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SECTION 232 RELOADED: THE FALSE PROMISE OF THE TRANSATLANTIC 'CLIMATE CLUB' FOR STEEL AND ALUMINIUM

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In using the removal of Section 232 'national security' tariffs on steel and aluminium imports as a bargaining chip, the United States demands that the European Union engage in negotiations on "global steel and aluminium arrangements to restore market-oriented conditions and address carbon intensity". The US demand has reportedly been inspired by a blueprint that would establish an international institutional arrangement – labelled a 'climate club' – which would externalise market-access restrictions afforded by US Section 232 tariffs to the customs borders of club members. While the declared objective is to incentivise non-members to adopt low-carbon steel (and aluminium) production methods the US blueprint suffers from various design flaws including inefficient incentives, WTO inconsistency and incompatibility with the EU Carbon Border Adjustment Mechanism.

The effectiveness of the proposed US scheme is severely compromised by the plethora of policy objectives it pursues, which go far beyond the goal of incentivising industrial decarbonisation in third countries, including secondary (ie protectionism) and tertiary (ie global power competition with China) objectives. The initial negotiation proposal submitted by the United States Trade Representative (USTR) to European Commission trade negotiators incorporates many if not all the problematic elements of this blueprint, setting the US on a collision course with the negotiation proposal put forward by the European Commission. This paper concludes that the adoption of the scheme proposed by USTR would result in a step backwards for international climate and trade cooperation, whereas not adopting the EU proposal would make for a missed opportunity. Given the sharply diverging negotiation positions and associated respective domestic constraints on both sides, however, policymakers should start to engage stakeholders now to manage expectations towards a low-ambition negotiation result, if any.

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1 Introduction

On 31 October 2021, the European Union and the United States agreed on temporary measures to settle their dispute over US Section 232 'national security' tariffs on EU steel and aluminium products. In addition to opening tariff rate quotas for historical EU export volumes, the joint EU-US statement mandates negotiations on a *"global steel and aluminium arrangements to restore market oriented conditions and address carbon intensity"*[1], with a deadline of 31 October 2023. The relevant paragraphs are an eclectic mix of transatlantic policy objectives in the areas of steel and aluminium decarbonisation, sectoral overcapacity, non-market practices and inbound investment screening:

> *"Compatible with international obligations and the multilateral rules, including potential rules to be jointly developed in the coming years, each participant in the arrangements would undertake the following actions: (i) restrict market access for non-participants that do not meet conditions of market orientation and that contribute to non-market excess capacity, through application of appropriate measures including trade defence instruments; (ii) restrict market access for non-participants that do not meet standards for low-carbon intensity; (iii) ensure that domestic policies support the objectives of the arrangements and support lowering carbon intensity across all modes of production; (iv) refrain from non-market practices that contribute to carbon-intensive, non-market oriented capacity; (v) consult on government investment in decarbonization; and (vi) screen inward investments from non-market-oriented actors in accordance with their respective domestic legal frameworks.*
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> *"To enhance their cooperation and facilitate negotiations on a global sustainable steel and aluminum arrangements, the United States and the EU agree to form a technical working group. Through the working group, the United States and the EU will, among other things, confer on methodologies for calculating steel and aluminum carbon-intensity and share relevant data"*[2].

At the time of writing – 20 months after the formal launch of negotiations and four months prior to the deadline, negotiators have set up two technical working groups – one covering the carbon intensity element and one covering the overcapacity element of the negotiations. They have also exchanged negotiation positions in the form of concept notes in December 2022 and January 2023 respectively.

On 10 March 2023, European Commission President Ursula von der Leyen and US President Joe Biden declared, as part of a further joint statement (The White House, 2023), that they were *"committed to achieving an ambitious outcome in the Global Arrangement on Sustainable Steel and Aluminum negotiations by October 2023. The arrangement will ensure the long-term viability of our industries, encourage low-carbon intensity steel and aluminum production and trade, and restore market-oriented conditions globally and bilaterally. Together, we will incentivize emission reductions in these carbon-intensive sectors and level the playing field for our workers. The arrangement will be open to all partners demonstrating commitment to countering non-market excess capacity and reducing carbon-intensity in these sectors"*.

But beyond this declaration of joint ambition, US and EU perspectives and their initial negotiation proposals diverge sharply in terms of both policy design features and the overall approach, objectives and vision of transatlantic and international climate and trade cooperation. This paper sets out the EU and US perspectives on the ongoing negotiations and evaluates US and EU initial negotiation proposals

[1] See European Commission press release of 31 October 2021, https://ec.europa.eu/commission/presscorner/detail/en/ip_21_5721.
[2] The US-EU Joint Statement is available at https://ustr.gov/sites/default/files/files/Statements/US-EU%20Joint%20Deal%20Statement.pdf.

as the transatlantic talks slowly but surely approach the 31 October 2023, deadline. The October deadline could mark either a breakdown of negotiations and automatic reinstatement of US Section 232 tariffs on imports of steel and aluminium from the EU, or a transatlantic agreement on a 'Global Steel and Aluminium Arrangement'. An agreement could follow either the US or the EU's vision for climate and trade cooperation, with all of the imaginable scenarios having considerable economic and climate policy implications for the US, the EU and the rest of the world.

As a benchmark for evaluation, Falkner *et al* (2022) noted that a prospective transatlantic climate club must be assessed on the basis of whether it adds or distracts from the multilateral climate regime or diverts resources away from crucial national abatement efforts. Here, we assess both the US and EU proposals for the arrangement against both the multilateral and the national benchmark, among others.

2 The EU perspective

The negotiation objectives listed in the transatlantic communiqué are vague enough – and therefore provide ample policy space – for the EU to merely continue to implement legislation it has already adopted. For the EU side, indeed, the two paragraphs do not require much or any additional action.

