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Climate Change and Carbon Trade

Kevin Smith

'The truth is, no country is going to cut its growth or consumption substantially in the light of a long-term environmental problem.'

Tony Blair, New York, 2005

The hegemony of the G8 in international fora such as the United Nations Framework Convention on Climate Change has meant that the response to climate change has been largely dictated by dominant neo-liberal economic norms. Despite the gravity of the threat, climate policy has been chosen not on the basis of its effectiveness in reducing emissions, but by its compatibility with the existing economic system. Given that the primary role of the G8 is to safeguard the stability of the international economic order, it stands to reason that their main concern in addressing the threat of climate change would be to ensure that the economies of the world's richest countries are not adversely impacted.

A number of economists, agencies and NGOs have been working for some years to promote the use of market forces to solve environmental problems. By assigning a price to nature's 'services', such as the earth's ability to absorb greenhouse gases, proponents believe, markets will begin – in a language familiar to commodities brokers in the world's financial centres – to 'inter-



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nalise externalities'. This can be seen most clearly in the climate change debate, where enormous amounts of time and energy have been devoted by business groups, NGOs, emissions brokers, governments, UN agencies and the G8 to creating a market for the world's foremost greenhouse gas – carbon dioxide (Smith et al. 2005).

Carbon trading takes two forms:

- Governments allocate pollution permits to big industrial polluters to trade among themselves as the need arises to cut the costs of meeting common emissions targets.

- Surplus carbon credits are generated from carbon offset projects that claim to reduce or avoid emissions in other locations, usually in Southern countries; these credits may be purchased to top up any shortfall in permits. Under the Kyoto Protocol, such offset projects are carried out in the South through the Clean Development Mechanism (CDM), or in Northern countries through Joint Implementation (JI).

The market is growing enormously. According to a World Bank report, the market at the end of the third quarter of 2006 was valued at USD 21.5 billion, up 94 per cent on the whole of 2005 (USD 11.1 billion).

Gleneagles onwards

Despite the hype, the 2005 G8 summit in Scotland produced little in the way of concrete action in dealing with climate change. The final communiqué made limp resolutions to 'promote' better practice and to 'encourage' companies to do better on the subject of climate change, with no mention at all of reducing the rate of extraction and consumption of fossil fuels. Blair was widely praised, however, for bringing the heads of state of Brazil, China, India, Mexico and South Africa to the negotiating table, and it was with these countries that the G8 plus 5 Climate Dialogue was launched. The dialogue brings senior legislators together with international business leaders, civil society representatives and opinion leaders to discuss a post-2012 climate change agreement, with the aim of presenting a consensus statement from the participants to the 2008 G8 summit in Japan.

The dialogue has a heavy bias towards trading schemes as the best way of dealing with climate change, with one of its four working groups dedicated specifically to developing market mechanisms. Furthermore, the G8 plus 5 summit has mandated the World Bank to facilitate the creation of a framework for climate change management, clean energy and sustainable development. This is in spite of the fact that the World Bank is part of the climate problem rather than the solution: since the UN Climate Convention was signed at the Rio Earth Summit in 1992, the World Bank has singlehandedly financed over USD 25 billion in fossil fuel based projects (Bank Information Centre et al. 2005)

In response to the G8 mandate, the World Bank produced a report called 'Clean Energy and Development: Towards an Investment Framework', an updated version of which was presented at the G8 plus 5 meeting in Mexico in October 2006. The report promoted carbon trading as the main means of providing financing for the development

of clean technology, despite the evidence that so far the carbon market has subsidised polluting industries in the South while encouraging polluting industries in the North to delay reducing their emissions in favour of purchasing cheap credits. The report also calls for the establishment of a long-term, predictable regulatory framework for greenhouse gases, beyond the first Kyoto commitment period, which ends in 2012, in order to provide stability and reduce investor risk in carbon trading.

The Bank's promotion of emissions trading through the G8 plus 5 creates a clear conflict of interest in that it is also the largest public broker of carbon purchases, with over USD 1 billion in its carbon credit portfolio, and generates a large revenue for itself through receiving a percentage commission on all the carbon credits it purchases to administer through its Prototype Carbon Fund. Through its influence in political processes such as the G8 plus 5, it has actively lobbied to make the CDM a more attractive proposition for investors and less effective in terms of actually reducing emissions.

The G8 plus 5 met again in February 2007 in Washington. The meeting was spearheaded by five US senators who have introduced a congressional bill that would allow US companies to certify emissions reductions, which may be traded on the international market to other nations. Keynote speakers included Angela Merkel as well as Nicholas Stern, whose influential Stern Review on climate change has been promoted as providing the economic rationale for the global carbon market, and Paul Wolfowitz, president of the World Bank.

