Trade and economic outlook under the EU's Green Deal

Written by

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Much of the typical character of activity in Brussels is functional incremental regulatory integration. However, every 10 to 15 years, the European Union launches itself into fundamentalist mode – the best examples are the 'Euro' and 'Enlargement'.

Today's European fundamental mission is the Green Deal. It is truly green, it is aspirational and transformational and aims to have the EU carbon neutral by the year 2050.

It is declared by the European Commission's President, Ursula Von der Leyen, to be Europe's 'man on the moon moment'.

Indeed, the success of the Green Deal very much depends on technological innovations and transformations, which will, in turn, transform European societies and economies. The relevant and related legislation package involved is enormous and undoubtedly challenging for both European citizens consumers and industry. See figure 1 for the Green Deal vision.

For the European fertilizer industry the most poignant feature is the new 'Clean Hydrogen Strategy'. This promises to remove natural gas as the essential feedstock, strengthen the ETS carbon charging regime and will likely introduce a Carbon Border Adjustment Mechanism (CBAM) to prevent carbon leakage. There will, however, also be supporting and flanking new trade, competition and state aid legal frameworks. In addition, a new EU framework industrial strategy facilitating the green transformation to 2050 has been launched. And alongside this, the already heavy load of existing laws – known as the Acquis Communautaire – will continue.

The success of the Green Deal depends on technological innovations

Hydrogen strategy for a climate neutral Europe

First announced in March 2020 as part of the EC's new Green Deal industrial strategy, by July 2020 the EC set out a roadmap whereby the Europe's ammonia industry should embark upon decarbonisation using hydrogen to replace natural gas. The vision includes on site renewable hydrogen facilities, hydrogen pipeline valleys and revamping the existing EU gas network to transform away from natural gas to hydrogen. Carbon capture and storage (CCS) is also considered a viable option albeit a 'blue' venture in ammonia and hydrogen terms. All this represents major challenges for all players.

The roadmap further suggests a first phase whereby from 2020 to 2024 at least 6GW of renewable hydrogen electrolysers are to be installed in the EU. In the second phase, from 2025 to 2030, it is the intention that hydrogen will become an intrinsic part of the EU's integrated energy system. The strategic objective is to install at least 40GW of renewable hydrogen electrolysers. This would contribute to the production of up to 10 mn t of renewable hydrogen in the EU.

The big test for the new Green Deal will be the Carbon Border Adjustment Mechanism

Another stand-out feature emerged from the EC sponsored Clean Hydrogen Alliance in the form of an additional 40GW of renewable hydrogen proposed for development inside the Ukraine and North Africa with the intention to supply the EU market. Furthermore, it is also foreseen that Algeria, Egypt and Morocco could supply up to 3 mtpa of 'green ammonia' while Ukraine might supply an additional 1 mtpa of green ammonia.

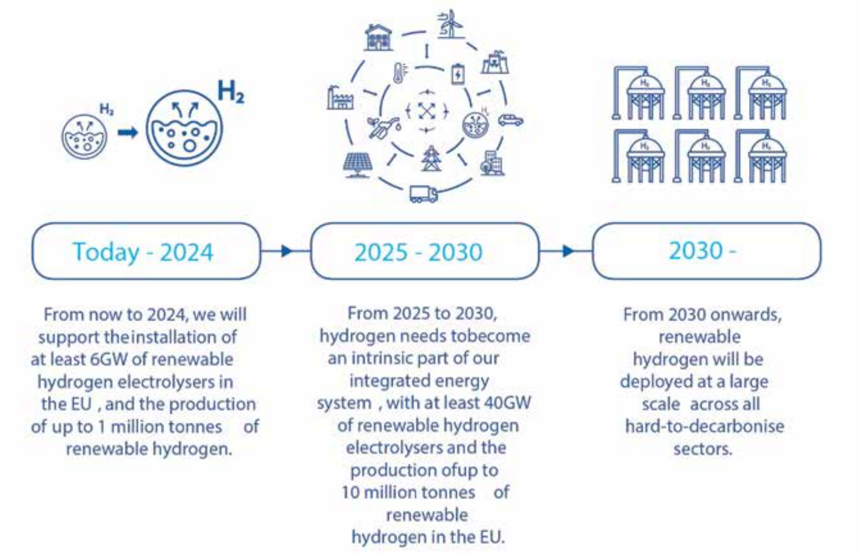
Such developments within a 10-year period are truly transformational proposals – not only for the EU gases and fertilizer industries, but also for established conventional suppliers to the EU such as Russia and emerging conventional suppliers in Sub-Saharan Africa, North America and the Arab Gulf.

