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Carbon trade market facing new challenges

Monday, April 06, 2009,
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Months of negotiations led by the Minister of the Environment Martin Bursík were concluded at the end of March with the signing of an agreement on the sale of 40 million emission credits (AAUs) by the Czech Republic to Japan. According to Jan Pravda, CEO of advisory firm Pravda Capital, Ukraine is the next country competing with the Czech Republic on AAU sales. Author: Martin Siebert

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As a result of the sale agreement with Japan, billions of Czech crowns should be allocated to the Green Investment Scheme (GIS) for Czech households. The Czech Republic has a surplus of carbon credits amounting to 140 million tons of carbon dioxide, and the state intends to keep 40 million tons as a reserve and sell the rest.

Pravda explained that the Czech Republic's emissions allowance stipulated under the Kyoto Protocol was based on the country's emission levels in 1990. "Since then, the Czech Republic's heavy industry has gone through a painful crisis and has downsized considerably as a result of the fall of the communist regime, the end of the planned economy and the introduction of market mechanisms and privatization. As a result, the state now has more than 100 million tons worth of carbon credits for sale on the AAU market," Pravda told CBW.

The agreed price of the AAU's, and thus the total volume of the deal with the Japanese remains confidential. "However, we still plan that approximately Kč 10 billion (€375 million) will be available for the Green Investment Scheme for 2009 thanks to the transaction with Japan and other partners" Minister of the Environment Bursík (Green, SZ) said.

New negotiations started

Two weeks ago the prime ministers of Japan and Ukraine hailed a deal under which Ukraine is to sell Japan rights to emit extra pollution and use the proceeds to buy Tokyo's latest green technologies. Under the deal Japan will purchase 30 million tons worth of emissions credits.

According to Pravda, Ukraine is the Czech Republic's closest competitor in AAU sales. "The snag is that Ukraine has about 2 billion tons, which is 20 times more than us and their AAU will go for a much lower price as [Ukraine's] GIS program is less credible," Pravda said.

Under the conditions for trading in emissions allowances for greenhouse gases, the Environment Ministry is responsible for administration of the AAUs and the revenues constitute income for the State Environmental Fund, which invests the money in GIS projects. “According to Czech law, the trade in emissions credits is regulated as any other commercial activity. Most likely [energy giant] ČEZ benefits the most as they can sell surplus allowances and but still charge their costumers top rates. I believe that the full potential for carbon trading by the Czech Republic is not being realized, but the situation can be improved by better informing the business community. Criticism of the program by labor unions such as the Confederation of Industry (SP ČR) certainly doesn’t help. That union hired Enviros environment consultants to state that emissions trading would damage industry,” Pravda said.

Poland - main opponent to carbon trade

At a meeting in Brussels a few weeks ago, European Union leaders put forward a proposal on committing funds for reduction of emissions by developing countries. Explaining why they had not come up with a funding proposal, the EU leaders said the priority should be to form a united EU position in preparation for the UN climate change summit in Copenhagen this December.

If the EU and U.S. put up a significant amount of cash for cutting emissions and environmental initiatives, developing countries may in return commit to considerable CO_2 reductions, even though the industrialized north is still responsible for most emissions.

Although last week Poland passed legislation to allow the country to start trading, sources close to the discussions confirm that Poland is the main opponent to committing EU finances for developing countries. Marta Girecka, country manager for Poland at Pravda Capital, explained that Poland’s opposition can be explained that it is one of the largest polluters in the EU, thus they would have to contribute one of the largest shares. “Therefore, as the one of the poorest [EU] nations, they consider that richer countries should contribute more,” she said.

Warsaw is arguing that the economic crisis is making it impossible to make firm commitments to financing emissions reduction initiatives without first agreeing what percentage each member state will pay. “Poland is opposing many things in this carbon trade program,” Pravda said.

Carbon prices are going down

The so-called cap-and-trade systems at the heart of most proposed climate laws are expected to create a market for permits to emit carbon dioxide and other greenhouse gases that may eventually rival existing oil markets. Research firm Point Carbon has estimated the market could be worth as much as $3 trillion (Kč 59.5 trillion) by 2020.

Greenhouse gas emissions among the 27 countries that take part in Europe’s carbon market dropped to 2.11 billion tons in 2008 from 2.25 billion tons in 2007. While the recession played a big role by slowing down economic activity and thus industrial production, analysts at Point Carbon said the drop in emissions also reflects the success of the European system. “Today’s numbers tell us two things,” Kjersti Ulset, an analyst at Point Carbon, said in a statement. “They confirm that the recession is leading to lower emissions, with both industry output and power demand down. But they also show that the carbon market works as intended. The emissions reductions we see in the power sector are partly a result of the high carbon price we had for the first half of 2008," reflecting demand for the permits. Since then, the prices for the carbon permits have collapsed. But the results still show that the European system is working, the analyst said.

The Carbon Trust, established and funded by UK government money, and consultancy PricewaterhouseCoopers (PwC) argue that some kind of floor price or carbon tax might have to be implemented to prevent the EU's emissions trading scheme (ETS) being discredited by a further collapse in prices, which have already slumped from €30 per ton to just over €10. "Last month the price was €7.5 as we predicted, but now it is €12.05. Unless we see a very clear agreement in preparation for the Copenhagen talks, the market will go down soon in response to that risk," he said.

PwC points to estimates that the world needs to spend about $500 billion a year over the next 20 years on renewable energies and energy efficiency alone, many times the current level. But even the current level of spending is dropping because of the financial crisis. Nevertheless, PwC points out that the extra money governments could generate through carbon taxes and trading could provide extra income to spend on environmental programs without having to raise income taxes or corporate taxes. Estimates show, for example, that carbon permit auctions within the framework of the ETS could raise up to £8 billion (Kč 235 billion) a year by 2020.

Cap-and-trade is sure to raise costs for American consumers. "We have heard from several unofficial sources that if Obama adopts the same program as EU, then he will face a revolution in the U.S.," Pravda told CBW.

Nevertheless, even if successful, EU and U.S. programs won't have any significant environmental impact unless developing countries including China and India also adopt similar programs. But neither the U.S. nor Europe can force them to do so. Attempts to impose carbon duties would hurt consumers even more by raising the cost of imports and could lead to a trade war that no one would win. Indeed, China has threatened a trade war if faced with imposed carbon duties, which it says are illegal under World Trade Organization agreements.