



Summary of Provisions to Protect the Competitiveness of U.S. Industry in the American Clean Energy and Security Act

Center for Clean Air Policy



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What are the Main Goals of the ACES Competitiveness Provisions?

The competitiveness provisions of the American Clean Energy and Security Act seek to:

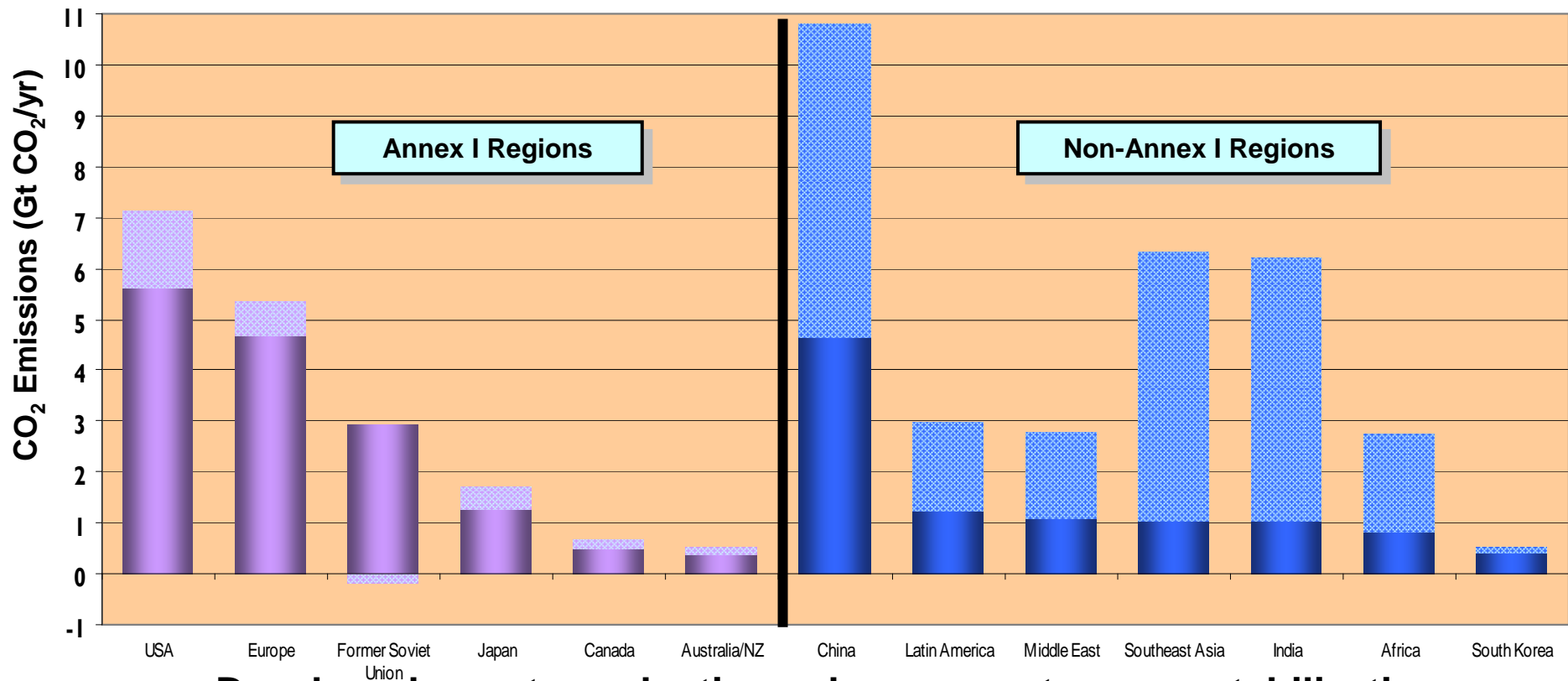
- **Help achieve an international agreement.**
- **Promote developing country action.**
- **Prevent leakage of emissions and jobs to developing countries by leveling the carbon cost playing field for US industry.**
- **Ensure World Trade Organization (WTO) compliance.**

What Solutions Would Address Competitiveness?

- 1st best -- A global climate agreement with developed and developing countries taking similar, meaningful action to reduce emissions.
- 2nd best – Protect energy intensive-trade sensitive U.S. industry until developing countries take action.

