Carbon Leakage Risks in the Post-Paris World

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With the adoption of the Paris Agreement, the world of climate policy has changed, with important implications for the debate on carbon leakage. This report looks at how the risk of carbon leakage changes for different constellations of climate policy targets, how the incentives for countries have changed, and what carbon leakage entails for global emissions under these constellations.

Under the Paris Agreement, all countries have set themselves climate targets in a bottom-up process – the so-called Nationally Determined Contributions (NDCs). This marks a change from the Kyoto regime, where only the industrialised countries (listed in the Annex I) had fixed emission targets, but where the vast majority of countries had essentially no obligations regarding their emissions. Since there is no common agreed format or structure, the NDCs differ widely in terms of the type of target they set, the ambition that these targets embody, whether or not targets are conditional on other factors, such as financial assistance, their timeframe, the sectoral coverage and the detail on envisaged policy measures. But – despite their diversity, with few exceptions the NDCs represent a clear commitment towards limiting and reducing greenhouse gas emissions.

This has implications for the carbon leakage debate. In the Kyoto world, the recipient could see carbon leakage as a welcome boost that stimulates foreign investment in the domestic economy and increases demand for domestic products. While carbon leakage from Annex-I to non-Annex-I countries would increase global emissions, this had no direct consequence for the recipient countries. This can be different now: For the large majority of countries, and the overwhelming majority of global GDP, the existence of the NDCs means that carbon leakage now comes with a consequence for the leakage recipient country. Instead, carbon leakage now also comes at a cost to the recipient country in the form of associated emissions. Thus, there will be a trade-off to make between the benefits of carbon leakage (for recipient countries) and its downsides – as the additional emissions make it harder for a country to achieve its own NDC targets, and will necessitate additional mitigation action. Thus, whether or not carbon leakage leads to a net increase in emissions will depend on the actual constellation of targets in the alleged “source country” and the “recipient country,” respectively. This report investigates the leakage risk and consequences for a number of constellations.

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