



Ariadne @ Brussels, 5 December 2023

SHAPING EU CLIMATE AND ENERGY POLICY: CLIMATE CLUBS – ECONOMIC SITUATION, LEGAL FRAMEWORK AND POLITICAL STRATEGY



GEFÖRDERT VOM



I. Presentations:

1. Climate Clubs and foreign policy

Michael Jakob, MCC – Mercator Research Institute on Global Commons and Climate Change, Berlin, Germany

2. Climate Clubs in (WTO) Legal Context

Jana Nysten, SUER – Foundation for Environmental Energy Law, Würzburg, Germany

3. Climate Clubs – Economic assessment

Lena Kittel, IER – Institute of Energy Economics and Rational Energy Use, University of Stuttgart, Germany

II. Discussion

CLIMATE CLUBS AND FOREIGN POLICY

DR. MICHAEL JAKOB

ARIADNE BRUSSELS WORKSHOP, DEC 5, 2023



GEOPOLITICS OF THE ENERGY TRANSITION

Decarbonization will **reduce dependence on imports** of fossil energy carriers. But **new dependencies** on imports of strategic goods

- › Green hydrogen
- › Critical raw materials
- › Key technologies (e.g. batteries, solar panels, heat pumps)

Declining revenues for fossil fuel exporters **might undermine political stability** there, which could shift the balance of power and spark regional conflicts.

Foreign policy classically deals with **security**. Economic goals have become more important, and most recently also environmental goals. Climate foreign policy hence needs to find the **right balance between a broad range of policy objectives**. These can have **synergies or trade-offs**.

LINKAGES BETWEEN CLIMATE POLICY AND FOREIGN POLICY

Security	Economy	Development
<ul style="list-style-type: none">• Scarcities (of food, water...) due to climate impacts could spark conflicts which might affect EU directly or indirectly• Climate refugees could pose additional challenge for migration regime• Import dependence (energy and resource security)	<ul style="list-style-type: none">• Concerns about competitiveness of domestic industries• Opportunity to open new markets for firms from the EU (or Germany)• Rivalry to capture future markets, industrial policies to attract strategic industries for clean technologies	<ul style="list-style-type: none">• Humanitarian assistance• Support for emission reductions and adaptation in low-income countries• Energy transition can foster economic opportunities, but also poses new challenges for sustainable development

DIFFERENT APPROACHES FOR INTEGRATING CLIMATE AND FOREIGN POLICY

Climate first	Competitiveness	Climate second	Means to an end
<ul style="list-style-type: none">• Focus on measures to increase transformation potential in third countries• Provide substantial resources for e.g. tech transfer and capacity building	<ul style="list-style-type: none">• Prioritize measures that benefit domestic industry• Other options to reduce emissions only if they have low costs	<ul style="list-style-type: none">• Prioritize non-climate targets• Climate policy only if it does not create tensions or use political capital	<ul style="list-style-type: none">• Climate change mitigation is not regarded as a goal per se• Only used to achieve other goals (security, economic...)

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WAYS TO INTEGRATE CLIMATE AND FOREIGN POLICIES



Finance

- Financial support to build up alternative industries
- Financial support for just transition policies
- De-risking instruments for investments in alternatives



Market access

- Lower tariffs and non-tariff trade barriers for alternative industries
- Long-term contracts for non-fossil imports
- Create lead markets, e.g. for hydrogen and green basic materials



Technology Transfer and education

- Preferential access to intellectual property rights
- Joint programs for technology adaptation to local needs
- Training of skilled labor force



Capacity building

- Policy exchange, e.g. on RE support and integration
- Training of administrative staff
- Support for institutional reforms, e.g. anti-corruption measures

Jakob et al. (2023)

EXAMPLES OF CLIMATE FOREIGN POLICY ON DIFFERENT GOVERNANCE LEVELS

Multilateral	Bilateral/Unilateral	Plurilateral/Minilateral
<ul style="list-style-type: none">• UNFCCC negotiations• International organizations and MDBs (World Bank, UNEP, UNDP...)• WTO provisions	<ul style="list-style-type: none">• Partnerships for climate, energy, resources, development• Bilateral development cooperation programs• CBAM	<ul style="list-style-type: none">• Inclusion of environmental provisions in preferential trade agreements• JETPs• Climate Clubs

CLIMATE CLUBS

The concept of a club applying joint carbon pricing and CBAM à la Nordhaus(2015) seems **unlikely to work in practice**.

Countries with ambitious climate policies will probably need a carbon price and CBAM, but this is unlikely to form a common denominator. **CBAMs as an enabling factor** as part of a diplomatic agenda.

To make trade work for the climate, **complement ‘stick’ of CBAM with ‘carrots’**, such as: (see Jakob et al. 2022)

- › Trade in Environmental Goods and Services
- › Green Material Clubs
- › Preventing disputes on clean technologies

G7 statement on a Climate Club from June 2022 puts **industrial decarbonization and partnerships** center stage. German and Chilean governments have jointly **launched climate club at COP28**.

OUTLOOK – TO DISCUSS

How can climate clubs pave the way for **carbon pricing** in member states?

How to strike the right balance between a **closed club that only provides benefits to members** and **support for non-members**?

Possible **convergence of climate club and JETPs**?

Does it make sense to design an **accession process** that allows to gradually ratchet up policies?

REFERENCES

Flachland, C., Steckel, J., Jakob, M., Fahl, U., Feist, M. Görlach, B. Kühner, A.K., Tänzler, D., Zeller, M. 2023. „Eckpunkte zur Entwicklung einer Klimaaußenpolitikstrategie Deutschlands“. Kopernikus-Projekt Ariadne, Potsdam.

Jakob, Michael, Stavros Afionis, Max Åhman, Angelo Antoci, Marlene Arens, Fernando Ascensão, Harro van Asselt, et al. 2022. “How Trade Policy Can Support the Climate Agenda.” Science 376 (6600): 1401–3.

<https://doi.org/10.1126/science.abo4207>

Jakob, M., Coetzee, K., Görlach, B., Vasij, L., Waterton, O. 2023. „How the Net-Zero Transformation Affects Fossil Fuel Exporters - Security Implications and Policy Options for the EU“. Discussion Paper of the 4i-TRACTION Deliverable D3.7. Climate Analytics, Ecologic Institute. Berlin.

