EU Emissions Program Hit as Prices Drop

By
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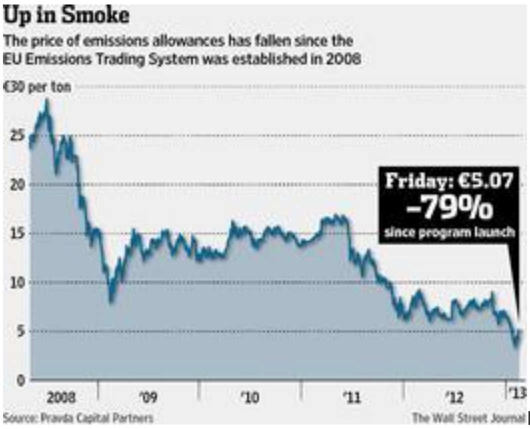
Europe's flagship effort to limit greenhouse-gas emissions faces an existential threat as the price of emissions has fallen dramatically, eroding an incentive for industries to pollute less and forcing policy makers to weigh environmental priorities against economic concerns.

With the cost of emitting carbon dioxide often around €5 ($6.70) a ton—a third of what it was 18 months ago—utilities in the Czech Republic, Germany and Poland are reconsidering plans to phase out coal-fired plants.



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On Tuesday, the environment committee of the European Parliament is set to vote on a proposal that would allow the European Union to delay the release of 900 million emissions allowances to the market by about five years in an effort to keep the price of permits from falling further, and eventually push it up.

The faltering of the market—known as the EU Emissions Trading System, or ETS, which like cap and trade programs creates a cost to pollute and rewards low emissions—is calling into question its effectiveness as a model of addressing global warming and encouraging the development of alternative energy.

Making it more expensive to pollute by requiring companies to buy emissions permits is central to the EU's goal of reducing emissions by 20% in 2020 from 1990 levels. But it would also be an unwelcome drag on a struggling economy.

That has turned decision-making on the permit scheme into a tug of war between those most concerned with sparking growth and those arguing that the EU shouldn't lose sight of longer-term environmental goals.

"There is a disparity between the economic priorities and challenges that Europe is facing and reaching more aggressive emissions reductions," said Divya Reddy, a Washington-based analyst for Eurasia Group who follows climate change.

Among those arguing most loudly for the primacy of economic concerns is Poland.

Polish Environment Minister Marcin Korolec said his government opposes any effort to increase the price of permits, saying that would make electricity more expensive and threaten the country's economy, which is experiencing a sharp slowdown in growth and rising unemployment.

"The ETS was designed as a market mechanism. I believe that it should continue to be operated based on market rules," Mr. Korolec said.

European Parliament members have been discussing the matter and looking for compromises, a parliamentary aide said, adding that the measure is expected to pass. If it does, the full Parliament must vote on the plan—something likely to happen in the spring.

If the panel rejects the proposal to withhold the allowances, and it later dies in parliament, the price of emissions permits would likely fall below €1 per ton and the market would cease to act as a serious long-term deterrent to polluting, according to Virtuse Group Suisse, a trader of the allowances.

Over the past five years, the price of permits has dropped from a high of €28.70 a ton before the global financial crisis started in 2008 to below €3 a ton last month when the European Parliament's industrial committee rejected the plan to delay allowances, in a nonbinding vote.

Slowing industrial production and electricity consumption linked to Europe's widespread economic troubles have significantly decreased demand for permits in a market already burdened with oversupply.

Jan Pravda, director of Pravda Capital Partners, a trader of the allowances, said that the ETS is also struggling because European manufacturers could move operations to countries that lack emissions trading systems, such as China or the U.S. He added that flaws in the system led to theft of allowances, value-added tax fraud and other abuses. The European Commission said it is taking steps to resolve these lingering issues.

The question is: How deep will the cuts in the number of allowances have to be to get the market functioning effectively again?

"Temporarily taking 900 million tons off the market is too little too late," Mr. Pravda said. "The real oversupply is several billion tons and this 'backloading' isn't taking supply off market but shifting it in time."

Environmental activist groups Climate Action Network and Greenpeace argue that 1.4 billion planned allowances need to be withheld and an additional 2.2 billion outstanding permits should be canceled.

One possibility is for the EU to set minimum prices for permits, an approach taken by California, which held its first auction for emission allowances in November. The average price was $10.09 per ton, just above the $10 minimum price. The minimum price will rise 5% each year and be adjusted for inflation. In 2013, for example, the minimum price for a ton of emissions is $10.71.

Ms. Reddy of Eurasia Group said that a minimum price could prevent another crash. "But from a political perspective it looks unlikely," she said.

What happens could well come down to a decision by Germany, which has roughly half of the votes needed for a blocking minority that could prevent any changes to ETS. But German leaders appear split.

Peter Altmaier, Germany's environment minister, supports the reduction of carbon allowances, while Economics Minister Philipp Rösler is against any plans that would lift power prices.

Mr. Rösler's main argument against the plan is that it would threaten competitiveness and jobs, an Economics Ministry spokeswoman said.

—*Marynia Kruk contributed to this article.*

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