POTENTIAL LOST CAP-AND-INVEST REVENUE UNDER THE MANUFACTURING DECARBONIZATION INCENTIVE

Kyle Meng[1] **and Jordan Wingenroth**[2]
Environmental Markets Lab, UC Santa Barbara — April 2026

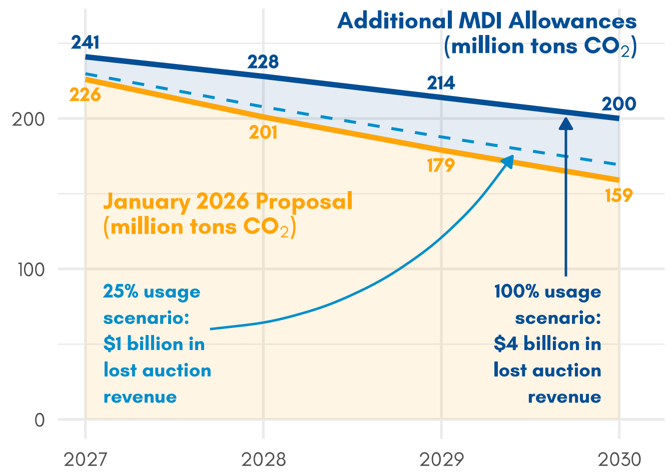
California Air Resources Board (CARB) introduced a Manufacturing Decarbonization Incentive (MDI) program in its April 2026 Proposed 15-Day Amendments for the cap-and-invest (C&I) program. This pool of pollution allowances is in addition to statewide pollution limits from the January 2026 Proposed Amendments and will likely lower demand for allowances sold at official auctions. **If fully utilized over the next four years, the MDI program could lower C&I auction revenue by $4 billion.** This revenue funds the Greenhouse Gas Reduction Fund (GGRF) and California Climate Credit (CCC).

In the April 2026 Proposed 15-Day Amendments, CARB introduced a new tranche of allowances for the MDI in addition to the official statewide cap. These MDI allowances may be granted to industrial compliance entities if they undergo specific forms of clean investment and can be used to meet emissions obligations under the C&I program. In total, CARB will allow up to 118 million allowances under the MDI, equivalent to the total 2027-2030 cap reduction between the current regulation and the January 2026 Proposed Amendments.

Our team at the Environmental Markets Lab analyzed the potential MDI impact on C&I auction revenue. By creating new allowances above the cap that are freely available for industrial compliance entities, the MDI lowers demand for CARB-auctioned allowances. With recently auctioned allowances selling at the price floor, this suggests that the number of MDI allowances would equal that of unsold allowances in future CARB C&I auctions. Unsold allowances, valued at the price floor, imply a loss in auction revenue and thus funds available for the GGRF and CCC.

To quantify this fiscal impact, we assume that additional MDI allowances would be distributed at the pace of the annual difference between the cap in the current regulation (blue line in the figure) and the cap in the January 2026 Proposed Amendments (orange line in the figure). We also assume that the macroeconomic conditions that place current allowance prices at the price floor would continue through 2030.[3]

To illustrate the range of potential outcomes, we evaluated several different MDI usage scenarios. If the entirety of the 118 million MDI allowances were released between 2027-2030 (the gray area in the figure), there would be a $4 billion loss in auction revenue over 2027-2030. For comparison, total auction revenue was $5.8 billion in FY 2024-2025, with $3.4 billion going to the GGRF and $2.4 billion to the CCC. **If this baseline revenue and spending share were unchanged during the 2027-2030 period, a fully utilized MDI would lower GGRF funds by $2.3 billion and CCC funds by $1.7 billion—a 17% reduction for each.**



Actual fiscal impact will depend on the rate of program adoption. The extent to which MDI allowances will be used is uncertain, and depends on macroeconomic conditions and on how the program is implemented. Total 2027-2030 auction revenue would fall by $1 billion, $2 billion, and $3 billion respectively if 25%, 50%, or 75% of the 118 million MDI allowances were used between 2027-2030.

One can look to recent California industrial emissions changes to understand potential future MDI usage. Between 2022-2023, industrial greenhouse gas emissions fell by 3.4 million tons. That emissions drop, if continued in 2026-2027 and granted MDI allowances, would be consistent with a 25% MDI usage scenario (dashed line in the figure). This estimate is based on existing GHG trends and thus is likely an underestimate as clean energy adoption should accelerate under the MDI.

Finally, the MDI is likely to push allowance prices, as reflected in the secondary market, below the price floor. This is because MDI allowances can be sold in the secondary market, outside the price floor maintained in CARB auctions.

[1] Associate Professor of Economics, UC Santa Barbara
[2] Data Scientist, UC Santa Barbara
[3] The 2026 price floor is $27.94 and is prescribed to increase annually by 5% plus the rate of inflation. We assume a constant 2% annual inflation.

Based at the University of California, Santa Barbara, the Environmental Markets Lab (emLab) conducts cutting-edge, data-driven research to align environmental objectives with economic incentives. Through collaborative innovation, we design, test, and implement scalable solutions that support both sustainable livelihoods and a resilient planet. Learn more here: www.emlab.ucsb.edu