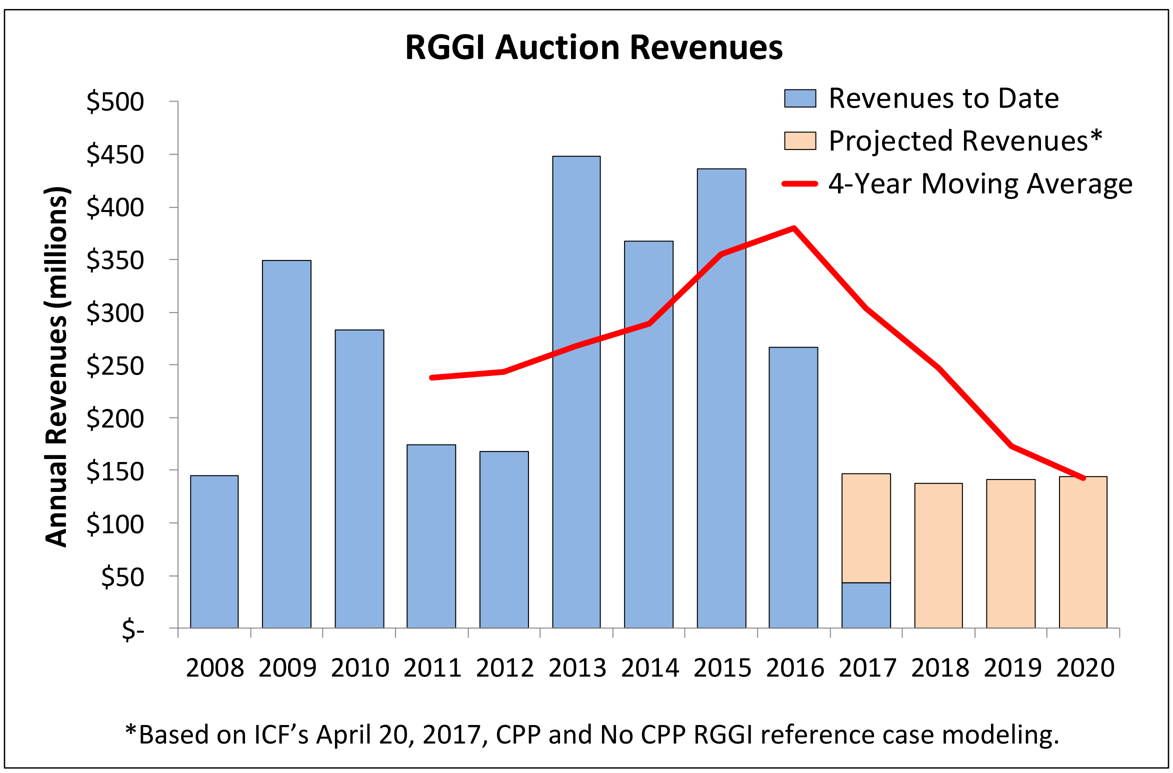
No Reason to Wait: Why The Next RGGI Cap Should Begin in 2019, Instead of 2021 (May 2017)

The RGGI states are engaged in a program review to determine the next phase of their pioneering carbon cap-and-invest program. This review has largely focused on potential changes to RGGI's carbon cap trajectory and other reforms that would take effect four years from now, in 2021. Consistent with past practice, we recommend that the states implement these changes sooner, in 2019 instead, while also resetting RGGI's cap level in 2019 to reflect a more reasonable level of emissions. RGGI has been a successful market mechanism, but if the states fail to reset the cap level and implement a sufficiently ambitious future carbon emission reduction trajectory and other reforms in 2019, RGGI will no longer send appropriate signals to the market and will cease to function as intended, undermining the states' climate goals. There are several reasons why reforms are needed in 2019, as recommended by numerous organizations[1]:

1. RGGI's cap is over-allocated today. Emissions consistently fall below the cap, and allowance prices are also falling. Without a correction soon to establish a reasonable cap level, allowance prices will remain low. ICF projects that allowances will fall to RGGI's minimum reserve price this year and remain at or near that level moving forward. Because higher allowance prices stimulate investments in clean energy and away from fossil fuels, a too-low allowance price is harmful to the states' climate objectives. RGGI cannot be an effective market mechanism if it is not functioning correctly due to allowance oversupply. Keeping RGGI on track requires both a reasonable 2019 cap level *and* an ambitious future trajectory.

