EUROPEAN PARLIAMENT

STUDY

Policy Department
Economic and Scientific Policy

Competitive distortions and leakage in a world of different carbon prices

Trade, competitiveness and employment challenges when meeting the post-2012 climate commitments in the European Union

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Responsible Administrator	Arttu MAKIPAA
Author - Chapter 1	Policy Department Economy and Science DG Internal Policies European Parliament Rue Wiertz 60 - ATR 00L006 B-1047 Brussels Tel: +32-2-28 32 620, Fax: +32-2-28 46 929 arttu.makipaa@europarl.europa.eu
Author - Chapter 2:	Karsten NEUHOFF Faculty of Economics University of Cambridge Sidgwick Avenue Cambridge CB3 9DE, UK karsten.neuhoff@econ.cam.ac.uk
Authors - Chapter 3:	Ralph CZARNECKI, Michael MEHLING and Nils MEYER-OHLENDORF The Ecologic Institute Pfalzburger Str. 43-44, D-10717 Berlin, ralph.czarnecki@ecologic.eu
Authors - Chapter 4:	Stéphanie MONJON and Philippe QUIRION CIRED & SMASH 45 bis avenue de la Belle Gabrielle F 94736 Nogent sur Marne cedex, France monjon@centre-cired.fr; quirion@centre-cired.fr
Authors - Chapter 5:	Ulrike LEHR and Christian LUTZ Institute for Economic Structures Research (GWS mbh) Heinrichstr. 30, D-49080 Osnabrück, Germany, lehr@gws-os.de, lutz@gws-os.de

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Executive Summary

Effective climate policy in Europe requires early commitment to ambitious emission reduction targets, with tight emission caps and rapid shifts towards auctioning of emissions. This guides a transition to a low carbon economy, provides growth opportunities for innovative sectors and technologies, and demonstrates leadership to drive international climate policy. Whether or not an agreement is reached at the Copenhagen COP in 2009, it is very unlikely that a single global price for carbon will prevail. A frequently voiced concern is that states with stringent climate policies will place domestic industries at a disadvantage relative to competitors in states with less ambitious climate efforts.

This study compilation is an attempt to present the policy options available in this possible future situation of different levels of ambitions in climate policies. It asks the question whether competitive distortions and leakage present a realistic danger in a world of different carbon prices. The prevailing assumption is that a considerable (and possibly growing) part of allowances in EU-ETS are auctioned as of 2013.

Chapter 1 presents the content of the study, clarifies the questions and summarizes the main arguments and results of the authors. The further study is a compilation of 4 contributions in chapters 2-5. They are all written by recognized experts in the field. The diversification of authorship across chapters allows further to include different points of views as well as to have both economic and legal approaches to the problem.

Karsten Neuhoff from Cambridge University argues in chapter 2 that only a few industrial sectors of the economy, accounting for 1-2% of total GDP would face significant cost increases through the higher carbon price. They can be individually assessed to see whether long-term carbon price differences would contribute to relocation of industrial activity and thus leakage of emissions. If it becomes necessary in 2010/2011, state aid, continued free allowance allocation or border adjustments can be implemented to address these leakage concerns.

Three authors from the Ecologic Institute take a more legal approach in chapter 3. They argue that the relationship between climate policy and international trade is complex, characterised by a wide spectrum of interactions that range from synergy to conflict. A multilateral solution would be the first best option, a view shared by all other contributors to this study compilation. Among the unilateral policy measures available, border adjustments to offset the regulatory burden of climate policies are not ruled out in principle by the pertinent rules of international trade law. Border adjustments should affect domestic and foreign producers in a non-discriminatory manner, and be justified on environmental, not competitive, grounds. However, legal uncertainties remain and the particular design of the adjustments is important.

Chapter 4 is a closer scrutiny of the implementation challenges of border adjustments. In their contribution, the authors Philippe Quirion and Stéphanie Monjon assume that the implementation of border adjustments is decided and discuss the main design options and their capacity to fulfil the ambition of countering leakage caused by higher production costs in the EU. Out of their discussion on the mechanism design, a particular form of BAs arises as the most viable, containing the lowest costs of enforcement and administration.

In chapter 5, Ulrike Lehr and Christian Lutz from GWS analyze the employment impacts of broader climate change policies in a literature survey. They find that the net employment impacts are very small. Carbon leakage is expected to be rather small in most studies and can be offset by technology spill-over. Employment losses due to carbon leakage will be concentrated in a few processes and facilities. Renewable energy and other policies outside the ETS are reported to be rather positive for the labour market.