Testimony of

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Before the

Subcommittee on Energy and Environment
Committee on Energy and Commerce
U.S. House of Representatives

April 23, 2009

Good afternoon. On behalf of the 850,000 active members of the United Steelworkers (USW), I would like to thank Chairmen Waxman and Markey for holding this hearing on the issues facing America and the world as we attempt to address climate change and the need for clean energy. In particular, I would like to thank the chairmen and the committee for their leadership and hard work in crafting climate policy with the need to ensure U.S. competitiveness in mind. My name is Tom Conway, and I am the International Vice President of the United Steelworkers. Our members supply almost every sector of the economy, and produce a wide array of products, including paper, glass, ceramics, cement, chemicals, aluminum, rubber, and, of course, steel. They produce these energy-intensive products in facilities that are as efficient as any in the world. They are ready to lead the way in the development and production of the next generation of clean, environmentally-friendly products that will not only revitalize the American economy and reassert our leadership on the cutting edge of new technology, but will provide the long-term solution to the challenge of growing our economy while reducing emissions. Still, they can only answer that call if their jobs are not unnecessarily squandered to the law of unintended, but not unforeseen, consequences.

These unforeseen consequences are damaging enough when the economy is growing and strong, but during a long, slow recovery they can be devastating. A well-designed climate policy can augment and fuel the recovery, and ensure that the economy comes back stronger and cleaner than before. A poorly-designed climate policy, however, can create a disincentive to bring production back online in the United States, and achieve emissions reductions only at the cost of thousands or millions of American jobs.

The United Steelworkers have long been a leader in the labor movement on environmental issues. In 1990, we stated our union's environmental policy in "Our Children's World" which included our declaration of the need to address the issue of climate change, a declaration we reiterated in 2006. We were one of the first industrial unions to support comprehensive climate change legislation. USW is also a founding member of the Blue-Green Alliance, which brings together unions and environmental groups to plan a new way forward for America through the promotion of policy solutions that spur growth and investment in green technologies and products produced here in America.

We are as convinced today as we were in 1990 and 2006 that climate change is the most important environmental issue of our lifetime. It is the challenge of our time to transform the way this nation and the world operate in order to bring this problem under control before it is too late. Still, in undertaking the enormous and critical task of crafting comprehensive energy and climate legislation, Congress must ensure that the desired emissions reductions and energy transformations are achieved in a structured, responsible way. While the legislation must not only strive to reduce emissions of greenhouse gasses to the level that the best science believes is necessary and ensure the development and deployment of clean energy technologies, it must do so in a way that minimizes costs to businesses and consumers as much as possible. It must place a special emphasis on the development of a domestic investment portfolio to ensure that these new clean energy technologies and products are developed and produced here in America; ensure that domestic exporters are not unfairly disadvantaged in the global marketplace; and it must ensure as much as possible that the jobs that exist here today in energy-intensive manufacturing are not lost, nor the production of those products offshored unnecessarily by neglecting the very real and potentially disastrous problem of carbon leakage. If leakage is not addressed in the development of a climate change regime, any policy runs a significant risk of not only costing American jobs, but actually exacerbating, instead of mitigating, the problem of global warming.

Carbon Leakage

Most policy proposals to address climate change, including cap-and-trade, arise from the idea that the assessment of a cost on emissions will provide an incentive to reduce them, either through the development of more efficient processes or of new products which can be made with fewer emissions. This theory is sound, as long as those costs cannot simply be evaded by companies offshoring production or downstream producers and consumers avoiding the cost by purchasing imported goods from nations who have not taken action to address the need for climate change abatement.

In industries like steel, glass, aluminum, chemicals, rubber, and paper, this threat is particularly acute because they are commodity-based industries, in which even small differences in production costs can have a huge effect. Finding a way to mitigate the competitive disadvantage that will be placed on these industries, and the carbon leakage that would occur as a result, is critical to recovering from the current recession and achieving the goal of stopping climate change. A recent study conducted by High Road Strateges and the Millennium Institute showed that climate policies that put a price on carbon "could have significant impacts on the competitiveness of U.S. energy-intensive manufacturing sectors over the next two decades if climate regulations are applied only in the U.S."

