



Options and Priorities for the EU-US Global Arrangement on Sustainable Steel and Aluminium

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Steel & Aluminium: Market Structure and Trends (1)

- Historically important strategic industries with disproportionate political influence on both sides of the Atlantic still today
 - Significant driver of 19th and early 20th century economic growth & jobs
 - Less than a century ago, vast majority of global output from U.S./Europe
- Stagnant or declining output in Europe and U.S. over the last two decades contrasts with dramatic growth in emerging economies
 - Since 2000: U.S. steel output -18%; Chinese steel output: +735%
 - China produces more than half of global output in each commodity
 - Also growing outward capacity investment from China in third countries
 - EU and U.S. have become large net importers of both commodities

Steel & Aluminium: Market Structure and Trends (2)

- Both sectors susceptible to government intervention; non-market practices have contributed to so-called “excess capacities”
 - Long legacy of trade disputes and trade defence measures
 - Emerging economies, notably China, engage in dumping practices
 - OECD e.g. estimates 630 mmt in excess steel production capacity
- Both sectors are also highly emissions intensive, due to differences in energy input and prevailing production processes
 - Production outside EU and U.S. typically more emissions intensive
 - EU and U.S. increasingly recycling scrap with lower-carbon electricity
 - Secondary production cannot meet global demand; primary needed

Transatlantic Trade in Steel & Aluminium

- EU and U.S. enjoy largest trade & investment partnership in the world, but steel & aluminium make up only a small share of trade
 - Iron, steel and aluminium products less than 1% of value of traded goods
 - Transatlantic trade dominated by machinery, vehicles, energy, and services
- Differences in prevailing production processes also affect emissions intensity of steel production across the Atlantic
 - U.S. has higher share of EAF production, EU of BF/BOF production
 - EU steel therefore on average more carbon intensive
 - Significant policy and investment push to accelerate commercialization of ultra-low carbon production processes and carbon-free inputs

The GSA: Context and Main Elements (1)

- Long-standing trade tensions escalate in 2018 with U.S. imposition of increased tariffs on imported steel and aluminium
 - Trump administration invokes Section 232 of the Trade Expansion Act
 - Tariff of 25% on steel and 10% on aluminium; 53% decline in EU exports
 - EU adopts “rebalancing measures”; both sides negotiate tariff rate quotas
- Announcement in 31 October 2021 that U.S.-EU suspend trade disputes and launch negotiations on “Global Arrangements”
 - U.S. tariffs replaced with tariff rate quotas based on historical levels
 - EU ends “rebalancing measures”, both sides suspends WTO disputes
 - Both sides agree to negotiate “global arrangements” within two years

The GSA: Context and Main Elements (2)

- “Global arrangements” meant to simultaneously address non-market excess production capacities and emissions intensities
 - Excess capacities framed as important driver of demand and emissions
 - Both sides pledge to expand participation to “like-minded economies”
 - Establish technical working group to confer on methodologies and share data
- Exact implementation mechanisms are not specified in the initial announcement, but broad pillars of cooperation are laid out
 - Agree to restrict market access for non-participants that do not meet conditions of market orientation or standards for low carbon intensity
 - Commit to ensuring that domestic policies support the shared objectives and support lowering carbon intensity across all modes of production
 - Agree to consult on government investment in decarbonization and screen inward investments from non-market-oriented actors

The GSA: Evolution and Breakdown of Negotiations

- Negotiations register little progress until concept notes over a year after the initial announcement reveal markedly different views
- With original deadline of 31 October 2023 unachievable, both sides agree to extend negotiations by two additional months
 - Both sides claim “substantial progress to identify the sources of non-market excess capacity” and “a better understanding of the tools to address the emissions intensity of the steel and aluminum industries”
- Most recently, the EU and U.S. are rumoured to be considering extending negotiations and the status by an additional two years

The GSA: Venturing a Diagnosis of the Stalemate

- Divergent starting points and political priorities, along with simultaneous pursuit of too many objectives, caused gridlock
- Deeply entrenched policy choices reflecting differences in political economy and in market structure underlie the disagreement
 - EU relies on carbon pricing with the EU ETS and CBAM, whereas the U.S. currently imposes no meaningful constraints on industrial emissions; *but*: IRA!
 - U.S. seeks to leverage its lower average carbon intensity through common external tariffs based on average emissions intensity benchmarks
 - U.S. expects exemption from the EU CBAM for its exports, which the EU opposes; EU calls for binding commitment to decarbonize both sectors by 2050
- Both sides also differ markedly in perceived role of WTO conformity

