



Marketable Permits

Committee on Regulation

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1 Marketable permits are government-created licenses¹ or obligations for a specific level of a
2 particular activity.² While many kinds of permits can be transferred together with the sale of a
3 business or underlying assets, marketable permits are distinguishable because they can be bought
4 or sold independently of any real property or other interest. Categories of marketable permit
5 programs include cap-and-trade, rate-based trading, and credit trading programs.

6 In cap-and-trade programs, regulators set an absolute limit on the total amount of activity that
7 can take place (e.g., tons of pollutant, allowable fish catch, or number of airport landing slots).
8 The agency then distributes permits; common practices include auctioning the permits or
9 allocating permits based on past levels of activity. Not all permit auctions raise revenue for the
10 government: a “zero-revenue auction” redistributes auction proceeds back to regulated entities.
11 When auctions raise revenue for the government, they have occasionally been challenged as
12 impermissible taxes. To reduce the chance that a permit auction is perceived by a court as an
13 impermissible tax, agencies can emphasize the market management and distributional reasons for

¹ In 2015, the Administrative Conference conducted a survey and issued recommendations on the design and tailoring of permits. This recommendation, by contrast, focuses on the use of marketable permits, which primarily concerns the alienability of permits and their allocation between parties. Administrative Conference of the United States, Recommendation 2015-4, Designing Federal Permitting Programs, 80 Fed. Reg. 78164 (Dec. 16, 2015), *available at* <https://www.acus.gov/report/licensing-and-permitting-final-report>.

² As there is no uniform definition of “marketable permits” across the literature, this recommendation adopts the definition as set forth by Jason Schwartz, Marketable Permits: Recommendations on Application and Management (March 15, 2017), *available at* <https://www.acus.gov/sites/default/files/documents/marketable-permits-draft-report.pdf>.



ADMINISTRATIVE CONFERENCE OF THE UNITED STATES

14 choosing auctions, such as avoiding windfalls and barriers to entry.³ After the initial allocation of
15 permits, interested parties are generally free to further trade permits. Regulators may restrict the
16 buying and selling of permits to regulated entities or may allow open access to brokers,
17 speculators, market facilitators, and the general public. More open access can promote market
18 liquidity and facilitate efficient price discovery.

19 A rate-based trading program may be similar in many respects to a cap-and-trade market, but
20 instead of capping the total amount of a regulated activity, agencies limit the relative amount of
21 activity per regulated entity. For example, a rate-based air pollution permit market may limit the
22 amount of pollution power plants can emit per unit of electricity generated.

23 In credit trading systems, regulators set a relative goal (e.g., no net emissions increase or no
24 net loss of wetlands) and then any covered entities seeking, for example, to increase emissions or
25 develop over wetlands must purchase offsetting credits that are sold by third parties and verified
26 by regulators. Credit systems can be combined with cap-and-trade or rate-based programs. For
27 example, in a greenhouse gas cap-and-trade program, unregulated sources may be allowed to
28 voluntarily reduce their emissions and sell verified credits on the market.

29 Evidence confirms that, in many regulatory applications, marketable permits allocate
30 privileges and obligations more efficiently than traditional regulation by allowing the market to
31 identify and prioritize the lowest-cost abatement opportunities or the highest value use of scarce
32 resources. For example, the acid rain market reduced costs by as much as 90% versus
33 alternatives without tradable permits, with savings estimated between \$250 million and \$1
34 billion annually.⁴ Marketable permit programs also likely incentivize innovation better than

³ See Cal. Chamber of Commerce v. State Air Res. Bd., No. C075930, 2017 WL 1282055, at *1 (Cal. Ct. App. Apr. 6, 2017) (ruling 2-1 that the state's greenhouse gas cap-and-trade program with an auction did not constitute an unauthorized tax).

⁴ H. RON CHAN ET AL., THE NET BENEFITS OF THE ACID RAIN PROGRAM 23 (2015); ROBERT STAVINS, MARKET-BASED ENVIRONMENTAL POLICIES 7 (1998).



