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Reflections on 2012 RGGI Review

RGGI stakeholder meeting, New York, September 19, 2011

Olga Chistyakova, Thomson Reuters Point Carbon

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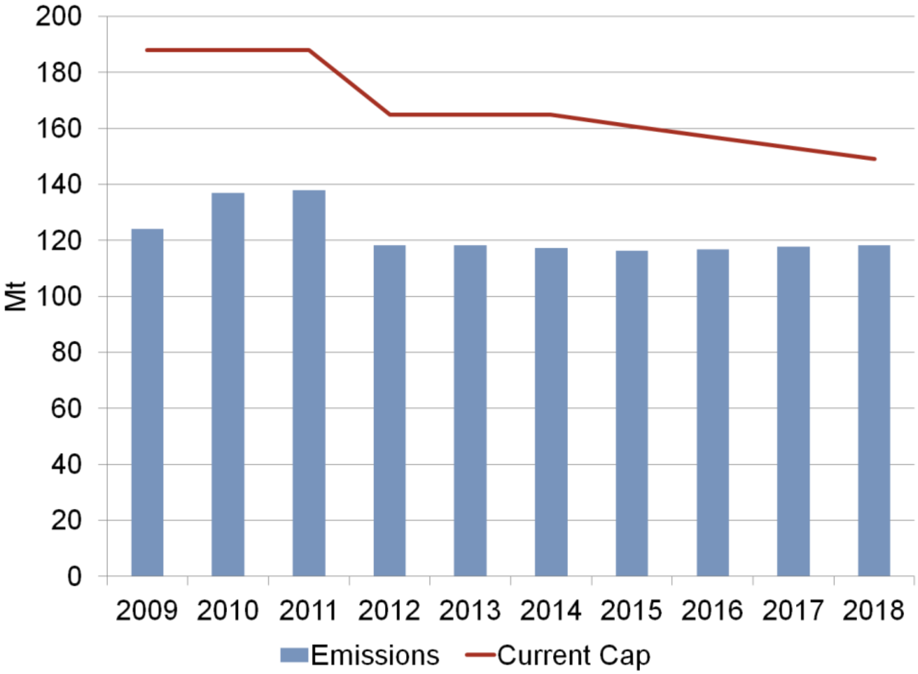
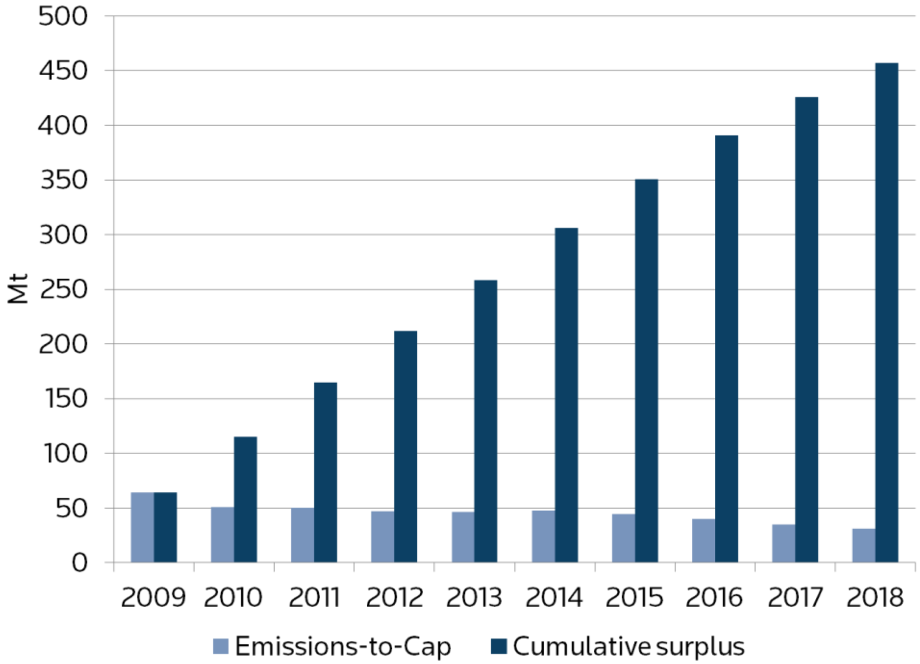
Today: RGGI over-allocated through 2018





Source: Thomson Reuters Point Carbon 2011

- RGGI emissions to stay below the cap through 2018
- Cap would need to be lowered to incentivize additional emission reductions
- Accumulated surplus of allowances could be many times the annual cap