Without Developing Country Actions, Emissions Growth Remains Substantial

CO₂ Emissions by Region - 2000 (solid color) & 2050 (shaded color)



Developed country reductions alone cannot ensure stabilization.



¹ Includes Fossil and other industrial CO₂.

Source: U.S. Climate Change Science Program. 2007. *Scenarios of Greenhouse Gas Emissions and Atmospheric Concentrations* (MINICAM Results).

What Mechanisms Does ACES Use to Encourage a Global Agreement & Increase Developing Country Actions?

- A significant and binding U.S. national emissions reduction target.
 - » The U.S. target need not be exactly the same as other developed country targets as there are different metrics of “comparability” and different national circumstances.
- Sufficient amounts of international financing-- including financing for technologies, reduced deforestation and international adaptation--to support strong developing country actions.
 - » Measurable, reportable and verifiable international financing is our main leverage to raise the bar on developing country performance.

Why is Financing So Critical?

- Developed and Developing Countries agreed to the Bali Action Plan in Dec 2007.
 - » Developing countries agreed for the 1st time to “Measurable, reportable and verifiable nationally appropriate mitigation commitments ... including quantified emission limitation and reduction objectives.”
 - » In exchange, developed countries agreed to support and enabled those efforts with technology, financing and capacity-building in a “measurable, reportable and verifiable manner.”

What Emissions Targets Does ACES Set?

- 2020
 - » 17% below 2005 from capped sectors
 - » 20% below 2005 economy-wide
- 2030
 - » 42% below 2005 levels
- 2050
 - » 83% below 2005 levels
- An additional 10% reduction in 2020 from using allowance value to reduce deforestation.
- Additional reductions from discounting of international offsets beginning in 2018.

What International Financing Does ACES provide?

- Establishes a Clean Technology program to provide financing and capacity building assistance.
 - » 1% of allowance value set aside; grows to 4% in 2027.
- Establishes an international adaptation fund.
 - » 1% of allowance value set aside; grows to 4% in 2027.
- Establishes a program for the purchase of emissions reductions from avoided deforestation equal to 10 percent of 2005 levels in 2020.
 - » 5 percent of allowance value set aside; begins declining in 2026, reaches 2% in 2031.

Concern: Leakage of Emissions and Jobs Until Developing Country Action

- **Timing:** U.S. proposed actions begins in 2012, with most trade sensitive industries covered in 2014. Developing country actions may take longer to design and implement.
- **Cost:** In the short-run, U.S. industries will pay a price for GHG emissions, whereas developing country industries may pay just for emissions reductions.
- Policies are needed to address competitiveness and leakage concerns until developing countries take significant action.

What Mechanisms are Used to Prevent Emissions and Jobs Leakage?

Two Integrated Provisions:

- ***Allowance Rebate Program:*** Temporary rebates (guaranteed through 2025 & phased out by 2035*) for energy-intensive, trade-exposed industries on an output basis.
- ***International Reserve Allowance Program:*** Border adjustment measures (border taxes) starting in 2020 on imports if international negotiations and actions are not sufficient and allowance rebates do not fully compensate affected industries.



*Unless the phase-out schedule is modified by the President as required under the Act.

What are the Advantages of this Architecture?

- The main advance of this bill is in how it integrates the rebate and border tax provisions.
 - » The rebate is the main “workhorse” in compensating costs while the border tax provides a backstop to rebate any uncompensated costs against countries that fail to act.
- Compensation via the rebate is provided on an “output basis,” encouraging efficiency improvements rather than locking in historic emission levels.
- The border tax—a more contentious provision with our trade partners—is implemented later and in a targeted manner. Further, the border tax is phased out immediately when no longer needed.

How Much Compensation is Given via the Rebate Program?

- Up to 15% of allowance value in 2014-2015, up to 13.4% in 2016-2025 is allocated to industrial sectors that are energy (or carbon) intensive and internationally competitive.
 - Provision seeks to fully compensate the direct and indirect costs of GHG regulation between 2012-2025 via output-based rebates.
 - Compensation to a given industry sector is based on 100% of the sector average costs and is distributed on an emissions per unit output basis.
 - Rebates may be reduced on a pro rata basis if the total calculated rebate amount exceeds the available allowance value.
- NOTE: Industrial customers will also receive a pass-through of allowance value from electricity providers through local distribution companies (LDCs), at least partly compensating for their higher electricity costs.

