Europe’s carbon-trading scheme

Corporate bonanza fails to reduce greenhouse gas emissions

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11 June 2007

Conflict over global warming took centre stage at the G8 summit with the European countries Britain, France and Germany taking the moral high ground in pressuring the United States to make a commitment to cuts in emissions.

The findings of the UN’s Intergovernmental Panel on Climate Change (IPCC) earlier this year, bringing together the work of scientists from throughout the world, firmly established that global warming is taking place and that the consequent climate change is a major threat to the future of humankind. It leads to the greater incidence of droughts, rising sea levels, flooding rivers, large-scale extinctions of plant and animal life, and greater malnutrition and disease. As a result, the US administration and the American oil and energy lobby are reluctantly shifting away from their previous stand of climate change denial.

In the end, US President George Bush agreed to a non-specific “substantial” cut in greenhouse gases and to negotiate a new climate change deal within the next two years. He also agreed to “seriously consider” the proposal for a 50 percent reduction by 2050, provided India and China were included in any agreement.

European leaders have polished their public images by appearing to take a lead in tackling global warming. German Chancellor Angela Merkel and British Prime Minister Tony Blair described the G8 discussions as “a major step forward”—Blair apparently regarding it as one of his greatest contributions to humanity before he leaves office. Environmental protesters, who have concentrated their anger on Bush, were left deflated and complained at the failure of the G8 to agree to “binding targets.”

In reality, the market-driven scheme, carbon trading, promoted by the European Union has so far failed to make any reduction in emissions. Because it does not make even the slightest inroads into the huge profits of the energy, oil and related industries—in fact, most of these companies support it—it completely fails to meet the challenge of climate change.

Despite all the favourable publicity being given to carbon trading, the European Commission reported that emissions from the major industrial users throughout the European Union actually rose by 1 to 1.5 percent in 2006. The “commitment” made by the EU leaders to cut emissions by 20 percent by 2020 is empty rhetoric.

In 2005, two markets came into operation that followed from the agreement to cut greenhouse gases made by most of the world’s nations—barring the United States and Australia—at the Kyoto climate summit of 1997. One is the European Emissions-Trading Scheme (ETS) organised by the European Union; the other is the United Nations Clean Development Mechanism (CDM).

The EU worked out the maximum number of tonnes of carbon dioxide that each of member states should produce. On this basis, each country gave out carbon credits or allowances to all its major corporations and organisations, ostensibly equivalent to the amount of emissions each would produce. Any company producing fewer emissions than its agreed-upon quota could sell some of its allocated credits on the market, supposedly a financial incentive to find ways of reducing emissions.

Given the pressure from industry, it was hardly surprising that the European Commission “miscalculated” and gave out too many credits. However, it took until the beginning of 2006 for this to be realised and for the price of carbon allowances to collapse. Before this happened, many corporations were able to sell credits and enjoy a free handout.

According to reports in the *Guardian* (June 2), the six UK electricity-generating companies “stood to earn some £800m in each of the three years of the scheme” and UK oil companies “were also poised to make a lot of free money: £10.2m for Esso, £17.9m for BP and £20.7m for Shell.” How much European companies actually gained has not been made public, but the effect has certainly been to encourage widespread corporate enthusiasm for carbon trading.

This first batch of allowances was meant to last until 2008 but was effectively abandoned. The EU set up a second phase of carbon allowances to cover the period 2008-2012 and gave out fewer credits to its member countries. Not only have prices kept up this time, but there has been a huge growth in the speculative trading of carbon credits. With the City of London at its centre, the market in carbon allowances trebled last year to US$30 billion (€22 billion), and specialist financial companies have emerged to service it. The *Guardian* on May 3 quoted Jack Cogen, president of an "emissions and renewable energy asset management firm," Natsource LLC: "In 2006 we saw growing activity in this asset class not only from industrial companies, but also from newer participants, like commercial firms, banks and financial institutions that recognise the attractiveness of this market for managing risks and earning returns on capital."

Whilst some US$25 billion of this market is in allowances created under the European ETS scheme, some US$5 billion are part of the UN's CDM scheme. This enables investment to take place in emission-reduction schemes in developing countries and countries such as China, India and Russia. It is this part of the carbon-trading system that is likely to expand in future and means that European companies can trade credits rather than being forced to reduce emissions.

Carbon-allocation prices can easily be kept down by investing in CDM projects that can make cuts in emissions at very little expense, since regulations and oversight are minimal. Using unpublished sources from within the UN, the *Guardian* suggests that up to 20 percent of carbon credits could be faulty and that the process "has been contaminated by gross incompetence, rule-breaking and possible fraud by companies in the developing world." They cite a CDM expert claiming that up to a third of the projects registered in India do not produce any cut in emissions and were wrongly approved.

Even discounting the effect of fraud, it is possible to make cuts in emissions far more cheaply than the price per tonne of carbon dioxide that has been established by the European market. In a recent survey, the *Economist* on May 31 cited the example of HFC-23 production in China. HFC-23 is the most potent greenhouse gas, which was used in refrigerators. Its global warming effect is more than 10,000 times the effect of carbon dioxide, but it is very cheap to destroy. Consequently, CDM credits worth US$11 on the market cost less than US$1 to produce in China.

Factories supposedly emitting HFC-23 as a by-product have found that it has become even more valuable than their main output. So lucrative is this scheme that the Chinese government is now taxing revenues from it at 65 percent and has set up its own US$2 billion CDM fund.

Although this particular hugely profitable emission-cutting scheme will soon end as HFC-23 runs out, the *Economist* note that "there will be no shortage of greenhouse gases produced there [in China] for rich-country money to clean up."

So while there is plenty of money to be made in trading carbon credits, there is very little incentive for European corporations to actually cut their carbon dioxide emissions. Even the *Economist*, an enthusiastic supporter of the scheme, has to note that though prices are now higher, "European emissions overall are not falling, which suggests there may not be as much switching out of coal, or as much technological innovation, as had been hoped."

It is this European and UN market-based scheme that is winning support in American corporations and explains Bush's move away from his previous refusal to consider cuts in emissions. As the *Economist* explains, "Companies that once pooh-poohed the idea of climate change have gone quiet; others have come out loudly in support of emissions controls. The shift culminated, in January this year, in the establishment of the United States Climate Action Partnership calling for 'strong' federal action to combat climate change. The initiative was launched by ten blue-chip companies, along with four NGOs. Membership has now doubled, and includes GM, GE, BP, Alcan and Alcoa." It has been suggested that a total of US$40 billion of carbon allocations would be handed out by the US government to industry to start off a similar scheme to the European one, with all the possibilities for speculative investments and trading.

No reliance can be placed on the carbon-trading market and the major corporations to deal with global warming or on the vacuous commitments of EU leaders to cut emissions. Recent scientific reports indicate that the speed of global warming is likely to be even faster than the IPCC predicted. For example, a study by the US National Academy of Sciences showed that carbon dioxide emissions have been increasing by about 3 percent a year during the last decade compared to 1.1 percent in the 1990s.