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## Article

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Aylin Shawkat, Oliver Sartor

# Cooperative Carbon Alliances: Defining an Agenda for Global Industrial Decarbonisation

There have been several recent proposals for cooperative climate alliances, from the OECD, the IMF, the World Trade Organization (WTO), the German Government, and others. The “Climate Club” concept comprises many different possible regimes and intents. They range from so-called transformational clubs (which incentivise membership and penalise non-members), to looser joint agreements on ambition level for climate action, such as the UN’s Net-Zero Coalition. Given this option, there is not yet any agreement on how to design such a “club”, or its aims, rules, or scope of membership.

We argue that any future industrial climate alliance should eschew unrealistic and impractical goals, such as achieving common carbon pricing or even full policy equivalence based on implicit carbon prices – and thus aiming to obviate the need for border carbon adjustments. Instead, climate “club” advocates should focus their efforts on something more constructive and realistic. This means building a collaborative alliance of countries with genuine climate ambition who want to work together to accelerate and (loosely) coordinate the transition of energy-intensive industries, e.g. steel, cement and chemicals, to climate neutrality. In such, climate alliances and carbon border adjustments can effectively complement each other in the transition to global industrial decarbonisation. We also argue that talk of “clubs” – with its implication of exclusivity and insiders and outsiders – is unhelpful when it comes to convincing key developing countries to buy into the process.

Key areas of collaboration for the industrial climate alliance must include:

- creating the political space for jointly-timed national efforts at market creation for low-carbon and circular materials and other national policy packages to decarbonise industry;
- defining intermediate and long-term milestones for transition to climate neutral production in key sectors, such as steel, cement and ammonia;
- anticipating and diffusing risks of unnecessary trade tensions related to climate policy, notably by agreeing on common principles for the design of CBAMs

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and carbon leakage policies based on the principles of openness to trade, non-discrimination and fairness; and agreeing on common principles for the provision of green subsidies to industry for decarbonisation;

- facilitating trade in green commodities from all members by agreeing on joint minimum standards for measurement, reporting and verification of embedded carbon emissions in energy-intensive basic materials and industrial products;
- promoting a global green hydrogen economy based on stringent agreed green hydrogen standards;
- supporting developing countries in decarbonising industry consistent with development goals and respecting principle of CBDR through capacity building, finance, support for the development of roadmaps, and facilitating technology transfer via the integration of their producers in the lucrative green value chains of the future.

There is an encouraging amount of common ground between this conception of a cooperative alliance and the emerging climate club agenda as proposed by Germany in the context of its G7 Presidency. However, some important differences remain. In particular, Agora is sceptical of the risks of an excessive focus on explicit or implicit carbon pricing; on avoiding the need for a CBAM, or on comparability of climate policies as the core aims of the alli-

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ance, as we believe these aims are unrealistic and could even backfire in some cases.<sup>1</sup>

### Being realistic on common carbon pricing goals

Some of the proposed “club”-designs have focused on common carbon pricing as the preferred parameter of international cooperation. According to the IMF’s proposal, a small group of high-emitting countries could coordinate on an international carbon price floor (ICPF) and be joined by other countries after an initial period. In doing so, the IMF aims to “circumvent pressure for unilateral border carbon adjustments” (Parry et al., 2021). The OECD, too, calls on countries to join a “voluntary framework to agree on how to best price both carbon taxes and other forms of environmental regulation” (Financial Times, 2021). However, if the objective of the alliance is to enable ambitious climate action while protecting first-movers from carbon leakage, then implementing common or minimum global carbon prices faces some key complications, as does the ambition to include implicit carbon pricing. Under the proposed IMF regime, the risk of carbon leakage to non-members would remain. While the IMF does reluctantly concede the possibility of a joint externally-facing CBAM, the issue of carbon leakage among club members will also remain in light of differentiation of the carbon price floor for developing countries. Arriving at an acceptable protocol for differentiation would be methodologically, politically and legally challenging.

Agreement on common (undifferentiated) pricing, however, would be even more difficult. Every country’s carbon pricing regime will be different in important ways that make harmonisation challenging. The EU, for example, has a floating carbon price which varies substantially. China has an ETS-based carbon price that is based on GHG intensity, as opposed to absolute caps. Canada has a different scheme again, based on an output based pricing system. The domestic politics of implementing carbon prices is also notoriously difficult. In that context, an international climate alliance that might be perceived as “imposing” common carbon pricing from abroad could potentially backfire politically, thus slowing down grassroots efforts to develop national carbon pricing. From a UNFCCC perspective, demanding a common carbon price as a condition of membership would also violate the concept of Common but Differentiated Responsibilities and Respective Capabilities.

