Determining industrial policy for the Cap-and-Invest Program 2035-2050

Background

Washington's Cap-and-Invest Program is the centerpiece of the state's climate strategy. To ensure its continued success, the Legislature must address how the program treats about 40 industrial facilities known as "emissions-intensive, trade-exposed industries" or EITEs (Chapter 70A.65.110 RCW).

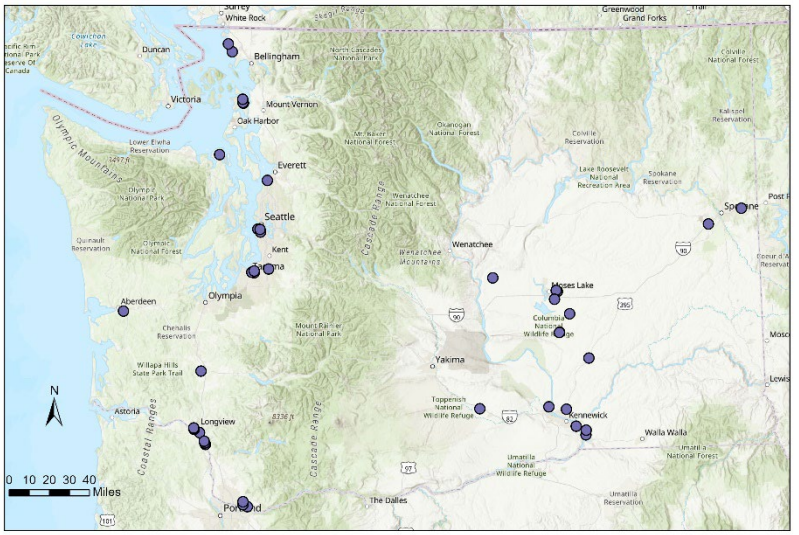


Figure 1. Map of 40 EITE locations across Washington

EITEs produce products ranging from paper and food to transportation fuels, building materials, glass, and airplanes. These facilities require lots of energy (emissions-intensive) and face unique barriers to decarbonize. They're also exposed to more out-of-state competition (trade-exposed), so added costs may lead EITEs to shift production somewhere with less stringent climate regulations. This is known as "leakage."

To enable EITEs to plan for and invest in emissions reductions and reduce the risk of leakage, the Legislature provided EITEs with most of the emissions allowances they need at no cost through 2034 and expresses intent to reevaluate a long-term EITE policy. Unless the statue is changed, EITEs will continue receiving the same amount of no-cost allowances through 2050. **This would prevent us from meeting our state's greenhouse gas limits because the number of projected no-cost allowances that go to EITEs would exceed the annual allowance budget by the late 2030s or early 2040s, leaving no allowances available for other businesses and eliminating state revenue.**

Pursuant to Chapter 70A.65.110 RCW, Ecology prepared a report to the Legislature to inform the decision-making process.

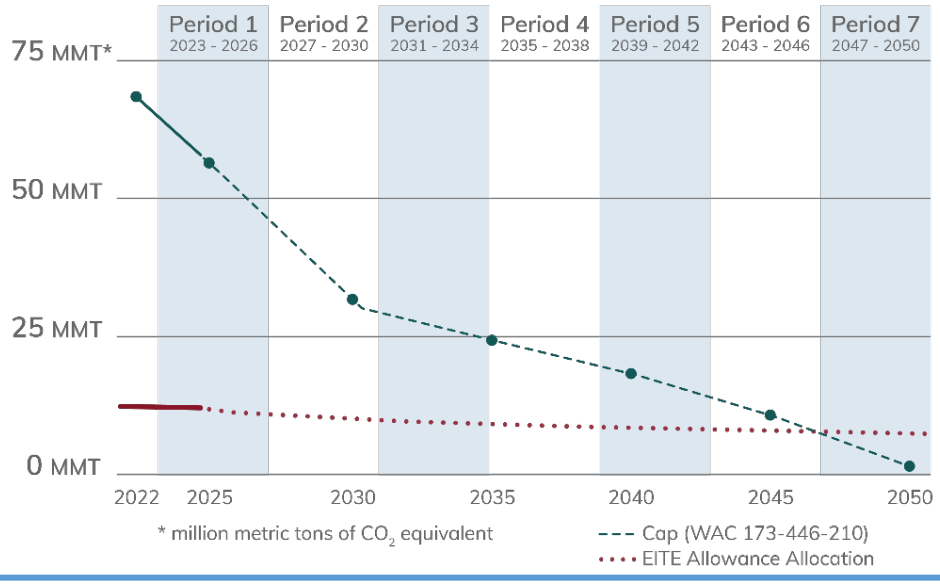


Figure 2. Projected EITE allowance allocation for 2025-2049 under the current policy

Report overview and recommendations

Ecology consulted EITE representatives, Cap-and-Invest market participants, Tribes, environmental justice and other advocacy organizations, and individual community members through two advisory groups and other forums.

Based on this feedback and analysis of the best practices available for protecting against leakage, we recommend the Legislature:

1. Continue no-cost allowance allocation to EITEs after 2034 while ensuring we meet our state's greenhouse gas limits. Ecology recommends EITE no-cost allocation for 2035-2050 is aligned with the emissions cap using a cap adjustment factor or equivalent policy—a common practice in other carbon markets. We also recommend requiring EITEs to sell some of their no-cost allowances at auction and invest the money in decarbonization projects.
2. Consider additional changes to optimize EITE no-cost allocation: Ecology identified a list of other policy options that could help address leakage risk and incentivize decarbonization. Some examples include targeting no-cost allocation toward the most trade-exposed EITEs or updating how emissions baselines for EITEs are calculated. We recommend considering these changes once policies addressing cap alignment and consignment are in place.
3. Consider local environmental justice and economic impacts of EITE policies. EITEs are important to Washington's economy—they provide local jobs and tax revenue. There are also concerns about how they may be contributing to local air pollution in nearby communities. We conducted a preliminary analysis of these issues and recommend several areas for further evaluation.
4. Consider other complementary measures to advance decarbonization by EITEs. EITEs can decarbonize through several common pathways, including energy efficiency, electrification, low carbon fuels, and carbon capture. However, EITEs face barriers such as high up-front capital costs, permitting challenges, and access to stable and affordable clean electricity, that cannot be addressed directly through the Cap-and-Invest Program. We recommend the Legislature consider complementary measures to support decarbonization by EITEs, such as accelerated permitting for critical decarbonization projects, new funding opportunities, electrical grid enhancements and other policy options included in the Comprehensive Climate Action Plan.

More information on our recommendations is available in Section 10 of the report.

Next Steps

Ecology recommends the Legislature prioritize updating EITE no-cost allocation for 2035-2050 to align with the emissions cap and adopting a consignment policy for EITEs. This would provide certainty for EITEs and help ensure the program achieves its long-term decarbonization objectives.

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