Nordhaus, William. 2015. “Climate Clubs: Overcoming Free-Riding in International Climate Policy.” American Economic Review 105 (4): 1339–70. <https://doi.org/10.1257/aer.15000001>

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FURTHER READING



Edward Elgar
PUBLISHING

Handbook on Trade Policy and Climate Change

Elgar Handbooks in Energy, the Environment and Climate Change

Edited by Michael Jakob, Mercator Research Institute on Global Commons and Climate Change (MCC), Germany

This insightful Handbook provides a comprehensive overview of the most recent developments in the academic debate on the numerous and complex linkages between international trade and climate change.

2022 c 400 pp Hardback 978 1 83910 323 0 ~~£180.00~~ £162.00 ~~\$265.00~~ \$238.50

Elgaronline 978 1 83910 324 7

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CLIMATE CLUBS IN (WTO) LEGAL CONTEXT

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Stiftung Umweltenergierecht



WTO-BASICS: MOST-FAVORED NATION AND NATIONAL TREATMENT PRINCIPLES

Art. I:1 GATT: „**Most-favored nation principle**“

- › „Any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded **immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties**“ (no discrimination between products from other WTO states).

Art. III:1 GATT: „**National treatment principle**“

- › „Internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, **should not be applied to imported or domestic products so as to afford protection to domestic production**“ (no discrimination against products from other WTO states).

WTO-BASICS: NATIONAL TREATMENT AND BORDER ADJUSTMENT TAXES

Art. III:2 GATT: „**National treatment**“ continued

- › “Any internal tax or other internal charge, or any law, regulation or requirement of the kind referred to in paragraph 1 which applies **to an imported product and to the like domestic product** and is collected or enforced in the case of the imported product at the **time or point of importation**, is nevertheless to be regarded as an internal tax or other internal charge, or a law, regulation or requirement of the kind referred to in paragraph 1, **subject to the provisions of Article XXIV** and so as to protect national production, **where the same conditions prevail, or a disguised restriction on international trade**”.

Art. II: 2 lit a GATT:

- › “A charge equivalent to an internal tax imposed consistently with the provisions of paragraph 1 of Article III in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part” (i.e. see above: BAT cannot be designed in a manner that protects national production).

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US-SHRIMP-TURTLE DISPUTE (WTO DS58/R 1998)

„ARBITRARY OR UNJUSTIFIABLE DISCRIMINATION“/“DISGUISED RESTRICTION“

„It is not acceptable to use an economic embargo to **require other Members to adopt essentially the same comprehensive regulatory program**, to achieve a certain policy goal **without taking into consideration different conditions which may occur in the territories of those other Members.**“

- › i.e. need to consider if/where other states have measures in place that are „**comparable in effectiveness**“.
- › Though: **not necessary** „to anticipate and provide explicitly for the specific conditions prevailing and evolving in *every individual Member*“.
- › Overall: States should „**engage in serious negotiations** with the objective of concluding **bilateral or multilateral agreements**“.

WTO-BASICS: CUSTOMS UNIONS (CU) AND FREE TRADE AREAS (FTA)

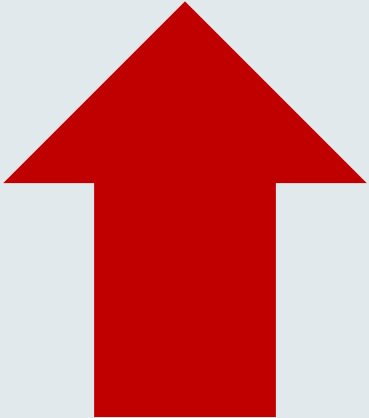
Art. XXIV:4 (ff) GATT:

- › Recognition of „desirability of increasing freedom of trade by the development, through **voluntary agreements**, of closer integration between the economies of the countries parties to such agreements” and accordingly,
- › The “purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and **not to raise barriers to the trade of other contracting parties with such territories**”.

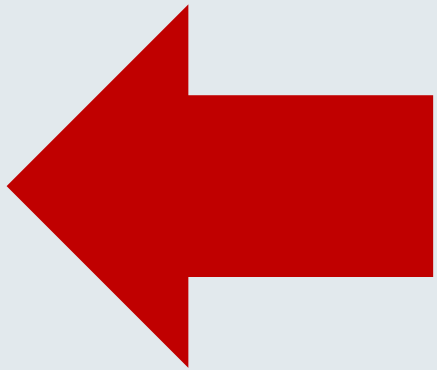
THUS: CU/FTA may **not** lead to duties or regulations for WTO parties not member to the CU/FTA that are “on the whole (...) **higher or more restrictive** than the general incidence of the duties and regulations of commerce **applicable in the constituent territories prior**” to the CU/FTA.

ALSO: **Plans for CU/FTA need to be consulted and approved** by WTO General Assembly.

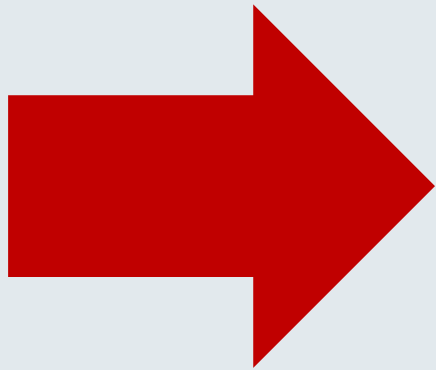
**Discrimination +
Justification
(environment)**



**„Climate
Club“**



**Border
Adjustment Tax**



**Customs
Union/Free
Trade Area**

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**“I REFUSE TO JOIN ANY CLUB THAT WOULD HAVE ME AS A MEMBER.”
GROUCHO MARX**

- There is **no „one“ Climate Club model** - or even idea;
- **WTO law** may be problematic for procedural requirements (Art. 26 GATT) as well as substantive requirements (Art. 20 GATT);
- But the „problem“ is not only a legal one, it is **political**.
- EU CBAM as an **attempt to push for a multilateral solution**, that may facilitate **minilateral – or even sectoral – progress**.

