

The Trouble with Carbon Trading: A Short Debate

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Abd Karmali, Managing Director, Global Head of Carbon Markets, Merrill Lynch:

Many questions have been raised about the value of carbon emissions trading.

Those who advocate only command-and-control regulation seem to ignore all of the published data, from the experiences of academics, governments and the private sector, that highlight precisely why emissions trading is a more cost-effective approach to reducing emissions than blunt regulation.

Put simply, it is better to reduce emissions in a way that results in lowest costs to society. Some other important benefits include:

1. The climate change problem is a problem of quantity - setting the cap and then reducing the cap is the only measure that provides policy-makers with certainty about the absolute level of emissions which will be attained
2. Having a price of CO₂ in the OECD countries provides an incentive for developing countries to reduce emissions too through the carbon credit mechanisms - again, a cap-and-trade approach is the only measure which has this stimulating type of impact during this transition period leading to a more widespread cap that includes more developed emerging markets such as China and India
3. Carbon markets are better than other instruments in overcoming barriers, diffusing learning, and rewarding those who are bold enough to innovate and provide risk capital for emerging technologies.

Those who assume that the carbon market is purely a private market miss the point that the entire market is a creation of government policy.

Moreover, it is important to realise that, to flourish, carbon markets need a strong regulator and approach to governance.

This means, for example, that the emission reduction targets must be ratcheted down over

time, rules about eligibility of carbon credits must be clear etc. Also, carbon markets need to work in concert with other policies and measures since not even the most ardent market proponents are under any illusion that markets alone will solve the problem.

There will always be sectors of the economy that are difficult to include a cap-and-trade programme because of, for example, high administrative or transaction costs.

Furthermore, low-carbon technologies that are too far up the marginal abatement cost curve (ie, they have very high costs/tonne of emissions reduced at present) will likely never be deployed under a cap-and-trade programme and need to rely upon some form of subsidy to help bring their costs down over time through wider deployment.

This is the rationale behind the European Union's decision to include a large number of allowances as a financial incentive for first-mover carbon capture and sequestration projects and, for example, the panoply of incentives schemes being used to promote renewable energy.

Larry Lohmann, The Corner House:

Abyd Karmali's claims are misleading. To evaluate them, we need to review the huge amount of information, analysis and on the ground experience regarding this complex issue that has become available over the last five years.

To take the arguments one at a time:

1. "The climate change problem is a problem of quantity." No, it's a problem of historical trajectory. Solving global warming means figuring out how to keep most remaining fossil fuels in the ground. That means reorganising industrial societies' energy, transport and housing systems – starting today – so that they don't need coal, oil and gas.

Setting precise targets on paper is futile unless accompanied by immediate steps toward structural change. Carbon markets are explicitly designed to delay those steps. They give the polluters who most urgently need to make a start on major reinvestment – such as big electricity generators – a way to continue business as usual for as long as possible, by buying in cheap greenhouse gas pollution rights from elsewhere.

By allowing companies to buy offsets instead of reducing their emissions, government are allowing years of inaction before the industries in question begin to do what they have to do to deal with global warming. Worse, these credits do not always even represent verifiable reductions. They come from projects that merely claim to be saving carbon over what would have happened without the credit sales.

Evidence suggests that most such projects – for example, the bulk of the 763 Chinese hydroelectric dams that have applied or are planning to apply to the United Nations to be allowed to sell over 300 million tonnes of greenhouse gas pollution rights – were going to

be built anyway, and are merely topping up their finance by claiming otherwise.

2. “It is better to reduce emissions in a way that results in lowest costs to society.” Fine, but carbon trading, even if it were reducing emissions, would not be reducing emissions in a way that resulted in lower costs to society.

At best, it would be lowering the price certain polluting industries have to pay to comply with very modest short-term reduction targets. That’s different. Thanks to carbon markets, such targets can probably be met over the crucial next decade without any of the structural change industrialised societies need to overcome their addiction to fossil fuels.

As most governments now agree, sweeping structural investment in a non-fossil fuel future has to begin now, not 10 years or even two years hence. The longer the delay, the more everybody has to pay in the end.

As law professor David Driesen at the College of Law, Syracuse University, USA, argues, lowering short-term business costs “does not increase incentives for valuable innovation.” By concentrating on saving some private companies a bit of short-term cash, carbon trading loses touch with the climate problem it is supposed to address.

3. “Having a price of CO₂ in the OECD countries provides an incentive for developing countries to reduce emissions too through the carbon credit mechanisms ... leading to a more widespread cap that includes more developed emerging markets such as China and India”.

Misleading on many levels. First, carbon credit mechanisms cannot reduce overall emissions. They are not designed to. The net climatic effect of even the most successful carbon credit-generating project cannot be more than zero, since every greenhouse gas molecule a project supposedly “saves” is used to license emissions elsewhere.

Second, most such projects are not replacing fossil fuels, but at most supplementing them; they are not helping Southern countries find a non-fossil industrial pathway. Third, countries like China and India are unlikely to agree to cap their own emissions until Northern industrialised countries show that they are taking serious action at home rather than playing number games with carbon trading.

4. “Carbon markets need to work in concert with other policies and measures.”

Trouble is, carbon markets actively interfere with positive approaches to global warming. For example, many in the UK government are using the EU ETS to talk down policies to stop new coal power stations from being built.

The logic is: “Why should we do anything about fossil fuels if any intervention by us to cut emissions will merely shift them somewhere else in Europe?”

Leading climate scientist James Hansen recently concluded that carbon trading is

“guaranteed to fail in terms of getting the required rapid reduction in emissions”. Even Lord Browne, former chief executive of BP and an early proponent of carbon markets, now says his enthusiasm was misplaced.

The writing is on the wall.

Larry Lohmann
The Corner House