

## **Draft Outline for EAAC Allocation Report – version 1 October ‘09**

### **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. Mechanisms for Allowance Allocation**

General discussion: free allocation and auctioning

Alternative bases for free allocation (historical, output-based, etc.)

- methods relevant to California decision

- strengths and weaknesses

Alternative auctioning approaches

- strengths and weaknesses

Comparison of the alternatives

- environmental effectiveness (considerations of leakage, etc)

- cost-effectiveness

  - administrative costs

  - interactions with fiscal system

  - other

- fairness (foreshadow sections 4 and 5)

- simplicity (the plan should be understandable) and transparency

### **3. Total Allowance Value**

General discussion:

- allowance value as product of allowance prices and quantities

- allowance quantities as determined directly by policy

- allowance prices as function of stringency of cap, abatement costs, and method of allocation

  - abatement costs as function of banking/borrowing provisions, policy linkages, and offsets

Quantitative: estimates of total allowance value (under alternative scenarios for time-profile of the cap)

- assessment of marginal source of abatement and of marginal abatement costs

- factors determining allowance price

  - short-run adjustments: reductions in demand (output), fuel-switching, and process change

- longer-run adjustments: invention and deployment of new technologies
- extent of leakage
- policy variables: presence/absence of banking provisions, policy linkages, availability of offsets
- estimated ranges for allowance value
  - ARB estimates, EAAC Committee's estimates

#### **4. Making Use of Allowance Value – General Considerations**

The alternatives:

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

Rationales for the various alternatives

fairness issues:

- ethical basis for compensation (discuss when compensation is appropriate)
- ethical basis for providing “dividends” to households
- ethical basis for reducing the deficit
- social returns from investments of allowance value
- efficiency gains from using revenues to finance deficit reduction

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

Potential legal restrictions

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

Compensation:

- Producer compensation: How large are the potential profit losses to major industries? What are the impacts on small businesses?
- Consumer compensation: what are the impacts on household budgets – in particular, budgets of low-income households
- Compensation (or transition assistance) to displaced workers: what is the extent of worker displacement?
- Environmental compensation: What are the local pollution impacts? Where are the disproportionate impacts?

Dividends to the General Public:

- What are the net impacts of dividends on households across the income distribution?

If dividends are taxable, how much will return to the state and local governments?

Investments:

Investment alternatives: new green technologies, other new technologies, job training

How might investment support divide between basic and applied research?

What types of market failure would justify devoting allowance value toward investments, and what types of investments do these market failures justify? Which investments seem to have the greatest promise?

Institutional issues: What institutions might be best suited to make decisions about allocation of funds for investment?

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

Tax Shifting – devoting allowance value to finance reductions in current taxes or deficit-reduction (future taxes):

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

## **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