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CLIMATE CLUBS – ECONOMIC ASSESSMENT

Lena Kittel, M.Sc.

Institute of Energy Economics and Rational Energy Use (IER)

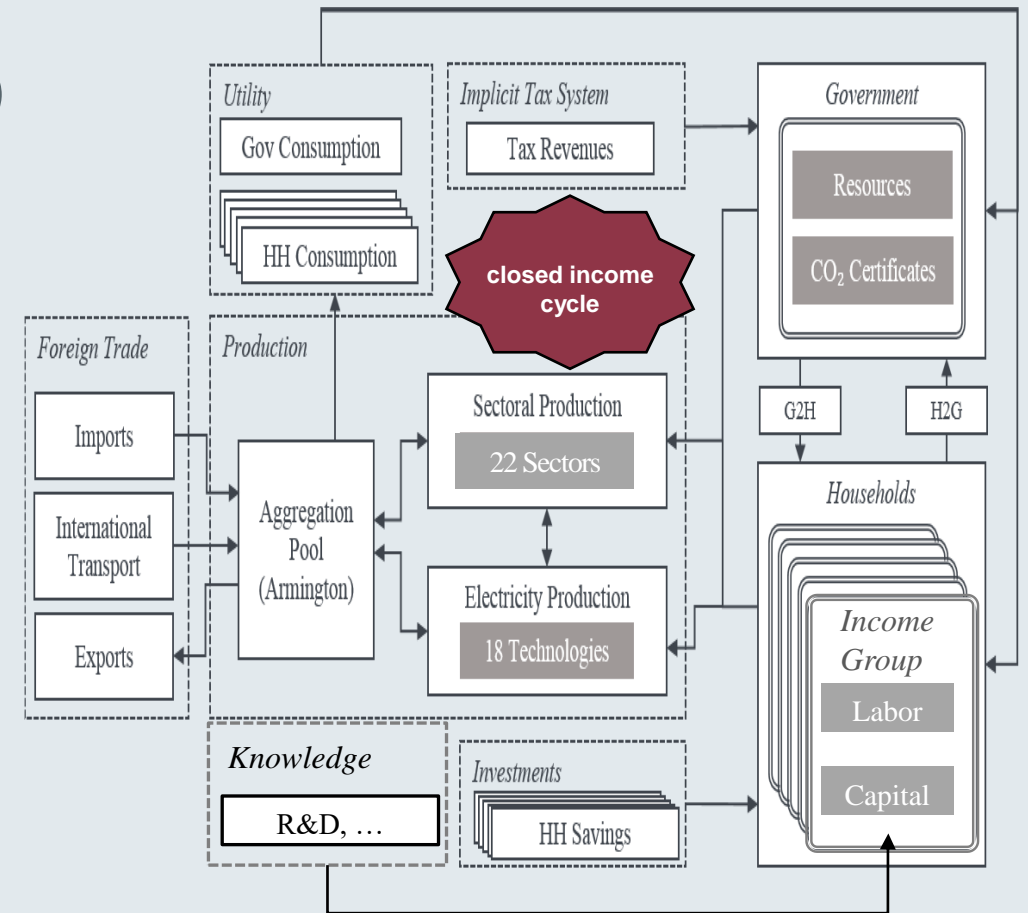
INTENTION OF THE ANALYSIS

› How can the EU prevent carbon leakage?
(e.g. free allocation, CBAM, climate clubs, etc.)

NEWAGE

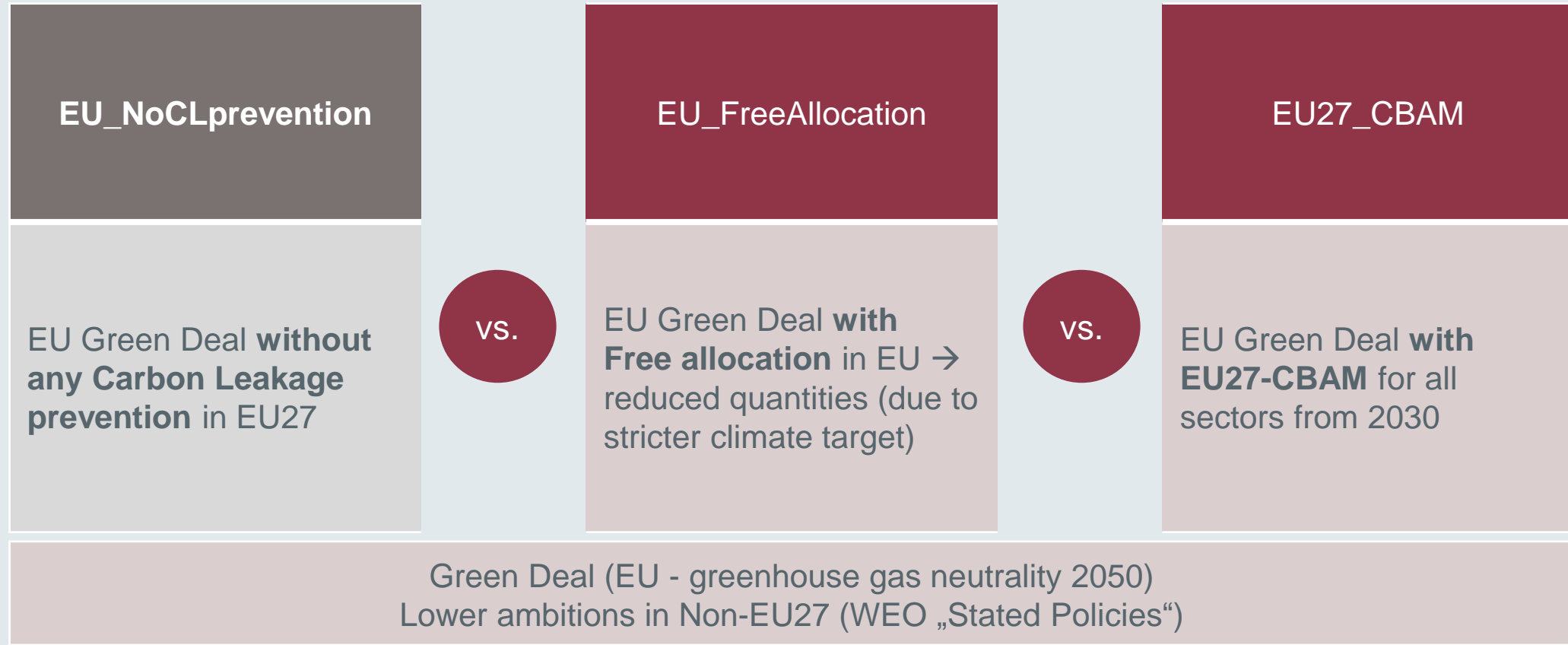
National European Worldwide Applied General Equilibrium