This is a global problem, and greenhouse gas emissions affect the environment exactly the same whether they occur here or abroad. The difference is that American industry and workers are among the best in the world, producing energy-intensive goods with some of the lowest emissions in the world. The same cannot be said of many of our competitors. For example, the American steel industry has become 25% less energy-intensive over the past 20 years, while the Chinese steel industry now emits as much carbon as the rest of the global steel industry combined. The production of a ton of steel in China generates more than three times the carbon emissions of a ton of steel produced here, because China relies more heavily on

older, dirtier production methods and higher-sulfur coal than the increasingly state-of-the-art U.S. industry, and the Chinese government is lax in enforcing those environmental laws they do have.

A climate policy that fails to prevent the unnecessary offshoring of production to less efficient, more carbon-intensive countries will not only cost American jobs, but because production in those countries emits more carbon, will actually cause a net increase in the global greenhouse gas emissions from these sectors, which will only make the problem of climate change worse.

A Framework for Preventing Leakage and Maintaining American Jobs

The USW is pleased that a growing consensus is forming around the idea that, if climate change policy is to be comprehensive and effective, measures must be taken to address the issue of carbon leakage. We thank Chairmen Waxman and Markey for including a competitiveness program in Title IV of their discussion draft, and are particularly grateful for all of the hard work done on this issue by Mr. Inslee and Mr. Doyle, whose output-based rebating proposal is an important piece of the program.

USW believes any leakage program must not only address the short and medium-term needs of energy-intensive manufacturing, but do so in a way that helps to lay the groundwork for a long-term solution. In the long term, climate change is a global problem and requires a global solution. To that end, we support the United States in its work through the U.N. Framework Convention on Climate Change to negotiate an international treaty that will bring global emissions down to the level necessary to avert the worst effects of climate change. Further, USW believes that in a global economy, the unique set of issues facing energy-intensive manufacturers are best addressed through a global climate treaty that includes a set of international sectoral agreements for these industries. Only by setting up an international system where all products must bear a carbon cost commensurate with their associated emissions, no matter where they are produced, can the playing field ever truly be leveled, and the cost incentive to reduce emissions most effectively leveraged.

With an international treaty featuring international sectoral agreements for energy-intensive manufacturing as the long-term goal, the best competitiveness policy is one that not only meets the short and medium term needs of domestic manufacturers, but starts the U.S. on the road to a comprehensive system for energy-intensive products by sector, which can be folded into such an international system as efficiently as possible.

The draft bill seeks to address the competitiveness issues facing manufacturers of energy-intensive products through a hybrid approach consisting of output-based rebates backed up by a variable border adjustment on these products. We believe the approach has promise, and, with the right improvements, could provide a workable solution to carbon leakage. We look forward to working with the Committee to strengthen the proposal to ensure it fulfills the goals we all share of reducing carbon emissions, preventing carbon leakage, and supporting a revitalized clean energy economy in the United States.

Output-Based Rebates

One of the most delicate balancing acts in designing an economy-wide climate change policy is determining if and how certain industries will have the cost of such a

policy mitigated to provide transition assistance to allow those industries to develop clean energy processes and products. Within that broader question are the questions of how much cost should be mitigated, for how long, and how to structure these programs to avoid windfall profits to industries which do not need help or may simply use these windfalls to facilitate the offshoring of production.

USW is keenly aware of all of these concerns, particularly the need to retain jobs and production in this country and avoid offshoring, and to provide incentives to ensure that the goal of having emissions reduced through increased efficiency, not simply relocated, is met. From that perspective, the Inslee-Doyle approach of tying allocations or rebates to output is the best and most effective allocation system that has been proposed to date.

First, eligibility is targeted very narrowly to those industries which demonstrate a high energy-intensity profile and the potential for significant competitive disadvantage if these costs are not mitigated. Specifically, the most recent version of Mr. Inslee and Mr. Doyle's bill (H.R. 1759) and the Waxman-Markey discussion draft target these rebates to sectors or subsectors which meet the test of being at least 5% energy-intensive and 15% trade exposed. Sectors or subsectors, as defined by six-digit codes of the North American Industrial Classification System (NAICS), are considered presumptively eligible for rebates if Census Bureau data for such a sector or subsector meets the 5%/15% threshold.

