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## The End of the EU's Cap-and-Trade Affair

*This could turn out to be very good news for the world's climate.*

By BJORN LOMBORG

For some time, a divorce has been on the horizon. For years these sweethearts have soaked up the limelight on the international stage, but the sordid reality has sunk in. On Tuesday, a vote in the European Parliament confirmed that the love affair between the European Union and its climate policy may be well and truly over. This could turn out to be very good news for the world's climate.

The EU's cap-and-trade system is the main plank in its approach to dealing with greenhouse gas emissions and has inspired policy makers from California to Canberra. But while it's come at a high cost, it has done almost no good.

The European Commission and green groups have tried fervently to save the system, most recently with a proposal (voted down last week in the parliament, by 334 to 315) to jack up the price of carbon by postponing, and most likely cancelling, emission permits. The good news is that last week's failure could herald a global move towards smarter, cheaper solutions.

For the last couple of years, the EU Emissions Trading System has been in the doldrums. From a peak price of more than \$40 per ton of CO<sub>2</sub> in 2008, the price of EU carbon permits dropped to \$20 at the onset of the financial crisis and has now slid to less than \$5, trivializing the system.

The reason? The EU has already nearly achieved its carbon target for 2020, partly because of its emission-reduction projects in China and elsewhere, but mostly because the global economic crisis has reduced EU activity and, hence, emissions. While an economic recession is not desirable, a 10% drop in EU electricity emissions over the past couple of years should have delighted environmentalists.

Most economists agree that a carbon tax equal to the damage caused by CO<sub>2</sub> would, in principle, be sound. But according to the biggest meta-study of 311 published estimates, the most likely damage cost of CO<sub>2</sub> is about \$5 per ton. Thus, a higher price (as the EU attempted, or as California and Australia are now seeing) wastes resources.

A carbon tax—which, indirectly, is exactly what the cap-and-trade system tries to impose—only makes sense in a global setting. The EU (and the other cap-and-trade systems in Australia, South Korea and California) likely "leaks" a large part of its much-touted national emission cuts. The EU has reduced its national emissions since 1990 by 12%—but increased its imported emissions almost exactly as much.

Then there's the problem of innovation: Any realistic carbon tax will be unlikely to create the right incentives for research and deployment of new energy technologies. Instead, the players focus on gaming the system, for instance by manipulating emissions reductions in the Third World, where

large parts of the supposed reductions actually come from meaningless production and then destruction of HFC-23 gasses.

So the proposal that got shot down last Tuesday would only hike costs, with minuscule benefits for the climate. The EU's current efforts to meet its target for carbon cuts (20% below 1990 levels by 2020) are costing \$250 billion per year in GDP growth, based on an average from five macro-economic models. Climate models show that if these were extended throughout the century at a cost of about \$20 trillion, temperature rise by the end of the century would be reduced by a mere 0.1 degrees Fahrenheit. For each dollar spent, Europe would avoid \$0.03 of climate damage. Increasing the EU emission cut to 30% would cost an extra \$300 billion per year and reduce the temperature rise by an additional and almost immeasurable 0.02 degrees Fahrenheit. For each additional dollar spent, the benefits would be less than one cent.

The divorce between the EU and its climate policy now paves the way for smarter policies. Today, green energy from wind and solar is too expensive and unreliable. Most developed countries can only afford to subsidize small subsets of their energy markets and developing countries simply ignore them.

Instead we should dramatically increase investments into technological breakthroughs for future generations of green energy. For example, if solar power with storage could become cheaper than fossil fuels over the next 20-40 years, everyone would switch—and with a net benefit. Economic estimates indicate that for every dollar spent on green research and development—solar power, for instance—we will avoid \$10 of climate damage.

Like any divorce, this one is painful. Green campaigners lamented the EU vote, calling it "a desperately sad day for the EU." But some couples never belonged together in the first place. This may prove to be an amazing opportunity for getting realism and economic rationality back into the climate debate.

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