- global, recursive-dynamic general equilibrium model
- macroeconomic analysis of energy and climate policy strategies → economic impacts
- interactions on the economic markets can be described in a closed circular flow of income
- direct effects in single sectors as well as indirect feedback effects in the whole economy
- Analysis via GDP, GVA, prices, CO₂ emissions, etc.



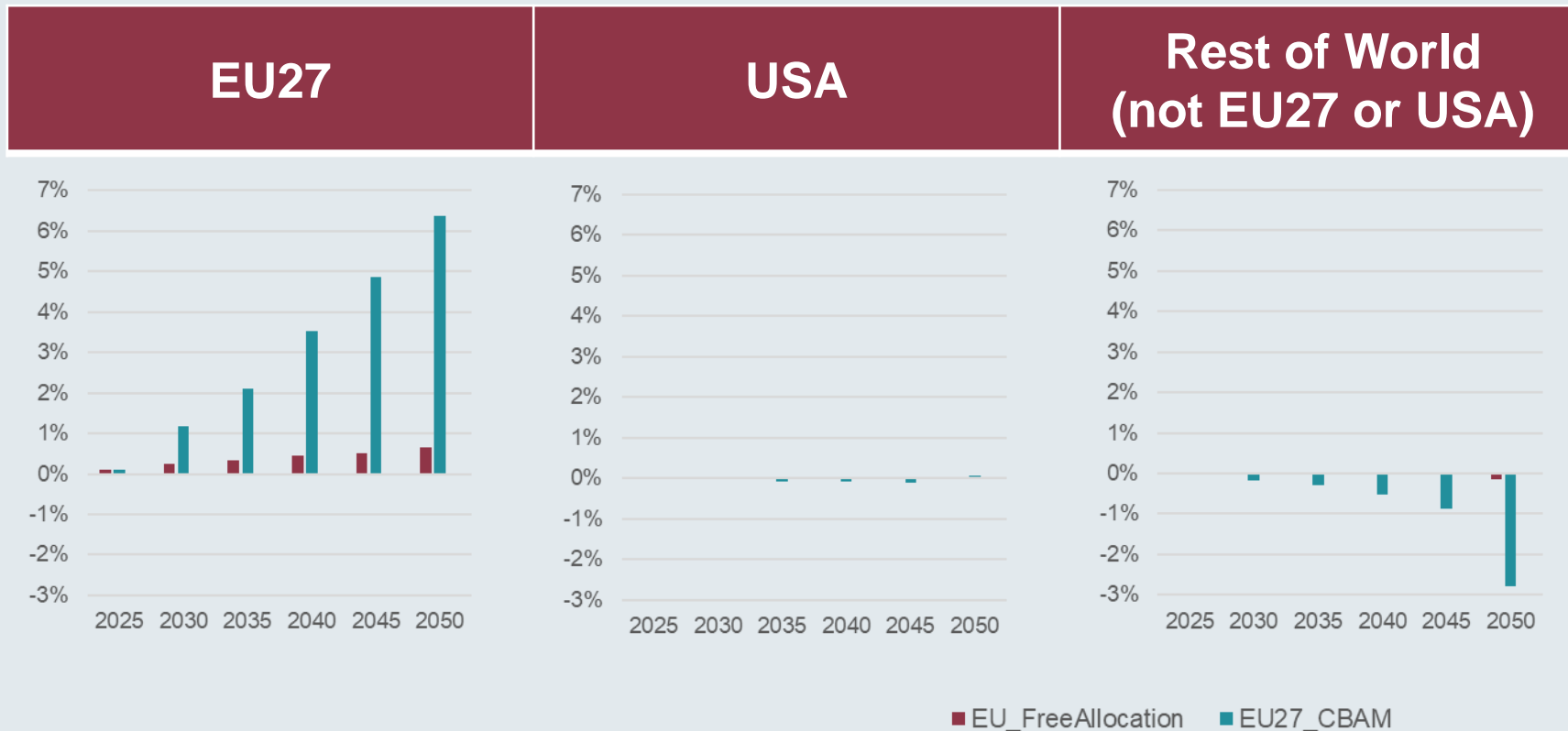
SCENARIOS (I)

EU – Carbon Leakage protection measures



ECONOMIC EFFECTS

Percentage deviation in GDP in relation to the comparative scenario (EU_NoCLprevention)

