# Insight from Brussels

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The EU's aim to be the world's first climate-neutral region by 2050 could disrupt global commodity trade flows, as it mulls ways to cut its emissions while protecting its industry and raising money for post-pandemic recovery spending.

The European Commission wants EU governments to focus on switching more sectors to renewable electricity, improving energy efficiency, and replacing fossil fuels with hydrogen and other low-carbon gases and liquids, as part of its European Green Deal strategy to cut emissions.

If successful, this will change EU energy supply and demand patterns, and trade relations with external countries – particularly China, Russia and the US.

The EC is looking at several options with a direct external trade impact: introducing a carbon border adjustment mechanism, extending the EU Emissions Trading System to international aviation and shipping, and setting methane emission performance standards for all natural gas and LNG sold in the EU.

Each of these would change the relative attractiveness of energy and commodities from different sources and regions, potentially changing trade flows.

The aim of the EU carbon border adjustment mechanism, for example, is to ensure that the EU's energy-intensive industrial sectors, including power generation, steel furnaces, oil refining and heavy manufacturing, do not shift their production to regions with less stringent carbon constraints, such as China and the US.

The EC is still considering how such a mechanism could work, and which sectors should benefit from it. The EU steel sector is particularly keen to be included. Any such mechanism would have to comply with World Trade Organization rules.

It seems likely, however, that an EU attempt to apply a carbon price to selected imports from selected countries would lead to tense trade and climate talks with those countries. France first floated the idea of a carbon border tax to protect EU industry in 2009, but quickly dropped it after the rest of the EU failed to back it.

The EU's increased climate ambition and the need to raise money to support recovery after the pandemic lockdowns have now revived interest. EU leaders on July 21 invited the EC to propose such a mechanism next year, with a view to introducing it at the latest by January 1, 2023.

The EC has estimated such a mechanism could raise between Eur5 billion ($6 billion) and Eur14 billion per year, helping to finance the EU's planned Eur750 billion recovery fund to help kick-start the economy over the next three years.

## Carbon fees for aviation, shipping

The EC estimates it could raise another Eur10 billion/year by requiring more sectors – possibly including international aviation and shipping – to buy EU ETS allowances from 2021, to cover their CO2 emissions. The EU ETS currently applies to stationary heavy industrial installations and intra-EU flights.

Targeting aviation and shipping would again likely create tense relations with the EU's trading partners.

The EU originally wanted to include international aviation in the ETS, but strong political opposition, including from China, Russia and the US, forced it to rethink. It then froze the idea and focused on working with UN aviation association, ICAO, on a global approach.

## Methane emissions

The EC's plans to address methane emissions, meanwhile, will have a major impact on the EU's natural gas, LNG and potential fossil-based hydrogen suppliers, its deputy director-general for energy, Klaus-Dieter Borchardt, told S&P Global Platts in an interview.

Methane is a potent greenhouse gas, and most leaks happen before the natural gas or LNG reaches the EU, so a new EU policy on methane emissions could have far-reaching impacts on the global gas market.

Introducing a methane emission performance standard for all gas sold in the EU market, for example, would create a quality component enabling customers to distinguish between different gas commodity grades based on their total carbon footprint.

The EU is keen to stay on good terms with all its existing fossil energy partners, including Norway, North Africa, Russia and the US, even as it switches its focus to renewables.

Russia is the EU's biggest natural gas supplier, and is also looking at producing "blue" hydrogen from natural gas with pyrolysis to sell to the EU.

US LNG, meanwhile, is likely to remain a good supply source for the EU over the next five to 10 years, helping to stabilize markets and drive prices down, Borchardt said.

But its carbon footprint, along with other LNG sources, is higher than pipeline gas, so LNG suppliers face a similar decarbonization challenge to remain relevant in the EU market, he said.

Borchardt called for all the gas exporting countries, including Russia and the US, to work together on reliable, standardized methane emission reporting.

The EC plans to set out initial thoughts and possible voluntary initiatives for measuring, reporting and verifying methane emissions in an EU strategy paper expected at the end of September or early October. It wants to follow this up with formal legislative proposals mid- to late 2021 to ensure compliance. ■