

CARBON PRICING & ADDRESSING COMPETITIVENESS



Carbon pricing – and the economics of policy decisions – should aim to preserve, if not enhance, a region’s economic performance and competitiveness.

Addressing real or perceived competitiveness impacts to affected industries is a critical dimension to smart carbon pricing design.



Companies which are covered by carbon pricing programs and which compete with national or international firms that are not subject to carbon constraints **do not have the leeway to raise product prices or recoup compliance costs**. These companies, many of which are “energy intensive and trade exposed” (EITE), are vulnerable to ‘carbon leakage’ (ie, corporate decision to relocate production to jurisdictions where no carbon pricing program is in effect).

In contrast, regulated companies that have more captive, local consumers and therefore not subject to leakage concerns (eg, power generators, fuels) are typically mandated to purchase all rights to emit and meet compliance.



Unlike other carbon policy measures like taxation and command and control, **cap-and-trade programs can effectively address these competitiveness and carbon leakage concerns** linked to a domestic carbon pricing. Many existing cap-and-trade programs, including the EU, California, Québec and Korea, freely allocate allowances to identified EITE sectors based on an agreed-upon percentage of the company’s regulatory compliance obligation.



Allowance allocation is the process of distributing allowances to covered entities in an emissions trading system (ETS). There are two basic options for allocation: allowances can be either given away (freely allocated) or sold at auction. **Because allowances have value, the allocation process is governed by rules to ensure their fair distribution.** A simple, transparent and credible process facilitates this politically contentious part of operating a trading scheme.



To address competitiveness concerns, a defined number of free allowance allocations is usually delivered to EITE sectors. The free allocation typically starts high, depending on the industry and susceptibility to leakage. Allocations then gradually decline (eg, 1-2% per year); this approach provides incentive to reduce emissions while lending incremental support to enable low-carbon transitions yet remain competitive in the global marketplace.

For example, in the EU ETS industry received 80% of its allocation for free in 2013 – but this will fall to 30% by 2020. Allocations are determined by benchmarks, set at the best available technology, ie so the most efficient plants in theory receive most of their allowances for free.



Some programs have also considered border carbon adjustments, whereby a carbon price is levied on imports of goods from outside the jurisdiction that are from a non-carbon constrained region. Such proposals are complex and open to legal and diplomatic challenges – as the EU experienced when it proposed including aviation in its ETS, and California has faced with efforts to level the playing field for fuel suppliers.