

Written Testimony of  
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Good afternoon. On behalf of the 850,000 active members of the United Steelworkers (USW), I would like to thank Chairman Levin for holding this hearing on the challenges to the competitiveness of domestic manufacturers and workers posed by the adoption of comprehensive climate change legislation. I am Leo Gerard, the International President of the USW. As you know, the members of the United Steelworkers produce more than just steel. They supply almost every sector of the economy, including the North American auto industry, and produce a wide array of products, including paper, glass, ceramics, cement, chemicals, aluminum, tires and rubber. Our members produce these energy-intensive products in facilities that are as efficient as any in the world. They are ready to answer the call to produce the next generation of clean energy products and parts, and reassert America's leadership on the cutting edge of new technology. But they can only answer that call if their jobs are not unnecessarily squandered to the law of unintended, but not unforeseen, consequences. Amid this economic collapse, this country cannot afford to lose any more jobs.

For decades, the USW has been a leader in the labor movement on the environment. In 1990, we published "Our Children's World" stating our union's environmental policy and the need to address climate change, and in 2006 we reaffirmed our union's commitment to environmental responsibility through the publication of "Securing Our Children's World."<sup>1</sup> We were one of the first industrial unions to support comprehensive climate change legislation, with our support for the Bingaman-Specter bill. That bill proceeded from recommendations made by the National Commission on Energy Policy, on which I serve as a commissioner. 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.

The Steelworkers are as convinced today as we were in 1990 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 operates in order to bring this problem under control before it is too late. Still, in undertaking the enormous and critical task of crafting comprehensive climate change legislation, Congress must ensure that the desired emissions reductions are achieved in a structured, responsible way. The legislation must not only strive to reduce emissions to the level that the best science believes is necessary, but it must do so in a way

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<sup>1</sup> Available on USW's website through the following links; <http://legacy.usw.org/uswa/program/content/1592.php> and <http://legacy.usw.org/usw/program/content/Environment-SOCW.php>.

that minimizes costs to businesses and consumers as much as possible. In doing so, attention must be paid to the need to provide incentives to build the next generation of clean energy products here in America, and the need to ensure that domestic exporters are not unfairly disadvantaged in the global marketplace. It must take into account that, for some products like steel and cement, some emissions are an unavoidable part of the manufacturing process, and that currently neither science nor technology exists to mitigate them. 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

The phenomenon by which emissions reductions in one country lead to increased emissions in another is known as carbon leakage. The reason this happens is that if one country puts a price on carbon emissions, that additional cost provides an incentive to the company to move its production and, therefore, its emissions, to a country where that additional cost does not exist. All policy proposals to address climate change, including cap-and-trade, arise from the idea that if a price is put on carbon, it will provide an incentive to emit less carbon. This theory is sound, as long as the cost cannot simply be evaded by companies moving production overseas or by downstream producers and consumers avoiding the cost by purchasing imported materials from nations that do not share the U.S.'s commitment to climate change abatement.

This threat of leakage is particularly acute among manufacturers of energy-intensive primary products like the ones made by members of the Steelworkers. In commodity-based industries like steel, glass, chemicals, rubber, and paper, even small differences in production costs can devastate an industry if they are not managed effectively. Finding a way to mitigate the competitive disadvantage that will be placed on these industries is not only an imperative, if we are to continue the recovery from the current recession, but it is an imperative if we are to actually achieve the goal of stopping climate change.

Greenhouse gas emissions and the resulting climate change are a global problem, and it makes no difference whether the emissions occur here in the U.S. or abroad. In fact, the shifting of these emissions to countries that do not share our commitment to addressing the problem of climate change is almost certain to make the overall problem worse. The reason for this is quite simple: American industry and American workers are among the best in the world, and they produce energy-intensive goods with some of the lowest emissions in the world. The same cannot be said of many of our competitors. The Alliance for American Manufacturing, a unique labor-management joint venture between the Steelworkers and several of our major employers, released a report yesterday on the pollution levels in the Chinese steel industry, and the findings are quite stark.<sup>2</sup> For example, while the American steel industry has become 25% less energy intensive over the past 20 years, 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 in the United States. This is largely because the

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<sup>2</sup> Available on Alliance for American Manufacturing's website through the link <http://www.americanmanufacturing.org/assessment-of-china>.

domestic industry is increasingly state-of-the-art and efficient, while the Chinese steel industry has a heavier reliance on older, dirtier production methods and uses higher-sulfur coal to power those processes. The Chinese government looks the other way while this goes on, and is lax in enforcing the few environmental laws and regulations it does ostensibly have in place.

