Wilson Center-KAS Roundtable:

Highlights regarding EU and US Climate Policy: Convergences and Differences

By Keith Rockwell, June 2024

As part of a joint effort to explore greater alignment between the US and the European Union (EU) on trade related matters, the Wahba Institute for Strategic Competition (WISC) of the Washington DC based Wilson Center and the German Konrad-Adenauer-Stiftung having analyzed each continents differing approaches to promoting an energy transition[1], hosted a transatlantic discussion (June 12th 2024) exploring the possibilities of alignment on a Carbon Border Adjustment Mechanism (CBAM). The event brought together congressional and parliamentary staff, government officials, business leaders, NGOs and members of research organizations seeking to sift through policy options and find common ground.

Few global policy issues receive more attention today than combatting climate change. The EU and the US have each allocated vast amounts of time and money to addressing carbon emissions. But their approaches have differed and have, at times, brought Brussels and Washington to the point of conflict. Recently there has been evidence of a recognition that each side is committed to addressing the problem and that the best approach would be one that is a cooperative.

The discussion held in June shed light on possible paths to policy convergence but also laid bare stark differences between the two sides on how trade tools may best be used to reduce carbon emissions.

The EU, with its CBAM introduced in 2023 set the benchmark for the discussion. The EU's CBAM, which will come into force in stages, is based on the longstanding EU Emissions Trading System (ETS) through which emissions permits are traded. This trading system establishes a price for carbon which in turn provides the basis for payments to be applied from 2026 on carbon intensive imports in seven categories – steel, aluminium, fertilizer, chemicals, energy, hydrogen and cement.

Products with higher levels of carbon intensity will face higher compensation payments. Assessments of the level of carbon intensity will be based on information provided by the importers and through inspections by the EU's executive branch, the Commission.

The US has been critical of CBAM, speaking despairingly of the program at the WTO and citing the threat of duties to US steel producers as a reason for not concluding the US-EU Global Arrangement on Sustainable Steel and Aluminium and for not striking a deal which would have rendered EU carmakers eligible for Inflation Reduction Act (IRA) subsidies on the sale of electric vehicles.

But with the establishment in April of the Climate and Trade Task Force, chaired by White House Climate Envoy John Podesta, the US position on CBAM has become more accommodating.

This shift was reflected in the roundtable discussion. Several participants expressed the view that the CBAM program could have the effect of prodding other countries –Australia, Japan and the United Kingdom were cited – to adopt a more ambitious approach to tackling climate change.

[1] See WISC-KAS publication "EU–US Divergence on Energy Policy: Differing Economic Structures and Possible Alignment on a Market Based Approach"

Differences

The politics in Washington remain sharply divided on climate change initiatives. Deep divisions remain over the IRA, over efforts at combating climate change and over international cooperation on climate and on trade. These differences have spilled over into the transatlantic relationship adversely impacting efforts to find a coherent and mutually supportive policy approach.

Policy Goals

One noteworthy example of the different US perspectives is whether a carbon border tax should be considered a trade measure or a climate measure. European officials stress that they see CBAM as a climate measure, but many US participants see a potential CBAM program as a trade measure designed to level the playing field for US producers.

The EU's CBAM is designed both to encourage more climate action in other nations and to ensure its own producers are not disadvantaged in the EU market relative to higher-carbon intensity competitors that don't face the same carbon charges at home.

With the subsidy driven US approach reflected in the IRA, the US is motivated by a desire to maintain the competitiveness of US companies investing in carbon reduction measures and the goal of imposing higher costs on higher carbon intensity countries, particularly China. This was reflected in widespread support among American participants for ensuring that investments in green production of steel, aluminium or other industries were not undermined by foreign producers not required to meet high environmental standards in their domestic markets. The use of a border mechanism attracted wide approval as a means of offsetting any cost advantage that foreign producers might have in this regard.

Several participants also pointed out that the US Congress has considered a variety of border adjustment measures, some similar to the EU's CBAM but others different from Brussels' approach in significant ways.

Carbon Pricing

The EU has forcefully argued that CBAM compensation payments were determined through a market-based approach linked to the price of carbon in its emissions trading system. The United States has no such market and there is strong opposition from some quarters in Congress to establishing a price for carbon. It was noted that 17 US senators signaled opposition to a carbon tax. Ten Democrats recently joined nearly all Republicans in the House of Representatives in supporting an anti-carbon tax bill[2].

This dynamic helps explain the divergence in the approach to the energy transition. While applying compensation payments at the border against imports of carbon intensive products is supported widely in the US, there is less support for applying carbon taxes on domestic producers.

