

EU-US Divergence on Energy Policy:

Differing Economic Structures and Possible Alignment on a Market Based Approach

By Keith Rockwell, June 2024

A general rule in global affairs is that if the US and Europe are aligned in an effort, it is more likely to succeed. As the world pursues the goal of effecting an energy transition, a shared transatlantic approach is urgently needed. This is especially true as both the [US](#) and the [European Union](#) (EU) are limiting trade on products from China that facilitate the energy transition. China's relatively inexpensive electric vehicles, batteries and solar panel combined with its [Green Belt and Road Initiative](#) represent its proposition to the world on how to address a global challenge. Will the transatlantic partners offer a compelling alternative or quibble among themselves. The world is watching. Can the US and Europe come together again to establish a common framework for effecting the energy transition?

Divergence in Public Attitudes on Climate Change as a Threat

Immediately following World War II, trans-Atlantic cohesion was essential to the development of multi-lateral rules-based order. A shared sense of purpose had been forged by the common experiences of prevailing together in a global conflict and then joint efforts to rebuild in its aftermath. In the eight decades since, the attitudes of the two continents have drifted apart in ways that make joint action more difficult.

In a recent global [survey](#), 81% on those in France and 73% in Germany defined climate changes as a "top global threat" while only 54% of those in US did so. While approximately 85% of those on the left side of the political spectrum in all three countries identified climate change as a global threat, there was wide divergence among those on the political right. In France, 75% of conservatives and 59% in Germany viewed climate change as a threat, while in the United States only 22% held this view.

This explains how US policies whipsaw back and forth from alignment with Europe when a Democrat is in power and divergence when a Republican is in power. It has less to do with the person elected president and much more to do with the portion of the population that elects them. Differing coalitions for victory explain Donald Trump's 2017 decision to withdraw the US from the 2015 UN Paris Agreement on climate change mitigation and President Biden signing an executive order rejoining the Paris agreement within hours of his inauguration. A common level of support from the left on each side of the Atlantic explains alignment during the Biden presidency in adherence to the UN Climate Change Conference process, joining the [consensus](#) at COP28 to "transition away from fossil fuels", and [contributing](#) to the United Nations Framework Convention on Climate Change's Green Climate Fund.

Divergence in Economic Interests

What is behind these differing views among conservatives. One factor is differing economic interests. To fuel their economy with carbon-based fuels, Europe must import. On the other hand, the US is by far the world's largest oil producer, providing almost 19% of global supply. Oil and Gas [represents](#) 8% of US GDP and less than 1% or the EUs.

While Norway is a major European producer of oil and gas and supplies, now supplying about [30 percent](#) of EU natural gas since the advent of the Ukraine War, it is not part of the EU. The Netherlands, an EU member, has continued to extract natural gas through the Groningen field, the largest in Europe,

but has decided to shut that down, only partly for climate reasons. Support for fracking on the continent is uneven but generally there is far more resistance than in the US and this has limited European production.

An industry [study](#) conducted by PwC found that the oil and gas industry supports 9.8 million US jobs or 5.6 percent of total employment. These voters are the ones cheering when Donald Trump tells his campaign rallies that his solution to inflation and other economic problems is to “drill, baby, drill” for more oil. There is no comparable segment of voters in Europe.

Given the administration’s concern about maintaining a healthy economy, voters’ concerns about [inflation](#) caused in part by high energy prices, a desire not to alienate voters in a swing state like [Pennsylvania](#) – which has significant shale oil production - and the need to [help Europe](#) ween off from Russian energy, even a climate committed president like Joe Biden finds it necessary to be reasonably supportive of the US oil and gas industry. These factors are behind the Biden Administration approving [more](#) oil and gas drilling permits for wells on federal lands during its first three years than the comparable period during the Trump Administration. One should not be surprised that in 2023 the US [produced](#) an average of 12.9 million barrels a day, more than any country in history. So far in 2024, monthly production averages exceed those in 2023.

Again, it would seem unwise to craft energy policy predicated on US administrations of either party abandoning support for an industry important to its energy independence and economic vitality.

Economic Differences Drive Different Approaches to Spurring Energy Transition

Differences in the importance of the oil and gas industry to their continental economies also explain the differences between how each has decided to approach spurring an energy transition.

With little domestic oil and gas industry to protect, the European Union (EU) chose an approach that extends its internal policy that imposes a price on carbon globally through the introduction in October of last year of its Carbon Border Adjustment Mechanism (CBAM).

In the US, the large oil and gas companies generally support a [carbon price](#) that will contribute to advancing a lower-carbon future and actions that enable the goals of the Paris Agreement. The US Chamber of Commerce is open to implementing carbon pricing. That said, there remains [concern](#) that it would result in “discouraging domestic manufacturing and energy production, more jobs and businesses moving overseas, and lower economic growth.”

