

What is cap and trade?

by The Nation - Robert S. Eshelman
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Cap and trade. Clean Development Mechanism. Carbon offsets. This is the language of solving climate change. What are they, though? How do they work? Do they work? And are there alternatives to market-based solutions that might help to reduce global emissions?

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I posed these questions to Oscar Reyes of Carbon Trade Watch, a project of the Transnational Institute and seeks a "justice-based analysis of climate change and climate analysis."

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The Nation: Explain cap and trade. How does it work?

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Oscar Reyes: The idea behind cap and trade is that it sets a limit on pollution. It provides permission to pollute to industries and then it uses a trading mechanism â€” the market â€” to allow them to exchange these permissions to pollute between themselves with the idea that this system allows for the cheapest available pollution reduction mechanism. That's the idea behind it. Unfortunately cap and trade doesn't work like that. In fact: it simply doesn't work.

The Nation: Why doesn't it work? What's the problem?

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Reyes: It doesn't work for three reasons.

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The first reason â€” and there's two parts to this â€” is that it simply doesn't reduce emissions. What we've seen in the European Union, where the largest cap and trade scheme exists â€” it's called the European Union Emissions Trading Scheme â€” is that far too many permissions to permit were handed out, which floods the market and pushes the price of these permissions down. And that's because governments are far too susceptible to lobbying by corporations that are involved in the scheme. A secondary problem with this trading scheme is what's called carbon offsets. This is a secondary type of carbon market, where instead of a company limiting its own pollution, it investments in what is called "emissions savings offsets," most of which are located in the global south. The problem with these projects, when you look at them, is that they actually don't lead to emissions reductions. The idea is that you set up a baseline for these projects â€” a scenario for what would happen â€” and then the credits are issued accounting for what would have happened versus what actually happened. The problem is that no one has a crystal ball. So, the projects get awarded when they have ambitious sounding claims and tell a convincing story. And there are studies that show that between 30% and 70% of these projects are actually not reducing emissions. Now if you say that you can exchange this kind of project for permits within a system that is meant to reduce emissions, what you end up doing is having a net increase in emissions

because you're flooding the system with things that represent reductions but in fact result in no reduction in emissions.

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A second piece of the problem with cap and trade is that it profits polluters. In the E.U. this happened in two ways. One is that the power sector gets permits for free but they put they pass on the imagined costs of these permits on to consumers, which actually rewards them with billions and billions of Euros. It's estimated that between 20 and 70 billion Euros will go to the power industry alone in windfall profits. On the other side of the scheme, every other economic sector is given too many credits. For example, ArcelorMitta, the world's largest steel company: their allocation of permits is about 20% to 30% more than their actual pollution â€“ meaning, without doing anything to reduce their pollution, they have a big surplus of the permits to sell. Estimates are that they actually made one and a half billion Euros since 2005.

The third reason is a justice argument. Especially with cap and trade and offsets together, you end up transferring the problem of tackling climate change to the global south. You pass on responsibility of this mess that industrial nations have created. The second part of this is the social and environmental damages that are caused by projects in the global south. The U.N.'s main mechanism for offset projects is called CDM â€“ the Clean Development Mechanism. Its not clean and it doesn't aid development. It costs companies around a hundred thousand dollars to even enter the scheme. What that means is that who gets involved in this scheme is the largest corporate polluters and a lot of financial interests. And really it's rewarding them for quite minor change or really paper changes, which they then call emissions cut. A lot of coal-fired power plants and hydroelectric projects are funded through this. In fact, most of the hydro-projects at this point apply for funding through CDM. And, since October, bio-diesel plantations â€“ palm oil plantations â€“ have been allowed into the scheme.

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The Nation: So, these sound like problems that might be fixed with better definitions, better oversight.

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Reyes: No, it can't be fixed.

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So people say: what would it mean to fix it? It means having a new system that generates a high and stable carbon price that would be financial incentive for companies to shift their energy production from, for example, coal to renewable energy. This is a scenario people would say could work.