Will Energy/Trade Intensive Industries Receive Enough Compensation? (1)

- Energy/trade intensive industries receive rebates for most or all of the cost of their direct and indirect GHG emissions between 2014-2025.
- In 2014-2015, up to 15% of allowances are given for free.
 - » EPA finds that 14.5% of allowances are needed to fully compensate direct and indirect costs.
 - The 15% allocation provides 103% of the needed compensation.
 - » McMackin finds 16.2% of allowances are needed to fully compensate direct and indirect costs.
 - The 15% allocation provides 92% of the needed compensation.
- Based on the EPA and McMackin analyses, the 13.4% allocation in 2016-2025 compensates 92% and 82% of the industry's direct and indirect costs.

Sources:

- EPA, Comparison of FTI and EPA analyses of H.R. 2454 Title IV, Memorandum to House Energy & Commerce Committee Staff, June 10, 2009.

- FTI, Greenhouse Gas Emissions Legislation Leakage-Exposed Manufacturers, Briefing Book 10, June 2009. (This analysis was commissioned by the Energy-Intensive

Manufacturers' Working Group on Greenhouse Gas Regulation, represented by Jack McMackin.)

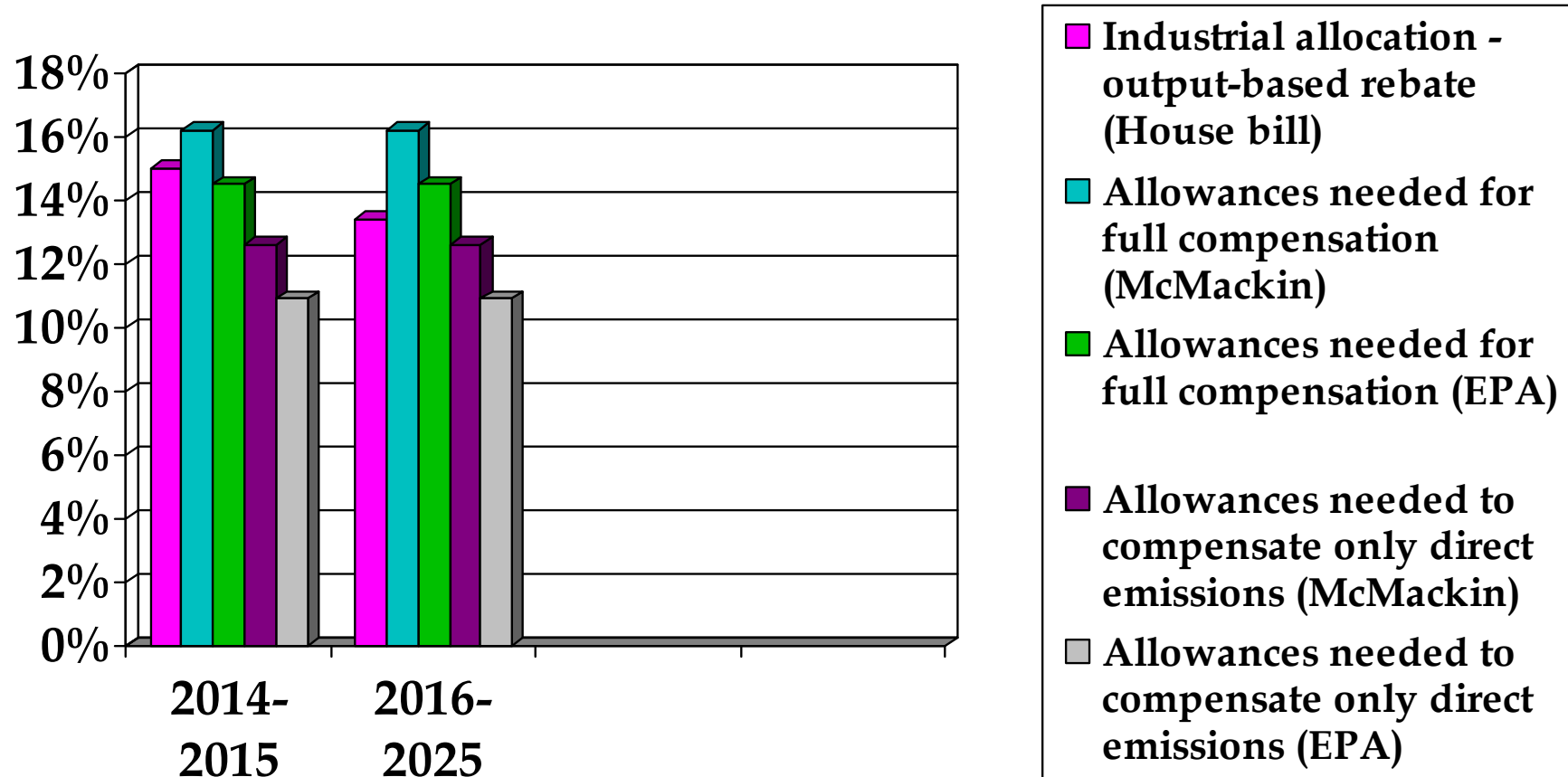


Will Energy/Trade Intensive Industries Receive Enough Compensation? (2)

- Energy/trade intensive industries receive additional compensation for their indirect emissions from electricity purchases via a required pass through of allowance value from their electricity providers (LDCs).
 - » EPA estimates that energy/trade intensive industries will need 3.6% of the total available allowance value to compensate for their indirect emissions costs.
 - » **If** industry receives 3.6% of the allowance value as a pass-through from LDCs, the output-based rebates would only need to compensate direct emissions, amounting to 10.9% (EPA) and 12.6% (McMackin) of the total allowance value.
 - » Allocations to energy/trade intensive industries in 2016-2025 is more than enough to fully compensate direct emissions.
- Starting in 2020, the border tax provides an additional backstop to level the playing field in case the rebates are insufficient.

Will Energy/Trade Intensive Industries Receive Enough Compensation? (3)

A. It depends on the size of the LDC pass through.



Sources:

