

Tough to keep the world from warming when carbon is this cheap

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Carbon markets, the free-enterprise solution to saving the world from global warming, are now in danger themselves.

The idea was simple enough: Set a cap on [carbon emissions](#), issue enough permits to allow power plants, refineries and the like to stay within those limits and then shrink the cap over time to achieve reductions. The companies whose emissions fall fastest can sell their permits for a profit to slower responders - call it a reward for good behavior.

The reality, though, is more complex. Undercut by a lack of political will on the size of caps and overtaken by costly new environmental mandates, carbon markets in the U.S., Europe and Asia are collapsing, with prices so low they've become virtually valueless. The credits auctioned in the U.S. Northeast in June, for instance, sold for just \$4.53 a short ton, a 40 percent drop from December.

"Climate policy has been muddled and messy," said Michael Grubb, a professor at University College London's Institute for Sustainable Resources who has advised the U.K. energy regulator. "Governments have set inadequate targets due to lobbying pressures and because they didn't think carefully enough about overlapping efforts. That has destroyed investor confidence that carbon prices will rise."

The idea of a carbon market originated 20 years ago with Richard Sandor, an economist who also pioneered interest-rate futures and

derivatives at the Chicago Board of Trade. Today, there are 38 countries, cities, states and provinces using pricing systems in an attempt to put a lid on greenhouse gases, according to the World Bank.

The problem is that the permits are selling at a slower and slower rate. The surplus of allowances is becoming so large in systems run by Europe, California and Quebec - which together account for more than 90 percent of global trading - that by 2022 it could cover the emissions spewing from every car on Earth for a full year, according to estimates by the London environmental group Sandbag Climate Campaign CIC and Bloomberg New Energy Finance.

In California's market, all 23 million allowances sold in an auction in 2014. In May, 7.3 million permits found buyers, only 11 percent of what was put up for sale.

The markets are crumbling just as the U.K.'s vote to leave the European Union throws into question the future of the world's largest market by threatening to shrink demand. Nor does the collapse bode well for China, as the world's top greenhouse-gas emitter prepares to start its own next year.

Alex Rau, a principal at the carbon-trading advisory group Climate Wedge Ltd., chalks up the downfall largely to "an extreme paranoia" that the price of carbon will rise too high. So instead of strengthening caps unpopular among some oil companies, polluting factories and consumers who ultimately shoulder costs, politicians around the world have stitched together a patchwork of overlapping measures that are less vulnerable to lobbyists.

Take the U.S., where states including California run carbon markets but have also imposed other regulations that require gasoline suppliers to cut the carbon intensity of their fuel and utilities to buy increasing volumes

of solar and wind power.

"When you put in place all these other mandates, there is little work left for carbon markets," said Meredith Fowlie, an economist and research associate at the University of California, Berkeley department of agriculture and resource economics.

In California, the state Air Resources Board still has the authority to pull excess permits from circulation to avoid a glut, said Dave Clegern, a spokesman for the agency. "One auction tells us very little," he said. "We're in the long game here."

Anna-Kaisa Itkonen, a spokeswoman for the European Commission in Brussels, noted that its emissions targets under a climate agreement hammered out by leaders in Paris last year were among the most ambitious in the world.

Germany, meanwhile, acknowledged that the system run by the EU is in need of an overhaul, especially in light of the Paris climate pact. "We will need to look at our ambition," Michael Schroeren, a spokesman for Germany's environment ministry, said in a statement. "After more than 10 years of emissions trading in Europe, we can look back on the lessons learned."

China risks falling into the same trap as others. While regulators looking to establish a national market there appear to be trying to avoid an oversupply, prices are already plummeting in pilots they're running, said Sophie Lu, an analyst in Beijing at Bloomberg New Energy Finance.

Just as carbon market history has repeated itself around the world, Lu said, China "may not be willing to pay the political and economic costs."

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