Climate and Energy in the Transatlantic Relationship

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Climate change is not only the world's single biggest global challenge, but also the biggest opportunity for the transatlantic political relationship. While various energy issues, including the Nordstream 2 pipeline, offer other opportunities for cooperation, none of them is nearly as important as climate change. Perhaps the most intriguing opportunity is integrating new unilateral climate proposals into an existing multilateral trade system. Doing so would help both parties in the context of increasing U.S.-E.U.-China geopolitical rivalry.[1]

Policymakers on both sides of the Atlantic are coming to see climate change as a competitive opportunity rather than a collective burden. The United States and Europe have watched as China became a global leader in the production of wind, solar, and battery technology.[2] Since 2001, for instance, China has gone from producing 1 percent to producing 66 percent of the world's solar panels.[3] China also produces roughly 70 percent of the world's lithium-ion batteries and a third of the world's wind turbines.[4] Chinese manufacturers have reaped a healthy portion of the European subsidies for renewable energy generation (using regulated "feed-in tariff" prices). Policymakers are now beginning to see the next generation of green technology – especially hydrogen, electricity storage, and carbon capture and storage – as a realm where they need to compete globally to capture industrial and commercial first-mover advantages.[5]

That shift in ideas and perspective has put industrial policy back in vogue. Green industrial policy means efforts by the state to invest public resources into technologies that support climate sustainability, and to guide private sector efforts to do the same. Academics have found that policy sequencing is crucial for effective climate policy, and typically the more successful sequence is green industrial policy first, with carbon pricing following later, if at all.[6] The Biden campaign has embraced this logic, focusing on decarbonization that generates good jobs for the middle class, and remaining rather quiet on carbon pricing. The recent election results in Georgia, giving Democrats a (precarious) majority in the U.S. Senate, raise the probability that the Biden team can achieve some of its climate aims.

While green industrial policy as a competitive opportunity is mostly good news, where it gets interesting is the intersection with international trade rules. Pro-climate policies like tougher regulation or a carbon tax can impose higher costs on domestic producers of carbon-intensive products like steel, glass, aluminum, and concrete. Both the European Union president Ursula von der Leyen and U.S. president Joe Biden have promised to use some version of border adjustment tariffs (BATs, also known as carbon tariffs or border adjustment measures) to shield their economies from the competitive disadvantages of pro-climate policies. Both von der Leyen and Biden are vague on the details. On the whole, BATs might be very useful as a way of reducing domestic political resistance to pro-climate policy. But they also run headlong into global trade rules, at the WTO and elsewhere, which forbid policies that discriminate between manufacturers on the basis of nationality.

How should BATs be incorporated into a multilateralized trade system? At the moment, both the U.S. and E.U. proposals are unilateral, creating the risk of disrupting trade and/or triggering retaliatory trade wars between countries. In an ideal world, the BATs might be paired with domestic carbon pricing (via carbon taxes or cap-and-trade system) to create a climate club.[7] Such a club would operate by reducing greenhouse gases (GHG) inside the club, while imposing an economic penalty (i.e., the BATs) on the countries that chose not to participate in the club's commitments. This type of arrangement could do a lot to eliminate the free-riding problem that has bedeviled previous climate deals like the 1997 Kyoto Protocol.[8] As I've argued in print elsewhere, it is crucial that such a climate club eventually incorporate China, even if it originates initially from the United States and E.U.[9] China now produces upwards of a quarter of the world's GHG emissions, meaning that no climate club can truly succeed without it. The implication is that the United States should not preemptively "decouple" with China's economy, thereby eliminating any hope of creating a climate club of the major emitters.

A climate club approach typically depends on some form of carbon pricing in the United States, like a carbon tax. In a way, France gave the Biden team a political gift that might help generate support for carbon pricing. Shortly after the U.S. election in November, France's Engie halted its commitment to a long-term U.S. liquefied natural gas contract with NextDecade Corp worth $7 billion. The French government, a significant stakeholder in Engie, pushed for the decision because of its concerns over the GHG emissions of U.S. gas production, particularly from the Permian Basin.[10] This action makes credible the argument that U.S. exporters will be at a competitive disadvantage unless they and the U.S. government take action on climate change. If the Biden team chooses to go after carbon pricing, they should use this argument domestically for all it's worth.

If U.S. domestic politics do not allow for carbon pricing, the question about climate tariffs and the trade system gets harder. Most proposals for a climate club that uses BATs depend on some minimum threshold of domestic carbon pricing for all member states that are part of the club—and the absence of such carbon pricing is what justifies the application of BATs to non-members. Conceivably, one could imagine states deciding that a certain level of green industrial policy – i.e., costly efforts to decarbonize an economy – is "equivalent" to a given level of carbon pricing. That would allow states to construct a carbon club even in the absence of U.S. carbon pricing. But the technical and political difficulties of creating policy "equivalences" between green industrial policy and carbon pricing are daunting. How to create such equivalences, and whether to even try, is an open question for both sides of the transatlantic community. A sector-by-sector approach, rather than an economy-wide approach, might be the only feasible way forward.

Regardless, the first step in making any transatlantic progress on climate change—via BATs or any other approach—is to repair the U.S.-E.U. relationship. The

Trump administration has done considerable damage. Withdrawing from the Paris agreement and the Iran nuclear deal (JCPOA) were just two of the more visible ways that the United States distanced itself from European governments. An example less well-known in the United States involves the Nordstream 2 pipeline. The Trump administration continued and increased the Obama administration's opposition to Nordstream 2, threatening sanctions on various non-Russian companies involved in the project. Even before President Trump took office, Europeans suspected that the nominal rationale for U.S. opposition to Nordstream 2—concerns about Russian threats to European energy security—was merely a cover for U.S. commercial interests (i.e., selling more natural gas to European customers). President Trump's obvious insouciance about Russia laid bare the cynical and self-interested nature of U.S. hostility to the project. Just by avoiding such shortsighted actions, the Biden administration is in a position to at least partially repair the relationship. Reversing some of them, like the sanctions associated with Nordstream 2, could earn them more goodwill.

Integrating the unilateral climate proposals from the United States and the E.U. into an existing multilateral trade system will not be easy, but it is where policymakers should direct their attention. In October 2020, Fred Shaia and I laid out a program of climate policy actions that the next President of the United States could and should take via executive orders and other actions, even without much help from Congress.[11] Our central messages were that the United States had to get its own house in order on climate change before demanding more of others; and that it had to use domestic policies in conjunction with foreign policies to make real headway on climate change. Both of those messages are crucial ingredients to a constructive relationship with Europe. By appointing John Kerry and others to senior government positions, the Biden team is off to a good start on climate change. We shall see where it goes.

Please note that this thought piece was written before President Biden announced his decision on Nord Stream 2.

Endnotes

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