Not wanting to directly confront the political opposition from America’s strong oil and gas industry, the Biden Administration chose to incentivize new forms of energy rather than to apply penalties on traditional sources of energy. Its broad-based approach includes incentives for carbon capture and clean hydrogen, thereby letting carbon-based energy companies see themselves as part of the energy transition solution.

EU CBAM Approach

The EU CBAM is a companion regulation to its carbon trading system - the Emissions Trading System (ETS). Under the ETS, companies emitting greenhouse gases purchase “allowances” to offset those emissions. Companies with lower levels of emissions require fewer allowances and can trade their surplus “allowances” on the secondary market through an exchange.

The ETS determines a price for carbon. Under the EU’s CBAM, importers must purchase vouchers at a price equivalent to the carbon price set for “allowances” through the ETS. This in essence imposes the

EU price for carbon on the world. When assessing the level of CBAM duties – which will be applied starting in 2026 - a series of factors will be considered including whether the exporting country sets a price for carbon in its home market. There is currently no such price set at federal level in the US. CBAM will apply to imports of select carbon intensive product categories - cement, steel, chemicals, aluminium, fertilizers, hydrogen, and electricity.

Since the outlines of CBAM were agreed in 2022 the EU has argued that the mechanism conforms to World Trade Organization (WTO) rules. It is non-discriminatory, as the border taxes set by the market are the same taxes that EU companies must pay. In January, importers began reporting to Brussels on the carbon data of the products they imported. In 2026 customs officials will begin to collect duties. At the end of the day any assessment of WTO compliance will likely depend on how the complex system is implemented.

Many EU trade partners, including the US, that have strong carbon energy industries and / or lack a carbon trading mechanism have argued against the EU's CBAM claiming that it will adversely affect their exporters. Setting aside the impact on the US, the fact that it would result in a significant wealth transfer from emerging and developing economies to the EU seems contrary to efforts to spark investment in these regions to advance development and energy transition goals.

US Subsidy Approach

The US has taken an altogether different tack in addressing climate changes, namely the [Inflation Reduction Act](#) (IRA). This catchall program covers a myriad of sectors and offers direct grants and tax breaks to consumers and producers of products like electric vehicles and solar panels. There are a host of trade provisions in the IRA and all of them favor US producers.

To [qualify](#) for tax breaks, producers must assemble 100% of the vehicle in North America by 2029, all the vehicle that is, save for the batteries. The batteries cannot be produced 100% in North America because the critical raw materials needed to make them are mined in places like the Democratic Republic of the Congo, Zimbabwe, Indonesia, South Africa, Australia and Chile. So, the rules permit tax breaks if these materials are imported from a country with which the US has a trade agreement.

Today, there are only [20](#) such countries including Australia and Chile. Japan which excels in the production of electric batteries does not have a trade agreement with the US. Instead, a special critical minerals trade agreement [with Japan](#) was hastily drafted and agreed enabling Japanese car and battery makers to gain favorable tax treatment.

No such deal has yet been extended to [the EU](#) because US Trade Representative Katherine Tai maintains that the EU does not do enough to enforce labor and environmental standards in third countries, an obligation Brussels counters, that is not required of Japan. Specifically, Washington believes the German car industry uses components that have been manufactured in the province of Xinjiang by forced labor of Uyghurs from the region.

Washington has acted by [impounding](#) thousands of Porsches, Audis and Volkswagens in US ports because the Biden administration maintains Volkswagen has violated the [2021 Uyghur Forced Labor Prevention Act](#), which essentially states that a company accused of such violations is guilty until proven innocent. It is unlikely a transatlantic critical minerals agreement will be achieved during the current US administration.

The IRA approach appears vulnerable. Part of the motivation of the recent increase in tariffs on China were to not have cheap goods crush the startups spawned by the IRA. In line with the voter attitudes and the fact that not even [a single](#) Republican voted for the IRA, it is likely that to the extent possible its provisions could be reversed under a second Donald Trump term, though the Chinese tariffs will still likely remain.

While the EU's CBAM and the US IRA subsidies provide starkly different approaches, both sides of Atlantic are advancing a mix of strategies to promote an energy transition. The EU maintains a large set of regulatory policies and [subsidies](#). The Biden Administration has advanced an executive-driven effort to add a major regulatory component under the [Clean Air Act](#), albeit with a highly uncertain [legal](#) and political future.

Steel Adds Further Complexities

Apart from frictions caused by the differing CBAM vs. subsidies approaches, there is another environmental thorn in the side of the US-EU trade relationship – steel.

In 2018, Donald Trump [slapped](#) a 25% import tariff on virtually all imports of steel and a 10% duty on imports of aluminum. The alleged rationale was national security. EU officials reacted swiftly and countered with tariffs on Kentucky bourbon, Levi jeans and Harley Davidson motorcycles among other products.

