International Competition and Climate Change Legislation

The Sectoral Approach

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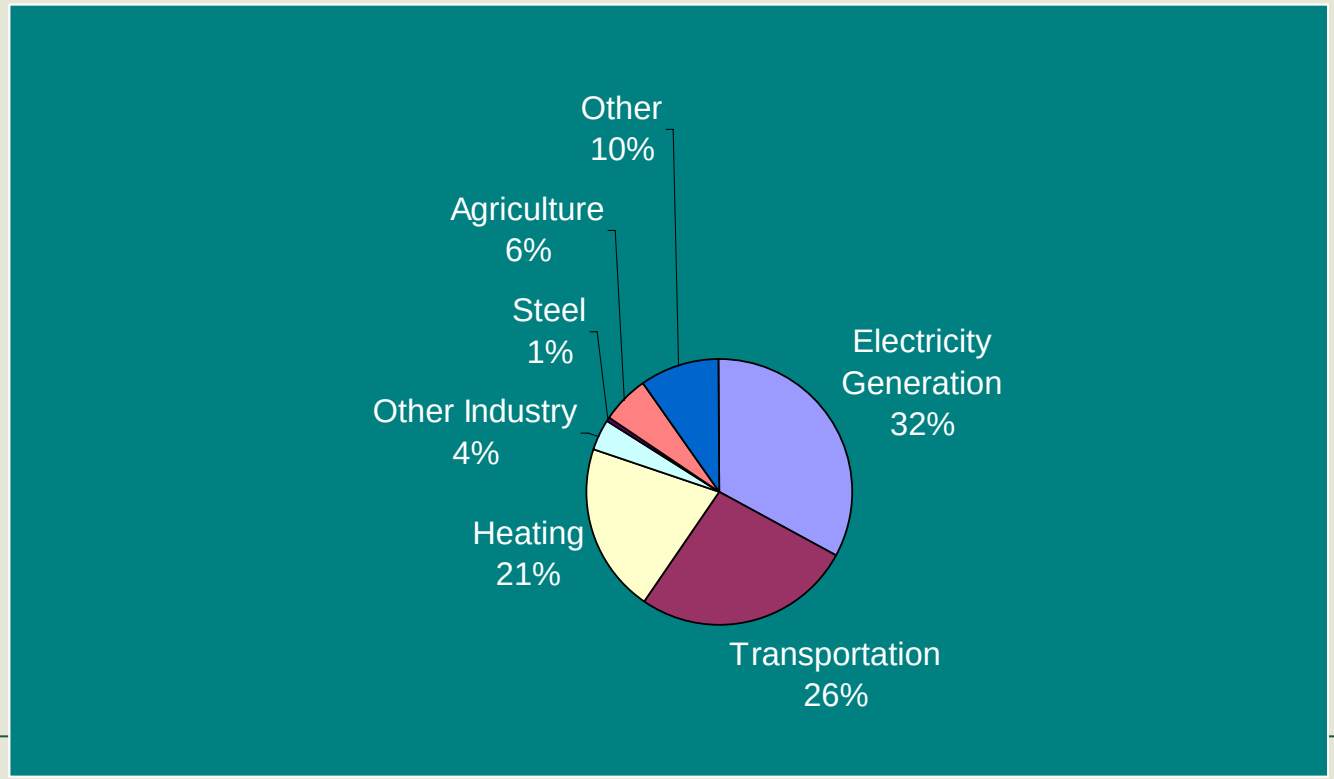
Climate Change and the Steel Industry

- Climate change legislation will affect industries whose goods are traded internationally (such as steel) very differently from those whose goods are not (such as electric power, heating, and domestic transportation)
- The issue: How to draft climate change legislation that
  - Is effective in reducing global greenhouse gas ("GHG") emissions
  - Does not allow weaker regulation of GHGs in some countries to become a source of competitive advantage
  - Does not encourage or force American manufacturers to move operations overseas