Adding to this complexity is the even more difficult, if not impossible, methodological challenge of putting a price

on non-price-based policies (and deciding which environmental policies to include in the accounting), as proposed by the OECD. Both the IMF and OECD proposals therefore unfortunately amount to an agenda that is so daunting that, if it could ever deliver enabling protection for industrial transformation, it would not be on the timescales needed. In the long term, global consensus on carbon pricing would be a powerful contribution to global climate action. Negotiating this consensus, however, will be politically sensitive, methodologically difficult and time-consuming. In light of reinvestment needs and long life cycles of industrial installations, a collaborative agenda is needed that creates enabling conditions for the industrial transformation now. This does not preclude the possibility that the alliance could be a forum for coordinating on international carbon pricing as global levels of climate ambition converge further down the line.

### Setting the right goals: What does industry need from international cooperation on climate policy?

Stepping back from these problematic design features, the more relevant questions are: What does industry need to accelerate its transition to climate neutrality globally? And in what way can this transition be furthered through international coordination? The following stand out:

1. Coordination to create lead markets for low-carbon and circular materials. *Why?* Industry needs clear signals that the demand for genuinely low carbon and circular materials will scale up, and that these markets will develop beyond small niches in one part of the globe. *How?* The alliance should help countries synchronise timeframes in order to adopt strong policies to create green lead markets for boosting the overall global investment signal. Such policies could include embedded carbon limits in buildings, low carbon and circular public procurement policies, and circular material targets/quotas.
2. Agreement on common accounting standards for embedded carbon in materials and common sustainability standards for goods such as green hydrogen. *Why?* Common measurement, reporting and verification standards of embedded carbon are critical enablers of investment and international trade; a fractured landscape of different national requirements raises costs for producers, discourages much-needed trade in low-carbon goods and technologies and perpetuates uncertainty about what investments to make to capture the green markets of the future. *How?* The mutual recognition or harmonisation of key tools such as accounting for embedded carbon in goods, the labelling of low carbon or recycled materials, and the definition of sustainable green hydrogen should be pursued.

<sup>1</sup> Agora Industry is a division of Agora Energiewende that develops strategies and instruments for climate-neutral industrial transformation – in Germany, the EU and globally. It works independently of economic and partisan interests. Its only commitment is to climate action.

3. Support countries to set milestones for industrial decarbonisation in key sectors. *Why?* By setting sectoral milestones for the decarbonisation of energy-intensive industrial sectors, countries create the necessary framework for investments to be directed into low-carbon technologies and avoid carbon lock-in. To the extent a critical mass of producers adheres to those targets, the risk of carbon leakage would be gradually reduced over time. *How?* This should be done on a sector-by-sector basis, given the particularities of each of the main emitting industrial sectors. Milestones could take on different natures depending on the sector. For instance, in the steel sector one option might be to aim at phasing down coal-based production units by a certain date, or increasing the rate of closed loop recycling; while another sector such as cement might set milestones based on reducing average CO<sub>2</sub> intensity per unit of cement and concrete. While all members should sign up for a minimum level of ambition embodied in the alliance's mission statement, the principle of Common But Differentiated Responsibility should nonetheless apply between developed and developing countries within the alliance and may be reflected in different schedules and levels of ambition. This is an essential condition for inclusivity.
4. Agree on common principles to guide members' development of trade-related industrial decarbonisation policies, notably for the provision of subsidies and carbon leakage policy. *Why?* Subsidies and carbon leakage policies, such as CCfDs and CBAM, are an inevitable part of the package for nations to decarbonise their incumbent industries without undue loss of market share to foreign competitors with less ambitious policies or carbon leakage. The issue is not whether to have them, but rather how to avoid them becoming a source of trade tension or disguised protectionism. In this context, agreed principles would help ensure that best practice is observed, guiding national policy in developed and developing countries, respecting international trade rules of non-discrimination and fair treatment, and acting as a bulwark against domestic interests in individual countries that might push a narrower agenda. Agreement of such principles could help to reduce risk of retaliation or trade tensions regarding such issues as the legality of free allocation, the legitimacy of CBAMs, or carbon leakage protection for exporters under CBAM policies. *How?* Members of the alliance should create a space within the mandate to discuss and agree on common principles for the implementation of policies around safeguarding domestic production against carbon leakage and subsidising the industrial transition, with respect to the twin goals of development and decarbonisation in developing countries. These principles should reflect, to the greatest possible extent, WTO principles of non-discrimination and special and differential treat-

ment, as well as aspire to meet the rigorous requirements the GATT places on environmental exceptions. However, possibly outdated or uncertain elements of WTO law, such as whether exporters can be protected from carbon leakage, should be discussed openly.

