



Perspectives on Cost Containment Allowance Reserves
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Perspectives on Cost Containment Allowance Reserves

Dallas Burtraw
Resources for the Future



Tools for costs management in cap and trade systems

Banking

Offsets

- Timing is an issue

Strategic Expenditures

- Energy efficiency

Price Collars

- Price floor / Reserve price (already in place)
- Price ceilings / Cost containment reserve of allowances



What is a cost containment reserve?

Limited cost containment reserve (“soft collar”)

- Introduce a limited, fixed quantity of allowances from an allowance reserve into program if the price reaches a ceiling trigger.

Unlimited cost containment reserve (“hard collar”)

- Introduce an unlimited quantity of allowances at price ceiling trigger.



Questions in designing a cost containment reserve

- Is there a tradeoff between cost ceiling and emissions ceiling?
- Where do allowances in the reserve come from?
- How do allowances from the reserve enter the market?
- Is harmonization among participating states necessary?
- Interaction with offsets?



Is there a tradeoff between a cost ceiling and emissions ceiling?

A limited reserve provides the biggest bang for the buck:

- The first allowances made available when price hits trigger provide greatest relief in terms of program costs.
- Diminishing returns to adding more allowances to reserve.
 - A limited cost containment reserve provides most of potential cost savings while avoiding the possibility of busting the cap.



Where do the reserve allowances come from?

- 1. Unsold allowances from prior auctions**
- 2. Assign allowances identified as part of adjustments to cap**

Options 1 and 2 bring additional emissions into program if reserve is tapped.

- 3. Bring allowances forward from future time periods**

The approach to be used in California: 4% of allowances over 2013-2020 in reserve.

Note “system borrowing” is distinct from “firm-level borrowing.”



How do allowances from the reserve enter the market?

- **Direct sales of allowances from the reserve could lead to rationing problem, rushes or market swings**
- **A secondary auction with a price floor equal to the program's price ceiling solves the rationing problem**
 - Could be held simultaneous to regular auction
 - Cost containment reserve auction could clear above its price floor



Concluding observations

Expected prices will depend on whether RGGI cap is tightened

- How cap might be tightened is relevant. The cap could be reduced or the price floor could be increased, or both.

Trading, banking and expected prices will be influenced by design of cost containment reserve

Simplicity is an important virtue in the program design *and* the design of the cost containment reserve

A large image of a power plant at sunset. The sky is orange and yellow, and the power plant is silhouetted against the bright light. The text 'Thank you!' is overlaid in the bottom right corner.

Thank you!