

Economic and Allocation Advisory Committee

**Memo from the Chair:
Preliminary Suggested Outline for EAAC Allocation Report
8/21/09**

[Note: This is preliminary and is meant to help us focus our continuing discussions. These discussions will surely lead to various improvements to the outline.]

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

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)

4. Making Use of Allowance Value – General Considerations

The alternatives

Economic and Allocation Advisory Committee

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

Rationales for the various alternatives
Potential legal restrictions

Comment [LG1]: I've grouped these two together since they both involve giving value to the government – in one case to invest or spend, in the other case to finance tax cuts

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

a. Compensation

- General questions: Where is compensation most needed? How much compensation is required in these cases?
- Producer compensation: how large are the potential profit losses to major industries?
- Consumer compensation: what are the impacts on household budgets – in particular, budgets of low-income households
- Environmental compensation: what are the local pollution impacts?
- Other?

Comment [LG2]: Below are some key questions related to the weighing of the alternatives. The list of questions is not meant to be exhaustive.

We will need quantitative information to address some of these questions.

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 [LG3]: 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
- comparing the ethical imperatives

6. Recommendations

Economic and Allocation Advisory Committee

- 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