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EMISSIONS TRADING

EU ETS: the fix

The EU's current attempt to institute a working emissions cap and trade system is set to be a half-hearted affair. It's unlikely to move the CO_2 emissions trading to the level beyond which companies will start thinking to go cleaner.

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THERE IS AN unfavorable vibe around the upcoming new rules of emissions trading in Europe. Instability on the carbon market and lack of agreement about increasing emission reduction goals are underpinned by the economic crisis just four months before the EU's Emissions Trading System (EU ETS) enters into a more rigorous Phase 3. The system itself is not working properly, either, and begs an effort by the EU to reform it.

It's not news that the European Commisison is having trouble instituting an effective CO_2 emissions cap and trade system. Phase 1, or the early iteration of the EU ETS, which lasted from 2005 to 2007, saw prices of emissions allowances reach bottom at €0.02 due to excessive oversupply.

It might seem that at today's prices of about €7, the balance between supply and demand has been adjusted somehow. Still, the Commission, looking to more ambitious action to mitigate climate change, is linking supply of Phase 2 (2008-2012) with that of Phase 3 (2013-2020) in a bid to solve the problem of unneeded permits. Banking allowances to another trading period, however, will affect Phase 3, which will be flooded by a mass of allowances saved during the years of economic crisis.

BANKED OUT!

It's not surprising at all, then, that the carbon market experiences long-lasting lows, affecting negatively the "green" investors who would otherwise invest in low-emission projects. The price of EUAs decreased by 60 percent to €6 during last 15 months. Also the Kyoto Protocol's certified emission reduction units (CERs) recorded a historical low in July, trading below €2.60.

Such low prices can please companies with shortage of permits but they paralyze market goals, first of all to lower the EU's emissions and secondly, environmentally friendly powering of their businesses. These goals are currently far from being realized, as the price of carbon at which it makes economic sense to replace coal with natural gas is at €24 euros.

SHORT-TERM CURE

To address the problems plaguing the EU ETS, the Commission in July published long-awaited proposals of amending the ETS Directive and the so-called Auctioning Regulation, or a document providing the rules for auctioning of permits as of 2013.

According to the proposals, the directive should give the Commission the power to adapt timetable of auctions to ensure "orderly functioning of the market". There is a proposal for the Auctioning Regulation that allowances back-loaded (meaning temporarily withdrawn from the market) in 2013-2015 will return to trading in 2018-2020. The changes, if approved, would result in the removal of 1.2 billion allowances from the market for five years on average. The Commission expects that its attempts at quick-fixing the EU ETS will triple the EUAs' price, pumping it up to €20-28.

Traders say, however, that the price rally can happen only in mid-term, as back-loaded allowances will flood the market again in 2018-2020. Secondly, traders knowing that the market will become oversupplied in 2018-2020 will reflect it in futures contracts that can get extremely cheap dragging the spot price down when getting closer to these years. Finally, back-loaded volume may not be high enough to shrink the entire oversupply banked from Phase 2. If this happens it may occur that the Commission's intervention will prove a failure, best described as 'too loud, too little, too late'.

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