For starters, the EU reformed its trade defence instruments[3] (TDI) in 2017 to better address 'significant distortions' of prices resulting from state intervention and to broaden the scope of its anti-subsidy rules. Measures adopted on the basis of these instruments restrict and will continue to *"restrict market access to exporters that, due to conditions of non-market orientation, contribute to excess capacity"*, as demanded by the EU-US joint statement. For instance, the EU currently applies 32 anti-dumping measures and three countervailing duty (anti-subsidy) measures against Chinese base metal exports[4], setting disincentives for Chinese excess capacity sales.

Second, the EU Regulation on a Carbon Border Adjustment Mechanism covers the energy-intensive trade-exposed (EITE) sectors of steel and aluminium, among others, and will *"restrict market access for non-participants that do not meet standards for low-carbon intensity"* by charging the EU domestic price on carbon[5] (imposed via the reformed EU Directive establishing an emissions trading system[6] on imports at the border, starting in 2026). Domestically, the May 2023 Directive (EU) 2023/959 revising the Union's ETS will see a phase-out of emission allowances altogether by 2038, meaning that, by that time, both the steel and the aluminium producing industries ought to be fully decarbonised. Third, the EU Framework for Foreign Direct Investment Screening (Regulation (EU) 2019/452) coordinates EU member states' efforts in that area, including the *"screening of investments from non-market-oriented actors"*.

The transatlantic 'technical working group', finally, would then serve the EU to socialise its respective policy approaches with the US partner.

In sum, the existing EU policy toolkit already comfortably meets the targets set out by the transatlantic negotiation mandate.

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[3] See European Commission memo of 4 October 2017, https://ec.europa.eu/commission/presscorner/detail/en/MEMO_17_3703.
[4] See World Trade Organisation Trade Remedies Data Portal, https://trade-remedies.wto.org/en.
[5] See European Parliament resolution of 18 April 2023, https://www.europarl.europa.eu/doceo/document/TA-9-2023-0100_EN.pdf.
[6] See European Parliament resolution of 18 April 2023, https://www.europarl.europa.eu/doceo/document/TA-9-2023-0098_EN.pdf.

3 The US perspective

Shortly after the publication of the EU-US statement on the temporary settlement of the 232 tariff dispute in October 2022, the *Financial Times* reported that:

> *"the US administration is heading tentatively down the policy path set out a few months ago by Todd Tucker of the Roosevelt Institute and Timothy Meyer of Vanderbilt University in this paper (which is worth rereading in light of this new deal). They argue that the US doesn't need to go down the same path as the EU and introduce carbon pricing, but can still work with allies to reach sectoral agreements that agree on how to measure carbon intensity and impose tariffs on carbon-intensive industries"*[7].

A comparison of the key parameters set out in the Tucker-Meyer plan (henceforth: TMP) and a USTR negotiation proposal leaked to the *New York Times* confirms that the USTR negotiation position broadly follows the script of the TMP with a view to achieving its core objective: *"Instead of getting rid of the global levies on steel and aluminum that the Trump administration introduced in 2018, this effort would replace them with a new global system of tariffs structured around climate concerns"*[8]. As demonstrated in the remainder of this paper, however, the connection of these tariffs to climate concerns is, at best, a loose one. Most importantly, both the TMP and the USTR negotiation proposal place great emphasis on taxing imported steel and aluminium, but do not credibly suggest parallel domestic restrictions on high-emission US steel and aluminium production. This circumstance reflects the fact that the US does not have in place a legislative agenda – or a roadmap – to decarbonise its high-emission blast-furnace steel mills, which make for roughly 35 percent of US steel production compared to roughly 65 percent low-mission electric arc furnace (EAF) production. What's more, both the TMP and the USTR proposal appear to be designed precisely to avoid confronting the US steel and aluminium sectors with the decarbonisation challenge and, instead, exclusively target third country steel exports for at least the first decade of the scheme's operation.

It is therefore argued here that both the TMP and the initial USTR negotiation proposal are ill-suited to support the achievement of proclaimed policy objectives other than maintaining the tariff protection afforded to US steel and aluminium industries, as originally imposed by the Trump Administration. Rather, the implementation of an arrangement along the lines of the TMP and the USTR proposal would leave both negotiating parties and the rest of the world worse off in terms of the achievement of climate targets, sectoral competitiveness, market orientation and economic welfare generated through trade, compared to any currently conceivable alternative (including a no-agreement) scenario.

The TMP suffers from a number of design flaws that are worth unpacking and putting on display given its evident influence on USTR's recent negotiation position and the development path of US sectoral climate policy proposals. The plan sets an important example for a disconnect between policy objectives, instruments and outcomes, and 'green-washed' protectionist policy. That said, the USTR proposal has evolved slightly from the TMP in terms of its design features. This development is worth careful analysis as the US is now charting its own climate and trade policy nexus path.

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[7] Aime Williams, 'A green deal to cull Trump-era metals tariffs', *Financial Times*, 3 November 2021, https://www.ft.com/content/539ee889-6e5d-4f0a-85cc-90ff4c0c3310. The paper cited is Tucker and Meyer (2021).
[8] Ana Swanson, 'U.S. Proposes Green Steel Club That Would Levy Tariffs On Outliers', *The New York Times*, 7 December 2022, https://www.nytimes.com/2022/12/07/business/economy/steel-tariffs-climate-change.html.

