Climate change

What price carbon?

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Britain and the EU have learnt from some green-policy mistakes, but not from others

Satoshi Kambayashi

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ECONOMIC theory says that when an individual's choice damages others' interests, that damage should be reflected in the price he faces. The husky-hugging antics of David Cameron, the leader of the British opposition, who went off to the Arctic last year to watch it melting, may seem a long way from economic theory; but the greener-than-thou competition between Mr Cameron and Gordon Brown, who will probably become Britain's prime minister later this year (see article and article), along with the EU's environmental drum-banging at the European Council meeting last week (see article), are the political face of attempts to build that principle into economic policy. So far, those attempts to reduce the emissions that cause climate change have failed; but decisions by the European Union, announced on March 9th after last week's meeting, and by the British government, expressed in the climate change bill published on March 13th, suggest that both have learned from some mistakes, though not from others.

Governments can try to reduce emissions in three ways: subsidise alternatives, impose standards on products and processes and price the greenhouse gases that cause the damage. The first is almost always a bad idea; the second should generally be avoided; the third is the way to go. Europeans do all three. America does the first and the second at state and federal levels. California has decided to do the third, and it looks as though a federal system to price carbon will follow.

Green energy is fat with subsidies. America's ethanol subsidy, which has led to a huge rise in production, rocketing maize prices and consequent rioting in Mexico, is the sharpest example of why government should not pick winners: once the fertiliser and fuel used in corn production are taken into account, ethanol is probably not much greener than petrol. Europe has similarly daft subsidy regimes with equally perverse consequences—the German subsidy for solar energy, for instance, which has diverted the world's solar-cell production to sun-free Germany, thus raising the price in sunny countries where it might be usefully employed. Consumers pay for these indulgences through surcharges on electricity prices, but politicians like them, which is why the Europeans and the British both indicated there would be more of them.

There will also be more setting of standards. The EU plans to force companies to produce a certain proportion of the fuel they sell from renewable sources, and Britain proposes stricter standards for energy-efficiency in buildings. Sometimes market failure justifies setting such standards; but, like subsidies, they require governments to allocate resources, and markets are generally better at that than are politicians or bureaucrats.

Neither subsidies nor standards should be needed if greenhouse gases are priced to reflect the damage they do. The EU's emissions-trading scheme (ETS), which caps the amount of greenhouse gases that factories may emit and gives them tradable allowances, is designed to do that. The principle is fine; but because governments handed out too many allowances, emissions have not fallen and the price of allowances has dropped from €34 ($42) per tonne of CO_2 at its peak a year ago to around €1.20 now—far too low to induce anybody to constrain their emissions. What's more, the scheme runs out with the Kyoto protocol, in 2012—too soon to affect industry's behaviour. If there's to be no carbon price after 2012, there's no reason for companies to invest in cleaner technology.

Green is groovy, but that may not last

The European Commission got tough last autumn, and slashed governments' allocation plans for the second phase of the ETS, which runs from 2008-12. As a result, the carbon price for 2010 has risen to €16. At the same time, both the commission and the British government are trying to establish a longer-term carbon price. That's the point of Europe's plan to set a binding target of cutting carbon emissions by 20% of their 1990 level by 2020, and Britain's of cutting by 60% by 2050: industry can work backwards from those targets, infer a carbon price and build it into its investment plans. So those targets are not grandiose political gestures but pragmatic attempts to address a practical problem. It's a shame that the same can't be said of Europe's, and indeed America's, approach to subsidies.

Climate change is so wildly fashionable now that hardly anybody dares object to measures designed to combat it. But as the costs of such policies rise, that may not last. The more money governments spend on wasteful subsidies, the bigger the backlash is likely to be, and the smaller the chance of sustaining the political will needed to keep the world cool.