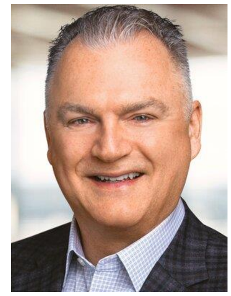
What's Causing EU-US Impasse On Steel And Aluminum

By **Bernd Janzen, Sarah Sprinkle and Hannes Sigurgeirsson** (July 28, 2023)



Bernd Janzen

Sarah Sprinkle

Hannes Sigurgeirsson

In October 2021, the European Union and the United States launched negotiations for a Global Arrangement on Sustainable Steel and Aluminum, or GASSA, which would link import restraints to exporting countries' efforts to reduce carbon intensity in metals production and global overcapacity in the aluminum and steel industries.

The two powers agreed to temporarily suspend additional tariffs on steel and aluminum imports while negotiating the arrangement. Negotiators are aiming to meet an October 2023 deadline when U.S. national security tariffs on EU-origin aluminum and steel could resume.

However, negotiators from the two economies must still overcome high obstacles to success, including demands by the U.S. that its aluminum and steel products be excluded from the EU's planned carbon border adjustment mechanism, which was recently approved by EU lawmakers and will impose charges on imports of steel, aluminum, and other carbon-heavy products starting in 2026.

October 2021 Commitment to Reach an Agreement

The GASSA negotiations are unfolding in the context of multiple conflicts within the context of the U.S.-EU trading and investment relationship.

Tensions rose significantly in 2018 when the U.S. imposed tariffs on EU-origin aluminum and steel under Section 232 of the Trade Expansion Act of 1962, claiming that these imports threatened U.S. national security. The EU retaliated by imposing additional duties on imports of symbolically important U.S. goods, including Harley-Davidson motorcycles and Kentucky Bourbon.

The Biden administration's enactment of the Inflation Reduction Act in 2022, authorizing the large-scale subsidization of various green energy technologies in the U.S. to the detriment of the EU, has further stoked tensions between the two nations, as has the EU's implementation of the carbon border adjustment mechanism with no carveouts for U.S.-origin products.

After three years and the initiation of two disputes at the World Trade Organization concerning the imposition of Section 232 tariffs by the U.S., the two powers reached a deal in October 2021 to temporarily suspend trade hostilities related to aluminum and steel.

At the time, the two governments released an ambitious joint statement outlining a comprehensive set of measures with the goals to "re-establish historical transatlantic trade flows in steel and aluminium and to strengthen their partnership and address shared challenges in the steel and aluminium sector."[1] As part of that partnership, the two parties declared their intention to negotiate a global arrangement to address carbon intensity and global overcapacity, i.e., the GASSA.

Within the GASSA negotiations, leaders of the two economies are seeking to establish their combined markets as the nucleus of a global trading arrangement to facilitate trade in aluminum and steel shown to meet certain carbon intensity benchmarks.

The U.S. is also pushing for an agreement that would ensure secure supply, address its concerns underlying the Section 232 tariffs, and reward efforts to combat the market-distorting effects of overcapacity, particularly in countries with state-owned or state-directed industries (i.e., China).

As a first step, the U.S. agreed in October 2021 to cease the application of Section 232 tariffs and allow the duty-free importation of EU-origin aluminum and steel at levels based on historic norms (i.e., established quotas for duty-free imports of EU-origin aluminum and steel). In return, the EU agreed to suspend its retaliatory tariffs on certain U.S.-origin goods.

The parties also agreed to suspend their WTO disputes over the tariffs at the same time.[2] To facilitate GASSA negotiations, the parties also agreed to establish a technical working group, through which both powers share data and confer on methodologies to calculate the carbon intensity of aluminum and steel.

Tackling Carbon Intensity and Global Overcapacity

The October 2021 joint statement observed that aluminum and steel manufacturing is one of the highest sources of carbon emissions globally. In particular, excess capacity generates unnecessary greenhouse gas emissions and deflates prices for aluminum and steel products made using high-emission manufacturing processes.

According to the statement, for aluminum and steel production to be sustainable, producers in these industries must address both global non-market excess capacity and carbon intensity.

