

Setting a higher carbon price in the EU*

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With the adoption of the *Green Deal*, the European Union (EU) is flagging ambitious targets for Green House Gas (GHG) emission reduction: 55% by 2030, and carbon neutrality by 2050. A growing number of scientific reports, from the Intergovernmental Panel on Climate Change (IPCC) and numerous other sources, point to the accelerating pace of anthropogenic climate change (Carbon Brief, 2020) and its devastating consequences on human health and well-being (Watts *et al.*, 2020), on biodiversity, etc. On December 3, 2020, the European Court of Human Rights has solemnly summoned 33 European states to demonstrate that they are effectively acting to fulfill the commitments taken in Paris in December 2015. And in spite of the fact that these commitments don't add up to a reduction sufficient to keep global warming below 2°C by the end of the century, the latest *Emissions Gap Report* (UNEP, 2020) clearly shows that the world is globally not on track to fulfill them (Carbon Brief, 2020).

Insufficient efforts so far

The EU is, so far, but the next steps will require a serious effort: whereas EU total territorial emissions have been reduced by 23% since 1990, and probably more with the sanitary crisis and its economic consequences, in some sectors (especially transport) emissions are still rising; and consumption emissions—which include carbon emitted abroad to produce and transport imports, less carbon emitted to produce exports—have been reduced much less (UNEP, 2020), pointing to a major flaw in the current European climate policy.

Along with emission standards on light vehicles and some eco-conditionality on EU budget expenditures as well as, more recently, on loans from the European In-

* Spanish version available at <https://euskadi.eus/ekonomiaz>.

vestment Bank –renamed «Climate Bank»–, the main climate policy instrument at the EU level has been the imposition of emissions quotas to large GHG emitters (utilities, cement, heavy industry and waste treatment factories, essentially, accounting for about 11.000 plants in the EU and about 45% of total emissions), coupled with the Emissions Trading Scheme (EU ETS, or European Carbon Market), set up in January 2005 in application of the Kyoto Protocol (1997).

The rationale for this «cap-and-trade» system is to set an annual limit on total emissions from these plants via emissions quotas distributed to them, and let them trade these quotas on a market so that a carbon price emerges. Of course, the market price of carbon thus entirely depends on supply and demand of emission permits, so that setting the cap right is crucial. With hindsight, it appears that the ETS has been ill-managed, so that over its 15 years of existence, the carbon price has, most of the time, been extremely low –less than 10 €/tCO₂–, too low to effectively incentivize significant emissions abatement from the sectors submitted to the quota system. Although emissions have indeed subsided, the pace and magnitude of reduction are clearly not up to what is required in the next decade to reach the new targets.

In 2017, after years of negotiations in the Council and EU Parliament, the Commission has enacted a reform of the EU ETS that sets the annual pace of reduction of the cap at 2.2% starting in 2021, instead of 1.74% previously, and increases the amount of permits that may be set aside to stabilize the carbon price in cases of unexpected falls in emissions, such as the one currently observed since the beginning of the Covid crisis as a consequence of the deep economic recession. As a result, the carbon market price has recovered since the beginning of 2018 and is currently close to 30 €/tCO₂.

Green Deal: a fresh start?

With the enhanced ambitions set for emissions reduction by 2030, and the goal of carbon neutrality by 2050, the cap will have to further tightened, so that the carbon price reaches higher levels –many analysts considering that it should be set between 33 and 66 €/tCO₂ in 2020 and reach between 41 and 82 €/tCO₂ by 2030 (Stern and Stiglitz, eds., 2017). It probably also will be necessary to submit more GHG emitters to the ETS, or alternatively to strengthen carbon taxation in the EU member states, so that the carbon price is effectively raised for all, or most emitters. And recent economic analyses (in particular, Saussay, *et al.*, 2018, Stiglitz, 2019, and Hepburn, Stern, and Stiglitz, eds., 2020) suggest that pricing instruments will not suffice and that the new ETS price stabilization mechanism may not work as expected.

Notwithstanding the political and social obstacles in the way of such a bold move, setting a higher carbon price in the EU may generate a competitiveness problem if the rest of the world is not following suit. Indeed in the past, the mere exist-

276

ence of a positive carbon price in the EU, in a context where many other areas of the world had not introduced carbon pricing, has fueled the fear of possible «carbon leakages», i.e. competitiveness effects that may trigger decisions by firms to relocate in countries with no carbon emissions restrictions. Although there is little if any empirical evidence so far of such effects (Verde, 2018), the growing discrepancy between the EU territorial emissions and «carbon footprint» (consumption emissions, i.e. emissions attributable to the production and transport of all what is consumed in the EU, see UNEP, 2020) constitutes indirect evidence that a fraction of EU consumption-related emissions has been shifted abroad, so that the reduction in global emissions has been less than EU emission reduction.

In order to remedy this carbon price gap between the EU and other regions of the world, it may prove necessary to introduce of carbon border levy on imports from those countries/regions that do not price carbon or price it much less than in the EU. This new instrument is now recommended for adoption by the EU Commission in the framework of the *Green Deal* (<https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12228-EU-Green-Deal-carbon-border-adjustment-mechanism->), the objective being to submit a new directive in the second quarter of 2021; in November 2020, the EU Parliament has expressed its support. This EU carbon border levy would also serve as a new own resource for the European budget, a welcome addition to service the newly created EU debt. But of course, such a project raises much opposition, both within and outside the EU, and it remains to be seen whether it will be adopted.

So far, progress in pricing carbon has been slow almost everywhere, and among the 70 countries participating in the UN Summit meeting held in London on December 12, 2020 on the 5th anniversary of the Paris Agreement, only Canada announced a target price for carbon: 170 \$/tCO₂ by 2030.

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