit**

- CARB's 2017 Scoping Plan assumes cap-and-trade will achieve enough emissions reductions—beyond those achieved by other policies—needed to meet the 2030 GHG limit.
- CARB staff estimated how the current program might affect *cumulative* emissions through 2030, but has not provided an analysis on how the program would put the state on track to meet its 2030 *annual* GHG target. We note that there are plausible scenarios where the state could meet the cumulative targets established by CARB, but where emissions are still significantly higher than the Legislature's 2030 annual target.

☑ **Consider Directing CARB to Provide Additional Evidence That Current Program Is Consistent With Legislature's 2030 GHG Goals**

- The Legislature should consider directing CARB to (1) explain how the current program is likely to put the state on track to meet its annual 2030 limit; (2) evaluate different options for adjustments to address a large number of banked allowances; and (3) establish clear criteria that will be used to make future adjustments, if needed.
- Options to increase the stringency of the program include moving allowances from the regular auctions to: (1) the price ceiling and/or (2) the "speed bumps." These options have a trade-off of putting upward pressure on prices. However, decisions about program caps and allowance supply should be guided primarily by what is needed to meet the state's environmental goals, while concerns about the risks of program costs exceeding acceptable levels should be addressed primarily through setting the price level for the ceiling (discussed below) and speed bumps.

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Setting Level of the Price Ceiling

☑ **CARB Staff Suggests Level of Price Ceiling and First Speed Bump**

- Price ceiling between $82 and $147 (in 2015 Dollars) in 2030.
- Lowest speed bump at $70 or more (in 2015 dollars) in 2021.

☑ **Consider Whether These Price Levels Are Consistent With Legislative Priorities**

- Setting the level of the price ceiling is a policy decision that will depend on how one weighs many different factors, including certainty that targeted emission levels will be achieved and interest in containing costs for businesses and households. Other considerations could include effects on linkages with other jurisdictions and the degree to which different price levels encourage development of new technologies to reduce GHGs in other jurisdictions.
- If the range of price ceilings currently being considered by CARB is inconsistent with how the Legislature weighs these different factors, the Legislature could set the price ceiling in statute or provide additional direction about how to weigh the different factors.

☑ **Consider Price Ceiling When Evaluating Options for Setting Post-2020 Caps**

- It is important to consider that a price ceiling will be part of the post-2020 program when evaluating any potential adjustments related to an oversupply of allowances and setting post-2020 caps (discussed above) because it can help mitigate concerns about risks of high costs.
- The price ceiling is a design feature that is specifically intended to limit price uncertainty and reduce the risk of excessively high program costs.

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Implementing New Limits on Offsets

☑ **Proposed Criteria Used to Determine Offsets That Provide Direct Environmental Benefits (DEBs) in the State Is Unclear**

- AB 398 establishes new limits on the percent of emissions that can be covered by offsets and no more than half of offsets can come from projects that do not provide DEBs in the state. It defines DEBs in the state as "the reduction or avoidance of emissions of any air pollutant in the state or the reduction or avoidance of any pollutant that could have an adverse impact on waters of the state."
- CARB staff is soliciting stakeholder feedback on how to implement the DEBs provision. However, the specific types of projects that would qualify, or criteria that would be used to evaluate the projects, are currently unclear.

☑ **CARB Staff Considering DEBs Interpretation That Appears Inconsistent With Legislative Intent**

- Staff comments at workshops suggest that CARB is considering allowing GHG reductions to qualify as DEBs.
- Since all offset projects are expected to reduce GHGs, such an approach would seem to allow all offsets projects to meet the DEBs requirement. In our view, this approach would be inconsistent with legislative intent to create a distinction between different types of offset projects.