Carbon emissions trading

The Kyoto agreement is avoidable as Europe is demonstrating.

London Times
November 29, 2006

Trading in a commodity where the variables include the inner workings of the Brussels bureaucracy is not for the faint-hearted.

Yet Europe's carbon dioxide emissions trading system (ETS), for all its imperfections, is at least a market-based stab at saving the planet. Polluters in various industries covered by the scheme - particularly power generators - have their emissions of CO_2 capped. They must buy allowances from cleaner participants or invest in green energy projects overseas to offset any surplus.

On Wednesday, the European Commission announced caps for 10 countries for the second phase of the ETS, which runs from 2008-12. In the first phase, 2005-07, several of the largest polluters (most notably France, Poland and Germany) took the precaution of allocating themselves annual allowances covering 12 per cent more CO_2 than they actually produced in 2005. Unsurprisingly, when details of this oversupply emerged at the end of April, emissions permit prices plummeted in a matter of days (from €30 a tonne to €14).

The Commission's announcement restores some credibility to the ETS. Overall, it caps emissions at a level 7 per cent below that proposed by the 10 states. Germany failed to win more lenient treatment despite last week's pre-emptive cut in its proposal level. In addition, the Commission indicated that it would limit the proportion of allowances that can be offset by building projects elsewhere. It will also not allow unused emissions capacity from phase I to be rolled over. This appears aimed at France and Poland, which are not among the 10 countries covered by Wednesday's announcement but which have enacted legislation that might allow them to exploit this.

Permit prices for December 2008 firmed a little on the news, to €18.30, but the cut was within the range expected. Still, the overall message is reasonably bullish for carbon prices. Generators with cleaner hydro or nuclear power in markets dominated by CO_2-heavy, coal-fired capacity should benefit: shares in both RWE and Eon reacted positively. Big unknowns remain, however. This will kick off negotiations rather than end them, and another 17 countries' caps have yet to be finalised - including both France and Poland.