2. Low allowance prices further reduce RGGI's benefits by reducing revenues raised by the states in quarterly allowance auctions, money which is used to achieve substantial consumer benefits. As shown below, RGGI revenues are likely to decline significantly in the next four years, absent state action.



[1] *Joint Comments (38 Environment and Health Organizations)* (May 3, 2017), www.rggi.org/docs/ProgramReview/2017/04-20-17/Comments/Joint_Comments_Environment_Health.pdf; *see also* comments from many other stakeholders supporting an ambitious future RGGI cap trajectory, posted online at www.rggi.org/design/2016-program-review/stakeholder-comments-2016.

3. Emissions that are below the cap have another consequence: the private bank of excess allowances is growing. While the states are considering a cap adjustment to account for this excess bank, delaying action means that the bank will continue to grow, increasing the size of the market correction that will be needed and putting further downward pressure on allowance prices that will reduce program gains.

4. Waiting until 2021 would needlessly delay market reforms needed to get RGGI back on track now, and is inconsistent with past practice. In their last review, the states agreed to reforms in early 2013, which they implemented in 2014. Market participants adapted quickly and consumers benefitted. Cap reforms that begin in 2019 would again provide a clear market signal that affirms the states' commitment to RGGI. Delaying reforms until 2021 would increase market uncertainty and reduce program benefits. Setting the level for RGGI's next cap four years in the future in 2021, rather than making a nearer term correction in 2019, is also likely to increase error. At the start of the program, the states set a 2009 cap based on 2005 projections, which resulted in a cap that was more than 50% over-allocated in year one.[2]

I. RGGI Allowance Prices and Revenues Will Continue to Decline Unless the States Act Soon

Recent allowance auctions and modeling by ICF shows that RGGI allowance value is deteriorating. In March, allowance prices fell to $3 per ton, their lowest level since December 2013.[3] ICF projects that allowances will continue to fall to RGGI's minimum reserve price of just over $2 per ton this year and remain at or near this level through 2030, unless the states bolster the market.[4] While RGGI is first and foremost a carbon reduction program, its revenue-raising function has also been key to its success. Since 2008, RGGI auctions have raised $2.68 billion,[5] which the states have reinvested in energy efficiency, renewable energy, and other consumer benefit programs. Investments through 2014 will avoid 15.4 million tons of CO_2 emissions, equivalent to taking 2.9 million cars off the road, and save consumers $4.67 billion on their energy bills.[6] Unless the states strengthen RGGI, funding for these investments will decline, reducing benefits to consumers and the states.

RGGI has been here before. Five years ago, allowance prices and revenues similarly bottomed out, and RGGI was underperforming its potential. In their 2012 program review, the states responded by strengthening the program. The states recognized that RGGI's cap was over-allocated and agreed to recalibrate the program to more accurately reflect emissions. They agreed to cut the cap nearly in half, beginning in 2014, and to further reductions in future years. When the states released their model rule in February 2013, the market responded almost immediately. Allowance prices rose above the minimum reserve price at auction for the first time in more than two years, and 2013 auction revenues more than doubled compared to 2012. The states adopted the new model rule by year's end, and RGGI's lowered cap officially went into effect at the beginning of 2014.

It is doubtful that the market would have responded in the same way if the states had delayed these changes for four years, as they propose in the current review. Delaying the cap correction would have sent a mixed signal to the market about RGGI's direction and the states' commitment to it. Maintaining an over-allocated cap beyond 2013 would likely also have resulted in a further build up of excess banked allowances, depressing prices. While the states agreed in the 2012 review to adjust future caps downward to account for such banked allowances, reducing the cap immediately in 2014 reduced the size of the adjustments needed in later years.