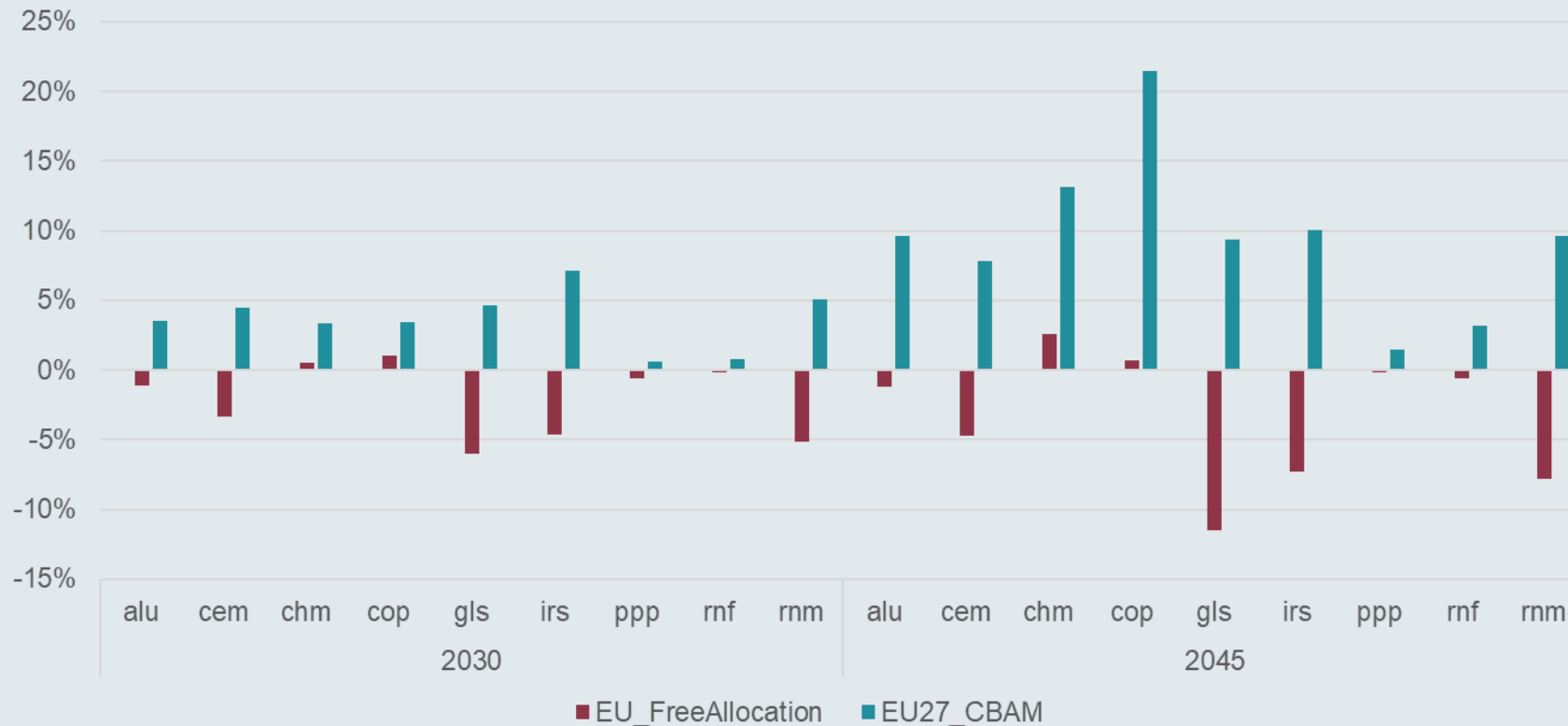


Increased mitigation efforts in EU27:

- An **EU27-CBAM** system is **better than free allocation** to protect the **European economy**
- Rest of the world sees negative effects

SECTORAL ECONOMIC EFFECTS

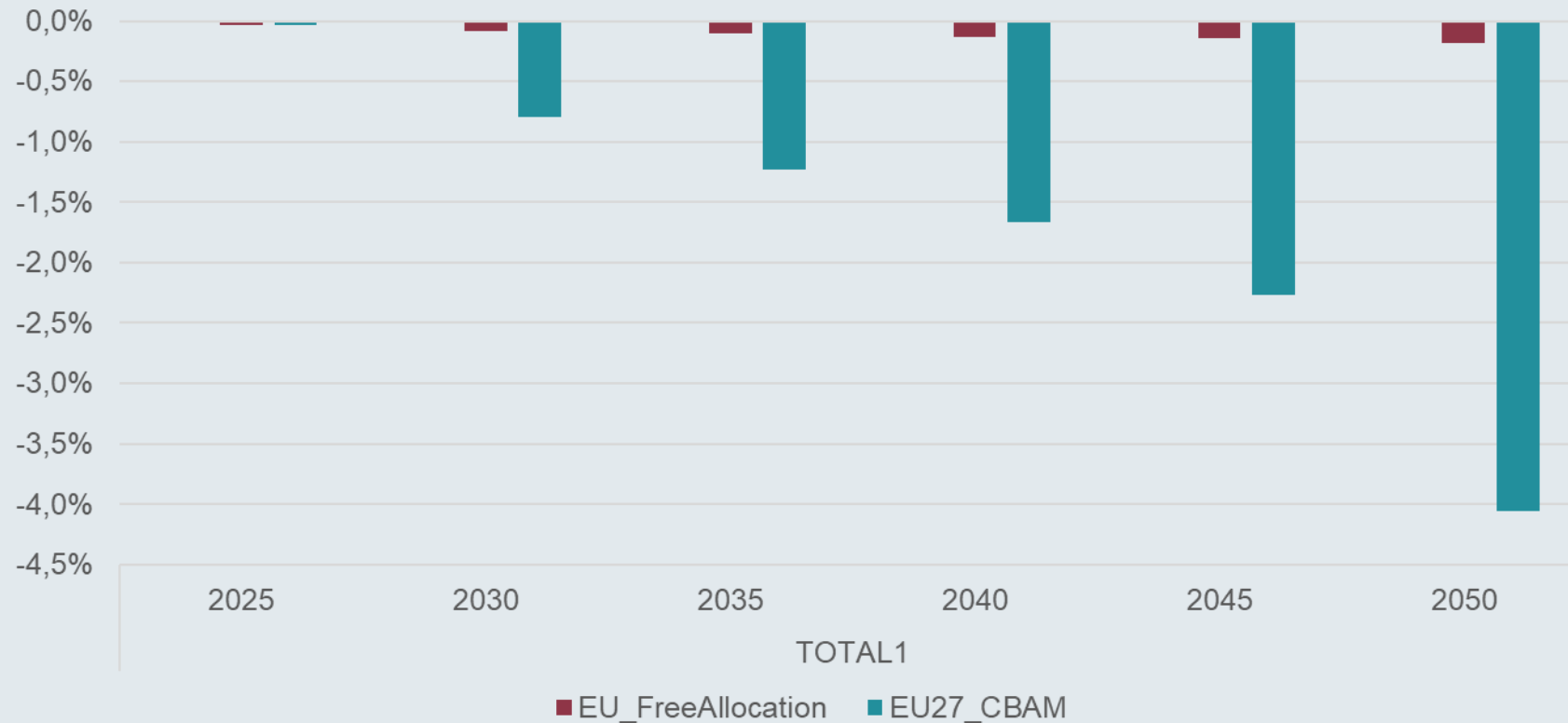
Percentage deviation of EU-GVAs (in energy intensive sectors) in relation to the comparative scenario (EU_NoCLprevention)



