EU carbon-trading scheme puts a price on pollution

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With climate experts still reeling from the disappointment of the Copenhagen climate summit, negotiations to develop a strong carbon market continue. The European Union's system could set an example for the world.

The European Trading Scheme (ETS), which began its first phase 2005, is seen by the European Union as the best way to force emission reductions in the industrial sector and shift to cleaner technologies. The ETS is about to moves into its second phase amid concerns that it has significant flaws.

In negotiations of the Kyoto Protocol in 1997, 37 industrialized countries signed an international agreement to reduce greenhouse gas emissions to below 1990 levels to combat climate change. The deal offers countries a means of meeting their targets with flexible market mechanisms, where permits to emit greenhouse gases are bought and sold.

Carbon-trading systems work by putting a price on emissions, but how that price is determined varies according to the type of system used.

There are two types of carbon markets. In a "cap and trade" system, a central body sets a limit on emissions by allocating each factory a number of pollution permits, which can be bought or sold from other companies as needed. The more permits a company has, the more carbon it is allowed to emit.

The second system, known as "carbon offsets," works to reduce greenhouse gases by having companies invest in projects designed minimize the amount of CO_2 in the atmosphere. The projects can be located anywhere in the world and can generate carbon credits that can be sold back into the cap-and-trade systems.

Paying for pollution

Both of these mechanisms are being used in the EU's Clean Development Mechanism and Joint Implementation projects that make it possible for developed countries to sponsor carbon projects in developing countries as a way of generating tradable carbon credits.

The systems are about ways of getting companies to pay for the pollution they put into the air, according to Oscar Reyes from Carbon Trade Watch.

"The two systems slightly contradict each other because one sets a cap on emissions, but the other introduces new credits which increases that cap."

In the EU's trading model, a certain amount of carbon credits were handed out to companies for free and the rest of them were sold in an auction, said Barbara Helfferich, the European Commission's environment spokesperson.

"They receive carbon credits which they can trade on the market, or if they don't make the immediate reduction efforts they would have to buy credits on the market," she said. "The point is that in the long term it's cheaper for companies to invest in cleaner technology than buying credits on the market.

Caps set too high

The system is effective because the market does not have enough available carbon credits, which keeps their price up and promotes green investment, Helfferich said.

In 2005, the European Commission introduced national allocation plans. The allocation system, dependent on the price of carbon, acts as an incentive for factories to reduce their emissions.

However, problems that emerged from the first phase of the trading system show that European carbon market does not reduce emissions, according to Reyes.

"In the case of the EU trading scheme, what happened in the first phase 2005-2007 was that the cap was set to high - there were too many permits allocated so it didn't cap anything, it didn't reduce emissions."

The EU's trading scheme's teething problems resulted from a near collapse in the price of carbon, said Helfferich.

"There was a time when there were too many credits distributed on the market, which created a very low price," she said. "But the reason for that was that we didn't know the actual emissions of the countries involved."

Lobbying for loopholes

The second phase is proving to be successful because part of European Commission carbon legislation now requires countries to monitor their emissions, Helfferich added.

Such initial difficulties when a trading system is setup are common since national governments are susceptible to corporate lobbying when setting emission caps, Reyes said, adding that the same groups also push for loopholes to be created when governments attempt to regulate emissions.

"There needs to be a change in the methodology of reducing emissions to a series of more conventional regulations, tax incentives and shifting subsidies away from fossil fuels," Reyes said.

Financial difficulties

Bogus claims from companies who say their emissions saving projects in the developing nations justify their carbon emissions domestically, is another reason the EU's Clean Development Mechanism is not generating emissions reductions, according to Reyes.

"The clean development method is flawed," he said. "They talk about 'additionally,' the idea that the claimed credits are from projects that wouldn't have happened anyway. What we found is that is really an improvable claim."

These flaws have been acknowledged by climate experts at the recent Copenhagen Climate Summit, however, the main issues of carbon trading systems like the one adopted by the EU, are financial, Reyes said.

"The issue is how the money is transferred from industrialized to developing countries and who is responsible for emission reductions," he said of carbon trading systems.

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