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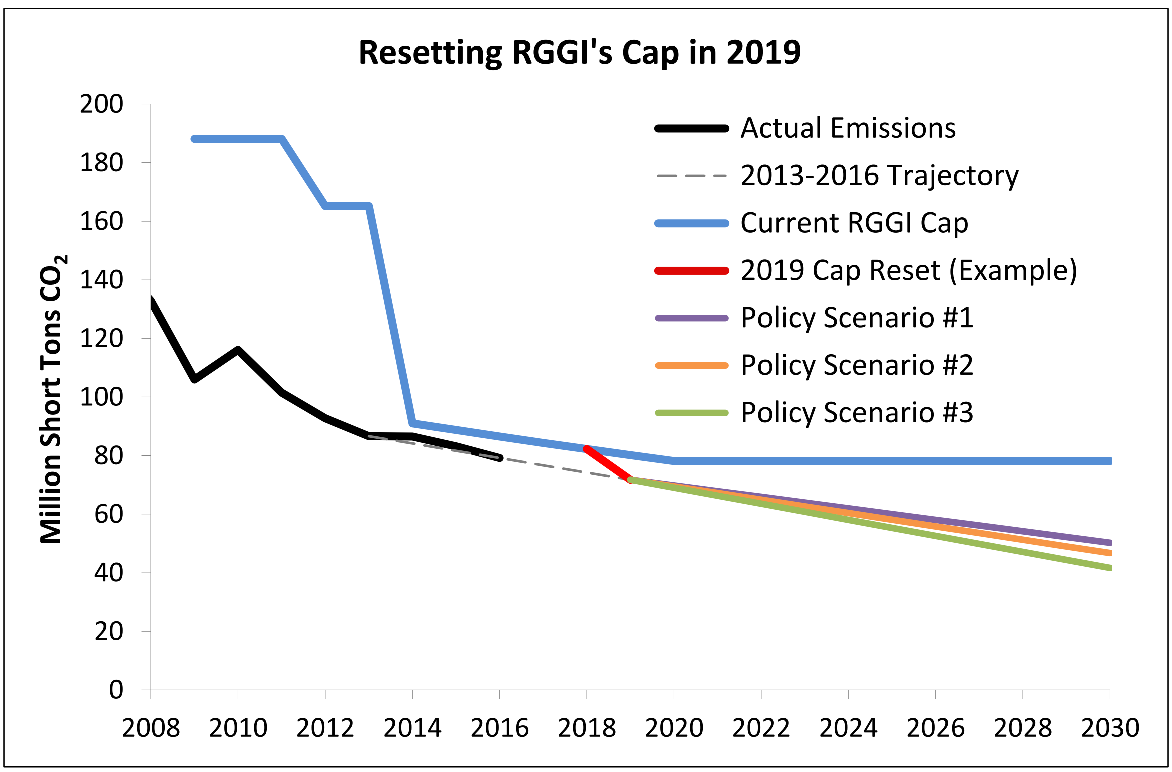
[2] Emissions in RGGI in 2009 in the nine current RGGI states and New Jersey, which was a member at the time, were 122.3 million short tons of CO_2, compared to a regional cap of 188.1 million tons. *See* RGGI CO_2 Allowance Tracking System, "Summary Level Emissions Reports," rggi-coats.org/eats/rggi/index.cfm?fuseaction=search.rggi_summary_report_input.
[3] RGGI, "Auction Results," www.rggi.org/markets/co2_auctions/results.
[4] ICF International, *Draft 2017 Reference Case Overview* (Apr. 20, 2017), www.rggi.org/docs/ProgramReview/2017/04-20-17/Draft_IPM_Reference_Case_Results_04_20_17.pdf, at slide 16.
[5] RGGI, "Auction Results," *supra* note 3.
[6] RGGI (2016), *The Investment of RGGI Proceeds through 2014*, www.rggi.org/docs/ProceedsReport/RGGI_Proceeds_Report_2014.pdf.

II. Consistent with Past Practice, the States Should Reset RGGI's Cap in 2019 to Reflect a More Reasonable Emission Level and Continue to Reduce the Cap in Future Years

Even with the states' 2014 adjustment, emissions have continued to fall faster in RGGI than expected, and the cap continues to be over-allocated. Emissions have remained below RGGI's cap in every year of the program and were more than 7.3 million tons below the cap in 2016.[7] As a result, a new bank of tens of millions of excess allowances has built up,[8] and prices are once again trending downward. Taking steps now to correct RGGI's cap would reverse these declines, strengthen the market, and ensure RGGI's future benefits.