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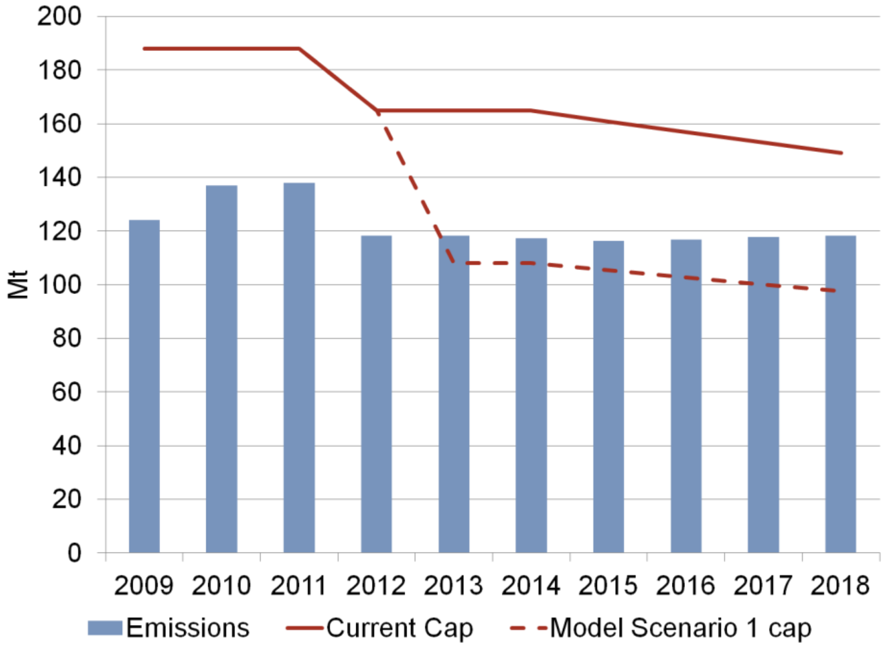
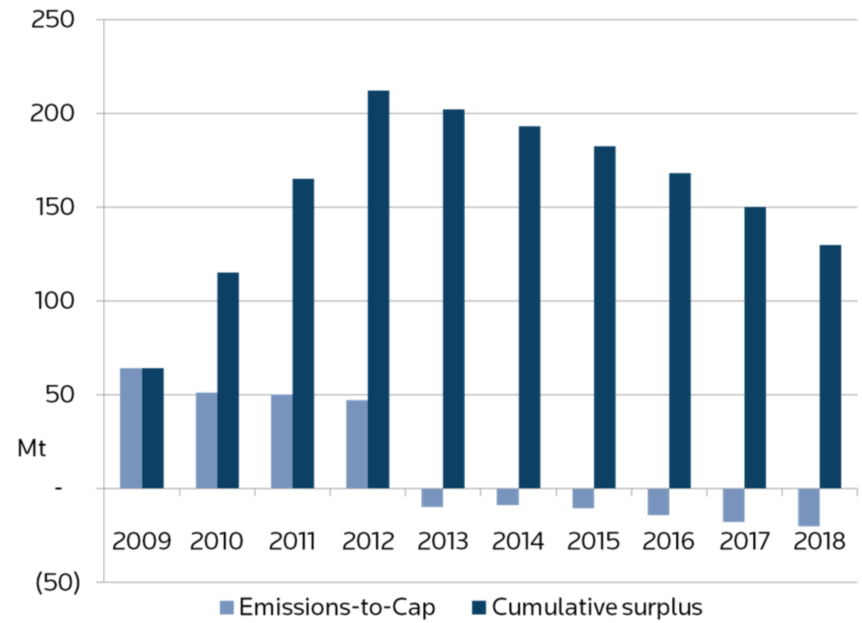
The problem with the allowance surplus





Source: Thomson Reuters Point Carbon 2011

- Surplus of allowances from Phase 1 could thwart efforts to make program short
- If cap lowered to 2009 emissions as a baseline, program is short - on paper
- But in reality surplus of allowances could keep program long through 2018

Who holds the surplus allowances?