ADMINISTRATIVE CONFERENCE OF THE UNITED STATES

35 traditional regulation by allowing parties to come up with innovative solutions.⁵ For example, the
36 trading and leasing of electromagnetic spectrum licenses has helped users develop novel
37 arrangements, such as sharing channels and voluntarily accepting more interference than the
38 Federal Communications Commission typically allowed in its direct licensing. Finally,
39 marketable permits may reduce long-term administrative costs compared to traditional
40 regulation. For example, the acid rain market famously achieved nearly 100% compliance with
41 only about 100 EPA staff.⁶

42 Many existing marketable permit programs have explicit statutory authority. Others have
43 formed under implicit authority, which has sometimes been codified after the fact.⁷ Additionally,
44 agencies have been directed in Executive Order 12,866 to assess the advantages of regulating
45 through “economic incentives to encourage the desired behavior, such as user fees or marketable
46 permits.”⁸

47 Marketable permits are a useful tool for agencies regulating a wide range of industries, but
48 are not suitable for all applications.⁹ However, their usefulness in certain scenarios has prompted

⁵ For example, because an air pollution cap-and-trade market puts a price on emissions but does not otherwise constrain compliance strategies, sources are free to experiment continually and develop new, unanticipated methods of low-cost abatement. And because unused permits can be sold for profit, sources can benefit the more reductions they make. By contrast, prescriptive standards frequently—and inefficiently—pick “winners” from among existing technologies: for example, regulating vehicle emissions by mandating use of certain biofuel technologies reduces the incentive to explore other, potentially better reduction opportunities, like new mass transit options. Jack Lienke & Jason Schwartz, *Shifting Gears: A New Approach to Reducing Greenhouse Gas Emissions from the Transportation* Section 5 (Policy Integrity Brief, 2014).

⁶ Lesley McAllister, *Beyond Playing “Banker”: The Role of The Regulatory Agency in Emissions Trading*, 59 ADMIN. L. REV. 269, 286 (2007).

⁷ For an in depth look at a wide range of marketable permit programs and their authorizations, see Schwartz, *supra* note 2, at 7–13.

⁸ Executive Order 12,866, 58 Fed. Reg. 51,735 (Sept. 30, 1993). Other examples of regulatory tools drawing on economic incentives include fees, penalties, subsidies, changes in liability rules or property rights, and required bonds, insurance, or warranties. Office of Mgmt. & Budget, OMB Circular A-4 (Sept. 17, 2003).

⁹ Current applications of marketable permits span a broad swath of the regulatory landscape, from air pollution markets, 42 U.S.C. § 7503(c), to fishery catch share programs, National Oceanic and Atmospheric Administration Catch Share Policy, 75 Fed. Reg. 55305 (Sept. 10, 2010), to the licensing of the electromagnetic spectrum, Federal Communications Commission, *Secondary Markets First Report and Order*, 68 Fed. Reg. 66252 (Nov. 25, 2003). There are also marketable permit programs at the state and local level, including transferable development rights,



49 bipartisan support, with implementations of marketable permit programs during the
50 administrations of Presidents Reagan, Bush (41), Clinton, Bush (43), and Obama. The
51 recommendations that follow provide several considerations for when marketable permits are
52 likely to be useful, features that can be included in the design of such programs to increase their
53 efficacy, and guidelines for establishing and monitoring the market for permits to limit fraud and
54 manipulation.

RECOMMENDATION

55 **Establishment of Marketable Permitting Programs**

- 56 1. Among the factors agencies should consider in adopting a marketable permitting program
57 are whether:
- 58 a. The marketable permit program is consistent with statutory language, the public
59 policy goals of the regulation, and other relevant considerations.
 - 60 b. Agencies can clearly define the privileges or obligations to be assigned by the
61 program and have the necessary information to set the level of regulated activity
62 at carefully considered, deliberate levels.
 - 63 c. Agencies have sufficient resources to design and administer the program and are
64 capable of reevaluating the appropriate target level of activity over time.
 - 65 d. There are informational challenges in discerning either compliance costs or the
66 value of the permits to be allocated. This often occurs when the activity to be
67 regulated is conducted by heterogeneous or small sources.
 - 68 e. The risk of unintended consequences from trading, such as the potential for highly
69 localized problems, can be fairly and efficiently managed.
 - 70 f. Regulators are reasonably confident that a robust market is feasible. This requires
71 interest and participation by regulated entities and requires them to have sufficient
72 knowledge to make efficient decisions in the market.

liquor license markets, and taxi medallion auctions. This recommendation deals solely with marketable permits at the federal level.



ADMINISTRATIVE CONFERENCE OF THE UNITED STATES

- 73 g. There is sufficient variation across different permittees' compliance costs or their
74 individual valuation of the permits traded to encourage trading of permits, and the
75 overall level of an activity matters more to regulators than the identity of the
76 actors.
- 77 2. When an agency designs a marketable permitting program, the agency should be
78 cognizant of the present and future resources that are required to develop and operate the
79 program. In the case of marketable permits, the agency should consider that designing
80 and implementing a marketable permitting program may require significant upfront costs
81 but require fewer resources to administer once the program has been established.
- 82 3. Before establishing a marketable permit program, regulators should make sure there is
83 sufficient legal authority to monitor permit markets for fraud, manipulation, and other
84 abuses.

