

February 27, 2009

Midwestern Greenhouse Gas Reduction Accord Advisory Group
c/o Mr. Jesse Heier, Washington Director
Midwestern Governors Association
444 North Capitol Street, NW - Suite 401
Washington, D.C. 20001

RE: Comments Regarding Draft Policy Recommendations

Dear Advisory Group Members:

Over 12 months ago, nine governors and two Canadian premiers signed on to participate or observe in the Midwestern Greenhouse Gas Reduction Accord (Accord). The Accord states have embarked on an important effort to promote renewable energy development, expand the region's energy conservation efforts and reduce regional greenhouse gas emissions.

The undersigned Midwest industry organizations include some groups in states that are not currently participating in the Midwestern Accord process as members or observers. Nevertheless, we all have a stake in a viable manufacturing base for the region. From our perspective, the Accord's draft recommendations on a regional cap-and-trade and low carbon fuel standard would cause serious economic dislocation across the region even in states not participating in the Accord process. As noted below, the Accord recommendations targeting fuels such as coal and Canadian crude oil hurt the Midwest economy particularly hard given our investment in those fuels. We are also concerned that certain proponents of the Accord are packaging and marketing this as a Midwest Accord supported broadly across the region by all Midwestern Governors Association states. That is simply not the case.

The Importance of Manufacturing to the Midwest Regional Economy

Prior to citing specific policy concerns associated with the Accord, it is necessary to place into context the importance of manufacturing to the Midwest regional economy. The twelve Midwestern Governors Association (MGA) states are home to more than 4.2 million manufacturing jobs and over 100,000 manufacturing businesses. Regionally, these manufacturing jobs pay an average wage of \$46,370, which is \$9,333 or 25 percent higher than the average wage of the twelve states.

Manufacturing is a critical component of our regional economy, as it accounts for roughly \$477 billion in economic output each year. Unfortunately, we have witnessed sharp declines in manufacturing employment across the Midwest region. Since the year 2000, the twelve MGA states have lost more than 1.2 million manufacturing jobs, representing a 22 percent decrease. Great care must be taken to reverse this trend and stop the loss of some of the highest paying jobs in our region. Regrettably, we believe certain policies associated with the Accord will do the opposite, and exacerbate this trend by accelerating the migration of manufacturing jobs outside the Midwest region.

Midwest Economies Will Be Uniquely Impacted by Regional Greenhouse Gas Regulations

The Midwest is unique compared to other states that have contemplated regional greenhouse gas policies. Our region is home to a much higher concentration of the types of manufacturing industries that would be subject to regulation under cap-and-trade than the ten Regional Greenhouse Gas Initiative (RGGI) states or seven Western Climate Initiative (WCI) states. For example, the Midwest's gross manufacturing output of \$477 billion each year is more than twice that of all RGGI states combined. Moreover, the

economic output of all 17 RGGI and WCI states combined cannot match the Midwest's regional manufacturing output. Disproportionate economic hardships will occur among MGA states if a regional cap-and-trade regulation is enacted here because the Midwest economy relies so heavily upon manufacturing.

Our region has also invested much more heavily in coal as an abundant and affordable fuel for electric generation than have RGGI or WCI states. The twelve MGA states collectively rely on coal for 71.9 percent of regional electric generation. By comparison, the RGGI and WCI states utilize coal for only 21.9 percent and 22.9 percent of their generation respectively. Perhaps more significantly, the MGA states generate far more electricity from coal on a megawatt hour (MWh) basis than both the RGGI and WCI regions combined. Midwest states generate roughly 688 million MWh of electricity from coal on an annual basis, which is eight-times the total of RGGI states (85.8 million MWh) and five-times the total of WCI states (135.2 MWh).