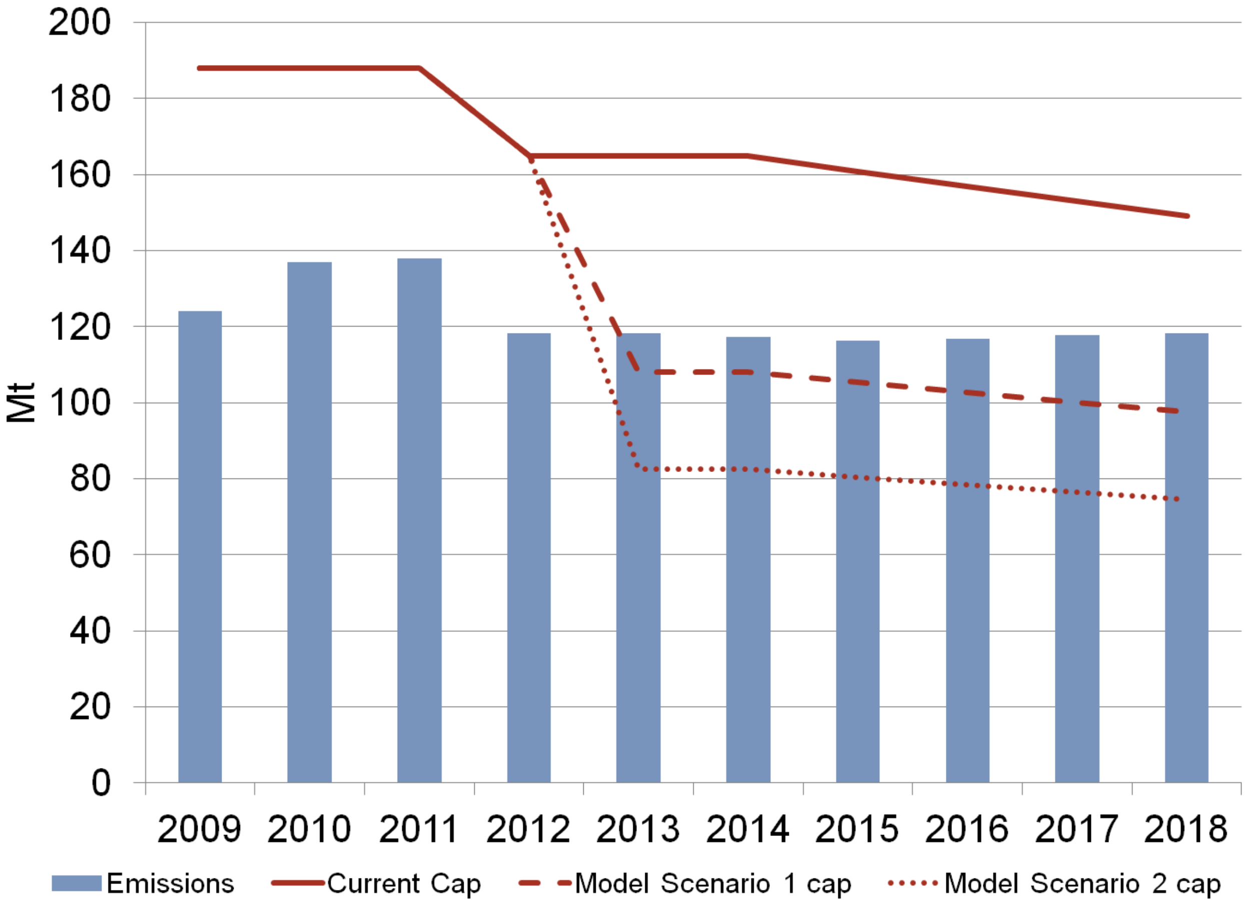
- Private bank = emitters or financials
  - allowances purchased by market participants over and beyond what is needed for compliance
  - We estimate to date only 10 Mt banked
- Unsold allowances = states
  - allowances not allocated for free and not sold
  - 4 out of last 5 auctions were undersubscribed: 93 Mt unsold to this date
  - We assume not all set asides have been distributed: 24 Mt
  - Total: we estimate to date, states have 117 Mt unsold allowances
- What to do with unsold allowances?
  - State regulations differ with regard to retirement of, or auctioning of unsold allowances
  - For simplicity in our modeling, we assume that unsold allowances don’t come to market

Remaining uncertainty: what about the next auctions?

