

German Proposal for an International Climate Club

Issue Brief 02/21

Highlights

- On 25 August 2021, Germany's Federal Cabinet discussed a joint [key-issues paper](#) for the creation of an international climate club, to boost the Paris climate agreement.
- The new climate club would help ensure that countries which press ahead with climate action suffer no disadvantages when it comes to the competitiveness of their industries.
- To do so, it would bring together climate pioneers and major emitters, including China and the US, to coordinate climate policy instruments and commit to a shared framework that prevents carbon leakage to countries and industries that are climate laggards.
- By setting a common framework and standards, the use of trade instruments, such as the EU's Carbon Border Adjustment Mechanism (CBAM), could be avoided amongst members of such a club, while common trade measures should be taken against third countries.
- Participants would in turn commit to assisting emerging market economies to transform their economies and industries in order to meet the standards developed by the club.
- Germany has already ensured the backing of France for the initiative and seeks to win over other G7/G20 countries to the idea, to avoid climate-related trade conflicts.

Background

As the German Federal Government moves ahead with its ambitious plans for decarbonizing key industrial sectors, it has become increasingly concerned about the prospect of "carbon leakage" and the loss of international competitiveness across an array of strategic industries.

At the same time, the German Government believes that "defensive measures", such as CBAM, won't be enough to prevent a competitive dynamic and risk triggering a new round of trade conflicts that would hurt Germany's export-oriented economy across the board.

The Federal Ministry for Economic Affairs and Energy first examined the idea of a "climate club" in March 2021, concluding that it should be led by the EU. Federal Finance Minister Olaf Scholz then picked up the idea in May, introducing his own ideas for such an international climate club, and once again promoted the idea at the recent G20 finance ministers meeting.

The new US-German Climate and Energy Partnership, adopted during Chancellor Merkel's official visit to the US in mid-July, signals tentative support by the US Administration.

The joint key-issue paper, while championed and promoted by Finance Minister Olaf Scholz, has been coordinated between the Federal Ministry of Finance, the Federal Foreign Office, the Federal Ministry of Economic Affairs and Energy, the Environment Ministry, and the Ministry for Economic Cooperation and Development, signaling strong support for the creation of such a climate club across key ministries and across party lines.

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Issue Brief 02/21

Key Elements

The proposal suggests the setting up of a broad International Climate Club that brings together EU countries, major emitters (China, US, Russia), key EU trading partners, and countries with existing levies on greenhouse gas emissions or large industrial sectors. Other target countries are smaller emitters that have adopted ambitious climate change targets.

In principle, participation is open to all countries willing to commit to ambitious climate targets and actions, as long as they adhere to the rules set by the new club. The basic condition is for members to accept the 1.5° C target of the Paris Agreement and to commit to achieving climate neutrality by 2050 at the latest, including by setting realistic interim targets.

The proposal identifies two specific areas of cooperation for the suggested climate club:

1. Cooperation and coordination amongst participating countries with the transformation of their energy-intensive industrial base. The specific aim is to create a level playing field amongst participating countries that avoids carbon leakage. This should be facilitated through joint targets, research cooperation, the creation of markets for clean industrial products, and a range of other actions. In addition, the proposal envisages a “hydrogen pact”, to build a global supply chain for green hydrogen, coordinate production and trade between members and non-members, and establish reliable definitions and certification of green hydrogen. The production of ammonia and raw gasoline (naphtha) for the chemical industry, as well as the production of CO₂-neutral methanol and eKerosene are also mentioned.

2. Members will adopt a common roadmap for measuring and documenting national carbon emissions and setting national carbon prices according to commonly agreed standards. The focus will be on carbon emissions of key industries, including cement, steel, aluminum, chemicals, fertilizer, glass, paper, and others where there is a clear risk of carbon leakage. To work towards a common carbon price amongst members in the medium term, the proposal also envisages an agreement on determining the explicit and implicit national carbon prices.

The proposal notes that if members enforce these common standards and measurements, additional defensive measures to prevent carbon leakage amongst participating countries could be avoided. At the same time, members should cooperate on common defensive measures against third countries. To this end, the paper includes some ideas for potential joint defensive measures by members against non-member countries and industries.

Finally, the proposal acknowledges that these efforts should not come at the costs of the least developed countries (LDCs) and other transition countries. To prevent this from happening, members should coordinate their support for climate mitigation measures in third countries and help them with the development of climate neutral industries and supply chains.

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Impact

The **Federal Government’s initiative for an international climate club, although at an early stage, could have a major impact for key industrial sectors in Europe and globally.** Efforts to coordinate international standard setting in climate-polluting industries, such as aluminum, chemicals, steel, and cements, will be crucial to the future development of these industries.

Through the proposal, the **Federal Government seeks to provide a multilateral alternative to unilateral trade measures** that are currently being considered as the main tool to prevent carbon leakage and ensure the long-term survival of key industries in Europe.

This provides a strong incentive for affected countries and industries to ensure their inclusion in any such club, in case there is broad international support for the initiative. Non-members, on the other hand, will bear the brunt of trade measures and turn into rule-takers.

Industry

The proposal envisages all members to coordinate the transformation of their industries towards climate neutrality, in particular by:

- Securing the necessary investments in new production facilities
- Developing global standards
- Supporting new value chains for climate-neutral production

The proposal has a specific focus on the transformation of energy-intensive industries such as the steel, chemical and cement sectors.

In order to achieve this transformation and incentivizing the necessary investments, the proposal suggests a coordinated schedule for emission-intensive goods, product standards for CO2 intensities, and joint initiatives in the field of research, development and innovation regarding new infrastructure. In this way, it hopes to create common lead markets for climate-neutral basic materials and products.

Emerging and Developing Countries

The proposal has a significant focus on emerging and developing countries.

- The transformation of their economies should be supported, to avoid future emission increases or lock-in effects.
- The revenue of an envisaged Carbon Border Adjustment Tax should fund capacity building in emerging economies and developing countries that are interested in meeting the standards set by such a club.

Capture and Pricing of CO2

The proposal outlines a roadmap for joint recording and pricing of CO2 emissions of raw materials, products, and existing CO2 prices, whilst working towards a similar and eventually a uniform pricing. This is seen as essential for protection against carbon leakage. To prevent carbon leakage vis-à-vis third countries, a common carbon border tariff, similar to the EU’s CBAM, could be implemented by all members.

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Issue Brief 02/21

Outlook

The initiative is at an early stage, with next steps to be coordinated especially within the EU. SPD Chancellor-Candidate Olaf Scholz, who has taken a lead on the initiative, has already discussed the proposal with French President Emmanuel Macron and it is clear that an SPD-led German government would be a clear champion of the idea, as would most other political constellations.

Consultations with the US, the UK, and within the G7 are expected to follow, before widening them to the G20 level. The proposal also suggests discussions within the framework of the WTO and UNFCCC. With the US signaling its willingness to enhance cooperation on international climate efforts, and major EU member states supporting the idea, the initiative is already likely to have some international support. Moreover, major emitters such as China and Russia that face potential consequences from CBAM could be open to this alternative.

In case the next German Government, with help of the EU, will be able to gather broad international support for this idea, it might provide a sensible way to avoid possible international trade conflicts. At the same time, there is a risk that any standards adopted by a club that includes major emitters may be weak and unable to prevent carbon leakage.

For industries directly affected by the new standards that such a club would develop, it will be important to pay close attention to the proposals being considered and to engage early on with relevant government actors in order to ensure that their points of view are being considered.

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Issue Brief 02/21

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