Within a given six-digit NAICS code, however, the potential does exist for different emissions profiles to exist for certain products that are not the result of inefficiency, but of different processes for the production of a given product which are necessary for a fully-developed industry. The example most often used to describe this issue is the steel industry, given that steel produced in integrated facilities and steel produced in electric arc furnace facilities have very different emissions profiles (integrated facilities use more coal, but electric arc facilities use more electricity). In order to create the most direct comparison possible, it makes sense to judge integrated facilities against each other, and electric arc facilities against each other, and we are pleased that the distinction between the two is specifically addressed in the discussion draft. Still, this is not the only example of this issue, and we are also pleased to see that the discussion draft includes a petition process by which an industry may seek to have a similar determination made within other sectors or subsectors.

Although this process by which companies and sectors qualify for rebates is an improvement over previous proposals, it results in anomalies that should be corrected. NAICS codes, by necessity, are very broad even at the 6-digit level, because not all products fit into certain categories. As a consequence, the NAICS code includes miscellaneous, catch-all codes designed to capture all of the products which do not fit into one of the other codes. This anomaly can result in a situation where, for example, a producer of ceramic tiles for construction is presumptively eligible to receive rebates because those products fall under a six-digit NAICS code that is presumptively covered, but a producer of ceramic substrates for environmental equipment such as catalytic converters would not be covered because that product falls into one of these miscellaneous codes that also includes other unrelated products that do not and would not need rebates. This anomaly is an unavoidable result of using NAICS codes, and would exist at whichever level of NAICS code was chosen.

There are many benefits of using NAICS codes, however, and this anomaly can be corrected by creating procedural improvements in the individual showing provision that will reduce the burden on efficient facilities that should qualify for presumptive relief – because they are energy-intensive and trade exposed – but do not because they are classified in one of these miscellaneous codes. The individual showing provision should allow the Administrator to consider the facility's individual data along with industry data in deciding whether to grant rebates to the facility. It should also require that the Administrator make a determination within four months. This should not create a presumption of eligibility or ineligibility, and will allow all those who should be covered under the program but who are not only for NAICS classification reasons an avenue for redress.

Once the determination of covered sectors, subsectors, and facilities is determined, the amount of the rebates is determined based on the average direct and indirect costs of producing each unit of these energy-intensive products, and the appropriate amount for each unit of output produced is rebated. The link to output is key, as it prevents a company from taking its free allowances, selling them on the allowance market, and using the windfall profits to build factories in India, Mexico, Brazil, China, or elsewhere. However, as discussed in more detail below, the average efficiency component of the rebate formula will result in some producers bearing compliance costs that may create leakage concerns if an effective border adjustment is not simultaneously imposed.

Trade Mechanisms

While an allocation system such as the output-based rebate system seeks to even out the cost differential between domestic and international products by reducing the effective cost of compliance, trade mechanisms seek to even out the differential by imposing equivalent effective costs on imports and ensuring exports do not bear those costs. An effective border adjustment mechanism is critical if carbon leakage issues are to be fully addressed and global emissions reduction goals achieved. Because the output-based rebates are designed to mitigate, not completely eliminate, the cost imposed on domestic producers, a trade measure is imperative to ensure that all goods consumed in the United States – whether imported or domestic – bear the same costs based on their associated emissions. Emissions generated by imports entering our market should be treated the same as emissions associated with domestic goods in the market. In addition, the border mechanism should ensure that goods not consumed in the U.S., such as exports, do not bear such costs.

Hybrid System of Output-Based Rebates and Border Adjustments

While USW appreciates all the work and leadership shown by the committee on these issues, we feel that further refinements are necessary before they can fully address the competitiveness needs of energy-intensive manufacturers. To the extent that a cap-and-trade program imposes a higher cost on U.S. manufacturers that are not borne by their competitors abroad, domestic goods will be put at a disadvantage against imports and, when exported, against goods in foreign markets. As long as that cost differential exists at any level, a commensurate amount of leakage will be unavoidable and our environmental goals will be unattainable.