- **Protection mechanisms can be helpful for the european energy intensive sectors**
- **EU27-CBAM ist better than free allocation in most sectors**

EMISSION EFFECTS

Percentage deviation of Worldwide CO₂ Emissions in relation to the comparative scenario (EU_NoCLprevention)

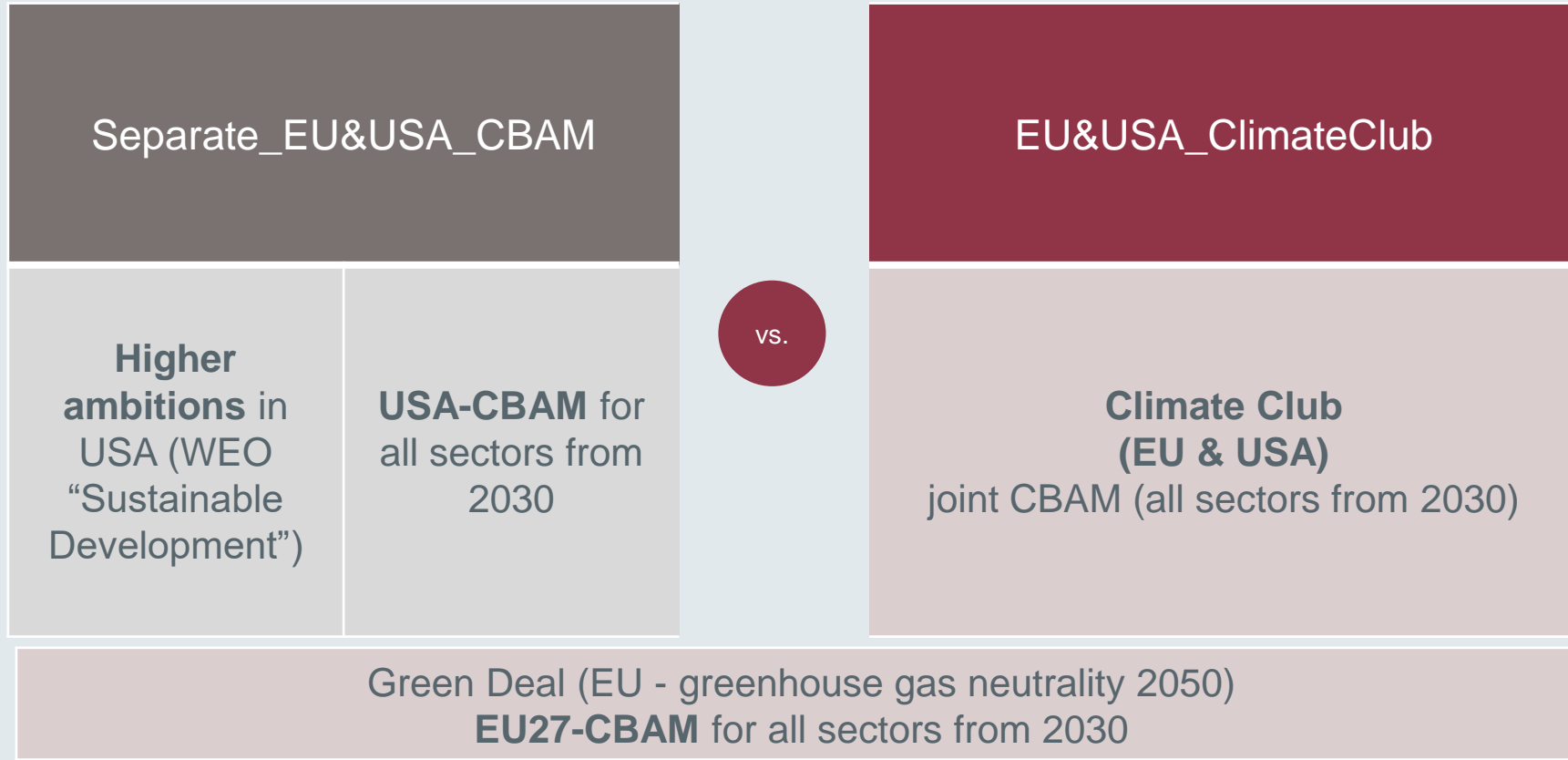


- Global emissions would be higher in the comparative scenario (without free allocation or CBAM)
- **EU27-CBAM** significantly **reduces global emissions**
- **EU27-CBAM** can **reduce Carbon Leakage**