3.1 Core elements and design flaws of the TMP's 'Green Steel Deal'

The TMP's 'Green Steel Deal' foresees the creation of an exclusive transatlantic climate club of the Nordhausian 'deep integration' type. The criteria for membership is the vague obligation to 'green' the domestic steel sector by requiring the sector-wide adoption of 'green production methods' within 10 years. The TMP document includes, however, very little information on the domestic legislative dimension of the plan as regards the decarbonisation of the US steel sector. This is important as a matter of emphasis by the authors who, instead, dedicate considerable attention and detail to tariff-based border protection against steel from countries that do not commit to the 'climate club'. Tariffs, it is suggested, are useful instruments for industrial decarbonisation. It is argued *"that the US, the EU and like-minded countries should harvest an early win in the fight against the climate crisis by imposing a common external tariff on carbon-intensive steel imports, while – as the Paris Agreement contemplates – allowing each other flexibility to pursue a range of decarbonization strategies domestically."*

After ten years of tariff transition, 'dirty' steel imports to climate club jurisdictions and 'dirty' domestic production therein should be banned entirely. The authors of the TMP do provide an indication of what should be considered 'decarbonised' by US standards, however: *"electric arc furnace* [EAF] *can be mostly decarbonized if recycled steel is used as feedstock and if the electricity that feeds the furnace itself is decarbonized."* This makes for crucial information for policymakers because it means that 65 percent of the US steel sector is already 'mostly decarbonised' if fed with scrap steel and electricity from renewable sources. As noted above, 65 percent is the share of existing EAF mills in the US. Moreover, we learn that the *"majority of further reductions would then come from changes in the Blast Furnace* [BF] *process, such as the use of natural gas, carbon capture and storage (CCS), direct electrolysis (DE) of iron ore, or hydrogen reduction."*

Given the fact that 65 percent of US steel production is already among the cleanest in the world, US proposals for embedded emission benchmarks restricting market access for imports would be expected to accommodate EAF performance standards and BF transition from the outset, making for *de-facto* discrimination, for international trade legal purposes, against imports from non-member countries. Such accommodation of US domestic producer interest would be achieved by using *average* domestic industry emissions as a benchmark, which is precisely what USTR has proposed in GSA negotiations, instead of production-route-specific emission standards, as proposed by the EU.

The TMP and the USTR proposal hence appear to cherry-pick an industrial sector for transatlantic climate club cooperation where the US is already comparatively carbon-efficient without having to impose domestic regulatory restrictions at the outset. Viewed in this context, it appears that the plan has one overarching aim and effect: to protect the US national steel and aluminium sectors – and the unionized integrated blast furnace steel mills in midwestern swing states in particular – to a maximum extent and for as long as possible, from the financial and socio-economic burdens associated with industrial decarbonisation.

3.1.1 A transatlantic common external tariff on steel and aluminium imports

At the core of the TMP lies the proposition that domestic administrative agencies on both sides convert *average incremental producer costs of greening production methods* (compared to production of conventional steel) into tariff rates for border adjustment. Average incremental producer costs of greening production methods make for a subcategory of average environmental regulatory adaptation costs. Average environmental regulatory adaptation cost is also what US Senator Coons and Representative Peters have favoured as the baseline for a US border adjustment in draft legislation that the two lawmakers released one day following the publication of the European Commission's

legislative proposal for Carbon Border Adjustment Mechanism (CBAM)[9]. Both the TMP and the Coons/Peters bill constitute important and similar observations in the evolution of US carbon border adjustment policy proposals.

Citing a Brookings study (Victor *et al*, 2019), the authors of the TMP estimate that a tariff rate of between 25 percent (exactly mirroring the Trump Administration's 232 'national security' tariffs on steel) at the lower end, to 50 percent at the higher end, approximates an accurate border adjustment for costs of greening production methods. But TMP leaves the reader in the dark over which US emission regulations could result in producer adaptation costs equivalent to a 25 percent or 50 percent border tariff adjustment.

It is noteworthy, in this context, that it was the technological development of electric arc furnace (EAF) run mini-mills in North America which significantly advanced carbon competitiveness in the steel producing sector. But the success of mini-mill production by the end of the twentieth century was not a consequence of US emission regulation (Israilevich, 1986). It was their promise to revive the US steel sector's competitiveness as a result of major efficiency gains. In other words, for the US steel sector, economic and carbon efficiency have gone hand in hand rather than in contradiction to each other, casting doubts over the question of necessity and legitimacy of a US border adjustment for steel imports in the first place. It is at least questionable whether firm-level spending for technological upgrades is not at least partially attributable to the normal investment cycle rather than regulatory decarbonisation requirements. In comparison to the TMP's proposed tariff of between 25 percent and 50 percent, the EU CBAM impact assessment cites an average tariff equivalent of ETS carbon costs paid by EU producers in all five covered sectors, of only 4 percent by 2035[10].

3.1.2 Caveats to non-pricing policy cost conversions

There are several important caveats to calculating carbon border adjustments on the basis of non-pricing policies (eg regulatory adaptation costs), as opposed to converting an explicit carbon price (a carbon tax or an ETS) into a CBA as prescribed by the EU CBAM regulation. The conversion of average regulatory adaptation costs into a tariff is much less accurate in projecting incentives for abatement at home and abroad. The individual nature of producers' abatement cost curves implies that cost averages converted into border charges will inevitably over-protect some and under-protect other domestic producers. The selection and conversion of individual regulatory measures into average cost is, moreover, associated with a degree of econometric complexity and arbitrariness of choice. The US methodology of choice, in other words, is far from an exact science.

All of the aforementioned pitfalls would be avoided if the US shifted abatement efforts to a threefold synergistic combination of a carbon pricing, the imposition of carbon intensity product standards and subsidy instruments to support the decarbonisation of existing installations. Adding a transatlantic regulatory layer of implicit cost adjustment alone, on the other hand, makes life unnecessarily complicated. Instead of import tariffs based on fabricated regulatory adaptation costs of domestic producers, the US needs a carbon tax, which can then be adjusted 1:1 at the border in a straightforward manner.