The arrangement is intended to address both issues, and each participant would commit to 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.

The U.S., however, has shown no indication that it will agree to any additional requirements or restrictions on U.S. producers to reduce their carbon emissions. Indeed, the U.S. is very unlikely to ever agree to such terms.

Both powers have indicated that like-minded economies will be invited to join the agreement. However, neither government is soliciting or accepting input from additional economies during the course of the negotiations.

State of the Negotiations

Since the October 2021 joint statement, EU and U.S. negotiators have attempted to reach a deal. However, with the October 2023 deadline looming, no breakthrough has been announced.

U.S. President Joe Biden and European Commission President Ursula von der Leyen released an optimistic joint statement on March 10, 2023, in which the U.S. and the EU were said to be "committed to achieving an ambitious outcome in the Global Arrangement on Sustainable Steel and Aluminum negotiations by October 2023."[3] The statement further declared:

> 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.[4]

In April, EU Trade Commissioner Valdis Dombrovskis claimed to be "moderately optimistic" about reaching a deal by the set deadline.[5] At the same time, unnamed EU officials have said that the reestablishment of a trans-Atlantic level playing field in aluminum and steel is "extremely difficult," and that views on what GASSA should entail remain "very far apart."[6]

The two governments continue to disagree on the scope of the arrangement, with the EU promoting soft policy tools to decarbonize global aluminum and steel production and the U.S. aiming for a system that would allow the imposition of hefty tariffs on China and other big polluters.

In December 2022, the U.S. sent a "concept paper" to Brussels that outlined a proposal to create a global "climate club." Under the U.S. proposal, members of the climate club would be subject to a zero-baseline tariff, plus an additional tariff based on carbon intensity, while nonmembers would be subject to a higher-level baseline, plus an additional level of tariff based on the carbon intensity of their industries.

The EU responded by proposing that the U.S. permanently lift its Section 232 tariffs and refrain from placing new duties on EU exports. The EU also wants members of the arrangement to be able to adopt border measures on imports of carbon-intensive steel and aluminum products.

The EU rejected another U.S. proposal in late June, where the U.S. again proposed to allow members of the arrangement to set emission standards and impose tariffs on countries that do not meet them. The EU proposed instead a levy on imports based on the embedded carbon emissions of the goods combined with the use of traditional trade defense tools.

The negotiations are ongoing, and talks are expected to intensify in the coming weeks and months. If no agreement is reached by October 2023, there is a risk that the temporary truce from October 2021 will come to an end, with both sides reimposing additional duties and resuming litigation at the WTO.

The Current Impasse in the Negotiations

As described above, negotiators from the U.S. and the EU have made limited progress in reaching an agreement, and the two governments' positions remain fundamentally incompatible as the October deadline fast approaches.

As an initial matter, the EU believes that any tariff system imposing additional duties to account for carbon usage must be underpinned by existing carbon prices assessed on the country's domestic industry.

For its part, the EU wants to link the agreement to its flagship climate policy, the carbon border adjustment mechanism, which relies on carbon prices established by the EU's existing emissions trading system. The U.S., however, does not have an existing carbon pricing scheme, nor is it likely to establish and implement such prices anytime soon.[7]

Instead, the U.S. continues to call for an agreement pursuant to which members would be required to meet certain emissions standards for the covered metals, commit not to contribute to excess global capacity, and limit activity by state-owned enterprises.

Pursuant to the U.S. proposal, as described above, baseline tariff rates would be zero for members of the climate club, and higher for nonmembers, with additional tariffs added to the baseline depending on carbon emission levels. There would be no requirement that a country's domestic industry be subject to carbon pricing in parallel to tariffs assessed on imports.

Further, the EU has stressed that any agreement must be consistent with WTO nondiscrimination rules, and it considers the U.S. approach — which is theoretically predicated on national security concerns — as unjustified under WTO law. For its part, the U.S. is extremely unlikely to concede that it is not justified under the WTO to impose tariffs based on national security concerns.

In addition, the EU is concerned that the U.S. proposal for a climate club would be vulnerable to claims of inconsistency with WTO nondiscrimination rules.