Any climate change policy that does not seek to prevent the unnecessary offshoring of production from state-of-the-art American industries to less efficient, more carbon-intensive industries overseas will both cost American jobs and, perversely, will actually make the problem of global climate change worse.

### Options for Combating Leakage

The USW is pleased that a growing consensus is forming around the idea that something must be done to address the leakage problem in formulating climate change policy. The question that follows is exactly what that something should be. A variety of solutions have been proposed, many of which fall into the broad categories of allocation schemes and trade mechanisms.

### Allocations

Because leakage is caused by the fact that the domestic industry will be bearing increased costs of production due to the requirement to pay an imposed cost of carbon, many proposed solutions center around the concept of mitigating those costs. These ideas are structured as allocations of allowances to industries that are at risk of leakage, which means energy-intensive and trade-exposed industries. The European cap-and-trade program relies exclusively on allocations to combat leakage.

Previous domestic efforts, such as the 2008 Lieberman-Warner bill, have included provisions that reserve a certain percentage of the total universe of allowances to be distributed to energy-intensive industries free of charge. This structure is less than ideal because the allocation of no-strings allowances provide little incentive to companies to avoid offshoring. The potential for a company to take its free allowances, sell them on the allowance market, and use the windfall profits to build factories in India, Mexico, Brazil or China is a serious concern. In addition, even those companies that use the allocations as intended still face a long-term leakage threat. Most allocation proposals decrease the percentage of the cap reserved for allocations over time, which would allow foreign competitors to wait out their domestic counterparts until the supply of free allowances runs out. Even those proposals that maintain a consistent percentage of the cap for allocations face the same problem, as the cap will get smaller and smaller, as will the total number of available allowances the consistent percentage represents.

While allocations are critical for the survival of energy-intensive manufacturers, they must be structured to provide an incentive to maintain or increase domestic production, and must eliminate the potential for windfall profits, particularly profits which can be used to facilitate offshoring.

### Trade Mechanisms

Where allocation schemes seek to even out the cost differential between domestic and international products by reducing the effective cost to domestic producers, trade

mechanisms do the opposite. An effective trade mechanism would eliminate the cost differential by requiring that any import that enters our market face the same cost as domestic counterparts for those emissions not covered by an allocation scheme.

The most prominent of these proposals is the international reserve allowance program in the Lieberman-Warner bill. Between the introduction of the bill and the version improved by Senator Boxer, the international reserve allowance program was refined and improved a great deal, but more work needs to be done before it can fully address leakage concerns. A workable trade mechanism must give consideration to downstream products and exports. It must require that all products consumed in the U.S. demonstrate the same commitment to combating climate change, no matter where they are produced. And it must be put in place as quickly as possible, to limit the amount of time that domestic producers face cost disadvantages because of the requirements of the domestic program. If it is not possible to begin both programs at the same time, then steps must be taken to prevent unnecessary harm to domestic industries until such time as the trade mechanism can be activated.

Access to our consumer market is the most powerful incentive the U.S. has to encourage other nations to commit to reduce climate change. It must be used in a strong and effective manner.

#### Hybrid Approach

The shortcomings of both the allocation approach and the trade approach are similar. Namely, this is a global economy that faces a global crisis, and there are limits to what any one country, even the United States, can do alone. The U.S. should, therefore, attempt to forge a global solution to the issue of how to deal with energy intensive manufacturers. This should take the form of global sectoral agreements within the larger global climate treaty being negotiated by the U.N. Framework Convention on Climate Change. Only by setting up a system where all products must bear a carbon cost commensurate with its carbon emissions, no matter where they are produced, can the playing field ever be truly leveled and allow us to confront this global problem.