Methodological pitfalls are also the reason why the European Union's CBAM regulation disregards regulatory adaptation costs at home and abroad as input for cost conversions for its border

[9] See Chris Coons press release of 19 July 2021, https://www.coons.senate.gov/news/press-releases/sen-coons-rep-peters-introduce-legislation-to-support-us-workers-and-international-climate-cooperation.
[10] See https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12228-EU-Green-Deal-carbon-border-adjustment-mechanism-_en.

adjustment. Conversions of implicit carbon costs also hardly lend themselves to international CBAM cooperation: a requirement to calculate the equivalence of all third-country regulatory measures relevant for exports in relation to an explicit or implicit carbon cost imposed at home would confront implementing agencies with a herculean task and might render the adoption of a CBAM impossible for many governments that operate in resource-scarce environments. The use of explicit carbon prices (ie a carbon tax or ETS charge) as the sole variable of carbon cost equivalence across jurisdictions, on the other hand, is a comparatively straightforward and, importantly, transparent exercise and, as a result, makes for the superior policy instrument.

3.1.3 Caveats to country-wide average carbon-intensity benchmarks

To determine eligibility for tariff exemptions, the TMP proposes to employ a single *average* sectoral carbon-intensity benchmark for all economies to assess compliance with the transatlantic 'green production methods' standard during the first 10 years. This makes for both an arbitrary and unjustifiable policy choice. Employing data of average country-wide carbon intensities, instead of data of actual emissions embedded in individual import shipments, vastly distorts incentives for abatement at the producer level and therefore runs counter to the TMP's proclaimed external decarbonisation objectives. Producers from high-emission countries (ie from jurisdictions where producers on average do not meet the transatlantic green production methods standard) receive virtually no individual incentive to advance decarbonisation because an exemption from the transatlantic common external tariff depends on country-wide and not individual decarbonisation efforts. 'Dirty-steel producers' from low-emission countries (ie jurisdictions where producers on average meet the transatlantic green methods standard), on the other hand, free-ride on the decarbonisation achievements of competitors who produce 'clean steel' in the same jurisdiction.

In light of these considerations, the European Union has included, in Article 7 and 8 of the CBAM regulation (Regulation (EU) 2023/956), what Mehling and Ritz (2020) call an Individual Adjustment Mechanism (IAM). The IAM allows individual producers to demonstrate by means of independent verification of actual emissions data that the emissions embedded in their products are lower than the scheme's benchmarks, and ensure that carbon cost and embedded emissions stand in perfect correlation to each other, therefore setting highly efficient abatement incentives and providing for a stronger (because perfectly correlated) relationship between the legitimate policy objective and the discriminatory adjustment instrument. In other words, the IAM not only enhances policy effectiveness but also the prospects of World Trade Organisation General Agreement on Tariffs and Trade (GATT) legal consistency, exemplifying the perfectly functional operation of the GATT Article XX test. In the EU, CBAM emissions reporting will begin three years before CBAM charges apply, allowing for enough time to socialise the new practice with importers, producers and government agencies.

3.1.4 Caveats to non-cost-crediting CBAM policies

The provision of transparent, individual and performance-based commensurate incentives is also the rationale that should apply to the instrument of crediting explicit carbon costs paid by foreign producers in their home jurisdictions. Neither 'Green Steel Deal' proposed in the TMP nor the USTR proposal include this option, neither in the transition phase nor after, whereas the EU CBAM regulation allows for the crediting of explicit carbon costs paid abroad to any CBAM charges that may apply (Article 9 CBAM Regulation). Not to credit carbon costs would set negative incentives against the adoption of explicit carbon pricing schemes in third-country jurisdictions because emissions embedded in their exports would be charged twice – in violation of WTO law. Non-crediting CBA policies also set incentives for WTO-incompatible (in regard to regulatory adaptation and ETS costs) and WTO-compatible (for carbon taxes) export rebates, and may, crucially, increase the potential that a global export-refund arms race will be triggered, with rising carbon leakage rates that find their valve in

international steel markets. Carbon cost-crediting policies, on the other hand, incentivise carbon pricing and hence industrial decarbonisation abroad, which makes for a key source of abatement of the TMP.

The functional benefits of cost-crediting policies in relation to their contribution to achieving protected policy objectives, as noted above, also greatly increase the likelihood of WTO legal consistency. Non-crediting schemes such as the TMP would likely be found to constitute a disguised restriction on international trade and/or unjustifiable discrimination among different WTO members, and would therefore fail the basic tests of the *chapeau* of Article XX GATT.

3.1.5 'Dirty steel' ban and use of tariff revenues

Without US domestic legislative instruments prescribing the decarbonisation of the US steel and aluminium sectors, the TMP's vague bilateral legal requirement for 'greening steel production methods within ten years' would thus make for the only (and undefined) burden applicable to the US side, compared to the carbon price charged to European producers via the ETS in the period of 2026-2034, and the complete phase-out of emission allowances by 2038.

The 'dirty steel' production and import ban based on product emission-intensity standards could apply from year one instead of year ten, and thereby lead to relatively lower imports of embedded emissions. Separating carbon-intensity standards from tariffs, however, would deprive the instrument of its revenue source that is meant to subsidise US sector-specific clean technology R&D. It follows that the brunt, if not all, of the costs of the US decarbonisation strategy for transatlantic steel sales would have to be borne by electricity generators and/or taxpayers subsidising clean electricity generation, non-club-exporters' decarbonisation costs, and exporters' tariff payments to the US government. The latter should be spent, according to the authors, on domestic R&D subsidies for green-steel production technologies and likely render the scheme 'a means of arbitrary or unjustifiable discrimination' and hence ineligible for protection under the WTO's GATT general exceptions, codified in Article XX of the Agreement.