Under the EU's CBAM program countries which have adopted carbon pricing and which tax domestic producers accordingly would be eligible for partial or full exemption from EU import compensation payments. Sponsors of US CBAM bills maintain that other metrics could be used to determine the extent of carbon intensity from any given production process. This view is reflected in the competing CBAM bills introduced in the current US Congress.

Under the Clean Competition Act, sponsored in the Senate by Sheldon Whitehouse, D-Rhode Island[3] and in the House of Representatives by Rep. Suzan DelBene, D-Washington, baselines would initially be

[2] https://www.eenews.net/articles/dems-join-republicans-to-pass-anti-carbon-tax-measure/
[3] A Democrat from Rhode Island.

set at the average level of emissions intensity of US producers in each industry. Both domestic producers and importers of foreign products would be subjected to levies when their carbon intensity exceeds the benchmark. Certain developing country producers would be exempt provided the market share of the specific product in the United States is not too large.

The Foreign Pollution Fee Act, sponsored in the Senate in 2023 by Senator Bill Cassidy, R-Louisiana[4], and Sen. Lindsey Graham, R-South Carolina, would similarly apply a border measure on foreign producers if the carbon intensity of their products was more than 10% greater than the US benchmark. It would not impose a carbon tax on domestic producers whose carbon intensity was more than 10% above the benchmark. The carbon intensity benchmark would be set on the basis of data from the US Environmental Protection Agency.

WTO Compliance

European officials are uncomfortable with any approach in which duties would apply to foreign products while similar products produced domestically are exempt from these charges. Such an approach, the Europeans are convinced would not be compliant with WTO rules which mandate that foreign producers be accorded national treatment. There is also the suspicion in many European capitals that US proposals which would discriminate in this way are aimed squarely at China. Again, Europeans are convinced that targeting one country like this would violate the WTO's non-discrimination article known as the Most Favored Nation principle.

In the 27-member European Union, international cooperation is a principle which is widely embraced. Complying with global trade rules matters to the European Union.

Today, this seems less the case in the US. Although the US was the driving force behind the creation of the General Agreement on Tariffs and Trade and its successor the WTO, the bipartisan view of the trading system is now ambivalent at best.

While concerns about the WTO exist in the EU, European economies are far more trade dependent than the US and trade is generally viewed far more positively by Europeans. This is particularly true in Germany.

Data

One difference between the legislative efforts on either side of the Atlantic is that the EU has spent years harvesting data that would enable it to implement its program. US participants acknowledge that they have a shortfall of relative emissions data, and that the EU is "far ahead" in its efforts at gathering this information.

The absence of emissions data in the US is also a concern for many Europeans who worry that some proposed congressional legislation would set anti-pollution border charges based on thresholds that were established in a random manner. Collecting emissions data has taken the Europeans years. But this data has proven essential in building the framework which will enable Brussels to set and apply the compensation payments. US participants in the roundtable acknowledged that for a US emissions reduction program like CBAM to work, more data is needed, which is why data collection is one of the main work streams for the recently established US Climate Trade Task Force.

The US participants said too that they intend to watch the EU process closely when payment collection commences in 2026. For their part, European officials acknowledge the complexities inherent both in

[4] A Republican from Louisiana.

determining the levels of imbedded carbon in finished products and in assessing the corresponding duty. They recognize moreover that adjustments will have to be made as the process is implemented.

Reflecting the widespread view that more data is needed, The Providing Reliable, Objective, Verifiable Emissions Intensity and Transparency (PROVE IT) Act, has bipartisan sponsorship, led by Sen. Chris Coons D-Rhode Island and Sen. Kevin Cramer, R-North Dakota. The act does not include a CBAM component but would aim to augment carbon intensity data by directing federal agencies to conduct research that would quantify carbon emissions intensity.

Potential Points for Convergence

In recent months bilateral US-EU relations pertaining to climate programs have improved and the roundtable discussion reflected this. The current US attitude towards CBAM, while not entirely favourable, is decidedly more positive. This reconsideration has been driven largely by the understanding that US companies would be disadvantaged if the costs they incur in retooling production to reduce emissions were not offset through a border measure. A CBAM type program would help protect these producers.

But while the mood music may have brightened fundamental differences remain. Can they be reconciled? What impact might a new EU Commission, a new EU Parliament and elections in the US and France have on the prospects for achieving alignment?

Even though a change in US administration may alter its approach to combating climate change, both sides of the Atlantic want to ensure their domestic producers do not suffer at the hands of lower cost foreign competitors not subject to strict environmental standards. Both sides have invested billions in developing clean technologies and both loathe to have these investments undermined by competitors who play by different rules.