- EPA, Comparison of FTI and EPA analyses of H.R. 2454 Title IV, Memorandum to House Energy & Commerce Committee Staff, June 10, 2009.
- FTI, Greenhouse Gas Emissions Legislation Leakage-Exposed Manufacturers, Briefing Book 10, June 2009. (This analysis was commissioned by the Energy-Intensive Manufacturers' Working Group on Greenhouse Gas Regulation, represented by Jack McMackin.)

Which Sectors are Eligible for the Output-Based Rebate?

- To be presumptively eligible, sectors must be in a six-digit NAICS classification that has either:
 - » an energy/GHG intensity of 5% or more AND a trade intensity of 15% or more, OR
 - » an energy/GHG intensity of 20% or more.
- Approximately 45 sectors would qualify now.
- Petroleum refining is excluded from the rebate program and addressed separately.
- Additional sectors may be added administratively based on subsectors meeting the above criteria and/or updates of trade intensity data.
- Rebates end if the sector no longer meets the eligibility criteria.

How Long do the Rebates Last for Qualifying Sectors?

- Output-based rebates are guaranteed at 100% of the sector average thru 2025.
- Starting in 2026, the rebate amount is automatically reduced by 10% per year from the 2025 rebate level.
- The automatic phase-out can be slowed or stopped if 85% or less of U.S. imports of the imported product come from countries that fail to demonstrate **climate action**.
- If the phase-out is slowed or stopped, it resumes if and when more than 85% of imports come from countries demonstrating climate action.
- The phase-out cannot begin early or be sped up in the event of international action, raising WTO compliance concerns.

What Constitutes Sufficient Climate Action for Other Nations?

A country meeting one or more of the following criteria qualifies as having taken sufficient action:

- 1) The country is party to an international agreement that includes a nationally enforceable GHG reduction commitment at least as stringent as that of the US;
- 2) The country has a multilateral or bilateral sectoral emission reduction agreement with the US; or
- 3) The country has an annual energy or GHG intensity for the sector that is equal to or less than the energy or GHG intensity for that sector in the US.