3.1.6 Preliminary conclusion

The plan, in sum, foresees the creation of a transnational 'deep integration' regime that provides for safe passage of Trump's 232 national security tariffs to an arrangement that allegedly incentivises domestic and third-country industrial decarbonisation. The scheme, by implication, would oblige the European Union and other club members to adopt Trumpian steel tariff protection for their own steel imports from China and others, in addition to already-existing anti-dumping, countervailing (anti-subsidy) and CBAM measures. In a second step, the EU would be required to transform tariff protection into a formal ban on 'dirty steel' imports and sales based on third countries' average industry cost of adaptation to environmental regulation, and average industrial emission intensity, instead of import-shipment-specific carbon intensity. Interestingly, the plan would extend the reach of the proposal of Congressmen Peters and Coons for an 'import polluter fee' and would export the regime to the European Union, where it is meant to supersede the EU CBAM with respect to steel and aluminium imports from the US, thereby effectively granting US exporters an exemption from EU CBAM charges (117th Congress, 2021).

4 Transatlantic GSA negotiations: comparing US and EU negotiation proposals

In December 2022, the US Trade Representative formally submitted a 'Concept Paper on the Design of the Global Steel and Aluminium Arrangement' to EU negotiators at the European Commission's Directorate General for External Trade (DG TRADE). In January 2023, DG TRADE reciprocated with its own GSA concept note submission to USTR. By and large, the US proposal reflects the TMP approach of an exclusive and coercive club setting, devoid of defined obligations for domestic restrictions. The European Commission proposal, in contrast, notionally and practically reflects the German G7 Presidency's proposal for open and inclusive climate cooperation, providing for joint ambition of long-term decarbonisation targets, while allowing for climate policy diversity, subject to the constraints of participants' international legal obligations. The remainder of this section outlines, compares and evaluates the design features of both negotiation proposals.

4.1 USTR's Concept Note on the 'Global Steel and Aluminium Arrangement'

To begin with the end, the final paragraph of USTR's GSA concept note explicitly envisions that *"the Global Arrangement will ultimately supersede the provisions of the EU CBAM, at least on a bilateral basis."* For the design of the GSA, the note proposes two core elements. First, it sets out GSA membership criteria. Secondly, it sets out a common GSA methodology for the determination of carbon-intensity related tariffs, which would provide preferential market access to GSA members.

4.1.1 Club membership criteria

Membership eligibility would be based on countries' *average* embedded product emissions, applicant economies' contributions to 'non-market excess capacity', and a to-be-agreed minimum percentage of public procurement of low-emission steel and aluminium.

A prospective members' *average* embedded product emissions, for starters, must not be more than a certain to-be-determined percentage above the average emission intensity of like products in the two cleanest member economies (ie the US and the EU). This benchmark would be adjusted downwards over time to reflect increasing ambition and would cover, at the outset, scope 1 (direct) emissions only, with the possibility of including scope 2 and scope 3 (indirect) emissions once data availability improves.

With respect to non-market excess capacity, the club-entry requirements proposed by USTR set out various criteria reflecting the multiplicity of objectives pursued, including non-climate goals. Criteria include an assessment of the risk of an economy becoming the source of non-market excess capacity, the operation of state-owned or controlled enterprises in an applicant economy, a commitment to refrain from export restrictions on *"relevant raw materials, intermediate inputs, and other related products"*, trade and investments from non-market economy sources with and in GSA applicants as well as measures taken to address market distortive effects deriving therefrom, and adherence to international labour standards.

At the initial stage, *"members of the Global Arrangement would not need to meet the criteria for both steel and aluminum to join the Global Arrangement (i.e., they may qualify for one sector and not the other)"*.

4.1.2 A common methodology for club members' steel and aluminium tariffs

Second, instead of a common external tariff as foreseen by the TMP, USTR's concept note proposes a common methodology for tariff-based market access restrictions for steel and aluminium imports from

and among GSA members, as well as for imports from GSA non-members. Crucially, USTR's proposed tariff methodology is not designed to adjust for any explicit or implicit carbon pricing schemes in importing jurisdictions. It is not designed to adjust for any potential emission abatement costs borne by domestic industry as a result of emission regulation or taxation. The US scheme, in contrast, prices imported embedded product emissions at the border depending on the degree to which they exceed a domestic benchmark, irrespective of the regulatory or tax-induced carbon costs incurred by domestic producers, as well as irrespective of regulatory or actual carbon costs paid by third-country producers in their home jurisdictions.

4.1.3 Tariffs for trade among club members

For trade *among GSA members*, the note sets out four preferential tariff tiers for steel and aluminium imports. The applicable tariff rate would be determined on the basis of *"how much more emission-intensive the imported product is than (a) the highest emission version as produced in the country of import or (b) alternatively, the average emissions intensity of that same (or very similar) product as produced in the country of import"*. The applicable tariff, in other words, varies in relation to how clean, on average, production is or, alternatively, how dirty the worst-performing installations are in the importing jurisdiction.