While the EU institutions can certainly set own their own governance for the Single European Market, it would seem likely that there will be internal and external diplomatic, political and legal challenges because traditional trade and competition patterns are likely to be disrupted or subject to redundancy.

However, all this will materialise in the medium term - in the mid-decade ahead. In the short term, the big test for the new Green Deal will be the CBAM.

Figure 1. Green deal – A European climate pact

Figure 2. Step-by-step path towards a European hydrogen eco-system



EU Carbon Border Adjustment Mechanism

By June 2021 the EC is expected to deliver a legal proposal providing for a CBAM which is WTO compatible and prevents carbon leakage for the EU industry. The task – principally given the Commission's customs and taxation DG and climate change DG - is tricky and complex because WTO rules are not comprehensive or clear on CBAM type measures.

However, in late autumn of 2020, the Commission's Trade function began early briefings of WTO members on the Green Deal and specifically on CBAM. The election of US President Biden and his immediate executive order to re-join the Paris Climate Change Treaty is certainly positive political encouragement for the EC and EU with its WTO partners.

The simplest international solution would be for the EU, USA and OECD countries to agree a waiver in the WTO allowing for green measures to over-ride standard WTO rules. The Montreal Protocol – another international climate treaty - with its non-compatible WTO features such as quota reduction measures demonstrates this is entirely possible. But then again other WTO members such as China, Russia and Saudi Arabia must ultimately agree to this too.

If a general exception waiver agreement can not be agreed then the most likely scenario is the EU's introduction of the CBAM, followed by a challenge by a major exporter country to the EU addressing a complaint to the WTO dispute settlement system. The outcome will be determined by the WTO compatibility of the EU mechanism and the extent to which it is non-discriminatory amongst suppliers and fairly and even-handedly administered. No one can truly predict this outcome.

Moreover, one peculiar factor is that both the Obama and Trump US administrations have pushed the WTO's ultimate judicial body the Appellate Body into paralysis and a return to normal is probably several years away.

EU ETS carbon charges

The ETS scheme is set to continue up to year 2030. The system is set to deliberately ratchet up carbon charges payable be EU industry.

By January 2021 EU carbon charges reached over EUR35/t of CO_2 equivalent. Therefore, the EU industry requires a 'levelling' mechanism at the border or inside the EU Single Market that is preferably WTO compatible – thus equally and fairly charging importers.

An alternative could be other major economies adoption of similar ETS type schemes with similar charges. But to-date this has not been

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forthcoming despite EU efforts to promote 'linkage' arrangements with international trade partners. With BREXIT the UK chose to adopt its own scheme.

With this uneven situation there could well be a big showdown at the Glasgow Climate Change summit due in November 2021. Diplomats and climate officials are entering busy turbulent times.

New EU competition and state aid rules

Recognising the need for major state aid support for the Green Deal transformation the Commission's competition authority is currently updating its 'guidelines on state aid for environmental protection and energy'.

Under the existing guidelines the EC has already approved a EUR2.9 bn batteries research and innovation programme and a EUR30 bn national Dutch decarbonisation programme. The latter includes support for hydrogen production (blue and green) and hydrogen valleys.

DG competition declares its support for the Green Deal but also declares its support for contestable competition, open and free innovation and entrepreneurship. It will not support 'greenwashing' or unjustifiable excessive state aid. It will certainly not have the intention to support black or brown ventures and there is provision for a transition away from such old fossil based ventures.

New EU/EC Trade Policy strategy

On 18 February 2021 the EC released a package of communications centred around its new strategic concept: 'Open Strategic Autonomy'. The EC gives a simple explanation of its meaning declaring that "open strategic autonomy means cooperating multilaterally wherever we can and acting autonomously wherever we must".

The communication in addition to the Green Deal transformation sets out an additional medium term objectives. They are:

- Support post Covid-19 recovery supporting green and digital objectives;
- Reforming the WTO
- Strengthening the impact of the EU's regulatory impact worldwide;
- Deepening partnerships with neighbouring, enlargement countries and Africa
- Enforcement of trade agreements – and ensuring a level playing field for EU business

More specifically there is a new drive to produce anti-coercion legislation with an immediate start-up consultation launched on the same day as the communication.

The EU continues to declare its intention to defend traditional trade and competition laws.

Indeed, the trade defence laws have already been strengthened by the 'modernisation' package and new dumping methodology to tackle state dominated situations. DG COMP intends to introduce a new law addressing the use of foreign subsidies on the single market which lead to market distortions or unfairly gained acquisitions. There is also a new anti-coercion regulatory initiative.

The decade ahead according to the EU should be green while also within a free and fair competition and trade framework.

It probably will be green, but also testing and even turbulent. ■