The two sides face additional hurdles beyond these two fundamental disagreements before any agreement could be reached.

The EU is also pressing for a "peace clause" in the arrangement, which would permanently lift the Section 232 national security tariffs imposed by the U.S. on EU-origin aluminum and steel. The removal of these tariffs is likely an indispensable requirement for the EU, especially considering that the U.S. has lost several WTO disputes challenging its Section 232 tariffs on imports of steel and aluminum.[8]

Further, the U.S. is seeking an exemption from the EU's carbon border adjustment mechanism. Again, the EU is unlikely to accept a carbon border adjustment mechanism exemption, including because a waiver could be seen as inconsistent with WTO nondiscrimination rules.

Although the two sides still seem very far apart, U.S. Trade Representative Katherine Tai remains publicly optimistic that a deal can be accomplished before the October deadline. Following her monthly meeting with Dombrovskis on July 5, Tai noted that they "remain optimistic to reaching an agreement" by October. For his part, Dombrovskis referred to the discussions as a "useful exchange."[9]

Closing Thoughts

If successful, GASSA would not only demonstrate the ability of the U.S. and the EU to overcome serious and complex disagreements impacting their bilateral economic relationship, but would also represent a milestone in a new era of trade deals negotiated with the express purpose of addressing global climate challenges.

However, if the two economies are unable to reach agreement, this failure would further highlight the significant challenges facing economies as they develop measures to mitigate the effects of climate change under the constraints of the existing global trade regime. In its current form, it seems ill-equipped to reconcile the competing U.S. and EU visions for mitigating climate change through their respective trade laws.

Bernd Janzen is a partner, Sarah Sprinkle is counsel and Hannes Sigurgeirsson is an associate at Akin Gump Strauss Hauer & Feld LLP.

[1] Joint EU-US Statement on a Global Arrangement on Sustainable Steel and Aluminium, European Commission, October 31, 2021: https://ec.europa.eu/commission/presscorner/detail/en/ip_21_5724.

[2] See US — Steel and Aluminium Products (EU) (DS548); EU — Additional Duties (US) (DS559).

[3] Joint Statement by President Biden and President von der Leyen, The White House, March 10, 2023: https://www.whitehouse.gov/briefing-room/statements-releases/2023/03/10/joint-statement-by-president-biden-and-president-von-der-leyen-2/.

[4] Id.

[5] David Lawder, "EU's Dombrovskis sees some progress on steel, battery minerals talks with U.S." Reuters, April 14, 2023, https://www.reuters.com/business/eus-dombrovskis-us-japan-battery-minerals-deal-good-basis-us-eu-talks-2023-04-14/.

[6] Joanna Sopinska, "Comment: Hard going in EU-US talks on global steel arrangement as approaches diverge," MLex Market Insight, 27 March 2023, https://mlexmarketinsight.com/news/comment/comment-hard-going-in-eu-us-talks-on-global-steel-arrangement-as-approaches-diverge.

[7] On July 5, 2023, the Office of the United States Trade Representative requested that the U.S. International Trade Commission institute an investigation and prepare a report that "assesses the greenhouse gas (GHG) emissions of the steel and aluminum produced in the United States, which the USTR states will help inform discussions regarding the Global Arrangement on Sustainable Steel and Aluminum." See "Greenhouse Gas Emissions Intensities of the U.S. Steel and Aluminum Industries at the Product Level," 88 Fed. Reg. 43,633, July 10, 2023. It remains unknown, however, what information the Commission will gather and what findings it will present, much less whether the Commission's final report will lead to any kind of U.S. carbon pricing regime. Therefore, this development seems unlikely to alleviate the EU's concerns regarding the absence of a U.S. carbon pricing regime anytime soon.

[8] US — Steel and Aluminium Products (China) (DS544); US — Steel and Aluminium Products (Norway) (DS552); US — Steel and Aluminium Products (Turkey) (DS564); US — Steel and Aluminium Products (Switzerland) (DS556)

[9] Inside U.S. Trade, "Tai: U.S., EU 'remain committed' to October deadline for steel talks," July 6, 2023: https://insidetrade.com/daily-news/tai-us-eu-remain-committed-october-deadline-steel-talks.