- What will happen at next auctions?
  - We assume final decision on 2012 Review happens late 2012
  - Policy uncertainty creates uncertainty on auction subscription rate
  - Market participants could bank an additional 62 Mt maximum if all auctions (Dec 2011-Dec 2012) are fully subscribed
- "Low banking case"
  - low subscription rate (10%) at Dec 2011 auction
  - Emitters buy only what they need for compliance in 2012
  - only 27 Mt banked by end 2012
- "High banking case"
  - emitters/financials buy all available allowances at Dec 2011 and 2012 auctions in anticipation of tighter cap
  - up to 91 Mt banked by end 2012

Revising the cap: scenarios

- We construct two scenarios:
    1. Use 2009 emissions as a baseline for 2013-2014
    2. Cut 2013-2014 cap level by 50%
- 2.5% annual decline 2015-2018 in both cases



Source: Thomson Reuters Point Carbon 2011

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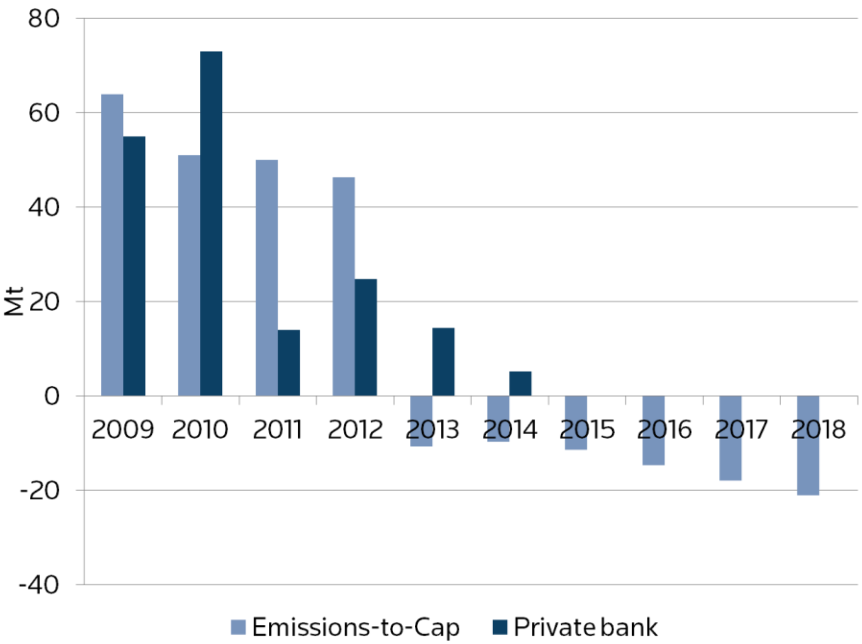
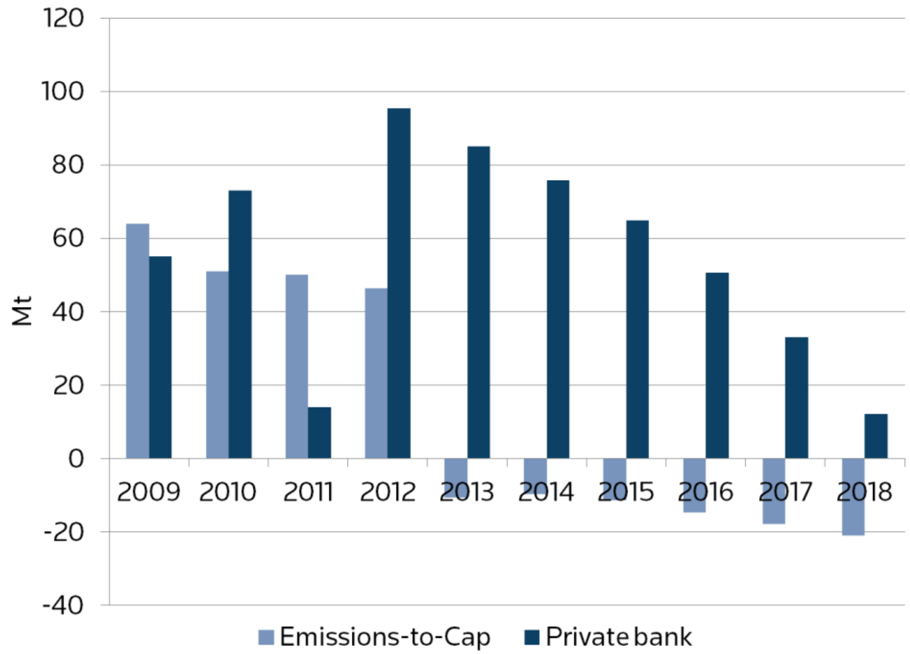
Scenario 1: Adjust cap to 2009 baseline

Low banking



High banking



Source: Thomson Reuters Point Carbon 2011

- Lowering cap to 2009 baseline works well if private participants don’t bank too much in 2011 - 2012
- Market remains long if emitters build a large bank