Because output-based rebates are designed to mitigate – not eliminate – these costs and provide an incentive to reduce emissions, they must work with a border adjustment to fully eliminate the cost disadvantage that leads to carbon leakage. Eliminating this cost differential does not mean that domestic producers will be able to evade paying their fair share as America addresses the issue of climate change. Instead, eliminating the cost differential simply ensures that the theory behind a carbon cost works as intended. As costs rise, companies will have incentive to reduce emissions and develop new processes and products to lower the amount they must pay. Under a comprehensive competitiveness program, those companies which can do this most efficiently will be rewarded, which provides direct incentive for investments in new technology. Without a comprehensive competitiveness program, however, companies would have little or no incentive to engage in these investments since they will face a loss of market share due to the flood of cheap, dirty products that will enter the country.

In the discussion draft, manufacturers in covered sectors or subsectors will only be rebated 85% of sector average carbon cost of producing each covered good. From an environmental perspective, it is necessary to impose some costs on inefficient producers in order to create an incentive to reduce emissions, which is one reason this less-than-full rebating has been proposed. However, this level would not only penalize the worst performers in a sector, but would impose an unrebated cost on a majority of companies in these sectors.

For example, a hypothetical company that produces energy-intensive products 14% more efficiently than the sector average is, by any measure, a high performer that should be encouraged. Even that company would not be rebated its full compliance costs and would face some threat of leakage if these additional costs are not equalized by an effective border adjustment. Many of these energy-intensive products, like steel and cement and chemicals, are commodities where even small price differentials like this can have outsized effects.

Once a border adjustment to equalize these unrebated costs is enacted, the rebate level can and will act as intended, as an incentive to producers to reduce emissions. Until then, however, it will not eliminate the threat of leakage. In the interim, we must ensure that these cost pressures do not effectively destroy critical sectors of the economy until the full extent of the competitiveness program can be implemented. Specifically, we recommend that the rebates to companies in covered sectors and subsectors be increased to 100% of each firm's direct and indirect compliance costs from the date of enactment of the domestic program until the date of enactment of an effective border adjustment.

Once the border adjustment is in place, we would recommend that the rebates be paid at 100% of sector average per unit of output. This will ensure that producers who are better than average for their sectors will not be penalized despite their high performance, and will provide below-average producers an incentive to reduce emissions to avoid paying an unrebated cost of compliance. As these below-average companies improve their performance, this will drive the sector average emissions down, prompting companies to continue reducing emissions. Such a race-to-the-top structure is both good environmental policy and good economic policy.

It is obviously in the environmental interests of the nation and of the USW that this rebate structure be put in place as soon as possible. However, as we stated, this will not work as intended until there is an effective border adjustment in place, and until

then, companies in covered sectors should be rebated 100% of their compliance costs. There has been much disagreement over the past several years over the question of how quickly such a border adjustment can be put in place. During last year's debate over the Lieberman-Warner bill, the border adjustment was scheduled to be enacted 8 years after the enactment of the domestic program in the original bill, a time frame which was shrunk to 3 years in the final version reported by Senator Boxer.

The position of USW is that a border adjustment should be enacted as quickly as possible, although we are cognizant of the arguments that have been made that suggest some period of time is necessary before it can be done. This is to allow for the negotiation of an international treaty, as well as to ensure as much as possible that such a program would be consistent with the United States' international obligations. In fact, that understanding informed the formation of our proposal, which we view as a way to solve this timing question. It is in both our economic interest and consistent with our environmental values to see this vital program designed and implemented in as responsible a way as possible. As such, we are prepared to accept whatever length of time is necessary for this to be done right, as long as we eliminate leakage concerns during the interim through full rebating of compliance costs.