Adopting policies that penalize coal-fired generation such as regional cap-and-trade regulation will create disproportionate hardships to our economies, particularly our manufacturing base. Having already lost more than 1.2 million manufacturing jobs, the Midwest should not self-inflict further economic dislocation by adopting policies that not only fail to consider our unique energy portfolio, but punish those investment decisions that were at the time endorsed by our elected officials.

A Regional Cap-and-Trade Regulation Will Result in Widespread Economic Hardship among Midwest States

Assessing the economic impact of a regional cap-and-trade regulation on Midwest states is a critical component of the Accord policy process, especially given the current economic downturn. Only then can policymakers render an informed judgment about whether adopting the Accord is in the best interests of each participating state individually, or to the Midwest economy as a whole. We are particularly disappointed, therefore, to learn that at this time the Accord process will not undertake economic modeling to produce reliable and discrete cost data associated with a cap-and-trade program. Compiling accurate information on the cost of the Accord, particularly a cap-and-trade regulation, should be a top priority for the Accord's Advisory Group.

Despite the lack of reliable economic data arising from the Accord process, other economic studies measuring the impact of cap-and-trade regulation have been undertaken at the national level. We believe these studies provide useful estimates of the severe impacts of carbon dioxide regulation in the Midwest. Specifically, the American Council for Capital Formation (ACCF) and National Association of Manufacturers (NAM) jointly conducted a state-by-state case study of the economic impacts associated with the Lieberman-Warner federal cap-and-trade legislation. Because the reduction targets in the federal bill are consistent with those proposed in the Accord cap-and-trade proposal, the ACCF/NAM study represents a reasonable, if understated, measure of expected impacts if the Accord were adopted.

The ACCF/NAM study predicts 259,000 lost jobs by 2020 and 637,000 lost jobs by 2030 among the MGA states under a "low cost" scenario for carbon. Using a "high cost" assumption, Midwest states stand to lose 388,000 jobs by 2020, and 850,000 jobs by 2030. These job loss figures are net losses, which account for the creation of so-called "green collar" jobs.

In addition to these troubling employment impacts, the ACCF/NAM study found the cost of natural gas and electricity would more than double by the year 2030, making it increasingly difficult to retain the manufacturing jobs that do not migrate out of the Midwest region. We cannot expect to attract new capital investment to our region, or grow our way out of the current economic recession, if we adopt policies which significantly increase the cost of energy in the Midwest.

As noted, the intensity of our manufacturing economy in the Midwest, along with our investment in coal-fired electric generation, will result in disproportionate economic impacts under a cap-and-trade regulatory program. But the severe impacts to our manufacturing base associated with a federal cap-and-trade program would be more acute under a regional, go-it-alone regulatory regime. Not only would such a program make our manufacturing base less competitive globally, we would impose upon ourselves costs not being borne by our competitors in other states. At a time of such severe economic stress to our manufacturing sectors and economies as a whole, we should be formulating policies that make us more competitive, not less.

A Regional Cap-and-Trade Regulation is No Longer Needed, Will Not Work, and Cannot Replace a National Approach

While we understand the Midwest Governors' desire to pursue regional regulation was a result of their frustration stemming from a lack of Congressional action, the political dynamics in Washington, D.C. have changed considerably since the Accord was signed in 2007. With the recent Presidential election and the commitments of President Obama, federal action on climate change is imminent, and there is no longer the need for regional action. That being the case, the Midwest's efforts should shift focus from an independent regional regulatory program, and instead focus on shaping Congressional action to protect regional jobs and the affordability of energy.

Greenhouse gas emissions do not know geopolitical boundaries, and regional reductions cannot and will not make a meaningful reduction in global emissions. Regional regulations, therefore, cannot replace a national or international regulatory scheme. Looking at the Midwest region as an example, roughly one-half of all emissions in the region would not be subject to regulation under the Accord because some of the largest emitting states have not signed on. A cap-and-trade emission market will not function properly without a robust number of buyers and sellers of emission allowances. With one-half of the regional emissions "off the table" in the Midwest market, the regional regulatory framework simply will not work.