4.1.4 Tariffs for trade between club members and non-members

For imports *from non-GSA members*, USTR's concept note proposes a set of four external tariffs. The tariff tier applicable to a respective import shipment would be determined by using the highest proposed tariff level for trade among GSA members as a baseline (baseline component), and adding a markup (markup component) determined on the basis of which of four embedded emission intensity ranges the imported product in question falls into. Which one of the four proposed tariff tiers applies to the respective import would depend – as with the GSA-internal tariffs – on how much more emissions-intensive the imported product is than (a) the highest-emission version produced in the importing jurisdiction, or (b) alternatively, the average emissions intensity of that same (or very similar) product. In other words, the tariff rate applicable to GSA members' imports from GSA non-members would be the sum of a baseline component and a markup component that is contingent on how clean the production of the importing member is on average or, alternatively, how dirty the worst performing installations in the importing member are. To reiterate the initial point: USTR's methodology does not in any way factor actual carbon costs incurred by domestic producers into the equation that determines the tariff that imported steel and aluminium would be subject to. The scheme, therefore, is not a carbon-border-*adjustment* mechanism, but protects domestic industry irrespective of domestic industrial adaptation costs actually incurred.

4.2 An assessment of the USTR negotiation proposal

As a slightly more refined version of the TMP and as such a proposal for an exclusive and coercive 'climate club', USTR's concept note carries many of the TMP's design flaws.

For starters, a club design implementing the USTR proposal would be, compared to the EU CBAM, relatively ineffective in curbing third-country embedded emissions because it sets inefficient incentives both for members and non-members of the arrangement. As regards entry requirements, the US GSA proposal resorts to candidate economies' *average* emissions intensity for a given set of products. But the average emissions-intensity criterium *a priori* forecloses preferential (GSA member) market access for relatively carbon-efficient producers located in jurisdictions that feature relatively high average industry-wide emissions. At the same time, the average emissions benchmark rewards

relatively carbon-intensive producers in jurisdictions that host industries characterised by average low carbon intensity.

Moreover, tariff tiers attributed to carbon-intensity ranges do not achieve the exact proportionality that the EU CBAM's Importer Adjustment Mechanism (IAM) discussed in section 3.1 results in. The EU CBAM's IAM establishes a perfect correlation between actual emissions embedded in an import shipment and the CBAM charge that is due at the border, and thereby sets efficient incentives for third-country producers to lower costs attributed to exported emissions. In sum, tariff tiers linked to carbon-intensity ranges make for inferior policy design compared to the EU CBAM instrument, whether the primary objective is carbon leakage prevention or setting efficient incentives for exporting third-country producers to decarbonise.

Third, the GSA entry requirements relating to an applicant's *"contribution to non-market excess capacity"* in the steel and aluminium sector appear to be largely if not entirely detached from the emission abatement objectives of the scheme. That is to say, while there is certainly a theoretical relationship between reducing excess supply and emission abatement, it is unclear whether several if not all of the listed criteria would indicate a *"contribution to non-market excess capacity"* and/or would result – in case of adherence to the proposed criteria – in supply and therefore emissions reductions in GSA member jurisdictions. Refraining from export restrictions applying to raw materials and adherence to international labour standards, for instance, does not seem to be even notionally related to the concept of excess capacity. Rather, the criteria appear to be specifically designed to exclude one economy from GSA membership, irrespective of non-market excess capacity considerations – ie China – and discourage prospective GSA members' steel and aluminium imports and investments from China, irrespective of carbon intensity and impact on the net-zero transition.

On the flipside, the note contains one notable omission, ie provisions for contributions to non-market excess capacity potentially induced by US measures (now or in the future), eg Section 232 tariff protection of US producers, production subsidies and local content requirements and bonuses with respect to steel, as included in the US Infrastructure and Jobs Act and the Inflation Reduction Act. These measures set artificial price incentives for US industries to produce quantities above an undistorted market equilibrium.

Legally speaking, the envisioned arrangement would violate basic non-discrimination obligations in general, and Article I (Most-Favoured-Nation treatment) and III (National Treatment) of the GATT in particular. While these rule violations are typical for measures restricting market access for like products on the basis of production and processing methods (PPM), these violations cannot be healed by Article XXIV GATT (Regional Trade Agreements) because the envisaged preferential trading scheme would fail to meet the basic criterium for a 'free trade arrangement' protected by Article XXIV, that is to liberalise *"substantially all the trade"* – instead of only 'carbon-free' steel and aluminium trade – among its members.

The tariff preferences granted to GSA members under the US GSA proposal also cannot be justified by Article XX GATT general exceptions and Article XX(g) GATT in particular. This is because the proposed entry requirements in regard of non-market-excess-capacity, labour standards and export restrictions on raw materials that are linked to the market access discrimination in favour of GSA members, do not discernibly *"relate"* to the protection of *"exhaustible natural resources"* – the objective protected by Article XX(g) GATT.

Moreover, even if such a relationship could be established, the scheme would arguably still not withstand legal scrutiny in connection with the requirement of Article XX(g) that the measures protected by the provision are *"made effective in conjunction with restrictions on domestic production*

or consumption". After all, the steel sector in particular was chosen as a pilot for a US-led climate club for the precise reason that US steel production is – measured by country *average* emission intensity – the most carbon-efficient in the world, while remaining unrestricted by explicit or implicit carbon pricing for the foreseeable future. The proposal to allow GSA members the flexibility to meet the entry criteria in only one of the two covered sectors, in addition, appears designed to exempt US industry from any adaptation cost to begin with, allowing for US membership without imposing any actual constraints on US aluminium smelters, which are known to be much less emissions competitive than much of the competition abroad[11].

The USTR proposal does not – in contrast to the TMP – attempt to justify the proposed border taxes with reference to regulatory adaptation costs the tariffs would adjust for in order to level the playing field and prevent carbon leakage. Rather, the only remaining environmental rationale for the scheme would be the coercion of third-country economies to decarbonise their steel and aluminium sectors both economy-wide and at the level of individual producers, while the US lacks a domestic legislative or other path for the decarbonisation of its integrated blast furnace steel mills. As a result, a WTO panel could well find that the scheme has the *"intended or actual coercive effect on the specific policy decisions made by foreign governments"*, which the Appellate Body in the *US-Shrimp* dispute found to be unjustifiable under the *chapeau* of the General Exceptions of GATT Article XX.