These points of agreement indicate that the two sides have common interests, hence compromise should be attainable, at least on some points.

Data Sharing

One area in which enhanced cooperation should be obvious is data sharing. The EU has a considerable head start in developing its emissions trading system and carbon border measures. These complex programs are underpinned by a wealth of data that has been collected for years. To gauge the level of carbon intensity the EU relies on reporting by importers supplemented by their own investigations. As CBAM is rolled out, valuable lessons will be learned on how to make these processes more efficient and more effective. The Americans acknowledge that the Europeans are ahead of them, and they have made clear they would benefit from the EU's experience. A system whereby data and experiences are regularly shared shouldn't be too politically difficult and should be adopted right away.

Mutual Recognition

A second possible area of cooperation could be in the realm of mutual recognition. If indeed it is politically impossible for the Americans to agree on a system of carbon pricing, then the two sides should develop a framework through which the US system of assessing carbon intensity and developing border measures – whatever that system may turn out to be – could be recognized by the EU as a proxy for pricing.

For this to work, the US would need to be as transparent as possible in explaining the procedures through which they arrived at their conclusions. The emissions thresholds beyond which duties are applied, and the level of the duties themselves would need to be grounded on sound data and science. For its part, the EU would need to have an open mind should the Americans develop a system which differs from their own. Both sides would need to guard against domestic political pressures to develop nationally favourable measures that can then be used to underpin unilateral tariffs.

The Americans made clear that they expect the Europeans to be patient with them as they develop their system. But they too need to understand that there are some red lines that, if crossed, could fatally undermine any efforts at cooperation. One of these could be a system which requires payments from foreign producers for levels of carbon-intensity but does not apply levies on domestic companies with similarly high levels of carbon intensity. Washington may not prioritize heeding WTO rules, but a system which so disadvantages foreign producers – including possibly EU producers – would bring a sharp response from Brussels. And keeping in mind the creation of a level playing field, European companies should be granted credit for costs they incur under the ETS.

Pending Elections Will Influence Future Options for Alignment

The US elections are a mere four months away, important elections are looming in France and the dust has not yet settled from the European Parliamentary elections. Such political turbulence is not conducive to policy convergence or compromise. What happens in 2025 and beyond depends very much on what happens in these elections. The ballooning US federal government deficits and the desire by many to extend provisions of the 2017 tax cuts put forward in the Trump administration that expire in 2025 is seen as an opportunity for some to advance carbon pricing. It is viewed as an option for helping to offset the $4 trillion price tag for extending the 2017 the tax cuts.

Most revenues generated by CBAM and the Clean Competition Act in the US would be channelled into government coffers. Under the EU's CBAM, 25% of the revenue would be given to the individual member states while the remaining three quarters would be deposited in the EU budget. Under the Clean Competition Act, 75% of the revenue generated by the tariffs would be given to the US Treasury Department. While it proposes extending grants to domestic producers to help them cut back on their carbon intensity, as with all things in politics, that is negotiable.

The Clean Competition Act proposes that the remaining 25% funds would be allocated to the State Department to be distributed through bilateral and multilateral assistance programs aimed at helping developing countries reduce their emissions. This recognizes the question, not fully addressed by CBAM, of how border adjustment measures impact emerging markets and developing economies.

There is a recognition that the EU's CBAM program will go forward and there is no indication that it would be delayed. Compensation payments on carbon intensity will be applied from 2026 and those countries that apply strong domestic environmental standards will face lower duties than those which don't.

Up to this point CBAM has been an abstract concept. But soon the program will enter into force, and it will be evident how it works in practice. Businesses are already coming to grips with this and have begun to adjust. This goes for US companies too. If, as the EU suggests, US companies which have clean production processes have little to fear from CBAM they may come to see the EU initiative as a transparent and predictable process which they can accept. Given the predilection of most businesses for harmony across regulatory regimes, pressure may soon mount on policymakers in Washington to pursue a program along the same lines.

Several US participants in the roundtable said they were uncomfortable being in the position of being a rule taker rather than a rule maker. But if that is to be avoided, Congress must act.

The current US aversion to using the WTO as means for rulemaking means that a bilateral approach with the EU may be the only way that differences on addressing climate change can be reconciled. Whether the two parties can reach common ground will be one of the most anticipated global policy questions in the years to come.

But a shared set of policies developed jointly by the EU and the US would set a formidable standard, one with which producers in other countries would be obliged to align if they want to access the two largest markets in the world.

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