Note: These action criteria are consistent with the emerging international framework for developed and developing country actions.

International Reserve Allowance Program

- A required purchase of an international reserve allowance (border tax) program is established for **imports of primary products** that receive free allowances under the output-based rebate starting in 2020, unless an international agreement is in place that meets the “negotiating objectives”.
- A border tax may also be applied to imports of “covered goods” which are products that are **downstream** from sectors receiving output-based rebates.

What Negotiating Objectives Must be Met to Prevent the Border Tax?

The bill establishes negotiating objectives for the U.S. They include:

- » reaching an **internationally binding** agreement in which all major GHG-emitting countries contribute equitably to reducing GHG emissions
- » requiring **provisions that recognize and address the competitive imbalances** that lead to carbon leakage *between* parties and non-parties
- » **not preventing parties from addressing competitive imbalances** that lead to carbon leakage and that may be created in the agreement *among* parties to the agreement
- » Including **agreed remedies** for parties that fail to meet its GHG reduction obligations.

Which Sectors are Subject to the Border Tax?

- Imports from sectors where the equivalent U.S. sector is eligible for the output based rebate, unless one of the following applies:
 - » The President decides it is not in the economic or environmental interest of the US to impose the tax in a given sector **and** the decision is supported by a joint resolution in congress; or
 - » More than 85% of US imports from the sector come from countries meeting the action standards.

Which Countries are Subject to the Purchase Requirements?

- A country is excluded from the purchase requirement for a given sector if one of the following apply:
 - » The country meets one of the action standards;
 - » The UN has identified the country as one of the least developed; and/or
 - » The country is responsible for less than 0.5% of global emissions in the most recent year **and** less than 5% of US imports in that sector.

Timeline: Application of Output Based Rebates & International Reserve Allowances (border tax)

H.R. 2454 – American Clean Energy and Security Act as passed in US House of Representatives

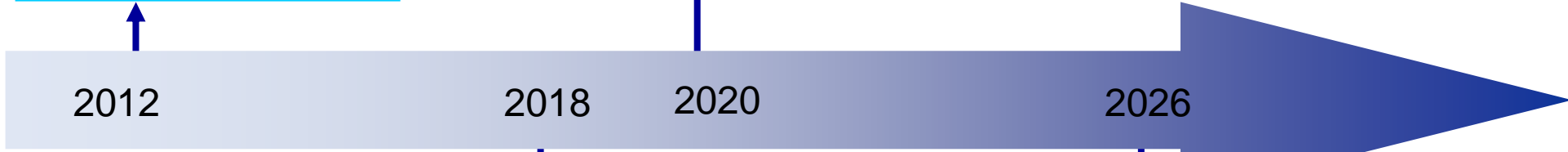
Action Standards: (1) The country is party to an international agreement with the US with a nationally enforceable GHG reduction commitment at least as stringent as that of the US; (2) The country is party to a multilateral or bilateral sectoral agreement; or (3) The country has an annual energy or GHG intensity in the sector that is at least as good as that of the US.

Rebates to energy intensive/trade exposed industries are based on output and average sector emissions and apply if a US industry sector has...

- an energy or GHG intensity of at least 5% AND a trade intensity of at least 15%; OR
- an energy or GHG intensity of at least 20% (note that petroleum production is compensated in another section).

Presidential Determination:
Do >85% of US imports in sector come from countries meeting **action standards**?

Border tax applied to sectors/countries **not meeting action standards** unless President determines that border tax in sector is not in economic or environmental interest of the US **and** Congress agrees by a Joint Resolution. (Excludes least developed and small emitting countries).



Is there an internationally binding agreement that meets **negotiating objectives**?

yes

no

No border tax program, rebates continue

Border tax program must be implemented starting in 2020

Presidential Determination:
Do >85% of US imports in sector come from countries meeting **action standards**?

yes

no

Phase out of output-based rebates begins and compensation is reduced by 10% of base compensation rate each year.

President can delay phase-out or reduce phase-down factor to maintain protection of US industry.

Negotiating Objectives: (1) An internationally binding agreement exists in which all major GHG-emitting countries contribute equitably to reducing GHG emissions. (2) Agreement contains provisions that recognize and address the competitive imbalances that lead to carbon leakage between parties and non-parties. (3) Parties are not prevented from addressing competitive imbalances that lead to carbon leakage among parties. (4) Remedies are included for any party that fails to meet GHG reduction obligations.