From this perspective, USW has strong concerns with certain aspects of the international reserve allowance program in the discussion draft. Under that provision, in 2017 – five years after the start of the domestic program for utilities and 3 years after the start of the domestic program for energy-intensive manufacturers – the President is directed to make a determination whether the rebates have been effective at preventing leakage. If the President does make an affirmative declaration that leakage is occurring, then that leakage – and the job loss that goes with it – will be allowed to continue for an additional 2-3 years while regulations are written before a border adjustment is enacted to prevent it.

Additionally, there is no requirement that the President make any subsequent determination if he determines that no leakage has occurred by 2017. This creates a dangerous incentive for foreign competitors to simply wait to flood our market with dirtier products until after 2017, when the President has decided that no border adjustment is necessary because leakage has not occurred to date, and when the output-based rebates begin to phase out. Many American industries would simply be wiped out in such an occurrence.

It is USW's position that the question of the border adjustment's imposition should not be left to the discretion of the President or anyone else. The legislation should require that the border adjustment begin on a certain date, and direct the President to issue regulations in sufficient time that it may begin on time. If competitive disadvantage is not occurring and the potential for leakage does not exist, a properly structured border adjustment will reflect that and it will be a fee no one has to pay. This is, in fact, the ideal situation. If at some point the potential for leakage develops as the rebates phase out, the border adjustment will seamlessly adjust to fill the gap between what costs are rebated and what costs are borne.

As the border adjustment is designed and implemented, it is imperative that the full range of products and issues raised are addressed. For primary products, eligibility for coverage under the border adjustment should be harmonized with the output-based rebate system. The six-digit NAICS code system, based on determination of

energy-intensity and trade exposure – with a petition process to allow for different treatment within a six-digit code, if necessary – is an effective framework for determining which sectors and products should be covered, and should also be used to identify primary products for inclusion under the border adjustment.

In addition to these primary products, the border adjustment should also cover downstream products made from energy-intensive inputs. If these products are not covered, competitiveness issues may be resolved for some, but for too many others they will only be pushed down the production chain to impose costs on finished goods manufacturers that are not borne by their competitors abroad. To the extent that downstream producers who face a significant disadvantage due to their reliance on energy-intensive inputs are not covered by the program, not only will the program not fully address the competitiveness needs, but will create a perverse incentive for the offshoring of assembly of these products.

The border adjustment program should also address the needs of American exporters, who will be disadvantaged in foreign markets by the imposition of carbon costs. While the needs of exporters would be met in the early years by the rebating of 100% of compliance costs, as those rebates phase out these exporters will face increasing disadvantage. The border adjustment should be structured in such a way that costs above the level rebated do not burden exports.

Conclusion

Addressing the potentially catastrophic issues posed by climate change is the challenge of our generation, and meeting that challenge will require the mobilization of everyone in the world behind a common purpose. America can and must lead this effort, not only by taking a bold stand to limit greenhouse gas emissions, but by harnessing this nation's greatest resource, the ingenuity and creativity of the American people. We must make a national commitment to rebuild America clean and green with products built here, to develop clean energy technologies and provide incentives to further their deployment. We must bring our power grid and energy infrastructure into the 21st century and train the American workforce to use these new technologies. We must create a revolution in our transportation sector, rebuilding the American auto industry to produce the best and cleanest vehicles in the world, and connect America's cities and neighborhoods with world class transit systems. And, of course, we must limit greenhouse gas emissions consistent with what the best science tells us.

As part of the global solution to this global problem, the long-term solution to the unique challenges faced by manufacturers of energy-intensive products is a global sectoral approach that regulates these products transnationally based on their emissions levels. The United States should be working to achieve such agreements in international negotiations, and to move that process forward our domestic program should from the outset be structured to be easily integrated into such a system and support its development. Our proposed competitiveness system is harmonized by sector and energy intensity and can be a useful step in demonstrating to the world that such a system can work.

It is time for America to reclaim its position of leadership in the world economy, and the United Steelworkers are ready to do everything in our power to assist that process. Again, I am grateful to Chairmen Waxman and Markey for holding this hearing, and for the leadership shown by them and the members of the committee,

particularly Mr. Inslee and Mr. Doyle. We look forward to working with you and the committee now and in the future.