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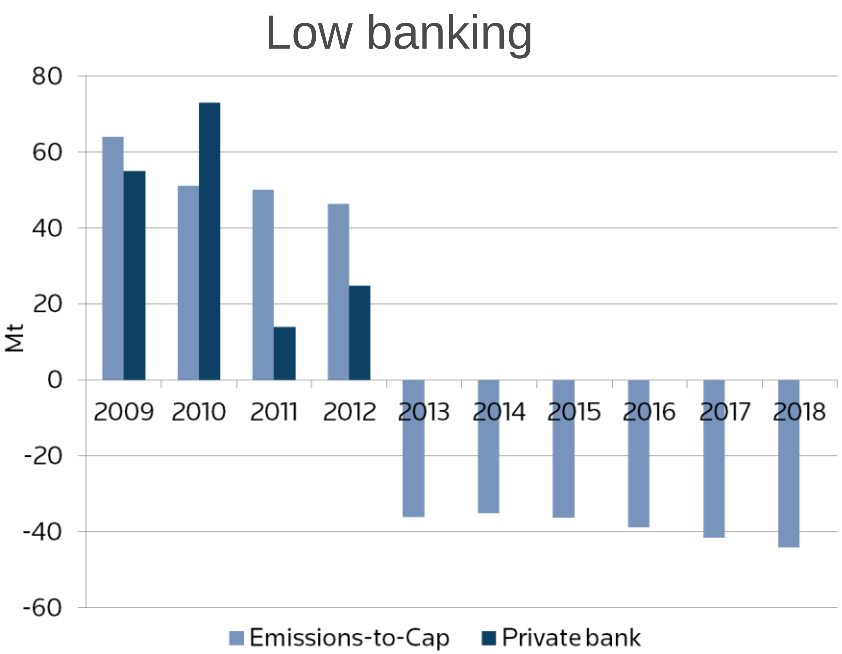
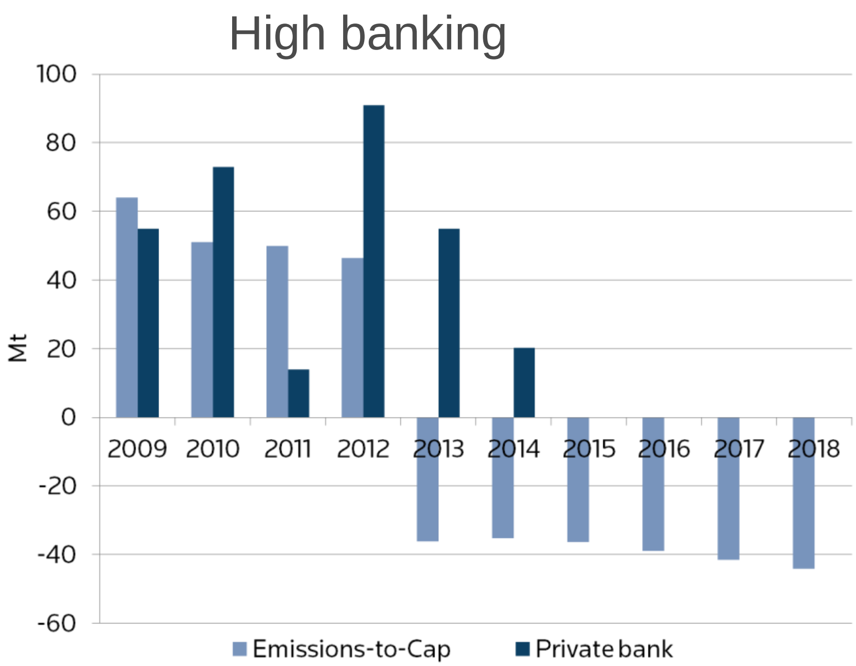
Scenario 2: Lower cap by 50%





Source: Thomson Reuters Point Carbon 2011

- Program sure to be short even if private participants build a large bank in 2011 - 2012
- Large volume of emission reductions required through 2018

Conclusion

- RGGI faces a serious over-allocation problem
- Over-allocation can only be addressed by combination of two actions from regulators:
  - Withhold unsold allowances

  AND
  - Lower cap
- Short market could lead to high prices
  - Limited abatement options in RGGI
  - Few offsets allowed, insufficient to keep prices low
  - Consider other price containment mechanisms, possibly using unsold allowances for back up (Price Containment Reserve)

Questions?

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