

What's the concern?

- First question to ask: What are we worried about?
 - Allowance prices too high?
 - Volatility?
 - Overall economic impact?
 - Economic impact on specific sectors, e.g. electric power?
- Environmental perspective
 - Very high prices could threaten the program (RECLAIM).
 - But busting the cap ahead of time is not a solution.

Problems with the leading solutions

- Price ceiling (“safety valve”)
 - Busts the cap
 - Changes behavior
 - Dampens incentive for investment and innovation
- Carbon market efficiency board
 - Much better than the safety valve, but ...
 - Devil is in the details
 - Rules vs. discretion
 - Institutional authority must be earned

The overlooked means of cost containment

- Allocation: Contain costs, not prices
- Financial instruments: Markets can manage volatility
- Borrowing: Government “discount window”
- Offsets: Expand the scope of the market
- Forest carbon tons: Reservoir of low-cost emissions reduction opportunities

What's the concern? (Refrain)

- Temporary shocks or long-run fundamentals?
- Long-run solution is simple: Adjust the target.
 - Note that we are also deeply uncertain about the long-run fundamentals of the climate system
 - Argues for an approach that keeps options open
- Built-in flexibility mechanisms should focus on accommodating short-run shocks.

What might a “starter kit” look like?

- Early years of the program are critical
- Would like to have a cushion in place against short-run shocks
- How do we get the market working well?
 1. Early tons are essential
 - Early action credits, offsets, etc. underway right away
 - Need forest carbon sooner rather than later
 2. Credibility is crucial
 - This is the heart of the matter, since in theory banking and borrowing are sufficient to smooth out SR shocks
 - Single allowance reserve? Long-run horizon for forward auctions?