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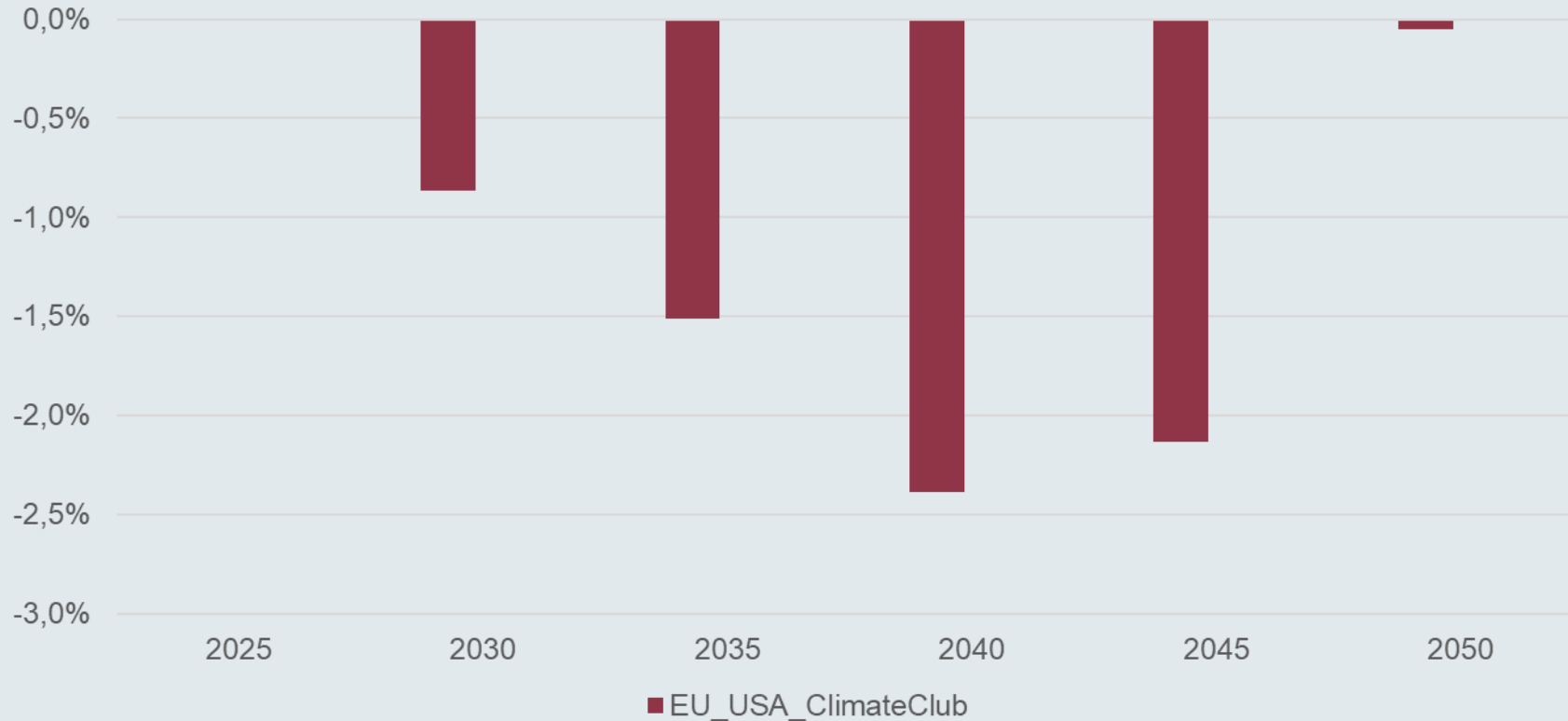
SCENARIOS (II)

EU & USA – INCREASING CLIMATE AND CARBON LEAKAGE PROTECTION AMBITIONS



ECONOMIC EFFECTS

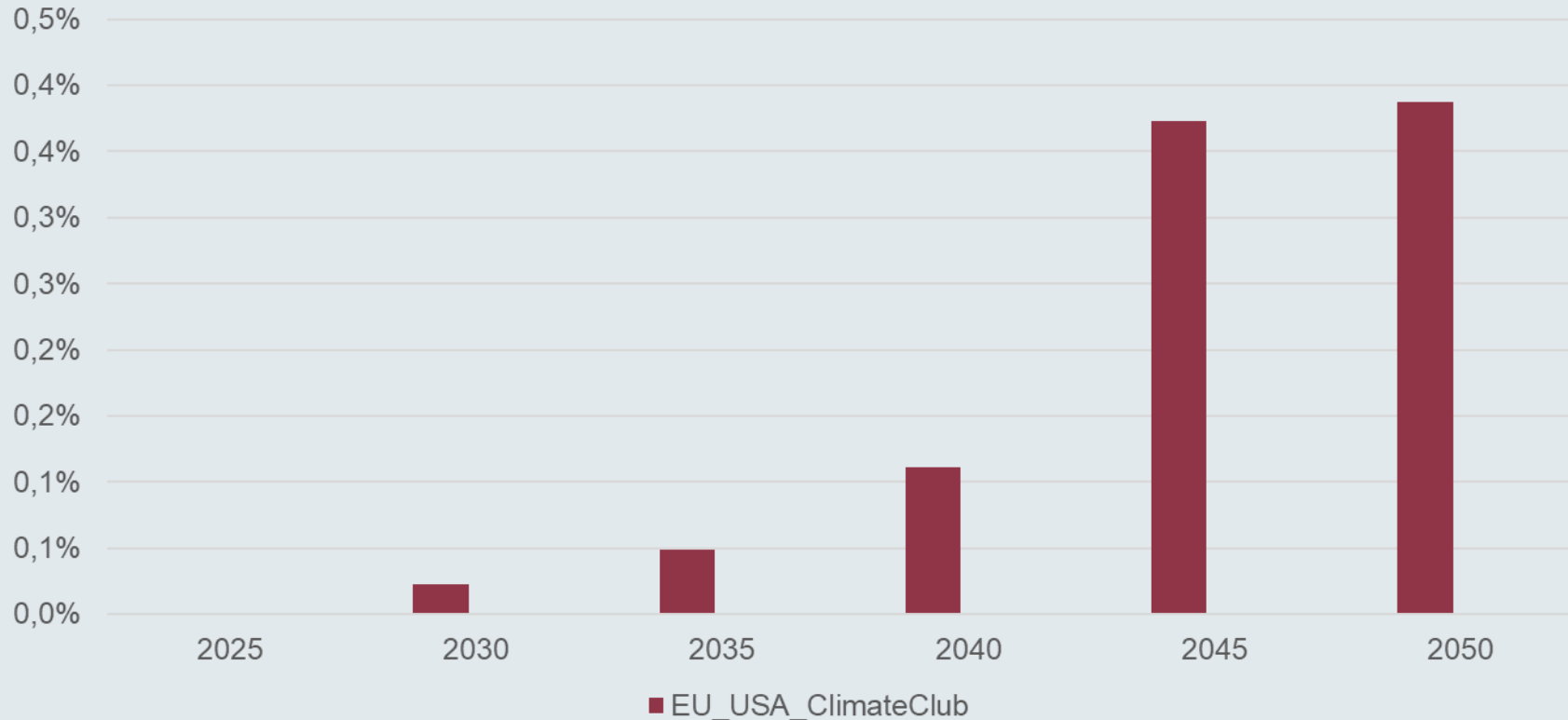
Percentage deviation in EU-GDP in relation to the comparative scenario (Separate_EU&USA_CBAM)