85 **Desired Features of Marketable Permitting Programs**

- 86 4. Agencies should establish clear expectations as to the longevity of marketable permits
87 and the precise obligations or authorizations that they convey.
- 88 5. Agencies should consider using notice-and-comment rulemaking to establish marketable
89 permit programs, in order to reduce uncertainty and inconsistent implementation. Where
90 guidance or other means may be used to establish a marketable permit program, agencies
91 should go through public notice-and-comment as a best practice.
- 92 6. When designing a marketable permitting program, agencies should consider whether
93 their policy objective would be better served by capping the total level of activity (e.g.,
94 when a pollutant's total emissions levels is what drives the environmental effects) or by
95 limiting the rate of the activity (e.g., for a short-lived pollutant with highly localized
96 effects, so that the rate of pollution from individual plants is what drives the
97 environmental effects). During the design phase, agencies should create a mechanism for
98 monitoring the level of activity and for subsequently adjusting the cap.
- 99 7. Agencies should consider allowing open access to the market so parties besides the
100 regulated entities can buy and sell permits.



ADMINISTRATIVE CONFERENCE OF THE UNITED STATES

- 101 8. Agencies should consider instituting mechanisms for issuing additional permits or
102 releasing reserved permits in case of emergencies that dramatically increase demand.
- 103 9. When making the initial allocation of permits, agencies should consider using auctions to
104 prevent windfalls and barriers to entry for regulated parties, although some form of
105 historical based allocations may be appropriate based on other factors. If auctions are not
106 feasible, agencies should consider alternate allocation techniques, like setting aside
107 permits for new entrants or using output-based allocations.¹⁰

108 **Oversight of Marketable Permitting Programs**

- 109 10. Federal agencies should provide clear guidance on trading policy to regional and state
110 offices, when applicable. This may include providing training sessions to regional and
111 state officials.
- 112 11. When designing a marketable permitting program, an agency should include a
113 mechanism for oversight and establish clear criteria for verification to ensure that credits
114 are not double-counted and constitute real offsets of the regulated activity. Depending on
115 feasibility and efficiency, agencies should consider overseeing the program directly,
116 making use of self-verification, or engaging third parties to verify compliance. If an
117 agency chooses to use third-party credit verifiers, it should set standards to ensure that
118 they are qualified, insured, and free from conflicts of interest.
- 119 12. Agencies should use available tools to limit fraud and abuse in permit markets.
120 Regulators should adopt limits on purchasing and holding marketable permits (including
121 a maximum number that can be held by a single party) or employ other tools to prevent
122 monopolies, excessive speculation, and other manipulations of the permit market.

¹⁰ Often proposed in marketable permit programs that regulate electricity generators, output-based allocation allocates permits for pollution based on the amount of electricity produced by a given party, as opposed to the historical amount of pollution that party generated. This results in awarding permits to some of the cleanest producers of electricity, like renewable energy, rather than disproportionately to the most heavily polluting producers. Project on Alternative Regulation, *Marketable Rights: A Practical Guide to the Use of Marketable Rights as a Regulatory Alternative* 14 (1981).



ADMINISTRATIVE CONFERENCE OF THE UNITED STATES

123 13. In designing a marketable permitting program, agencies should include sanctions with
124 sufficient deterrent effect for noncompliance and require plans for coming into
125 compliance.

126 **Information Management**

127 14. Agencies should collect data on the operation of marketable permitting programs and
128 consider periodically assessing both the policy effectiveness and economic efficiency of
129 existing marketable permitting programs. Agencies should be cognizant that some of the
130 data collected will likely be confidential and should implement procedures for handling
131 this data appropriately.

132 15. To the extent feasible, agencies should release non-confidential data on permit
133 transactions, prices, and holdings to help the public gauge a market's policy effectiveness
134 and to help parties make efficient decisions in the market.

135 16. Agencies that manage marketable permitting programs should coordinate with other
136 agencies that have specific expertise to improve marketable permitting programs and
137 design more efficient systems in the future. Agencies should explore formalizing
138 agreements allocating respective responsibilities or developing standards or policies
139 jointly, where appropriate.

140 17. Marketable permit regulators should develop communication policies for announcing
141 policy changes or enforcement actions that could influence the market to prevent pre-
142 publication leaks and information asymmetries.