It is not clear what targets there are for dealing with climate change at the 2007 G8 summit in Germany, but the majority of governments, industry and International Financial Institutions are keen to see the groundwork laid for an international emissions trading framework extending beyond the 2012 Kyoto commitment period, that will include the other greenhouse gases and other emissions-producing sectors, such as the airline industry. At the international level, it is clear that the emphasis on market-based approaches tends to squeeze out the possibility of implementing other more meaningful approaches to dealing with climate change. There is an urgent need for stricter regulation, oversight, penalties for polluters at community, local, national and international levels, the cessation of fossil fuel subsidies, as well as support for communities adversely impacted by climate change. But currently such policies receive precious little attention, as they contradict the sacred cows of economic growth and the free market.

The G8 and free-market environmentalists have been at the forefront of championing a rosy narrative of 'win-win' scenarios where the quest to maximise corporate profits can go hand in hand with addressing the climate crisis. But the commodification agenda implicit in the paradigm is deeply contentious, and free-market environmentalists themselves appear to be acting more out of faith than an ability to point to demonstrable outcomes. There is, unfortunately, no 'win-win solution' when it comes to tackling climate change while maintaining an economic growth pattern based on the ever-increasing extraction and consumption of fossil fuels (Panitch and Leys 2006). The elaborate and esoteric accountancy procedures involved

in maintaining the carbon trade shell-game creates a smokescreen of apparent climate activity that obfuscates the stark necessity of structural, long-term changes that will actually be effective in keeping coal and oil in the ground. Activism on climate change must expand its critique to synergise with other important struggles in the areas of trade, finance, human rights, environmental justice and democracy if an effective challenge to the neoliberal paradigm is to be mounted.

The G8 nations and emissions trading

There has never been total consensus on emissions trading among the G8 nations, largely due to the unilateralism of the US in refusing to ratify the Kyoto Protocol. The other seven nations, however, are involved in a variety of trading schemes and projects through which they intend to achieve their emissions reductions targets as laid out under Kyoto, and there are also a number of trading schemes taking place within US states and regions. There are also political moves afoot in the US among the business community, the government and civil society organisations that suggest that it might not be long before the US enters the global carbon market.

France, Germany, Italy and the UK

Since the start of 2005, France, Germany, Italy and the UK have been participating in the European Union Emissions Trading Scheme (EU-ETS), the biggest experiment yet in carbon trading and the harbinger of the global market which will become operational in 2008. The first phase runs from 2005 to 2007 and the second phase will run from 2008 to 2012 to coincide with the first Kyoto commitment period, with further five-year phases expected subsequently. The scheme works on a 'cap and trade' basis, with each EU member state being required to set an emission cap for all of the 12,000 installations covered by the scheme (fossil fuel power generators, oil refineries, cement producers, iron and steel manufacturers, glass and ceramic manufacturers, and paper and pulp producers) across the EU. Each installation is allocated allowances for the particular commitment period in question according to a document called the National Allocation Plan (NAP), and then installations are free to purchase allowances from other installations in order to make up shortfalls in their emission targets. The EU Linking Directive also provides companies with the opportunity to purchase credits from the project-based market.

In the current neoliberal economic environment, trading rules inevitably succumb to the pressures of corporate lobbying and deregulation in order to ensure that governments do not 'interfere' with the smooth running of the market. This has been clearly evident in the first phase of the EU-ETS, when, under corporate pressure, governments massively over-allocated emissions permits to the heaviest polluting industries in the initial round. This resulted in windfall profits for some of the biggest polluters, who in successfully exaggerating their need for emissions allowances received enormous numbers of permits that they could then profitably sell on. The companies also made money by passing on the nominal 'market costs' of the permits they received for free to their consumers. The German Environment Minister claimed that the four biggest European power producers – Eon, RWE,

Vattenfall and EnBW – profited from the first round of the EU-ETS to the tune of between €6 billion and €8 billion. News of the massive over-allocation caused the price of carbon to drop by more than 60 per cent, from around €30 to as low as €8.6 per tonne, creating an even greater disincentive for industries to lower their emissions at source.

The evidence suggests that the lessons haven't been learnt. A working paper released in November 2006 by German researchers said that of the 25 second-phase NAPs submitted for EU approval, 18 were too generous, and many of the new caps were set above 2005 emissions levels. While the UK NAP was approved by the EU, Germany was ordered to reduce its allocations by 6 per cent, prompting German utilities companies to write an open letter to the government warning that they might have to 'trim costs' (a veiled threat of job cuts) should they need to buy more carbon credits at a higher price between 2008 and 2012. At the time of writing, the NAPs for Italy and France had still not been approved by the EU, with both countries waiting several months after the deadline to submit them.

In terms of the project-based credit market, the UK is the biggest purchaser of credits, largely due to the numerous carbon broker trading firms located in the City of London, which bought an enormous 45 per cent of project-based credits generated in the first nine months of 2006; Italy was the second largest purchaser with 19 per cent.

Japan

As a country with little access to energy reserves, Japan made big efforts to improve energy efficiency following the oil crises of the 1970s. This means that it is now more difficult for cuts to be made in its emission levels through such domestic measures, as it is already the most energy-efficient country in the industrialised world. With emissions having increased 8 per cent over 1990 levels, Japan is struggling to meet its Kyoto commitment to reducing its emissions levels by 6 per cent from 1990 levels. Consequently, Japan is heavily committed to using emissions trading to make up the shortfall.