Both sets of tariffs were deemed illegal by WTO dispute panels and when Biden took office, he pared back the tariffs – as did the EU – but kept quotas in place which limit EU exports. The tariffs have also only been suspended, not repealed. Discussions to strike a deal under the current US administration have hinged to a certain extent on ensuring that steel and aluminum exports between the two are produced in the cleanest possible way. As another little twist, is the idea that the two sides should limit imports from non-market economies with an eye on China.

Efforts to strike a deal foundered for several reasons including EU reluctance to waive CBAM duties on US exports and to unilaterally sanction China. Rather than reimpose tariffs on both sides, the two agreed to [suspend](#) discussions on the issue until after the US elections.

In pushing resolution of these issues aside, the parties may have taken some controversial issues out of the 2024 political discourse, but the possibility of a fierce trade conflict have not been averted, merely forestalled.

Sustainability of Subsidies Approach Uncertain

Until attitudes towards climate action on the right side of the political spectrum changes in the US, Europe and the world should not expect a cessation of the whipsaw of approaches amongst administrations of different parties relative to actions motivated solely by climate action. It is perhaps as likely that the gap in attitudes towards climate changes between the continents will shrink due to European voters becoming more resistant to green measures. Protests against such measures by [French farmers – and the subsequent EU decisions to postpone their implementation – was followed by a poor showing by Green parties in the recent EU parliament elections](#). It is more unlikely that US conservatives will become more [concerned](#) about the impact of climate change.

Partisan pressures. That said, once a subsidy system is in place, it is politically hard to reverse. Even though the US Chamber of Commerce and the petroleum industry opposed the IRA, they are [supportive](#) of continuing incentives for hydrogen and carbon capture and storage. Provisions supporting processing critical minerals, manufacturing batteries, capturing and storing carbon dioxide and producing biofuels are least at risk. The tax credit for the purchase of [electric vehicles](#) faces perhaps an even greater threat. While there is much discussion of reversing incentives for renewable energies, it bears mention that a [majority](#) of investments for large solar, wind and storage projects spurred by the IRA are located in Republican districts, something which may influence any final action on repealing segments of the bill.

Texas, a long time Republican stronghold, is a case in point. Recently, the Lone Star State [overtook](#) California as the largest solar power producer. How did this happen? It turns out that rural counties desperate for economic development stand to gain [most](#) of the benefits from expanded renewables and storage. It also turns out that the less burdensome Texan approach to [connecting](#) to the grid facilitated a faster rollout.

Fiscal Pressures. While the US under a second Biden administration may wish to double down on a subsidies-based approach and EU countries may wish to follow suit, widening fiscal deficits driven by aging populations may constrain such ambitions. Rather than the \$369 billion originally determined to be the IRA's cost, an April 26, 2023 [estimate](#) of its cost by the Joint Committee on Taxation was \$515 billion. Goldman Sachs [estimated](#) that same month that the IRA "will provide an estimated \$1.2 trillion of incentives by 2032." The impact of such stimulus on inflation and the push to increase defense spending could also limit fiscal options.

As economists become increasingly concerned with debt levels in both the [US](#) and [Europe](#), pressure for the US to pivot from its subsidy approach may increase. Consider the fact that current US Congressional Budget Office projections forecast the budget deficit could "swell to \$1.9 trillion this fiscal year and keep growing until the overall national debt hits \$50.7 trillion a decade from now". Deficits would range from 6.5% - 7% of GDP for the decade ahead. And that forecasts assumes that tax cuts passed in 2017 during the Trump Administration are allowed to expire. Extending those tax cuts would [add](#) another \$4 trillion to already excessive deficits. And even as global defense spending is at an [all-time high](#), US defense spending as a share of GDP is at a [post-World War II low](#). Even though history suggests mustering the political will necessary for deficit reduction is rare, as Jamie Dimon, the head of JPMorgan Chase, recently [suggested](#), mounting US debt will eventually spark a "rebellion" in global markets, thereby forcing political action.

A New Day for CBAM in America?

While the effort to advance carbon pricing in America [failed in 2010](#), does the advance of the EU's CBAM and importantly the heightened desire to counter Chinese trade distortions mean that carbon pricing and CBAM have a greater chance of acceptance? China's heavy dependence on coal results in it having a [more carbon intensive](#) economy than the US and certainly the EU. China consumes [more](#) coal than the rest of the world combined. Stealing a page from the steel discussions by applying a joint CBAM could neutralize China's energy cost advantages.

Many questions abound about the future of actions on the energy transition on each side of the Atlantic. Should Trump get elected, what current policies will be reversed? Will a more market-based approach like a revenue neutral carbon pricing combined with CBAM have a chance in the US? Should President Biden be re-elected, how patient will the new EU Commission and the new Parliament be with Washington's nationalist positions on trade? How will the rest of the world react when their producers are disadvantaged by provisions in CBAM and the IRA? Is there likely to be a legal challenge of these programs at the WTO?

While questions abound, one thing seems certain. The US and Europe aligning on a common approach is more likely to lead to success in achieving an energy transition.



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