WESTERN CLIMATE ADVOCATES NETWORK

August 28, 2009

Thank you for considering these comments submitted by the Western Climate Advocates Network (WeCAN) Cap Setting and Allowance Distribution Committee* on behalf of WeCAN – a network of environmental and public interest organizations around the Western U.S. and Canada working to advance critical issues related to the Western Climate Initiative (WCI). WeCAN appreciates the opportunity to respond to the WCI Draft Statement of Principles and Review of Proposed Options for Addressing Industrial Competitiveness Impacts.

WeCAN appreciates the work that the WCI Partners have done on the issue of competitiveness and the opportunity to comment. While progress has been made, we find significant room for improvement. The input we offered in response to the stakeholder questions for discussion appears to have been ignored. Our submission first acknowledged that the potential for job and emission leakage due to competitiveness effects deserves serious consideration. Then we made our central point: over compensation for competitiveness concerns can also be a problem. This has been a critical lesson in the European Union's real world experience with cap and trade. To the extent possible, the WCI should capitalize on the availability of empirical data and lessons learned in order avoid the mistakes that others have made.

Toward this end, we ask for the addition of a fourth principle to those included in your *Draft Statement of Principles*:

WCI Partners will:

- Minimize leakage…
- Address transitional challenges…
- Consider a harmonized approach…
- *"Avoid overcompensation and over-identification of who qualifies in response to competitiveness concerns, recognizing that allowances are a valuable public asset, that unjustified or excessive free allowance allocation can create windfall profits, and that subsidies for high emitting industries have opportunity costs in the form of lost investments to advance clean energy development, the smooth transitioning of workers, and consumer protection."*

The new non-partisan research report *Climate Policy and Industrial Competitiveness: Ten Insights from Europe on the Emission Trading System*[1] is a crucial piece of work on this topic.

An important dynamic at work will be the incentive for entities regulated under cap and trade to inflate competitiveness challenges in an effort to receive a great number of valuable allowances. The added principle is intended to signal that WCI decision makers will be on guard against inflated claims and aggressive lobbying. The report *Climate Policy and Industrial Competitiveness* includes this recommendation amongst its key lessons learned: "Resist inevitable pressures from industry to maximize free allocation, but engage companies more constructively in designing and understanding the full implications of the system," p. 4.

A somewhat more technical but related point is that competitiveness assessments should be done at the most fine grained level of analysis possible in order to most accurately evaluate energy costs and trade exposure and to avoid overcompensation. For example, steel is different than primary aluminum production which is different from secondary aluminum smelting which is not copper. A limitation of the *Review of Proposed Options for Addressing Industrial Competitiveness* is that the advantages and disadvantages of the different approaches are not discussed. These considerations should have an empirical grounding to the greatest extent possible. To consider the EU's approach starting in 2013 (i.e. Phase 3), while ignoring experience from Phases 1 and 2 is an unnecessarily myopic choice that we hope will be remedied going forward.

Some of the key findings of *Climate Policy and Industrial Competitiveness:*

- "Despite initially opposing the EU ETS, all participating industrial sectors in Europe have in aggregate profited from its operation to date, perhaps excessively," p.4.
- "Industrial competitiveness impacts are limited to a small number of industry sectors… Most sectors can accommodate carbon costs without significant impacts to their profits, sales, or competitiveness," p.4.

[1] Michael Grubb, Thomas Brewer, Misato Sato, Robert Heilmayr, Dora Fazekas, 2009, "Climate Policy and Industrial Competitiveness: Ten Insights from Europe on the Emission Trading System," Climate & Energy Paper Series 09: German Marshall Fund of the United States.

- "Free allocation introduces risks of windfall profits… Some economic inefficiencies can be avoided by basing allocations on historical data or benchmarks, but this can generate windfall profits and may not prevent international leakage," p.4.
- "There is a compelling economic rationale to maximize auctioning," p.5.
- "International trade effects are immaterial for most sectors. Except in a few cases, therefore, carbon cost impacts will have very little impact on international trade. Carbon costs for other activities would be very small compared to differences in international labor, energy, and other input costs… In most sectors, multiple impediments to greater trade mean that some carbon costs may be passed through. For example, the cost of producing industrial gases is sensitive to carbon prices, but transport cost and safety considerations impede import substitution. Flat glass is similarly not cheap to transport. A given company may produce specialized products not matched by foreign competition or have local networks that favor local production. The availability or composition of local raw materials is also an important driver for production and trade patterns (e.g., scrap metal for electric arc furnace steel and barley for malt)," p. 22

Thank you for considering WeCAN's comments.

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