

Policy Brief

EUROPEAN CARBON PRICING: A PATHWAY TO NET-ZERO BY 2050

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This policy brief examines tools that can enable the EU to achieve carbon neutrality by 2050, with particular focus on its Emissions Trading System (ETS). It considers the important role played by the EU-ETS in carbon pricing and evaluates its success in achieving previous reduction targets. Considering the significant revisions to its structure included in the most recent European Commission Fit-for-55 Proposal (2021), this report refers to the system's revised version when assessing its impact and ambition. The focus is on what could strengthen EU proposals from a technical standpoint while maintaining feasibility from a socio-political one. So far, emissions allowances were traded based on a cap-and-trade principle within the ETS. The scheme covered the electricity sector, the heat sector, and energy-intensive industries. The proposed reform intends to encompass new sectors in the system, readjust trading conditions, and alter the price of allowances.

The EU-ETS must also be considered in a broader context. Even though the Fit-for-55 Proposal includes many essential amendments and supplements existing EU climate policy tools, shortcomings remain and debates continue surrounding their solutions. Securing systemic resilience of the ETS in the medium and long-term can only be achieved by addressing central problems directly. One issue is the heterogeneity in Carbon Pricing especially (but not exclusively) between different EU-level ETS' which are hypothesised to jeopardise trading mechanisms in the long-run. Until recently, the price of CO₂ was too low to contain its incentive steering effect. However, it has increased up to 75€/tonne in 2021. Even though current projections indicate that prices will not drop significantly below this level, new challenges are emerging, particularly with regards to the social compatibility of the price regime. Uncertainty and price volatility further undermine long-term planning and distort investment. Another obstacle stems from differences in national policies, both between EU member states and non-EU countries, which can lead to potential waterbed effects and carbon leakage. These problems make it difficult to secure socio-political support for the system since member states with below-average incomes and carbon-intensive industries, and more generally low-income households, are most affected.

To address the challenges concerning the effectiveness, uncertainty and fairness of carbon pricing, this policy brief introduces three recommendations:

- 1) Introduce an **EU-wide Carbon Price Floor** for the ETS through a buyback mechanism
- 2) Improve the design of the **Social Climate Fund** by **including** specific targets for direct financial support to affected households in its first period and providing technical guidance to member states in submitting their Climate Social Plans
- 3) Regularly publish an estimated **European Carbon Shadow Price** and include it in cost-benefit analyses of other EU policies to increase transparency and accountability

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