Stern Words While in Europe They're Trading Hot Air

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Thursday, 07 December 2006

Taken from the December Issue of â€œParliamentary Briefingâ€• (www.thepolitician.org)

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The Stern Review on climate change has been widely applauded for marrying economics to science and thus speaking a language that politicians and the business community can understand.

On the back of the Stern Review, Gordon Brown has called for a long-term framework for the development of a worldwide carbon market, leading to â€˜a low-carbon global economyâ€™.

John Kay, a financial journalist, wrote in the Financial Times that, â€˜when a market is created through political action rather than emerging spontaneously from the needs of buyers and sellers, business will seek to influence market design for commercial advantageâ€™.

On the cusp of launching into the second round of the EU Emissions Trading Scheme (EU-ETS) there needs to be an honest evaluation of whether or not this sort of free market environmentalism is going to prove an adequate response to climate change, or whether it is simply providing business with a cost-effective way of not having to take effective action.

The genesis of the many different emissions trading schemes today was the US 1990 Clean Air Act, which sought to reduce sulphur dioxide emissions through a national trading system. While this saved industry a great deal of money by avoiding investment in technological innovation, it wasnâ€™t necessarily the most successful attempt at addressing sulphuric pollution.

The US programme is expected to cut sulphur dioxide emissions by only about 35 per cent by its 20th anniversary in 2010; Germany cut power plant sulphur emissions by 90 per cent from the first proposal in 1982 to the completion of its programme in 1998, relying on firm regulation and legislation and no trading scheme of any sort.

An evaluation of the Clean Air Act by Margaret Taylor of the Goldman School of Public Policy at the University of California, Berkeley concluded that â€˜the weight of evidence of the history of innovation in SO2 control technology does not support the superiority of the 1990 Clean Air Act â€¦ as an inducement for environmental technological innovation, as compared with the effects of traditional environmental policy approachesâ€™.

Inspired by the emerging EU-ETS framework, the UK pioneered the first-ever national greenhouse gas emissions trading scheme in 2002, with a cap-and-trade system between many of the big industrial pollutors.

An investigation of the scheme from the National Audit Office reported that some companiesâ€™ targets â€˜may be undemandingâ€™, and that â€˜in some key cases emissions baselines were well above direct participantsâ€™ emissions at the of the schemeâ€™.

Labour MP Gerry Steinberg described the scheme as a â€˜mockeryâ€™ and an â€˜outrageous waste of public moneyâ€™. Ove generous baselines meant that four companies, Ineos Fluor, Invista, BP and Rhodia, massively over-complied in the first year.

The fact that their emissions were already controlled under other environmental regulations led Edward Leigh, the Conservative chair of the Public Accounts Committee, to observe that the scheme â€˜seems to be paying [the four companies] Â£11 million for keeping emissions down to levels they had already achieved before they joinedâ€™.

Today, as the end of the first period of the EU-ETS approached, numerous problems have come to light, many of which were touched upon in the July edition of Parliamentary Brief.

A massively generous allocation resulted in windfall profits for some of the UKâ€™s most polluting companies, to the collective value of Â£940 million according to Franck Schuttelar, an analyst at the energy-trading firm Gaselys. This over allocation caused huge fluctuations in the market, with the price of carbon at one stage plummeting by 60 per cent.

The availability of these cheap permits has been a further disincentive for industry to invest in energy efficiency and clean energy infrastructure. Under the first round of the EU-ETS, almost half of the 25 EU nations are off-course to meet their Kyoto targets, including Germany, Italy and Spain, three of the five biggest economies in the region.

It would seem that John Kayâ€™s statement about market design and corporate advantage has been proven true in regards to pollution trading. There is much evidence that while a great deal of money may have been saved, or even earned, through the development of these markets, they have not necessarily been effective in delivering the required emissions reduction.

If the lessons havenâ€™t been learnt from the short-comings of the examples of market failure given here, will they be applied to the second round of the EU-ETS?

The evidence appears to be no. A working paper released in November 2006 by German researchers said that of the 25 Phase 2 National Allocation Plans (NAPs) submitted for EU approval, 18 were too generous, and many of the caps that have been set are above 2005 emissions levels.

A group of 50 economists, led by Professor Michael Grubb from Cambridge University and Dr Ottmar Edenhofer from the Potsdam Institute for Climate Impact Research, submitted a statement to Environment Commissioner Stavros Dimas saying that if the cuts made under Phase 2 were to be consistent with Kyoto targets, then current allocations would have to be cut back by about 10 per cent.

There have been marginal increases in the number of permits being auctioned to industry rather than given as a windfall, but there is resistance from the business community to paying more for quotas.

Andrew Sentance, a member of the Monetary Policy Committee at the Bank of England, stated, â€˜If emissions trading started to be used effectively as a big money-raising scheme through auctioning permits I think business would grow more sceptical.â€™

With all the uncertainty and doubt surrounding emissions trading it seems like an enormous gamble, given the need to act as quickly as possible, to place so much faith in the market being able to solve the problem of climate change.

Previous experiences of emissions trading have taken place on a far smaller scale than is being attempted with the greenhouse gases, with at best mixed results. Before the implementation of Kyoto there were many examples of innovative and successful legislation introduced unilaterally by governments in order to reduce CO2 emissions that were not reliant on trading schemes.

In the 1990s Denmark introduced a variety of â€˜green taxesâ€™, including an energy tax, the revenues from which were recycled into subsidies for energy saving projects.

In 1991, Germany provided the wind-power industry with a huge boost in the form of feed-in tariffs, and the wider renewable energy industry benefited when this legislation was improved and expanded in 2000 with the Renewable Energy Sources Act.

Waiting yet more years to learn further lessons from the next round of ineffective emissions trading is a luxury we donâ€™t have. However politically unfashionable it may be, and however inimical it is to the business community, there is an urgent need to return to the tried and tested means that do deliver real results in terms of emissions reductions, such as stricter regulation, oversight and penalties for polluters on community, local, national and international levels, as well as support for communities adversely impacted by climate change.

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