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Analysis of today
Assessment of tomorrow

By: Adair Turner

Carbon Pricing Is Advancing Despite American Boycott

Many fear that America's withdrawal from the Paris climate agreement will undermine the international consensus to reduce greenhouse-gas emissions.

Yet just in the last month, there have been two major steps toward widespread carbon pricing where it is needed most.

To be sure, carbon pricing is not always the best policy, and not all sectors need to be subjected to schemes that require international consistency.

If India electrifies its vehicle fleet more slowly than Europe, European industry suffers no competitive disadvantage. But the situation is different in long-distance shipping and aviation, and in heavy industries such as steel and chemicals, which account for around 25% of global emissions.

Here, carbon pricing is key to cost-efficient decarbonization, and must be imposed on an internationally consistent basis.

Fortunately, the technologies needed to achieve net-zero emissions by mid-century in each sector already exist. For example, methanol or ammonia can be used instead of fuel oil in ship engines, and hydrogen can replace coking coal in iron production.

As matters stand, these technologies would impose a significant "green cost premium" at the intermediate product level, but with only a small impact on consumer prices.

For example, even if shipping-freight rates doubled, the price of a pair of jeans made in Bangladesh and bought in London would rise less than 1%. If making zero-carbon steel costs 50% more per ton, that would add around 1% to the price of an automobile made from green steel.

A carbon levy

Carbon pricing is essential to overcome the green cost premium, and it could drive cost-efficient decarbonization at a trivial cost to consumers.

But in each of these sectors, inherently international products (long-distance shipping) or the international trade in products (steel) make purely domestic approaches untenable.

That is why the International Maritime Organization (IMO) agreed on April 11 to impose a carbon levy reaching $380 per metric ton on ship operators whose emissions intensity exceeds a defined threshold.

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The IMO agreement is not perfect. The organization aims to cut global shipping emissions by 20% by 2030, but the new pricing scheme would achieve only an 8% reduction.

Still, concluding a new multilateral agreement despite a US boycott of the negotiations is a big step forward. China, India, and Brazil were among the 63 countries in favor.

Decarbonization in heavy industry

Carbon pricing could also drive decarbonization in heavy industry, but if it is imposed in only some countries, production and emissions will simply move to others.

Though the ideal solution would be common carbon prices worldwide for these energy-intensive sectors, there is no international rule-making body like the IMO. The second-best solution, then, is for individual countries to impose domestic carbon prices combined with border carbon tariffs.

> The EU is removing the free allowances that heavy industry previously enjoyed

The European Union is pursuing this approach. Not only will its emissions-trading scheme likely price carbon around $140 per metric ton by 2030; it is also removing the free allowances that heavy industry previously enjoyed and introducing a border carbon adjustment mechanism (CBAM) to subject imports to the same carbon pricing as domestic production.

In principle, this creates strong incentives for decarbonization, while protecting domestic competitiveness.

But the CBAM has been too weak, and heavy-industry decarbonization projects have been delayed. As a result, in March the European Commission committed to strengthening the regime in three respects: by ensuring a level playing field for exports as well as domestic sales; by widening the product coverage; and by improving the measurement of imports' carbon intensity.

How developing countries will respond?

The crucial question now is how developing countries will respond. In the past, several governments – in particular China and India – have criticized CBAMs as protectionist. But their arguments are unconvincing.

Combining a domestic carbon price with a CBAM does not give domestic producers a competitive advantage. It simply maintains the competitive balance that existed before both were introduced.

Moreover, it is the only way that developed countries can truly decarbonize their heavy industry, rather than hypocritically claiming to reduce emissions that have merely moved to other countries.

The EU's approach could unleash a global wave of carbon pricing on heavy industry, matching the IMO's progress in shipping

The objective of the policy is not to raise tariff revenue, but to encourage other countries to impose carbon prices at home.

These arguments are beginning to gain traction in developing countries. China's own emissions-trading scheme has been extended to heavy-industry sectors, and prices are slowly increasing – though they still hover around $10-15 per metric ton.

If carbon prices in China, India, and other developing countries gradually rose to European levels, and if CBAMs were imposed on those outside this low-carbon club, Chinese and Indian companies would also decarbonize.

Even better, the impact on local consumer prices would be trivial, and governments would generate revenue.

In this way, the EU's approach could unleash a global wave of carbon pricing on heavy industry, matching the IMO's progress in shipping.

Ideally, policies would reflect internationally agreed standards for measuring the carbon intensity of production, and some of the revenues from CBAMs – and from the IMO's carbon levies – would go toward supporting emissions reduction in lower-income countries.

These ideas should be debated at COP30 in Brazil this November, regardless of whether an official US delegation attends.

Adair Turner, Chair of the Energy Transitions Commission, was chair of the UK Financial Services Authority from 2008 to 2012