In the transition the **EU27 tends to loose GDP** by joining together in a **climate club**, compared to separate protection by a CBAM in the EU27 and the USA

ECONOMIC EFFECTS

Percentage deviation in USA-GDP in relation to the comparative scenario (Separate_EU&USA_CBAM)



The **USA tends to benefit** from joining forces in a **climate club** as opposed to independent protection (via individual CBAM)

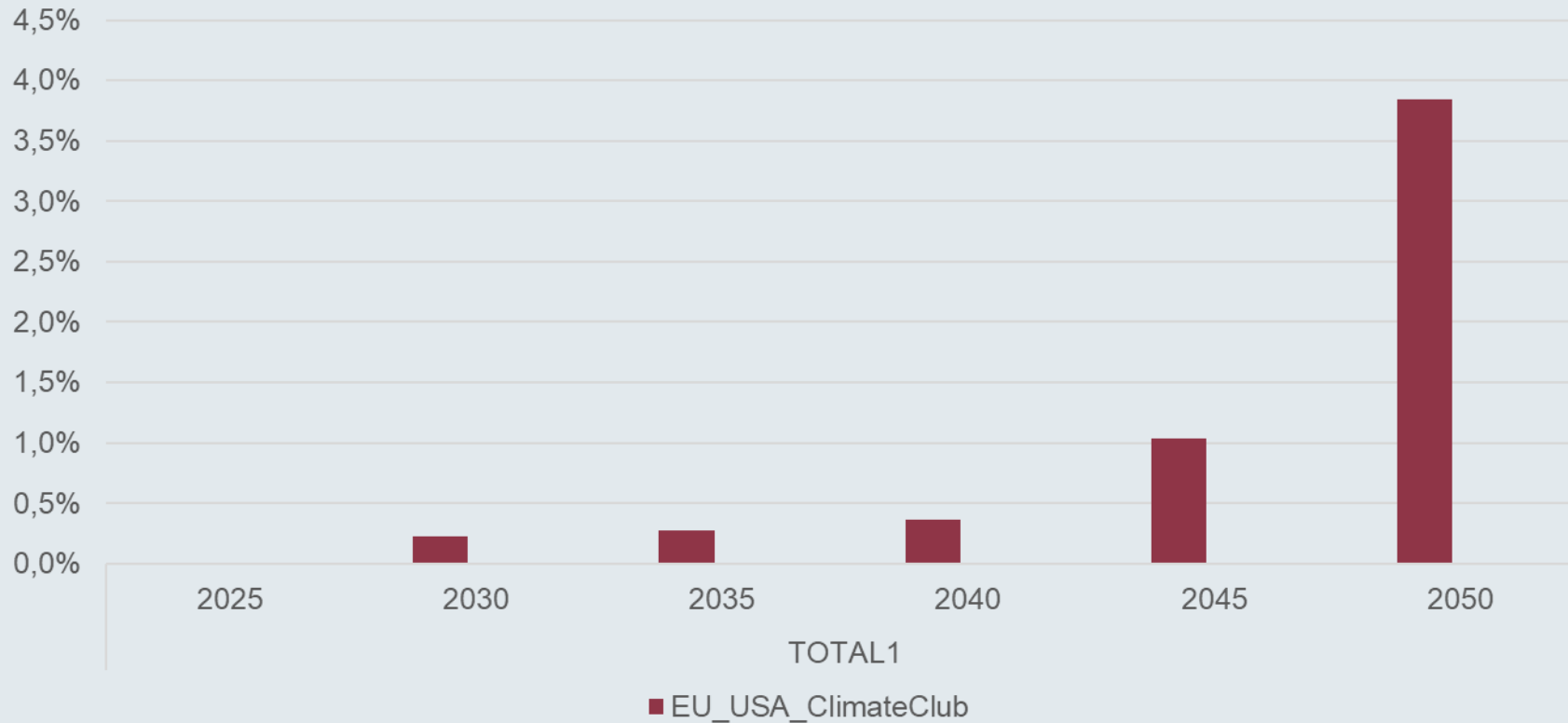
➤ **Interplay of various effects:**

- EU no longer receives CBAM revenue from the USA
- Alignment of CO2 prices through climate club
- Compared to the EU27 path the US Sustainable Development path is less strict

➤ **Distributional effects**

EMISSION EFFECTS

Percentage deviation of Worldwide CO₂ Emissions in relation to the comparative scenario
(Separate_EU&USA_CBAM)



The **joint climate club** leads to the **harmonization of CO₂ prices** and makes it **easier** for member countries **to meet their targets** and consequently **relieves the burden** on world trade.

OUTLOOK

- › Tool for the analysis of different **designs of Climate Clubs**
 - › **Sectoral coverage**
 - › **Member states** (e.g. EU27 & USA, 36 member states due to COP-28 presentation in Dubai, etc.)
 - › CBAM, joint CO₂ price systems, etc.
- › Analysis of different effects
 - › EU in total vs. effects on individual member states

→ **ARIADNE Publication in 2024**

DISCUSSION



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FOREIGN POLICY

- How can Climate Clubs pave the way for **carbon pricing** in member states?
- How to strike the right **balance** between a closed club that only provides **benefits to members** and **support for non-members**?
- Possible convergence of Climate Club and **Just Energy Transition Partnerships (JETPs)**?
- Does it make sense to design an **accession process** that allows to gradually ratchet up policies?

LEGAL CONTEXT

- There is **no „one“ Climate Club model** or even idea.
- **WTO law** may be problematic for the procedural requirements (Art. 26 GATT) as well as substantive requirements (Art. 20 GATT).
- But the „problem“ is not only a legal one, it is **political**.
- EU CBAM as an **attempt to push for a multilateral solution**, that may facilitate **minilateral – or even sectoral – progress**.

ECONOMIC ASSESSMENT – DESIGN OPTIONS

- **Sectoral coverage**
- **Member states** (e.g. EU27 & USA, 36 member states due to COP-28 presentation in Dubai, etc.)
- CBAM, joint CO₂ price systems, etc.