STATE OF WASHINGTON
DEPARTMENT OF ECOLOGY
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July 1, 2022

Dear Senator Short:

Thank you for inquiring about the economic impacts of the draft rules for the cap-and-invest program, chapter 173-446 WAC. We appreciate your engagement as we work to implement the cap-and-invest program in a manner that will reduce greenhouse gas emissions and improve air quality in vulnerable communities, while protecting consumers, job growth, and the economy.

As you saw in our recent email notice to the leadership of the Senate Environment, Energy, and Technology Committee, Ecology published a report today that analyzes the cap-and-invest program. Vivid Economics modeled three different scenarios to determine the likely costs for businesses to buy allowances at auction: a market linked with other jurisdictions, a market with allowances "frontloaded" in the price containment reserve, and a market without linkage or frontloading. The Legislature has expressed clear intent for Washington's cap-and-invest program to link with other jurisdictions (see RCW 70a.65.060(3) and RCW 70a.65.210). Therefore, the auction price modeled in the linked scenario, estimated at $41 per metric ton in 2023, is the most credible and likely number to use as a forecasted price.

To answer your specific questions:

At this allowance price, what is the impact on the price of gasoline for consumers?

As you are aware, gasoline is a historically volatile commodity, the price of which is impacted by numerous global factors. National and global events that affect supply and demand – such as the pandemic, the invasion of Ukraine, price of crude oil, and decreased refinery production – play a dominant role in price fluctuations. Moreover, research shows state regulations play a very minor role by comparison.

Notwithstanding these factors, we used Vivid's economic analysis and projected cost impacts of the cap-and-trade program to estimate the impact on consumer gas prices. At an allowance price of $41 (the scenario with linkage) there would be about a 0.67 to 1.9 percent increase in fuel prices, while electricity would increase by about 1 percent and natural gas would decrease by about 1 percent. If the price of gas is around $5 per gallon as it is today, this would translate into an additional 5 cents per gallon in 2023. Our modeling shows that the impact to fuel prices would fall over time as our economy shifts toward low-carbon energy sources and businesses covered by the law switch to using banked allowances that they purchased at lower prices in prior years.

It is important to highlight that the cap-and-invest program authorized by the Climate Commitment Act (CCA) is designed to work with Washington's other greenhouse gas reduction policies. When we combine the cap-and-invest program with policies like the Clean Fuel Standard and the Zero Emission Vehicle standard, the impact of the policies offset each other, so the impact on fuel prices remains at a roughly one percent increase in 2023.

At this allowance price, how much state revenue will be generated in the auctions?

Since receiving the results of Vivid's economic analysis, we have not recalculated the amount of state revenue to be generated in the auctions for the most likely allowance price of $41. Our last estimate for projected state revenue from the CCA is reflected in Ecology's Fiscal Note for the CCA, available here. These estimates were based on auction data from California's market, which was the best data available at the time.

We understand that there has been speculation on the amount of revenue expected to be generated at auction. We caution against use of these estimates for two reasons:

- First, the expected revenue requires an analysis that is more complicated than simple multiplication. An updated estimate will need to consider factors such as the number of allowances released from the price containment reserve, the number of allowances consigned by natural gas and electric utilities, and the expectation of businesses banking allowances for future use.
- Second, the revenue estimates we have seen are based on an allowance price in a market not linked with other jurisdictions. Given the Legislature's direction that Ecology pursue linkage agreements with other jurisdictions, revenue estimates based on an unlinked market should not be relied upon for future revenue projections.

Given current uncertainty around these factors, considerable research and analysis will be necessary to develop a well-grounded revenue estimate.

We are planning to reanalyze anticipated auction revenues based upon the updated information from the Vivid report. We will keep you and others informed as we have that information available.

Did the agency account for inflation when it modeled this and other allowance prices?

No. All allowance prices estimated in the Vivid economic analysis and our Preliminary Regulatory Analyses are in real dollars. It is standard practice in economic analyses to present costs in real dollars to reflect the purchasing power of a dollar at any time.

Presenting prices in nominal dollars, which accounts for inflation, for future years is misleading and inappropriate. Presenting prices in nominal dollars does not reflect the purchasing power of a dollar in that year, and therefore distorts the meaning of the prices. Inflation impacts all prices of goods and services in the economy (including wages and revenues), meaning that the true value of the dollar, or purchasing power, changes. Therefore, presenting future allowance prices in nominal dollars may indicate the price one would pay in that future year, but our understanding of the true value of that price would be overstated.

Building a functional, transparent, and sustainable cap-and-invest program is essential for Washington's shared environmental future and for supporting a robust green economy in our state. We are concerned that any legislative proposals meant to delay, weaken, or eliminate the cap-and-invest program would perpetuate regulatory uncertainty and destabilize the marketplace, thereby making it more difficult for businesses to plan for the future and for the state to plan for investment of revenue. Notably, increased uncertainty over the cap-and-invest program, specifically around linkage with jurisdictions, could drive a significant increase in allowance prices.

I hope this information is helpful. If you have additional questions, or would like to discuss the issues further, we would be happy to meet with you.

Sincerely,

Kathy Taylor
Air Quality Program Manager