Marketable Permits

Committee on Regulation

Proposed Recommendation for Committee | March 28, 2017

[Preamble]

RECOMMENDATION

Establishment of Marketable Permitting Programs

1. When an agency designs a marketable permitting system, the agency should be cognizant of the present and future resources that are required to develop and operate the system. In the case of marketable permits, the agency should consider that designing and implementing a marketable permitting system may require significant upfront costs, but require fewer resources to administer once the system has been established.

2. Agencies should consider the following additional factors when deciding whether to adopt a marketable permitting system. Agencies should consider adopting a marketable permitting system when:
   a. Agencies can clearly define the privileges or obligations to be assigned by the program, and have the necessary information to set caps or baselines at the appropriate level.
   b. Regulated entities have more information about compliance costs, and the value of the resources to be allocated, than regulators. This often occurs when the activity to be regulated is conducted by heterogeneous or small sources.
   c. The overall level of an activity matters more to regulators than the identity of the actors, and the risk of unintended consequences from trading, such as the potential for highly localized problems, can be efficiently managed.
d. Regulators are reasonably confident that a robust market is feasible. This requires interest and participation by regulated entities, and requires them to have sufficient knowledge to make efficient decisions in the market. In addition, variation across different permittees’ compliance costs or utilities in the resources traded is needed to encourage trading of permits.

3. Agencies must be cognizant of legal authority when designing a marketable permitting program. At a minimum, regulators need implicit regulatory authority from broad statutory language to design such a program. Explicit language authorizing a marketable permitting system may help minimize legal uncertainty, but it is not necessary in every instance. In addition, before establishing such a program, regulators should make sure they have sufficient legal authority to monitor permit markets for fraud, manipulation, and other abuses.

**Desired Features of Marketable Permitting Programs**

4. When designing a marketable permitting program, agencies should cap the total level of activity of the marketable permitting system, rather than capping the rate of activity. During the design phase, agencies should create a mechanism for fine-tuning the cap. In addition, agencies should allow open access to the market so citizens can retire credits.

5. When distributing the initial allocation of permits, agencies should opt for auctions over grandfathering to prevent windfalls and barriers to entry for regulated parties. If auctions are not feasible, agencies should consider alternate allocation techniques, like set-asides for new entrants, and output or community-based allocations.

6. If an auction is used, agencies should emphasize the market management and distributional reasons for choosing auctions besides raising revenue. This could help avoid potential categorization of the permit auction as an impermissible tax.

7. In designing a marketable permitting program, regulators should include clear sanctions. Ideally, sanctions would include both penalties for non-compliance and the creation of plans for coming into compliance.
8. When possible, agencies should pursue economies of scale in managing marketable permitting programs. Federal agencies should provide clear guidance on trading policy to regional and state offices, where applicable. This may include providing training sessions to regional and state officials.

9. Where marketable permit programs exist without explicit statutory authority, Congress should consider endorsing these programs to help reduce uncertainty for market participants and regulators. In the absence of explicit statutory authority, agencies should communicate to Congress any legal barriers to marketable permits.

10. To avoid misperceptions about permits’ permanence or compensation for takings, agencies and Congress should avoid calling marketable permits “rights,” and should instead use the language of marketable licenses or obligations.

11. Agency guidance on marketable permit programs should, at a minimum, go through public notice and comment. Agencies should consider codifying marketable permitting regulations to reduce uncertainty and inconsistent implementation.

12. When designing a marketable permitting program, an agency should include a mechanism for oversight. Depending on feasibility and efficiency, agencies should consider overseeing the program directly, making use of self-verification, or engaging third-party credit verifiers. If an agency chooses to use third-party verifiers, it should set standards to ensure that third-party credit verifiers are qualified, insured, and free from conflicts of interest.

13. CFTC should consult with other agencies on the oversight of secondary permit markets, and should identify to Congress any need for additional statutory authorities to regulate permit markets. In addition, Agencies should work with CFTC to develop procedures for monitoring derivative markets relating to regulatory permits. CFTC should monitor
active derivative markets relating to regulatory permits, and exercise its authority to prevent fraud, manipulation, and excessive speculation.

**Information Sharing**

14. Agencies should collect data on the operation of marketable permitting programs, and should periodically assess both the policy effectiveness and economic efficiency of existing marketable permitting programs.

15. To the extent feasible, agencies should release non-confidential data to the public that would help the public gauge a market’s policy effectiveness.

16. Agencies that manage marketable permitting systems should coordinate with each other to improve existing marketable permitting systems and design more efficient systems in the future.