European carbon market suffers in annus horribilis

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Activists burn a symbol of carbon dioxide in Berlin. Europe's market in carbon emissions is hoping for outside help after a year in which prices slumped to record lows, savaging claims that trading in CO2 brakes the rise of dangerous greenhouse gases.

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Launched in 2005 and accounting for 97 percent of global carbon commerce, the European Union's Emissions Trading Scheme (ETS) is the big daddy of initiatives which harness the power of the market against carbon dioxide.

Under it, some 12,000 plants have been given CO2 quotas.

If firms get below their ceiling they can sell the surplus on the ETS. If they are above it, they can meet their quota by buying what they need in the marketplace.

But this carbon-cleanup incentive is falling short of what it was touted to be.

After fluctuating in the past few years between 15 and 25 euros (19.5 and 32.5 dollars) per tonne of CO2, carbon crashed in 2011. Last week, it was changing hands at 6.5 euros (8.45 dollars) a tonne, the lowest on record.

"This market was put together to give a price signal that would spur investment in decarbonising the economy," says Pierre Ducret, head of CDC Climat, a subsidiary in climate market services owned by the French state bank Caisse des Depots.

"But prices today are so low that this tool is just not effective."

Rock-bottom prices for carbon mean that power companies, cement makers and other big emitters see little need to invest long-term in energy efficiency or switch out of fossil fuels.

"Fair prices on CO2 along with price stability over time are imperative for industry to continue along the path to a green growth economy," says Andres Eldrup, chief executive of DONG Energy, a green-energy firm based in Denmark.

The cause of the slump is twofold, say market watchers.

One is rooted in the financial crisis in 2008, which spurred Europe's economic downturn. Less demand means less activity and less carbon emitted, as well as a softer price for coal, oil and gas.

But another lies in the way the ETS has been managed.

The EU has been criticised for allocating quotas that are too generous for emitters and failing to give a steer on its plans beyond 2020, said Raphael Trotignon, a researcher at the Paris-Dauphine University.

Europe has unilaterally pledged to reduce its annual greenhouse-gas emissions by 20 percent by 2020 compared to 1990, the benchmark year used in the UN climate negotiations.

Sanjeev Kumar, based in Brussels with the green campaign group E3G, says the flood of unneeded trading allowances, combined with carbon credits earned under the UN's clean development mechanism (CDM), amount to a whopping 2.2 billion tonnes.

"It's really, really big. That's the source of the problem," he said.

"The first thing we have to do is to intervene on the market. If it carries on like this, by very early 2012 the price could drop to as low as one or two euros, which would render it almost pointless."

What can be done to shore up the carbon price?

CDC Climat argues for a floor of 17 euros per tonne from 2013 for quotas that will be sold by states.

Another possibility would be for the EU to deepen its unilateral cut, from 20 percent to 30 percent, in 2020 emissions compared to 1990.

But right now this is an almost impossible "ask" at a time of austerity in

Europe and when other major carbon emitters -- China, the United States and India -- are perceived as doing far less.

Some voices are driving for a cut in allowances for the next trading phase, running from 2013-2020.

The idea was backed last week by the European Parliament's environment committee and has the support of the EU Corporate Leaders Group, a panel launched by the Prince of Wales to lobby for green policymaking.

"We need an immediate and meaningful recalibration of the ETS to drive up the price of CO2," said Graeme Sweeney, an executive vice president at Shell.

"This action will provide a strong CO2 price signal that business can respond to."

What happens to Europe's troubled child next year will be closely scrutinised by other countries which have launched, or plan to launch, their own ETS.

Australia is to set up its own ETS from 2015 and talks are underway for hooking this up with an existing market in neighbouring New Zealand.

In the United States, 10 East Coast states launched a cap-and-trade system last year that covers the power sector and California in September approved a cap-and-trade market from 2012.

China is working on pilot schemes in carbon trade while South Korea is pursuing a "cap without trade" initiative involving some 450 companies from next year in preparation for a full ETS from 2015.