5. Support developing countries to decarbonise industry consistent with development goals and respect the principle of CBRD. *Why?* In the context of an inclusive alliance across countries of different levels of development and at different stages in their domestic transition, there is likely to be value in an alliance that provides mutual support for members to achieve their goals. In some cases, access to existing international climate finance opportunities could be enhanced for developing countries by support for the development of national policy frameworks and domestic roadmaps that funding can plug into. *How?* While the funding capacity of the industrial climate alliance in addition to existing international climate finance mechanisms is currently uncertain, experience with past initiatives shows that domestic capacity to measure, report and manage emissions can be improved via international cooperation at the technical level. Lessons from existing policy experiences can be shared to promote best practice and build capacity across members, especially for developing countries. This can take the form of support in the development of national industry decarbonisation roadmaps, promoting project visibility for attracting international climate funding or best practice guidance on attracting technology and skills transfer in practice. It will also be important to listen to the concerns of developing economies about the potential barriers that regulatory standards set in mature economies pose for the stepwise transitions that are considered most feasible in the developing economy context.

### Who needs to be in the alliance?

The question about membership faces a trade-off between effectiveness and global legitimacy: To be effective, members of the alliance must be genuinely interested in accelerating the industrial transition and fully commit to the collaborative agenda at the heart of the alliance. It must not be naively ignored that certain members of the G20, for example, have a track record of either outright non-compliance with the Paris Agreement that they ratified, or, worse, have a history of using their seat at the table to actively slow down progress on climate action. This is particularly the case for countries and governments with strong economic and political dependencies on fossil fuel production. However, to have global legitimacy and not to be perceived as protectionist, this new institution will need to be open to the inclusion of key developing countries.

As a guarantee of ambition, and thus effectiveness of the alliance, we suggest that membership should be conditional on the following minimum criteria:

- Fulfilment of obligations under the Paris Agreement (e.g. an up-to-date NDC reflecting the nation's highest possible ambition)<sup>2</sup> and clear commitment to climate neutrality;
- Unreserved commitment to the goals of the alliance.<sup>3</sup>

It is important to note that the issues where international co-operation can add value to the quest of global industrial decarbonisation outlined above can be discussed somewhat independently from a country's concrete level of climate ambition – unlike in the case of international coordination of carbon prices. Instead, the member base of the alliance should aim to cover key countries with the largest shares of international trade in key products. To illustrate the potential for large gaps in a climate alliance that focuses on, say, G7 members is salient when looking at global steel production (Figure 1). Without at least China and India at the table, over 60% of global steel production would remain outside of the alliance, limiting the transformational impact. If a key goal of the alliance is to help establish a global system for tackling issues such as carbon leakage, developing lead markets or setting low-carbon product standards, then representation beyond a small club of wealthier, G7 or OECD countries is critical.

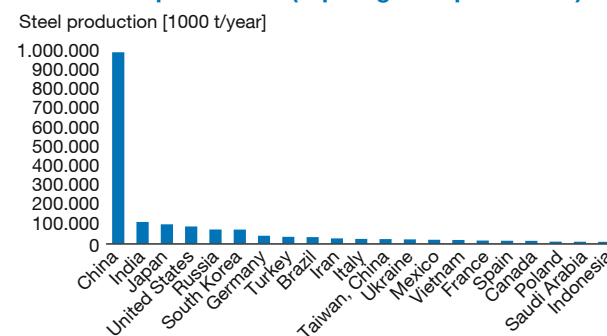
### Where should the alliance be housed?

The platform or venue for such a cooperative alliance should be inclusive enough to accommodate membership by any countries that are willing to commit to the obligations described above. It should also have a mandate that covers the recommended key areas of collaboration. And by preference it would be attached to an existing organisation or initiative to avoid duplication and build on existing secretarial expertise. The closest fit to those criteria is the Clean Energy Ministerial's Industrial Deep Decarbonization Initiative (IDDI), supported by UNIDO. Unlike the OECD or G7, it has the necessary legitimacy with developed and developing countries alike, experience with industrial policy topics and an existing secretariat. Its work programme addresses some of the key goals outlined

- <sup>2</sup> This is a requirement of each successive NDC revision under the Paris Climate Agreement, to ensure that each NDC is more ambitious than the last.
- <sup>3</sup> These goals are a part of the Alliance's founding Mission Statement and should reflect the bullet points listed at the beginning of this document.

Figure 1

### Global steel production (top 20 global producers)



Source: <https://worldsteel.org>.

above – including how to measure embedded carbon, how to design joint public procurement policies across members, and how to define standards for low carbon materials.

However, some limitations apply to the IDDI initiative and the CEM more generally. First, the work programme of IDDI does not cover all the key areas of collaboration identified above. Second, the membership of IDDI remains limited to just four countries, while the CEM's membership includes virtually the entire G20, including countries that would not necessarily meet the key criteria for initial inclusion in the alliance. To address these concerns, different options are possible. One solution could be to make IDDI, backed by an expanded mandate from the G7, the major element in a larger initiative that encompasses the broader aims of the co-operative alliance. By supporting this initiative as part of its G7 Presidency, Germany could create significant momentum for the global industrial decarbonisation agenda, while sending a strong signal of inclusivity to countries outside of the G7. Less desirable but also possible would be to build a completely new organisation to house the collaborative agenda, which seeks to exploit the workstreams of different industrial initiatives, including IDDI, LeadIT and perhaps certain elements of the OECD's work programme.

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