

Price Containment in the California Cap & Trade Market

Emissions Market Assessment Committee

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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: *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