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Now, even in that scenario, what you would actually end up having is you would see something like what we see, for example, in the U.K., where the largest coal fire power station says that it's ok to have to pay a little bit of money for this scheme. But what they can actually do mix 10% of their biomass with their coal fire power station. So, then, they can say that they're cutting emissions. They pushed the carbon off their books. And this way, they can carry on polluting but the biomass does not count.

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In fact, if you got anywhere close to the scale of the carbon price that would be required to make an incentive to change, the corporate lobby would step in. I mean: they are talking about the ceiling price of \$30 on carbon. I mean, you can use the pricing mechanism and talk about a totally different scale, \$150 and upwards for a ton of carbon.

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Beyond that, we say there is also a fundamental problem with the idea of making the cheapest solutions first. Sounds very nice. But the cheapest first is not the same as the most socially or environmentally effective first.

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And if you look at what's cheapest within our current economic model, it's just not the same thing. And when you have seen that there have been really large-scale changes in how industry and power sectors work, those have not happened through incentive-based price mechanisms. Those have happened through large-scale public investment and a shift of the mindset, of the framework, of how we look at things.

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The final point though is if we look at "can it be fixed?" that assumes the problems with cap and trade are problems with design. Actually the flaws are by design. They're flaws that say we can mix this cap and trade theory with its offset. The schemes of this, which are on the ground, are nothing like the theoretical models of the cap and trade.

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And there's a reason for that, which is that the deal with the power of the corporations covered by the scheme that lobbied for the laws to be set in a way that gives them benefit for free permits.

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For example, in Europe, they've said they're going to be introducing auctioning. It's been a perpetually displaced promise. The first phase was implemented but now we're finding that 75% of manufacturing is still going to get free permits. So these are not things that are accidentally wrong; they are examples of quite entrenched power interests – some of the interests that pushed for the cap and trade scheme in Europe in the first place. So we're not looking at theoretical schemes that don't work, but actually the practice on the ground and some many flaws and loopholes in the system.

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The Nation: So, if not cap and trade, if not a market-based system, which is pretty much the only solution being seriously discussed in climate talks here or in Washington, then what?

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Reyes: There's not one single solution, because cap and trade puts together, and carbon trading more generally, puts together a whole series of mechanisms in order to make a single commodity that can be traded.

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If you're attacking climate change you don't need to look at the world that way. We're talking about a problem that has come about through how we produce goods, how we produce our power, how we run our agriculture – and how much of those things we do through our international system. Climate change is something that is endemic to our system and there won't be one single fix or single treaty. That said: there are several different mechanisms for how one can tackle climate change. For example, we still spend globally about \$200 billion a year, funding fossil fuel infrastructure. We need to say we'll actually we should shift those subsidies to renewable energy. We need to look at our taxation systems, not necessarily by implementing carbon taxes, but also by closing loopholes that allow aviation industries, aviation fuels to be tax exempt. Also, there's the fact that corporate taxes have actually gone down. We need public investment in terms of how you shift industrial infrastructure. Investment in and of itself is not enough because it's a question of how that is governed and expended. And we need regulation, which is always treated as a dirty word meaning a command economy. But I'm talking about setting up a mechanism for rewarding best practices based on performance standards for example by bringing small scale renewable energy on line. There are many, many types of regulation. And regulation can really set up a situation for innovation.

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I would say, lastly, that public policy is not enough. We really need to be thinking bigger and thinking about how are system functions more fundamentally. Cap and trade interprets climate change into the language of neo-liberal economics. What we're saying is that that is using the problem to fix the problem. Instead we are saying we need to rethink our trade system and rethink how we produce and consume goods. And we need social movements to build that perspective and that's why we're in Copenhagen – to try and build social movements that look at how to reorient society in a more sustainable way.

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Oscar Reyes is a researcher with Carbon Trade Watch, a project of the Transnational Institute, and co-author of Carbon Trading: how it works and why it fails.

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