With that as the long-term goal, the short-term goal should be to craft a hybrid approach of allocations and trade measures that increases the potential that such agreements can be reached, while still addressing the leakage and competitiveness questions and ensuring that industry has sufficient incentive and confidence to maintain domestic production here, while continuing to improve its operations, until such agreements can be reached.

In this hybrid approach, allocations could be awarded to energy intensive manufacturers commensurate with their output and their carbon emissions. If allocations diminish over time or are insufficient to eliminate the leakage problem, they can be combined with appropriate border adjustments to equalize costs for domestic and foreign goods consumed in the United States based on their associated emissions. A phased-in, hybrid approach could provide the space for both the negotiation of an international agreement – which should start upon passage of the legislation – and providing sufficient notice to the rest of the world of the eventual imposition of a meaningful trade mechanism, while preventing domestic producers from facing unnecessary competitive pressures during that time. In addition, the hybrid approach can be designed to address the problems of downstream products and exports by ensuring that costs to inputs are minimized, and thus

downstream products do not see an additional cost disadvantage. Similarly, if exported goods do not face a disadvantageous cost differential abroad, their competitiveness in global markets should not be harmed.

After the negotiation period is over, a variable border adjustment will be imposed on imports. This adjustment will be imposed on imports that enjoy a cost advantage over domestic products because of lack of action on climate change. It will be based on the carbon intensity of these products and the net cost borne by domestic manufacturers of those same products.

It is a simple concept. The right to sell goods to consumers in our market brings with it the responsibility to confront the costs associated with addressing climate change.

If the output-based rebates are working as intended and meeting the competitiveness needs of energy-intensive manufacturers, the border tax adjustment will lay dormant. Similarly, if sectoral agreements are forged and work as intended, this will be a tax that no one has to pay. That is the goal, and the border tax adjustment is envisioned to be a last resort, put into use only if and when the allocations are insufficient, or the sectoral agreement is not enforced.

### An Alternative Approach

Hybrid approaches, allocation schemes, and trade mechanisms that could face WTO challenges are all quite complicated ways to address the questions of leakage and competitiveness. The questions themselves largely stem from the fact that the architecture of a cap-and-trade system is focused on the production of goods, but the global economy is focused on the consumption of goods. An alternative approach for energy-intensive manufacturers would be to create a separate emissions regime for these industries in which the inefficient allowance-based system is replaced with a simpler and more effective system in which emissions fees are assessed on all carbon-intensive goods consumed in the U.S. if their associated carbon emissions exceed a determined industry standard.

The potential benefit of such a system would be that the leakage problem would be effectively eliminated, because the focus would be shifted to ensuring that all products consumed in the U.S., regardless of where they are made, demonstrate the U.S.'s commitment to addressing climate change. Domestic manufacturers would face incentives to reduce emissions in order to bring emissions under the standard and avoid the tax. At the same time, they would not face unnecessary competitiveness concerns because equivalent costs can be assessed at the border on imports and rebated on exports, in much the same way as a value-added tax. In addition, the transparency of these fees would help industry attract the necessary capital to make improvements, because future costs could be more easily determined using an established fee rate than in attempting to divine the price of a volatile market in carbon allowances.

### 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 new forms of clean, renewable energy and provide incentives to further their deployment. We must bring our power grid and energy infrastructure into the 21<sup>st</sup> 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.

In creating a program to achieve these emissions reductions, we must make the development of manufacturing a centerpiece of that program. The products made by our members and millions of other hard-working Americans are quite literally the building blocks of all these new technologies. If the U.S. is to build windmills, we will need steel and aluminum. If we are to build solar panels, we will need glass. And if we are to build the next generation of industrial scrubbers to filter out these emissions, the ceramics industry cannot be ignored.

When the world transitioned to an industrial economy, America led the way by developing and producing the best products in the world. Now, as the world transitions again to a green economy, the time has come for America to lead again. This change will not come easily, and it is a heavy load to bear. But I am here to tell you today that American workers are ready and willing to help bear that burden and help lead America into a new, green future.

Thank you again, Mr. Chairman, for holding this hearing. The United Steelworkers and I look forward to working with you and the committee to renovate our economy to meet these challenges.