

Carbon Trading: If at first you don't succeed, try, try, try again

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By Commodity Technology Advisory LLC

It had been a rough day in the carbon markets for Arnulf Kohler.

But that was typical for Arnulf (known by Arn to his very few friends) who led an austere, lonely life, much like all the others in his profession. His job was filled with anxiety, he suffered from a lack sleep, and he was convinced his work environment was causing any number of other psychological disorders.

It didn't help that most workers in Arn's profession were routinely ostracized by society, and it was disheartening to him that many considered his trade dishonorable and frequently accused him of evil practices.

To top it all off, he'd fallen asleep again in his office, nearly burning down his place of work, and now the boss was coming by, most likely to give him the axe. This was most worrisome, as getting the axe from the local burgermeister mostly likely meant his head would literally roll.

Such was the nature of the carbon markets, and the life of the village "charcoal burner", in 1518. Fast-forward 500 years and Arnulf Kohler's great-great-great-great (well, you get the idea) grandson most likely still has anxiety-filled days and sleepless nights caused by the somewhat lackluster performance of the carbon trading markets in his native German land.

The most mature and active market, the European Union passed the decade mark last year with their carbon trading system, and governmental and regulatory agencies are considering reforms to help bolster its sagging performance. Despite a growing market volume, the overall market has been burdened by low prices and an oversupply of allowances.

The result is that the overall market value has continued to shrink annually, reflecting also the shrinking average price of a metric ton of CO2 emissions.

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When the EU first initiated the Emissions Trading Scheme, or ETS, its enthusiasm was perhaps a bit too unbridled and it issued an excess of emissions permits, creating a surplus supply from the start. Toss in other factors like a recession and the EU's cap and trade process has been rather anemic, to put it mildly.

As one industry analyst noted, the EU had the right idea with the cap portion of emissions, but the trade and price aspects of cap and trade have been less than stellar.

Market critics say the EU's experience should be a dire warning for the US not to engage in cap and trade as the Clean Power Plan intends to do by encouraging states to use trading as a mechanism to reduce emissions from entities such as power plants.

The US itself is not without experience in the trials and tribulations of cap and trade. The current performance of the cap and trade program California initiated in 2012 is a telling window into the potential pitfalls of a nationwide cap and trade program. In roughly the last six months, less than 2% of the CO2 credits offered by California's Air Resource Board were sold at auction, giving the warnings of cap and trade naysayers solid ground to stand on.

To further complicate matters, the California Chamber of Commerce has challenged the constitutionality of the auctions by arguing that the program is essentially an illegal tax. With the specter of the possibility that carbon credits could become worthless, many companies have ceased purchasing them, waiting for an appeals court to make a ruling sometime in 2017.

However, despite the uninspiring performance of the EU's program, California's program, and a few other nascent emissions trading programs, it hasn't deterred Mexico from attempting to launch its own cap and trade market. The pilot carbon pricing program will launch in November and run on a trial basis for a year with about five dozen companies participating voluntarily in the program, testing a carbon credit system that Mexico intends to launch as a national carbon market sometime in 2018.

But the biggest disrupter in the quest for a prolific and profitable carbon trading market may be the world's biggest producer of those very same carbon emissions. China recently announced that it will launch a national cap and trade program in 2017, leveraging their own abundant amount of industries that emit greenhouse gases along with all the lessons they've learned from the struggling EU and California programs.



If China, who emits almost a third of the entire world's CO2 pollutants, is successful in creating the first (and perhaps largest) profitable carbon trading market, the irony would be lost on no one, least of all the Chinese themselves.

But perhaps that's only fitting. You see, old Arnulf Kohler in 1518 was merely a footnote in the long history of charcoal burners. One of the first civilizations to utilize the process of charcoal burning starting around 4,000 BC was ... you guessed it ... China.

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