The resulting lack of emission allowances available for purchase, coupled with the absence of commercially available retrofit technology to meet regulatory caps, will result in significant migration of both jobs and emissions to other states who understand that a regional regulation is unworkable, ineffective and economically harmful.

The Draft Low Carbon Fuel Standard Will Adversely Impact the Midwest's Fuel Supply and Drive up Energy Costs

In addition to the cap-and-trade program, we have severe reservations over the imposition of a Low Carbon Fuel Standard (LCFS) among Midwest states. Much like our reliance on coal, Canadian crude oil currently is and will continue to be a key component of the Midwestern economy. The draft LCFS prepared by representatives from the Accord's Advisory Group and affiliated organizations would restrict access to this vital energy source, reducing the Midwest's energy security.

At its core, a LCFS is a bias against the use of Canadian crude oil by imposing a total "life cycle" carbon emissions baseline that considers emissions resulting from the extraction, processing and refining of fuel. Under this proposed regulatory regime, fuel derived from Canadian oil sands may be disqualified, or rendered cost-prohibitive. The result would be to cause Canadian crude oil to be redirected out of the Midwest and lower carbon crudes imported, probably from less reliable, and sometimes hostile foreign regimes. Moreover, this "Crude Oil Shuffle" has the perverse effect of increasing greenhouse gas emissions as a result of transportation to and less efficient production in destination countries.

Canadian crude oil is the largest and most secure source of crude oil outside of the U.S. It is a growing resource and is vital to increasing North American energy supply while decreasing dependence on Middle East supplies. About half of the Canadian crude oil brought into the U.S. is derived from oil sands, and this proportion will increase as oil sands production triples to about 3.5 million barrels per day in 2020. The Midwest is increasingly reliant on Canadian crude oil and uses nine times more Canadian crude oil than California and other West Coast states. In addition, billions of dollars are committed to refinery and pipeline investments in the Midwest to process this vital and secure crude oil resource.

Moreover, if a life-cycle analysis includes the impact of land use changes, biofuels made from food crops such as corn ethanol will also be disadvantaged under a LCFS. Eighty percent of U.S. corn ethanol production is in the Midwest. As with a regional cap-and-trade, disadvantaging Canadian crude and corn ethanol will disproportionately harm the Midwest's economy. It makes little sense to restrict the use of these vital, regionally produced fuels to the benefit of higher cost and less reliable energy sources.

Conclusion

While we recognize the hard work performed by the Advisory Group, we believe that a regional approach towards climate change regulation is no longer necessary, and will not achieve the intended emission reductions. The sheer magnitude of the Midwest manufacturing economy and the unique nature of our electric generation profile distinguish our region from other groups of states pursuing localized carbon regulation. A careful approach to climate change regulation must therefore be taken to prevent a crippling blow to our regional economy.

Failure to recognize the manufacturing and energy characteristics unique to the Midwest will result in widespread economic dislocation and job migration. A regional approach to carbon regulation through flawed policies like a Low Carbon Fuel Standard or the proposed cap-and-trade scheme will simply result in the economic isolation of Midwest businesses. If those policies are adopted, manufacturing jobs, electric generation and the corresponding greenhouse gas emissions will simply move to other states or countries.


We therefore respectfully request that the Midwest Governors defer this issue to federal lawmakers, and instead concentrate on shaping Congressional action to protect regional jobs and the affordability of energy. A uniform federal policy will ensure that businesses in all states compete on a level playing field. In doing so, the MGA should shift its focus toward state policies that promote the research and development of clean energy technology, and programs which promote energy efficiency and conservation.

Thank you for your thoughtful consideration of our request. We look forward to working with you in the future to ensure the availability of affordable, secure and reliable energy necessary to sustain a vibrant manufacturing economy in the Midwest.

Sincerely,



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cc: Governors, Midwestern Governors Association