

Greenhouse gas trading looks set to balloon

By Daniel Dombey and Vanessa Houlder.

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The emissions trading business - the use of trading schemes to allow countries to reduce emission of greenhouse gases at the lowest possible cost - could receive one of its most significant boosts on Monday, when European Union environment ministers are likely to agree on an EU-wide system.

Another milestone should be passed on Friday, when the Slovak Republic announces the sale of greenhouse gas emissions "allowances" to a Japanese group - the first trade of a government quota under the regime set up by the 1997 Kyoto protocol to combat climate change.

Margot Wallström, the European Commissioner for the environment, argues that the mandatory scheme ministers will discuss "will deliver the most cost-effective way of meeting Kyoto targets", saving 35 per cent of the costs of compliance or €1.3bn (\$1.29bn, £828m) each year by 2010.

Emissions trading works by setting limits on how much countries or companies can emit. These allowances can then be bought or sold. Although the unlimited use of emissions trading has led to some criticism that it absolves countries from responsibility for curbing their own emissions, it is increasingly recognised as the cheapest way of reducing emissions.

"Think for one moment on what the alternatives to emissions trading would be," Ms Wallström said this week. "We have to respect our Kyoto obligations, but we would have to do so by other means. We might have to increase energy taxes; we might have to decide on ceilings for greenhouse gas emissions. I am not sure many . . . would favour such a strategy."

That is why the EU scheme is likely to be approved by EU member states on Monday. Such a move, if subsequently backed by the European parliament, would establish a pan-European trading system, which would dominate the fast-growing but fragmented emissions trading market. It would cover over 40 per cent of European carbon dioxide emissions, creating assets worth an estimated €10bn a year.

Across the world, there have already been \$350m-\$500m of deals since 1996, according to a recent report by the World Bank's Prototype Carbon Fund. These deals have taken place on an ad hoc basis, or else as part of a growing number of trading schemes established by countries, companies, regions and states, including the UK, Denmark and Massachusetts.

Many of these systems have incompatible rules, making it more costly to trade between them and making it harder to create the large, homogeneous trading system envisaged from 2008 under the Kyoto Protocol.

Hence the significance of the EU decision, which is likely to set the global standard for emissions trading. "The European system will have a huge influence because it is so big and it sends an important political message," says Michael Grubb, professor of climate change at Imperial College in London.

However, the deal is likely to be marked by the compromises that are the hallmark of EU legislation, not least by concessions to Germany, one of the countries that currently operates a voluntary emissions trading scheme.

The current compromise would permit groups of companies to "pool" emissions and act as single participants on the trading market.

Ms Wallström argues that "pooling will undoubtedly mean less trading, which reduces liquidity [and increases] the costs for everyone" - but under German pressure both she and Denmark, the holder of the rotating EU presidency, are willing to accept such a state of affairs until 2012.

Germany has also secured an "opt out", which would allow "installations and activities" to be excluded from the scheme until an initial phase ends in 2007.

Meanwhile, other countries such as Sweden, which wanted the option of broadening their trading schemes to include non-CO gases, are set to be disappointed.

One of the remaining points to be decided on Monday is whether countries will be allowed to charge for a percentage of the allowances - which environmentalists argue would provide extra incentive to reduce emissions.

WWF, the conservation group, says the changes to the European Commission's original plan will reduce its effectiveness. It argues that unless a rigorous directive is adopted speedily, much could be at stake, namely, "Europe's credibility, its ability to meet its Kyoto targets, the potential to achieve this at minimum cost and the will to pay the way for even deeper reductions in the future".