California Carbon Allowances have the potential to help the state meet higher climate targets

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California sets higher climate targets

California has an ambitious decarbonising goal: to reduce greenhouse gas (GHG) emissions by 85 percent below 1990 levels, no later than 2045. Its cap-and-trade market, that uses California Carbon Allowances (CCA), is a key policy tool to achieve this goal. The 2022 Scoping Plan for Achieving Carbon Neutrality was signed in November 2022 and lays out a path to cut emissions aggressively. The agreed Scoping Plan also implements an intermediate step: to reduce GHGs by 48% below 1990 levels by 2030, up from the 40% proposed in the draft Scoping Plan. CCAs have the potential to play a larger role in the policy toolkit than ever before.

Path to achieving higher targets will be revealed, with a potentially greater role for CCAs

California Air Resources Board (CARB) has modelled various scenarios and has determined that in none of its scenarios are current policies (that is, policies in place from its 2017 Scoping Plan) sufficient to meet it 2022 Scoping Plan targets. California has a number of tools to tackle climate change and inevitably they overlap one another. Accelerating the use of one tool may mean that the call on another tool is reduced. CARB has already indicated it will increase the stringency of low-carbon fuel standard (LCFS) and require carbon capture and sequestration (CCS) on the majority of petroleum refining. CARB will update its models in 2023, incorporating the implementation of these measures later in the decade, and determine how much more the cap-and-trade market will need to deliver. It is likely to focus on a more aggressive reduction of the cap. This year, we also expect CARB to make some announcements on how they will reduce the overhang of allowances from prior years.

Successful auctions indicate greater optimism in the CCA market

California carbon markets have suffered from years of oversupply. As a result of achieving the 2020 target several years earlier than mandated by law, there are unused allowances in circulation. CARB estimated the amount to be approximately 310 million allowances after the conclusion of the third compliance period (2018–2020)1. In 2016, 2017, and 2020 auctions were undersubscribed and prices up until 2021 barely lifted off the reserve price. The reserve price increases by 5% plus inflation every year.

However, since 2021, with the new Scoping Plan being debated and then announced in November 2022, CCA prices have moved decisively above the reserve price. The most recent auction on 15 February 2023 saw all allowances sold2.

Source: WisdomTree, California Air Resources Board (CARB), February 15 2023.

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2023 could be an exciting year for the CCA market, as the California Air Resources Board puts together implementation plans for the latest Scoping Plan. The cap-and-trade market's role in the decarbonisation effort may increase.

1 https://ww2.arb.ca.gov/sites/default/files/2022-12/2022-sp.pdf

2 https://ww2.arb.ca.gov/sites/default/files/2023-02/nc-feb_2023_summary_results_report.pdf

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