The Japanese government set aside 5.4 billion yen (USD 45.9 million) in its 2006 budget to purchase carbon credits from abroad. Japanese companies are also actively engaged in developing carbon offset projects abroad. As of February 2006, the Ministry of Economy, Trade and Industry (METI) and the Environment Ministry had approved some 41 predominantly CDM projects, in countries such as Malaysia, India, South Korea, Indonesia, China and Vietnam, with even greater numbers of such projects in the pipeline. In addition, Japan is one of the biggest investors in the World Bank Prototype Carbon Fund, with eight out of the 17 corporate investors being Japanese corporations, and another being the government's own Japan Bank for International Cooperation.

In September 2006, the government also launched Japan's Voluntary Emissions Trading Scheme, with 34 companies and corporate groups committing to a certain emissions reduction that can be met by trading amongst themselves in return for government subsidies for the installation of emissions reduction equipment.

Canada

Canada's new conservative government has been making disgruntled noises about its Kyoto commitment of reducing its emissions to 6 per cent below 1990 levels, with Environment Minister Rona Ambrose recently stating that the target is 'impossible' to achieve. It is still unclear what form the new government's climate strategy will take, as Ambrose has previously commented that she thought that the EU trading scheme was a failure and that the CDM was little more than a recipe for corruption and wasted money. It is possible that the government's ambivalence towards emissions trading schemes might be the result of its having 'given up' on its Kyoto targets. The conservative administration has not delivered on the previous Liberal government's promise of money to the CDM executive board, the international body that oversees and approves CDM projects, and has underfunded the Canadian CDM/JI office to the point of near irrelevance.

The Montreal Exchange that runs Canada's market for equity, currency and interest-rate derivatives has announced its intention to open a carbon trading operation, but it has been waiting for the government to take a more explicit position in its climate policy. In October 2006, the government introduced a Clean Air Act that set 'intensity targets' rather than absolute emissions reduction targets.

Russia

The collapse of Russia's economy during the 1990s meant that it had an enormous drop in emissions, at one point almost 40 per cent below its 1990 level. This means that not only is Russia guaranteed to reach its Kyoto commitment of stabilising its emissions at 1990 levels, it also has a huge pool of surplus allowances that it can sell on to other countries when the global emissions market opens for business in 2008. This supply of surplus credits, achieved by external circumstances rather than by having implemented any sort of energy efficiency or renewable energy measures, is referred to as 'hot air' by critics who point to it as an example of how emissions trading can be profitably exploited, with no action being taken to deal with climate change. Russia is also laying the groundwork for foreign companies to invest in JI projects to generate credits. Not surprisingly, Russia has been enthusiastic about its opportunities to profit from emissions trading. One World Bank estimate suggests that Russia could profit by USD 11 billion under Kyoto.

USA

George Bush famously refused to ratify the Kyoto Protocol in 2001 and so the US is not taking part in emissions trading in order to meet any domestic compliance targets at the national level. Yet several private initiatives, including the Chicago Climate Exchange, are trading in offset credits. However, with the recent Democrat takeover of Congress, the US attitude to emissions trading is set to change. Ten US corporations, including DuPont and General Electric, have joined with green groups to form the US Climate Action Partnership to urge Bush and Congress to create a carbon market for the US. At the 2007 World Economic Forum in Davos, chief executives of European and US power and industrial companies said that the

US needs to lead the way in setting up a global carbon emissions trading regime.

Carbon trading as part of the problem

There is a growing feeling that this approach won't work. Critics argue that carbon trading encourages the industries most dependent on coal, oil and gas to delay shifting away from fossil fuels. There is little incentive for expensive plans for long-term structural change if you can get by in the short term by buying pollution rights from operations that can reduce their emissions (Lohmann 2006).

Furthermore, a number of researchers and civil society organisations, like those involved in the worldwide Durban Network for Climate Justice, see carbon offset projects in Southern countries as a form of 'carbon colonialism,' and the transformation of carbon-absorbing capacity into a tradable commodity as an enormous privatisation that has occurred relatively unnoticed and uncontested (Bachram et al. 2003). More than 200 groups have signed the Durban Declaration on Carbon Trading (2004), which states: '[H]istory has seen attempts to commodify land, food, labour, forests, water, genes and ideas. Carbon trading follows in the footsteps of this history and turns the earth's carbon-cycling capacity into property to be bought or sold in a global market. Through this process of creating a new commodity – carbon – the Earth's ability and capacity to support a climate conducive to life and human societies is now passing into the same corporate hands that are destroying the climate.'

For G8 countries seeking to demonstrate their commitment to climate action, the inherent problems of emissions trading are swept aside in favour of a belief in the perceived omnipotence of the market. The problem of climate change requires not radical reductions at source, but the 'invisible hand' of the market to sweep up the mess in the most cost-effective manner possible. The neoliberal ethic embodied in power blocs such as the G8, themselves highly dependent on the fossil fuel economy, is ultimately what drives this agenda forward.

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