To put RGGI on a stronger path, the states should once again reset their regional carbon cap to reflect actual emission trends. Consistent with past practice, this should occur in the earliest possible year, as the market has shown that it is able to respond quickly, and correcting the cap sooner will provide greater benefits. With a new model rule not expected until late summer 2017, it is unlikely that the states could complete necessary legislative and regulatory processes in time to establish a new cap for 2018. However, a 2019 start date should be achievable. Following the 2012 review, the states adopted their proposed model rule within 10 month. If a new model rule were ready by the end of August 2017, the states would have 16 months before 2019 begins.

To avoid continued allowance oversupply, the 2019 cap level must reflect a more reasonable emission level for that year. RGGI's current cap for 2019 is 80.2 million tons of CO_2. Yet emissions were already more than a million tons below that level in 2016. Emissions in RGGI have fallen by 2.5 million tons per year since 2013, and 3.8 million tons per year since 2009, suggesting that the 2019 cap could be over-allocated by several more millions of tons. Consistent with trends in the region and RGGI's goal of reducing emissions, we believe it is important that the 2019 cap be set *lower* than current emission levels. For example, assuming continued reductions of 2.5 million tons per year would result in a 2019 cap of 71.7 million tons.



[7] RGGI's CO_2 emissions were 79.2 million tons in 2016 compared to a cap of 86.5 million tons. *See* RGGI CO_2 Allowance Tracking System, "Summary Level Emissions Reports," *supra* note 2.

[8] Acadia Center (2016), *Regional Greenhouse Gas Initiative Status Report; Part II: Achieving Climate Commitments*, acadiacenter.org/wp-content/uploads/2016/08/Acadia-Center_RGGI-Report-2016_Part-II.pdf, at 8-9.

To continue RGGI's progress, the states must also cut emissions after 2019. Recently, the states proposed to consider reductions of 1.954, 2.275, and 2.736 million tons of CO_2 per year through 2030.[9] As shown above, we recommend that these reductions (or others that the states consider) begin from the new 2019 cap level, similar to the states' approach in the 2012 review, in which annual reductions began from the new 2014 cap.

A 2019 cap reset, ambitious post-2019 cap trajectory, and other reforms, including a full adjustment for banked allowances and closing program loopholes, would produce immediate market benefits. In contrast, if the states delay changes until 2021, allowance prices and revenues will likely remain low, the excess bank of allowances will continue to grow, and RGGI's benefits will be reduced. RGGI has been an enormously beneficial program, and has the ability to continue its strong track record of economic, public health, and environmental success well into the future. But this outcome is not guaranteed. Unless the states act soon to strengthen RGGI and address the current and projected oversupply of allowances, the program will fall well short of its potential and RGGI's carbon price and cap will fail to provide the market signals needed to meet the states' climate change and carbon reduction goals. A cap reset similar to the 2012 review and a new ambitious emission reduction trajectory moving forward is needed now to reestablish RGGI's carbon price signal and get the program back on track.[10]

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[9] RGGI, *RGGI Program Review: April 20, 2017 Stakeholder Meeting* (Apr. 20, 2017), www.rggi.org/docs/ProgramReview/2017/04-20-17/Proposed_Policy_Cases_Next_Steps_04_20_17.pdf.

[10] In the future, the states may be able to avoid or reduce the need for similar corrections through creation of a well-designed Emissions Containment Reserve (ECR), which would automatically reduce future cap levels when allowance prices are low. Such a mechanism is worth considering as a complement to the needed near-term cap correction, ambitious, pre-ECR emission reduction trajectory for the region, and other program reforms. *See* NRDC, "Exploring a New Mechanism to Cut Carbon Pollution in RGGI" (Feb. 6, 2017), www.nrdc.org/experts/jackson-morris/exploring-new-mechanism-cut-carbon-pollution-rggi.