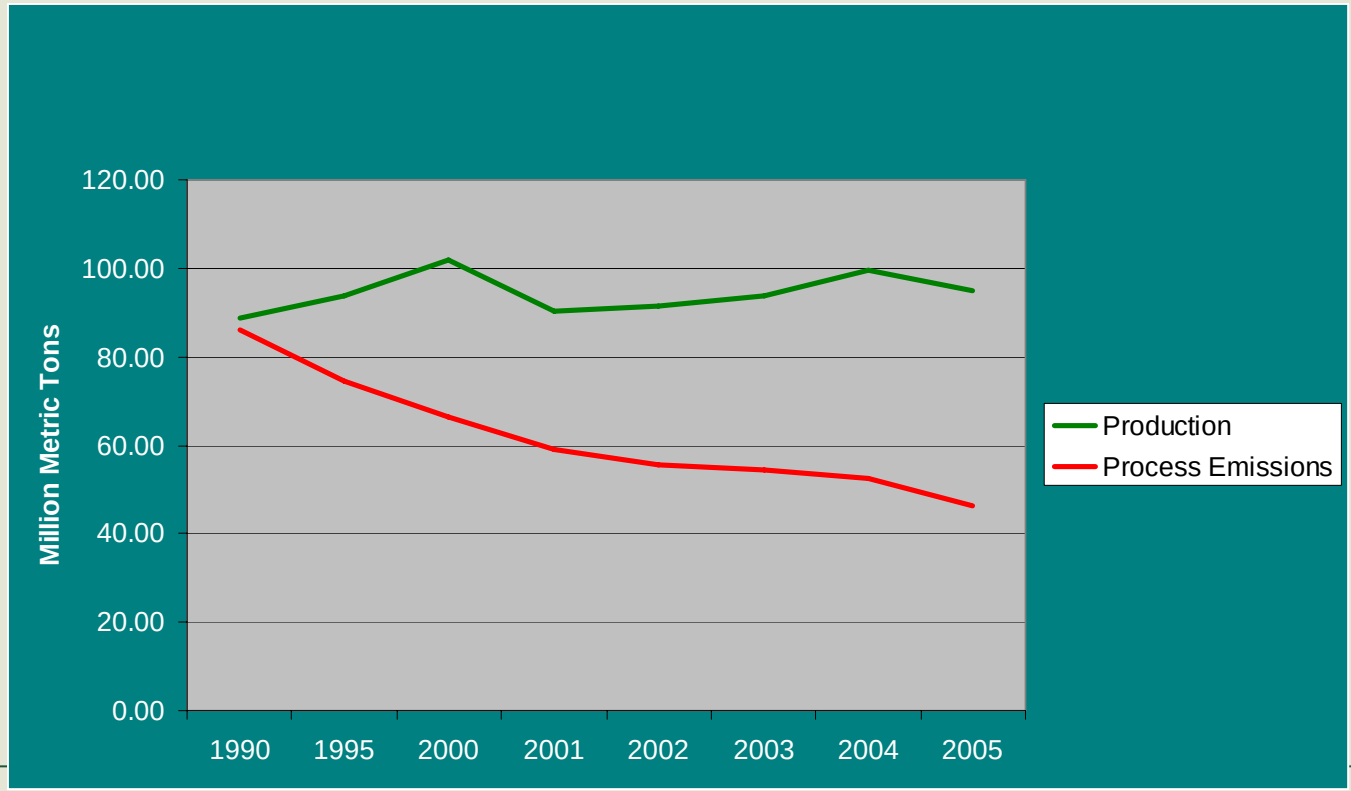
Industry and GHG Emissions

- According to the EPA, industrial emissions account for only 5% of total GHG emissions in the United States
- The steel industry's direct GHG emissions are less than 1% of the US total



Steel Industry Emissions

- According to EPA, the steel industry's direct GHG emissions have fallen by more than 50% since 1990
- The U.S. steel industry's GHG emissions per ton are among the lowest in the world



The International Steel Industry

- Steel is widely traded internationally
  - The United States imports about 25% of its steel needs
- Most of the world's steel is made in developing countries
  - China alone accounts for nearly 40% of world production
  - Virtually all expansion of steelmaking capacity is in the developing countries
- The main steel producers in the developing countries are large companies with full access to capital and technology
- Major steel companies are increasingly transnational

Cap and Trade

- A cap and trade system
  - Sets an absolute limit on GHG emissions
  - Requires allowances for some GHG emissions
- The United States is likely to end up with some form of a cap and trade system
- National caps generally do not have global reach
  - This gives a cost advantage to producers of internationally traded products located in countries that do not have cap and trade systems

Effects of Cap and Trade in Europe

- Much higher energy costs for European industry
- European steel producers have moved new investment to countries like Brazil that do not regulate GHG emissions
- Steel imports into Europe from China and other countries that do not regulate GHG emissions have grown sharply

Sectoral Approaches for Global Reach

- An approach for global reach is for the major producers of energy-intensive products to negotiate binding limits on the GHG emissions associated with the manufacture of those products
- These limits could apply to
  - Energy usage on a per unit basis
  - Actual GHG emissions on a per unit basis
- Emissions limits would apply to all covered products
  - Domestic
  - Imported
- Products that exceed these limits could not be sold in the United States
- Emissions limits could be negotiated internationally for individual sectors of energy-intensive manufacturing (steel, cement, aluminum, etc.)
- Limits would be periodically reviewed and adjusted to reflect advances in technology

International Support for Sectoral Approaches

- The International Energy Agency is working on a model for sectoral approaches
- Japan and China have recently expressed support for the sectoral approach concept
- In response to its experience with the EU cap and trade system, Eurofer (the European steelmakers' association) is also advocating a sectoral approach
- The International Iron and Steel Institute has begun work on international GHG/energy efficiency standards for steel production

Sectoral Approaches Under the WTO

- The Agreement on Technical Barriers to Trade explicitly allows countries to impose limits
- Unilaterally imposed limits would be considered permissible technical regulations under the Agreement on Technical Barriers to Trade
  - Limits would be imposed on a non-discriminatory basis to both domestic and imported products
  - Limits would not represent an unnecessary barrier to trade
- The TBT encourages the use of internationally negotiated limits
- These issues are addressed in a recent article by Charles Verrill, "Maximum Carbon Intensity Limitations and the Agreement on Technical Barriers to Trade," *Climate Change Law Review* 43 (1/2008)

The Sectoral Approach and the Steel Industry

- Preparation and administration of GHG limits for steel on a per ton basis would be straightforward
- There are only two direct sources of GHG emissions in steel production
  - Coal and coke
  - Natural gas
- Steel producers track each of these factors in the course of their everyday business
- IISI has derived emissions factors for each of these energy sources, allowing simple calculation of GHG emissions

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The Sectoral Approach and Caps

- The sectoral approach is possible under a cap and trade system
  - There would still be a total national cap
  - The receipt of allowances could be conditioned on satisfying emissions limits
- Standards will not allow industries to "bust the cap"
  - The rate of emissions reduction in the U.S. has exceeded the rate of expansion in the U.S. steel industry
  - The U.S. steel industry is expanding by only about 1% per year

Final Thoughts

- Even with the sectoral or the AEP approach, we will need to address the inflationary impacts of energy costs on competitiveness
- There are practical and legal obstacles to giving a cap and trade system global reach
- The sectoral approach is a way to extend GHG emissions limits to domestic and imported products in a straightforward, WTO-legal manner
- By discouraging emissions migration, sectoral approaches can reduce global GHG emissions
- Other new approaches are emerging (Rep. Inslee)

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