What Others Are Saying About The Need For A Price Collar In A GHG Cap-and-Trade System

A price collar sets an upper limit (ceiling) and a lower limit (floor) on the price of carbon dioxide (CO_2) emissions allowances in a greenhouse gas (GHG) cap-and-trade program. A price collar is designed to minimize the economic disruption of a national carbon policy. Many public policy groups, energy experts, and economists alike agree that including a price collar in a cap-and-trade program is an effective part of cost-containment measures needed to help protect consumers and the nation's economy from volatile carbon prices and possible market manipulation, while supporting emissions reductions. Here's what they're saying…

A Price Collar Provides Cost Certainty, Reduces Price Volatility, and Protects Against Market Manipulation

- "Another way for a cap-and-trade program to mitigate the effects of unexpected [allowance price] changes would be to specify an upper or lower limit, or both, on allowance prices. An upper limit protects firms and consumers from unexpectedly high prices. … A lower limit on allowance prices ensures that cheap abatement opportunities continue to be pursued. …One study finds that, for a given cumulative emissions reduction, a combined price ceiling and floor can reduce costs by almost 20 percent compared with a cap-and-trade program without any cost-containment mechanisms (Fell and Morgenstern 2009)."
  - *Council of Economic Advisors: "Economic Report of the President," February 2010, p. 251.*
- "A simple price cap that is paired with a minimum price floor and that escalates in a pre-determined manner over time still offers, in our view, the most straightforward and effective response to the cost concerns expressed by many stakeholders, both with respect to long-term mitigation costs and with respect to mitigating the potential for short-term price volatility."
  - *National Commission on Energy Policy: "Forging the Climate Consensus: Managing Economic Risk," July 16, 2009, p. 11.*
- "A symmetric safety valve is a price collar that provides a floor as well as a ceiling on the price of emissions allowances. … What a symmetric safety valve can be expected to do is lower price volatility in a cap-and-trade program, thereby reducing unproductive economic disruptions. … And it provides a safeguard against potential manipulation of the market by limiting the potential payoff for such behavior."
  - *Resources for the Future: Written testimony of Dr. Dallas Burtraw, submitted to the U.S. House of Representatives Committee on Ways and Means, March 26, 2009, pp. 2, 5.*
- "A cap-and-trade program that included both a ceiling and a floor for allowance prices could achieve a long-term target for emissions while minimizing both the overall cost of achieving the target and price volatility."
  - *U.S. Congressional Budget Office: Written testimony of then-Director Peter R. Orszag, submitted to the U.S. House of Representatives Committee on Ways and Means, September 18, 2008, p. 12.*
- "Together, a price ceiling and floor—or 'price collar'—substantially reduces the uncertainty about the costs of a climate program. … The presence of a price collar ensures that there will be a functioning trading market to achieve compliance at lower costs."
  - *Bipartisan Policy Center: Written testimony of President Jason Grumet, submitted to the U.S. Senate Committee on Energy and Natural Resources, September 15, 2009, pp. 4-5.*

- "Policymakers could help reduce fluctuations in allowance prices by setting a floor and a ceiling (often referred to as a safety valve) for the price of allowances. The price floor would induce firms to make more emission reductions than would be necessary to meet the cap in low-cost years. … The price ceiling would allow firms to make fewer emission reductions in high-cost years, thereby exceeding the annual cap."
  - *U.S. Congressional Budget Office: Written testimony of Director Douglas W. Elmendorf, submitted to the U.S. House of Representatives Committee on Ways and Means, March 26, 2009, p. 9.*

A Price Collar Encourages Technology Investment

- "Compared to a carbon policy regime with more predictable carbon prices, we estimate that CO_2 price volatility under current policy proposal[s] could delay investment in low-carbon and carbon abatement technologies by 10 years or more. We propose that an effective policy to reduce this investment barrier would be a safety-valve mechanism that includes both a floor and a ceiling on CO_2 prices. This would reduce volatility and protect both investors and customers from extreme carbon prices."
  - *The Brattle Group: Metin Celebi and Frank Graves, "Volatile CO_2 Prices Discourage CCS Investment," January 2009, p. 1.*
- "[T]he reduced price volatility resulting from the introduction of a ceiling and a floor enhances the investment climate for new investment beyond that which results from unbridled price volatility. … [A price collar] can also lower the hurdle rate for new investments in innovative technology, thereby reducing the overall cost of the program."
  - *Resources for the Future: Written testimony of Dr. Dallas Burtraw, submitted to the U.S. House of Representatives Committee on Ways and Means, March 26, 2009, p. 2, 5.*
- "By preventing the policy from being either unexpectedly lax or unexpectedly stringent, a price collar protects both investors in green technologies and households and preserves strong incentives to abate."
  - *Brookings Institution: "Time for a Price Collar on Carbon," Adele Morris, Peter Wilcoxen, and Warwick McKibbin, opinion article in Politico, July 24, 2009.*