Against this background, the supersession of the EU CBAM through a scheme featuring design characteristics similar to that set out by USTR's concept note appears highly undesirable. Adopting a policy instrument that only imposes additional trade costs on third-country exporters without placing any discernible restrictions on the domestic industry at the outset, moreover, would severely undermine transatlantic credibility in international climate and trade diplomacy vis-à-vis partner country governments and stakeholders. This comes in addition to the ills associated with the Trumpian genesis of the USTR's demand for a GSA, to secondary (protectionist) and tertiary (global power competition) US policy objectives, as well as from to the quasi-coercive USTR approach of leveraging the removal of Trump tariffs in order to impose a WTO-inconsistent exclusive sectoral trading regime on partner countries,

Finally, but crucially, the US GSA proposal also fails to resolve the transatlantic trade dispute over US Section 232 tariffs on steel and aluminium imports from the EU. It would retain some tariff protection afforded by the Trump Administration vis-à-vis EU exporters by transforming the Trump tariffs into a restriction on international trade disguised as 'carbon tariffs'. It may be telling, against this background, that the Biden Administration reportedly considers using a now internationally renowned domestic legal basis for the adoption of the prospective GSA, notably US Section 232 of the 1962 US Trade Expansion Act[12].

4.3 The European Commission's concept note on the Global Steel and Aluminium Arrangement

The European Commission's GSA concept note proposes a sharply distinct GSA design and vision of international climate and trade cooperation. The Commission's proposal is broadly in line with the approach outlined in the G7's Terms of Reference for an inclusive and cooperative Climate Club, which, as some have suggested, should be labelled a 'Climate Alliance' to avoid confusion with a Nordhaus-style club setting (Sartor *et al*, 2022). The Commission's concept note employs the GSA design

[11] Phil McKenna, 'Why American Aluminum Plants Emit Far More Climate Pollution Than Some of Their Counterparts Abroad', *Inside Climate News*, 6 December 2022, https://insideclimatenews.org/news/06122022/why-american-aluminum-plants-emit-far-more-climate-pollution-than-some-of-their-counterparts-abroad/.
[12] *World Trade Online*, 'Analysts: Section 232 could provide a path to greener steel', 27 December 2022, https://insidetrade.com/daily-news/analysts-section-232-could-provide-path-greener-steel.

proposal as a vehicle to socialise and advance existing EU climate and trade policies, and underscores the centrality of international legal obligations as a benchmark for GSA members' conduct, while largely putting the focus on GSA members' own – instead of third countries' – decarbonisation of the steel and aluminium producing sectors.

4.3.1 Primacy of the EU CBAM

Above all, the note implicitly but *de facto* underscores the primacy of the EU CBAM with respect to EU market-access restrictions based on carbon intensity by providing for full discretion for GSA members to adopt respective policies, including to prevent carbon leakage, subject to the disclaimer that any such measure should be compatible with their international legal obligations. With that, the Commission's note does away with the US demand for a joint approach to GSA internal and external 'carbon tariffs'.

4.3.2 Binding commitments on domestic sectoral industrial decarbonisation

Instead, the European Commission's concept note places the emphasis on operationalising GSA members' domestic medium and long-term joint ambitions with respect to sectoral industrial decarbonisation, requiring members to demonstrate domestic legislative steps that commit them to sectoral 2050 net-zero emission roadmaps, with binding measurable commitments to intermediate decarbonisation in 2030 and 2040 respectively. In addition, the average embedded product emissions intensity of GSA members should not be more than a certain percentage higher than the average emissions intensity of EU and US steel and aluminium, subject to a ratchet mechanism that adjusts this figure downward over time. Product emissions-intensity benchmarks would be established and adjusted over time for existing distinct production methods (eg for steel production: blast-furnace production vs electric-arc furnace production). GSA members would use a compatible (ie joint) methodology to determine product emissions intensity in the steel and aluminium sectors.

4.3.3 Non-market excess capacity

On non-market excess capacity, the Commission's note acknowledges the link between industrial overcapacity and emissions caused, as well as the impact of overcapacity-induced deflated prices on generating undue competition for low-emission alternatives. In order to disincentivise excess capacity, the proposal suggests that GSA members employ standard trade-defence instruments, including anti-dumping and countervailing duties as well as safeguard measures. Second, the Commission proposes to develop binding transparency obligations and a code of conduct for best design practices in terms of permitted subsidies to the steel and aluminium sectors of GSA members. Third, the note suggests developing a 'green box' that would exempt certain environmental subsidies from GSA members' countervailing duties. Fourth, finally, and interestingly with respect to the substantive content of the US Inflation Reduction Act, the Commission proposes to commit GSA members to change any domestic legislation not in line with prohibitions on domestic content, assembly and sourcing requirements, with a view to conforming with WTO obligations.

4.3.4 Additional commitments

The Commission proposal, furthermore, would commit GSA member government procurement to a certain percentage of low-emission steel and aluminium acquisition, facilitate trade in low-emission steel and aluminium through the development of low-emission standards, enhance R&D cooperation on clean technologies among members, and commit members to support least-developed countries and other steel and aluminium producing economies in their decarbonisation efforts.

Finally and crucially, the note proposes that the US permanently lifts Section 232 steel and aluminium tariffs on imports from the EU, whereas the EU would commit to permanently lift corresponding retaliatory measures.

4.4 An assessment of the European Commission's negotiation proposal

Beyond fending off a comparatively ineffective, protectionist and unnecessarily adversarial multi-purpose approach to international climate and trade cooperation, the European Commission's GSA concept note advances several useful proposals that could, if adopted, result in enhanced competitiveness of clean steel and aluminium products in the international market place, more credible transatlantic leadership in climate and trade nexus policies, and potential positive spillovers onto third-country policies and markets.

