Clean & Prosperous INSTITUTE

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RE: Comments on Report to Legislature: No-cost Allowances for Emissions-Intensive Trade-Exposed Industries (EITEs)

Background

In passing the Climate Commitment Act (CCA), the Washington state Legislature requires the Department of Ecology to prepare a report by the end of this year that:

> "describes alternative methods for determining the amount and a schedule of allowances to be provided to facilities owned or operated by each covered entity designated as an emissions-intensive, trade-exposed facility from January 1, 2035, through January 1, 2050. The report must include a review of global best practices in ensuring against emissions leakage and economic harm to businesses in carbon pricing programs and describe alternative methods of emissions performance benchmarking and mass-based allocation of no-cost allowances."

Ecology has indicated that this report will provide information and recommendations on how best to proceed regarding:

- Best practices for avoiding leakage (when EITEs relocate or limit their operations).
- Different approaches for measuring the emissions generated by EITEs per unit of production.
- Opportunities and barriers for decarbonizing EITEs in Washington.
- How to allocate no cost allowance to EITEs from 2035-2050.
- Implications for environmental justice outcomes, local air quality, statewide emissions limits, and revenues generated by cap-and-invest auctions.

CPI Comments

Through six draft documents and public meetings with Policy and Industrial Advisory Groups, Ecology has developed a detailed and informative index for the Legislature. Clean & Prosperous Institute (CPI) appreciates the depth of options and the policy considerations that have been defined for emphasis, including:

A. Establishing a level playing field for EITEs producing within the jurisdiction vis-à-vis competitors in jurisdictions without comparable carbon pricing policies.
B. Identifying and targeting assistance to industrial sectors that are most at risk of leakage.
C. Maintaining incentives for EITEs to invest in decarbonizing their operations and reward efficient production within the jurisdiction.
D. Aligning with the overarching goal of carbon pricing programs: To reduce emissions in line with jurisdictional (and global) emission reductions targets.

There are two draft recommendations in particular which provide specific and actionable information to the Legislature. These are *Draft Recommendation 3.2* concerning the option of using consignment of EITE allowances and *Draft Recommendation 4.1* concerning the use of cap adjustment factor to align EITE allowance allocations program budgets. Many of the other recommendations are insightful, but involve a more open-ended continued period of study and analysis of a wider array of options.

In this regard, we find a recent report from RMI, *Opportunities for Industrial Modernization in Washington*, to provide a useful template for recommendations.[1] It is particularly helpful to see a distilled set of recommendations in the RMI report, including seven recommended policy approaches for determining allocation of no-cost allowances ranked from "Least Favored" to "Most Favored", and 18 complementary policies characterized as either "Essential," "Recommended," or "Worth Considering."

There are three key concepts we would like to see clearly communicated and elevated in the report to the Legislature:

- Recognition of the long on-ramp (three compliance periods) of near baseline no-cost allowances, including the value of those allowances, as well as available incentives that position EITE entities to better avoid leakage and deploy lower emissions technologies and processes by 2035. The RMI scenario modeling indicates the potential for 39 percent emissions reductions for EITEs at

[1] https://rmi.org/insight/opportunities-for-industrial-modernization-in-washington/

cumulative costs of $2.94 billion compared to a market-value of no-cost allowances awarded to EITEs of at least $5.4 billion from 2023 to 2034. It would be useful to include discussion of the comparative obligations and market value of allowances afforded in California and Québec, jurisdictions the state intends to pursue a linkage agreement with. Pending reauthorization and extension of California's program, there are inherent benefits to seeking greater policy alignment across jurisdictions.

- The importance of clear market rules and the role of program revenue and free allocation to motivate investment in decarbonization. Evidence of continued capital investment in facilities is a signal of intent to compete and stay in Washington, inherently mitigating leakage risks. To this end, post-2034 allowances should not penalize early action to reduce emissions in the first three compliance periods (*e.g.* by resetting the baseline to a later time period than 2015-19 thereby lowering no-cost allocations for entities that have reduced emissions below their no-cost allocation). The Legislature taking timely action to clarify the post-2035 program rules sends clear market signals to reinforce capital investment decisions that are considered over a multi-decade time horizon.

- The critical importance of clean energy availability and siting for deep, cost-effective emissions reductions from EITEs - a point raised in the RMI *Opportunities for Industrial Modernization in Washington* report. We recently submitted comments on the Clean Energy Siting Annual Report, and those challenges are relevant to EITE emissions reduction opportunities. The RMI report outlines the growth in power demand from sector-specific technical pathways it evaluates to be 35 percent above baseline power consumption by 2030 and 65 percent by 2050. Given other demand drivers and the clean power shares required by the Clean Energy Transformation Act, this presents a significant hurdle for opportunities to reduce EITE emissions. Further, the state should monitor “new large load” policies being adopted by utilities that could substantially raise the cost and feasibility of timely electrification.

In considering the prioritization of draft recommendations, CPI suggests a focus on:

- **Draft Recommendation 3.2**: Ecology should assess the implementation requirements and impacts of using consignment to require EITEs to invest some of the value of their no-cost allowances in decarbonization projects.

- **Draft Recommendation 4.1**: Ecology should assess the policy design requirements and impacts of implementing a cap adjustment factor to ensure EITE allowance allocation aligns with program allowance budgets and net-zero emissions limits.

While CPI is supportive of the following recommendations, we believe they are likely already captured or required by existing law and administrative code:

- **Draft Recommendation 1.1**: The Legislature should maintain Ecology's authorization to provide no-cost allowances to EITEs from 2035 onwards provided it aligns with program objectives, allowance budgets, and emissions limits.
- **Draft Recommendation 1.2:** Ecology should monitor developments in carbon pricing policies in key jurisdictions and relevant federal policies as part of periodic program evaluations, including developments in carbon border adjustment mechanisms or alternative policies to address leakage risk.

CPI believes the following is consistent with the work that the Legislature has requested Ecology to report on. To that end, we recommend that Ecology continue the work within these recommendations:

- **Draft Recommendation 2.1**: Ecology should develop an objective approach for assessing leakage risk for EITEs in Washington and assess the impacts of implementing an assistance factor that targets allowance allocation based on this objective approach.
- **Draft Recommendation 3.1**: Ecology should assess the implementation requirements and impacts of adopting product-based benchmarks or alternative methods for establishing allocation baselines for EITE allowance allocation.
- **Draft Recommendation 4.2:** Ecology should assess at least one alternative policy option that would achieve a similar outcome as a cap adjustment factor.
- **Draft Recommendation 5.1**: Ecology should assess the environmental justice and economic impacts of the proposed policy options in Draft Recommendations 1.1, 1.2, 2.1, 2.2, 3.1, 3.2, 4.1 and 4.2 and interactions with existing CCA policies.

From the RMI, report CPI supports advancing policies deemed as *Essential*: (1) Expedite electrical grid enhancements for industrial electrification, and; (2) Accelerate permitting procedures for critical decarbonization projects. CPI also supports three of the policies deemed as *Recommended*: (1) Consign EITE no-cost allowances at auction, (2) Increase funding for the Hard-to-Decarbonize Sector Grants Program, and (3) Set up an industrially focused green bank.