Revitalizing the GSA: Strategic Accommodation

- Each country's or jurisdiction's approach is different, sometimes in fundamental ways, and none will be easily revised to accommodate the interests of international cooperation, however urgent the need
- There is a clear need for platforms or architectures of international collaboration that can countenance different approaches to climate policy, different starting points
- Instruments of *strategic accommodation*: the ability to accommodate entrenched differences—with the agreed understanding that they will diminish over time—in the interest of building international cooperative efforts
- One such instrument: product carbon requirements (PCRs): maximum GHG-intensity standards as a condition of sale on domestic markets. Ratcheting down over time
 - Can accommodate different GHG-intensity starting points, with agreed trajectory of convergence.
 - Can work in tandem with both US and EU approaches
 - Suitable platform for broader participation – truly global arrangement
 - Fulfils the negotiating mandate of the GSA

Revitalizing the GSA: Viable Areas of Cooperation

- If the goal is industrial decarbonization pursued internationally, need to identify what are the most urgent areas for cooperation, and in what venues should they be pursued. Don't assume that all those efforts should be housed in the GSA as a venue
- Obvious areas for cooperation, by dint of being spelled out in mandate: addressing non-market excess capacity, addressing high carbon intensity, screening inward investment
- Also obvious: cooperation on GHG-intensity accounting protocol, as a prerequisite to addressing high carbon intensity. Venue though? This is a crowded space – no less than 10 existing or developing methodologies for steel. Better to pursue agreement aligned with existing ongoing efforts
- Here again, may need strategic accommodation to bridge gaps on a common standard. Could start with a sliding scale as a function of percentage of scrap used (e.g., Arcelor-Mittal proposal) but make it dynamic, to achieve convergence over time at a technology-agnostic standard (e.g., Global Steel Climate Council standard)
- Not so obvious areas for cooperation:
 - Acceptable form for industrial subsidies, including on subsidies conditional on local content requirements: hard to find agreement within the GSA; not clear it's critical to agreement
 - Carbon pricing: Lack of carbon pricing is arguably an entrenched position for the U.S., so hard to find agreement here; not clear it's critical to agreement

What Role for the CBAM in a GSA Outcome?

- Strategic accommodation starts by defining those aspects of domestic realities that have to be respected in any final agreement. CBAM has the characteristics of one of those realities
- It is a centrepiece of the 'Fit for 55' package, integral for the scaling back of free allocation under the ETS and imposing meaningful carbon price on EU EITEs. All in turn are central planks of the European Green Deal. These mark hard-fought political agreements and carefully balanced final deals
- If the GSA outcome consisted of a common external tariff on goods already covered under CBAM, it would require double charging for steel and aluminium, and risk provoking diplomatic and WTO legal backlash. Would be exacerbated by an arrangement that exempted "club" members from the double charge
- CBAM could work in tandem with instruments such as PCRs, if that were the agreed way forward for the GSA

Why the GSA has to Expand beyond the EU and U.S.

- Steel and aluminium production has increasingly shifted to emerging economies, with China alone contributing over half of global output
- Future growth in both output and demand will also be concentrated in the developing world, where most of these commodities will be used
- Driven by policies currently in place, the emissions intensity of EU and U.S. production will further continue to decline
- As a result, the U.S. and EU share of global emissions from both sectors will rapidly decline, limiting the contribution to global decarbonization
- Importantly, GSA also has to help foster trust between developed and developing countries, and support the latter in their climate efforts

Central Takeaways and Way Forward (1)

- Steel and aluminium are important sectors on the path to global decarbonization, and the GSA can make a helpful contribution
 - Both hard-to-abate sectors retain disproportionate political significance
 - Fraught trade relations epitomize challenges of industrial decarbonization
- Different starting points and entrenched political economy path dependencies stand in the way of easy transatlantic agreement
 - Divergent climate policy preferences and different views on the role of WTO conformity contributed to the breakdown of negotiations
 - Simultaneous pursuit of multiple goals encumbers negotiations
 - Political sensitivities will be accentuated by upcoming elections

Central Takeaways and Way Forward (2)

- A pragmatic way forward will leverage strategic accommodation of these deeply entrenched differences across the Atlantic
 - Product-based maximum GHG intensity standards can be designed to flexibly accommodate different carbon intensities and levels of ambition
 - They also can be implemented alongside the existing EU ETS and CBAM without requiring harmonization or cooperation on carbon pricing
- GSA also has to be structured such that it is attractive for participation from emerging economies and developing countries, or it risks being irrelevant
 - Production and demand growth concentrated in the developing world
 - Growing trust deficit threatens broader climate cooperation