Commendable suggestions that deserve further specification include credible and transparent legislative roadmaps for domestic industrial decarbonisation in the steel and aluminium sectors, commitments to low-emission public procurement, the development of internationally recognised carbon accounting and embedded-emission product standards, a 'green box' for environmental subsidies exempt from CVDs (Kleimann, 2023), the development of a code of conduct for otherwise non-prohibited (actionable) subsidies, the reiteration of WTO legal prohibitions that are evidently functional in enabling effective climate policy roll-outs, and the provision of assistance to third countries in their industrial decarbonisation efforts.

5 Conclusions

The difference between EU and US climate and trade-policy toolkits and objectives, the structural divergence of the respective political economies and polities, and the overall prohibitive costs of aligning around a lower US denominator render the achievement of the proposed club features a mission impossible and highly undesirable. A transatlantic carbon customs union – or the adoption of a common tariff methodology – would require integration at the level of the deficient US policy toolkit. As a result, the EU would have to shelve its CBAM regulation, unlink its CBA policies from its mature and tested ETS, and give way to evidently less-efficient, less-effective, less-legitimate and WTO-inconsistent policy solutions.

It appears out of the question that the Union's institutions would accept demands with such far-reaching implications for existing and very recently adopted domestic legislation. The EU's 'no', however – a message that has reportedly been conveyed to US government interlocutors at various levels of EU governance – is likely to frustrate the expectation of a common transatlantic approach to 'carbon tariffs' (Hillman and Tippett, 2021) and hopes for the exemption of the US from the EU CBAM[13].

In this way, overambitious yet erroneous club design may well – through failure – give international climate and trade cooperation more broadly an unnecessarily bad reputation. Falkner *et al* (2022), for instance, noted that a prospective transatlantic climate club must be assessed on the basis of whether it adds to or detracts from the multilateral climate regime, or diverts resources away from more effective national abatement efforts. Baron and Lee (2021) found, moreover, that conventional climate clubs built on the Nordhaus example, such as the TMP's 'Green Steel Deal', are too simplistic to address the complexity of the abatement challenge and therefore make for a *"waste of time"*.

[13] Alberto Nardelli, Jorge Valero and Eric Martin, 'US Seeks Exemption From EU Carbon Border Levy to End Tariff Dispute', *Bloomberg*, 23 March 2023, https://www.bloomberg.com/news/articles/2023-03-23/us-seeks-exemption-from-eu-carbon-border-levy-to-end-tariff-spat.

Indeed, in light of the prohibitive costs associated with the creation of a transatlantic carbon customs union, the EU and the US should focus their joint efforts on more flexible, pragmatic and fruitful cooperation objectives. Transatlantic climate and trade diplomacy should be viewed akin to a technical-cooperation opportunity that knows only 'winners' (ie beneficiaries) as long as it is not loaded with secondary (eg protectionist) or tertiary (eg global power competition) objectives, which distract from the only two legitimate ends of climate and trade nexus cooperation: emissions abatement and the prevention of carbon leakage.

A transatlantic arrangement for steel and aluminium to address carbon intensity is an opportunity for the US in particular to align its climate and trade policies progressively with the EU standard and best practices, which are laser-focused on creating efficient incentives for abatement at home and abroad, as well as achieving effective decarbonisation and carbon-leakage policies. At the outset, a carbon customs union or a common methodology for 'carbon tariffs' is not the right way to achieve this objective.

The German government's key issues paper on an international carbon club (Federal Ministry of Finance, 2021) and the G7 Terms of References for such a carbon club (G7, 2022), appear to be more suitable for the purpose of creating an inclusive climate cooperation platform among major emitters, setting out an incremental integration approach, retaining full flexibility on the elements of cooperation between jurisdictions that typically diverge significantly from each other in terms of their regulatory, industrial and political structures. It is fortunate that the EU concept note and initial negotiation proposal for the GSA arrangement reflects this inclusive and open-ended approach to international climate and trade cooperation. It remains unfortunate, at the same time, that USTR insists on using the leverage of Trumpian Section 232 steel and aluminium tariffs to coerce the EU into adopting a coercive and ineffective climate-club regime loaded with secondary and tertiary objectives.

Priority should be given to cooperation on prerequisites of carbon-leakage policies, including first and foremost, the joint development of methodologies for pricing and measurement of carbon emissions, industrial transformation/decarbonisation roadmaps with specific timeframes, and transatlantic green-procurement and investment initiatives. Once pricing and measurement methodologies and product standards have been developed and enacted, members could consider the progressive development of an international CBAM network along the lines of best practices that facilitate and reinforce the operation of individual CBAMs operating in different jurisdictions. Cooperation with non-club members to similar ends, and the provision of technical and financial assistance through a greening of aid for trade, would support the ambition for leadership by example through an open and inclusive climate cooperation platform.

Meanwhile, the quite dramatically diverging US and EU negotiation proposals for a Global Steel and Aluminium Arrangement currently generate a balance of policy instruments that are equally unlikely to find their way into a negotiated outcome, if viewed in context of the respective other party's objectives, visions and domestic political constraints. This circumstance leaves negotiators on both sides of the Atlantic with the formidable challenge of preventing the reinstatement of Trump's Section 232 'national security' tariffs on EU steel and aluminium exports and EU 'smart list' retaliation on US exports. Seen in this light, the most acceptable – as in: the least disruptive – result for the October 2023 deadline may well be to prolong the *status quo* and settle for a more informed, pragmatic and inclusive climate and trade cooperation roadmap for the years to come.

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