When does International Reserve Allowance Purchase Requirements (Border Tax) Apply to Imports of Primary Products?

H.R. 2454 - American Clean Energy and Security Act as passed in US House of Representatives



Is there an internationally binding agreement that meets **negotiating objectives**?

Negotiating Objectives: (1) An internationally binding agreement exists in which all major GHG-emitting countries contribute equitably to reducing GHG emissions. (2) Agreement contains provisions that recognize and address the competitive imbalances that lead to carbon leakage between parties and non-parties. (3) Parties are not prevented from addressing competitive imbalances that lead to carbon leakage among parties. (4) Remedies are included for any party that fails to meet GHG reduction obligations.

yes

no

No BTA for all sectors

Presidential Determination: Do >85% of US imports in sector come from countries meeting **action standards**?

yes

no

No BTA in sector for all countries

Presidential Determination that BTA is not in economic or environmental interest of the US and Joint Resolution in Congress

Country is one of least developed

Country responsible for <0.5% of global emissions and <5% US imports in sector

Sector/country meets **action standards**?

Action Standards: (1) The country is party to an international agreement with the US with a nationally enforceable GHG reduction commitment at least as stringent as that of the US; (2) The country is party to a multilateral or bilateral sectoral agreement; or (3) The country has an annual energy or GHG intensity in the sector that is at least as good as that of the US.

yes

no

No BTA in sector for all countries

No BTA in country for all sectors

No BTA in sector for each country

No BTA in sector for each country

BTA applied in sector for each country

When are Downstream Products Covered by the Border Tax?

Downstream products may be covered by the border tax when the following conditions are met:

- The downstream product includes substantial amounts of primary product or similar goods produced by an eligible industrial sector covered by the rebate program.
- There is an international reserve allowance program in effect for the eligible industrial sector and the cost of the international reserve allowances is greater than 0.
- The sector producing the downstream product has a trade intensity of at least 15%.
- The producer of the downstream product demonstrates and the EPA Administrator determines that the international reserve allowance program is feasible and appropriate, considering the energy and greenhouse gas intensity of the industrial sector producing the product and ability to pass on cost increases.

Major Changes from Earlier Drafts of ACES

- Under earlier drafts, the border tax program was implemented no sooner than 2025 at the President's discretion. Under the House-passed bill, the border tax begins in 2020 by default unless certain conditions are met.
- Under earlier drafts, the output-based rebate phased out sooner and faster contingent on international action. Under the House-passed bill, the rebate cannot start to phase out prior to 2026.
 - » The international action trigger for phase out of free allowances was "70% of global output." Under the House-passed bill, the trigger is "85% of US imports" for not invoking or stopping the border tax.
- Under earlier drafts, only primary products were eligible for participation in the border agreement. Under the House-passed bill, downstream products were added.

Major Differences Between ACES and Lieberman-Warner

- Lieberman-Warner provided free allowances to energy-intensive firms (less than under ACES), but not in the form of an output-based rebate.
- Under Lieberman-Warner, proceeds from the sale of international reserve allowances are used to mitigate the adverse impacts of climate change on disadvantaged communities in other countries. ACES is silent on the use of these proceeds.
- Lieberman-Warner allowed countries subject to the border tax to submit foreign allowances or international offset credits in lieu of international reserve allowances. ACES does not.

Observations

- Energy and trade-intensive industries could be fully compensated with the combination of free allowances and pass-throughs from electricity providers.
- The current border tax provision provides an additional backstop, but by beginning automatically in 2020, it may create an inhospitable climate for international trade and climate negotiations.
 - » A border tax is best used as a last resort against a few remaining countries that do not take national or sector-based actions.
- International actions are the best way to reduce or eliminate the need for both the border tax and rebate.
 - » While the border tax phases out immediately once the international action trigger is met, the rebate does not begin to phase out until 2026, raising WTO concerns about unfair subsidies to US industry.
- A border tax for downstream products would create substantial administrative and implementation costs and burdens because of challenges in tracking the production of imports.

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