Competitiveness and Climate Policy: Avoiding Leakage of Jobs and Emissions

ORAL TESTIMONY

The Energy and Environment Subcommittee

Energy and Commerce Committee

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Mr. Chairman, Mr. Upton, members of the subcommittee, thank you for the opportunity to testify. My name is Eileen Claussen, and I am the President of the Pew Center on Global Climate Change.

Addressing global climate change presents policy challenges at both the domestic and the international levels, and the issue of competitiveness underscores the very close nexus between the two. In the long term, a strong multilateral framework ensuring that all major economies contribute their fair share to the global climate effort is the most effective means of addressing competitiveness concerns. In designing a domestic climate program, the question before Congress is what to do in the interim – until an effective global agreement is in place.

A first step in addressing competitiveness is assessing the potential scope and magnitude of potential impacts. Our focus must be on energy-intensive industries whose goods are traded globally, such as steel, aluminum, cement, paper, glass, and chemicals. As heavy users of energy, these industries will face higher costs as a result of domestic GHG constraints; however, as the prices of their goods are set globally, their ability to pass along these price increases is limited.

To empirically quantify the potential magnitude of this competitiveness impact, the Pew Center commissioned an analysis by economists at Resources for the Future. This work, which we will be publishing shortly, analyzes 20 years of data in order to discern the historical relationship between electricity prices and production, consumption, and employment in more than 400 U.S. manufacturing industries. Our analysis found that, at the price level studied, the projected competitiveness impacts, as well as the broader economic effects on energy-intensive industries, would be modest but not insignificant, and, in our view, readily managed with a range of policy instruments.

In a domestic cap-and-trade system, competitiveness concerns can be addressed in part through banking and borrowing and the use of offsets, which can help reduce the costs to all firms. However, other transitional policies may be needed to directly address competitiveness concerns for energy intensive industries in the period preceding the establishment of an effective international framework. Allow me to mention a couple of options we would not recommend, and then a few that we would.

One option is to exclude vulnerable sectors from coverage under the cap-and-trade program. Exclusions, however, would undermine the goal of reducing GHG emissions economy-wide, and reduce the economic efficiency of a national GHG reduction program. They also would give exempted industries an economic advantage over nonexempt competitors, and provide no incentive for improved performance.

A second option is to try to equalize GHG-related costs for U.S. and foreign producers by imposing a cost or other requirement on energy-intensive imports from countries with weaker or no GHG constraints. Such measures, however, would apply only to imports to the United States, and would not help "level the playing field" in the larger global market, which is where U.S. manufacturers compete. In addition, if the United States were to impose border requirements, there is a greater likelihood that it would become the target of similar measures. There is a significant risk that border adjustments would engender more conflict than cooperation, in the end making it more difficult to reach agreements that could more effectively address competitiveness concerns.

The Pew Center instead believes that Congress should seek to address competitiveness concerns by: 1) strongly encouraging the executive branch to negotiate a new multilateral climate agreement establishing strong, equitable, and verifiable commitments by all major economies; 2) including in domestic legislation incentives for such an agreement, including support for stronger action by major developing countries; and 3) including in cap-and-trade legislation transitional measures to cushion the impact

of mandatory GHG limits on energy-intensive trade-exposed industries and the workers and communities they support. These transitional measures should be structured as follows:

- In the initial phase of a cap-and-trade program, free allowances should be granted to vulnerable industries to compensate them for the costs of GHG regulation. For direct costs, allocations should be based on actual production levels. For indirect costs, allowances should reflect an emitter's production-based energy consumption, taking into account the GHG intensity of its energy supplies.
- Allocations should be set initially so a producer whose emissions intensity is average for that sector is fully compensated for regulatory costs, while those who are above or below average receive allowances whose value is greater or less than the their costs, respectively. This factor should be adjusted over time as an incentive to producers to continually improve their performance. This is similar to the approach proposed by Congressmen Inslee and Doyle.
- Allowance levels should decline over time, gradually transitioning to full auctioning, although at a slower rate than for other sectors.
- A review should be conducted periodically to assess whether sectors are experiencing competitiveness impacts and, if warranted, to adjust allowance levels or the rate of transition to full auctioning.

- A portion of allowance auction revenue should be earmarked for programs to assist workers and communities in cases where GHG constraints are demonstrated to have caused dislocation.
- Transition assistance should be curtailed for a given sector upon entry into force of a multilateral or sectoral agreement establishing reasonable obligations for foreign producers, or upon a Presidential determination that such measures have been instituted domestically.

We believe this approach addresses the transitional competitiveness concerns likely to arise under a mandatory cap-and-trade program, while maintaining the environmental integrity of the program and providing an ongoing incentive for producers to improve their GHG performance.

I thank you for your attention and would be happy to answer your questions.