

Economic and Allocation Advisory Committee

Memo from the Chair: Draft Outline for EAAC Allocation Report version 4 September '09

[Note: I've revised this draft based on discussions in conference calls involving the various subcommittees.]

1. Introduction

- Role of cap and trade in AB 32 (as indicated by Scoping Plan)
- Significance of allowance allocation to cap and trade
- Formation of EAAC
- EAAC's mission; critical roles
 - assess total allowance value
 - recommend relative emphasis (at various points in time) on free allocation vs. auctioning of allowances; recommend auction design (if applicable) and basis for free allocation (if applicable)
 - recommend alternative ways to distribute or make use of allowance value
- Criteria for choosing among the alternatives
 - their relationship to specified objectives of AB 32

2. Total Allowance Value

- General:
 - allowance value as function of abatement costs, stringency of cap, and output prices, and method of allocation
- Quantitative: estimates of total allowance value (under alternative scenarios for time-profile of the cap)

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3. Mechanisms for Allowance Allocation

- General: free allocation and auctioning
- Alternative bases for free allocation (historical, output-based, etc.)
 - strengths and weaknesses
- Alternative auctioning approaches
 - strengths and weaknesses
- comparison of the alternatives
 - environmental effectiveness (considerations of leakage, ...)
 - cost-effectiveness
 - administrative costs
 - interactions with fiscal system
 - other
 - fairness (foreshadow sections 4 and 5)
 - simplicity (the plan should be understandable) and transparency

4. Making Use of Allowance Value – General Considerations

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The alternatives

- compensation (to producers, consumers, low-income households, displaced workers, particular localities)
- dividends to the general public
- investments (new technologies, job-training) and other public spending
- revenues to finance tax reductions

Timing Issues – relative emphasis on the different alternatives can change over time

Rationales for the various alternatives

Potential legal restrictions

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5. Making Use of Allowance Value – Weighing the Needs and Claims

a. Compensation

General questions: When is compensation appropriate? Where is compensation most needed? How much compensation is required in these cases?

What should be the duration of compensation?

Producer compensation: How large are the potential profit losses to major industries? What are the impacts on small businesses?

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Consumer compensation: what are the impacts on household budgets – in particular, budgets of low-income households

Compensation (or transition assistance) to displaced workers

Environmental compensation: What are the local pollution impacts?

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b. Dividends to the General Public

Here the goal is to offer the public allowance value as a payment for the use of its environmental resources. How can this goal be reconciled with other goals, such as compensating adversely impacted parties and financing various investments? Should the relative status of this goal increase through time, with the relative status of the compensation and investment goals receding through time?

Comment [LG1]: The separation of (b) and (d) here is somewhat artificial. In both cases, the general public receives a payment for the use of its environmental resources. In case (b), it's in the form of a rebate check. In case (d), it's in the form of a reduction in individual tax rates. Indeed, (c) too can be seen as a way of giving the public a kind of "payment" for the use of its environmental resources.

c. Investments

What are the most promising potential investments? What are the potential rates of return on the various alternatives?

Should these investments be financed through allowance value? To what extent should they be financed through other public revenues?

d. Returning Auction Revenues to the General Treasury to Finance Tax Reductions

To what extent can using revenues this way improve overall economic performance by reducing other, distortionary taxes?

e. Bases for Choosing among the Alternatives

- comparing social rates of return on the alternatives

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-- comparing the ethical imperatives

6. Recommendations

- a. for relative reliance on free allocation and auctioning
- b. for specific form of free allocation (if applicable) and auctioning (if applicable)
- c. for use of allowance value