A Price Collar Achieves Cost-Effective Emissions Reductions

- "We hope you will consider that cap-and-trade will be more successful if it provides a price collar that limits volatility and moves upward on a predictable path to reach agreed emissions goals…"
  - *Clean Air-Cool Planet and Environmental and Energy Study Institute: Letter to Senators Max Baucus, Jeff Bingaman, and Barbara Boxer, July 29, 2009.*
- "As with the ceiling policies, the price collar achieves nearly the same reduction in cumulative emissions as the OA [Obama Administration] policy. … Either a ceiling policy or a price collar can provide cost containment without unduly compromising the environmental goals of the policy."
  - *Brookings Institution: "Consequences of Alternative U.S. Cap-and-Trade Policies: Controlling Both Emissions and Costs," Warwick J. McKibbin, Adele Morris, Peter J. Wilcoxen, and Yiyong Cai, July 24, 2009, p. 13.*
- "In our simulations, we find that price collars and safety valves can reduce expected abatement costs by as much as 18 and 17 percent, respectively, relative to a cap-and-trade system with no banking and borrowing. … A price collar is always more cost-effective than a safety valve for a given expected emissions outcome because it encourages inexpensive abatement when allowance prices decline."
  - *Resources for the Future: "Alternative Approaches to Cost Containment in a Cap-and-Trade System," Harrison Fell and Richard Morgenstern, Discussion Paper, April 2009, p.23.*

A Price Collar Provides Financial Protection to Consumers and the U.S. Economy

- "As proposed, the House cap-and-trade system would set a quantity target on emissions and allow the market to determine the price of carbon—but with a price floor. Given that a key political vulnerability of the program is its economic effect on American households, sponsors of a Senate cap-and-trade bill could strengthen its prospects by imposing a price ceiling, in effect establishing a price collar."
  - *Brookings Institution: "Time for a Price Collar on Carbon," Adele Morris, Peter Wilcoxen, and Warwick McKibbin, opinion article in Politico, July 24, 2009.*
- "A policy that seeks the long run environmental objectives of the Obama proposal or the Waxman-Markey discussion draft targets, if augmented by a price collar or price ceiling, could very significantly cut emissions over the long run while firmly limiting compliance costs."
  - *Brookings Institution: "Consequences of Alternative U.S. Cap-and-Trade Policies: Controlling Both Emissions and Costs," Warwick J. McKibbin, Adele Morris, Peter J. Wilcoxen, and Yiyong Cai, July 24, 2009, p. 14.*

A Price Collar Is a Straightforward Approach

- "A price collar would be simple to administer, would not require an elaborate regulatory system to administer, and would produce certainty ex-post as to the actual level of emissions under the cap. … A price collar or safety valve sets a reliable and simple upper and lower bound on allowance prices in a cap and trade system."
  - *Dr. Michael Wara, Stanford Law School: Written testimony before the U.S. Senate Committee on Energy and Natural Resources, September 15, 2009, pp. 2, 10.*
- "Price floors and ceilings could provide timing flexibility and more certainty about allowance prices … the floor would tighten [the] cap in low-cost years; [the] ceiling would loosen the cap in high-cost years."
  - *U.S. Congressional Budget Office: Presentation by then-Director Peter R. Orszag, Wellesley College, October 27, 2008.*
- "The administration of a symmetric safety valve [or price collar] is straightforward. At the price ceiling, additional allowances would be sold directly into the market. Revenues from the sale of additional allowances might be dedicated to program-reinforcing investments, such as investment stimulus in technology or energy efficiency. The price floor is enforced through the introduction of a reserve price in an auction. If bids in the auction fall below the specified floor, then the given lot of allowances would not be sold. That would tighten supply in the market and bring up the spot price.

  … The size of the collar or the difference between the ceiling and the floor is less important than the midpoint because the midpoint represents a signal to investors about the level of effort Congress and society expect to have to make to achieve climate goals. … For a given program design, the expected price path in the models maintained by EIA and EPA provide a reasonable range that can be used as a basis for expected costs. I suggest that a symmetric safety valve with the ceiling and floor set equal distance from that expected path would be a good design."
  - *Resources for the Future: Written testimony of Dr. Dallas Burtraw, submitted to the U.S. House of Representatives Committee on Ways and Means, March 26, 2009, pp. 2, 7.*

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