



## Hot stuff from Brussels!

### But can Europe lead on climate without a federal carbon bank?

by Chris Layton

With its wide ranging proposals published on January 24 the European Commission has taken a decisive step towards establishing the EU as a credible leader in the global effort to combat climate change. The question now is whether the member states will go along with its core proposals and whether a further fundamental institutional change will be needed to make it work.

The pearls at the heart of the Commission's proposals on climate change are the proposals to strengthen the European Emissions Trading Scheme: by cutting allocations, moving to the auctioning of emissions by 2012, blocking some of the Kyoto loopholes and adopting a community wide CAP on emissions from 2013 onward.

Tough national targets to implement the Union's commitment to generate 20 per cent of its energy from renewable energy by 2020 are also proposed. These, though moving vigorously in the right direction, are contentious, hard to enforce and considered a distraction by market purists. By contrast the proposals to cut emissions allocations in the next phase of ETS, and by 20 per cent by 2020 are essential to drive up the price of carbon to the level necessary to make investment in renewables, nuclear power and carbon capture profitable over time. Rising oil, gas and coal prices already encourage energy saving and renewables. But they also drive research and exploitation of dirtier and less accessible fossil fuels (like Canada's coal tar sands). Only a large differential between the price of carbon-intensive and clean fuels will give the power industry the longterm signal its European leaders plead for as they plan investment in some 660 gigawatts of new electric power capacity over the next thirty years.

Green critics point out that the 20 per cent target for 2020 is insufficient if cuts in emissions of 80 per cent are to be achieved by 2050 - the scientific imperative to contain rising temperatures within the Union's target of a 2 degree Centigrade increase during this century. But at Bali the Union offered to cut by 30 per cent by 2020 if others reciprocate. Further tightening will be needed if the carbon price fails to rise to the kind of levels (above €40 per ton) required to bring the green shift in investment in electric power that is required.

The Commission has also proposed a series of measures to block the blatant Kyoto leaks (through the CDM and Joint Implementation), which have turned the cap so far into a sieve. Above all the move to auctioning will be essential, ending the absurdity of subsidising the largest polluters by giving them emission permits which they profitably sell. It will provide flexible means of managing and steadying the carbon price and welcome revenue, some of which must be invested in post carbon technologies and adaptation.

The move to a single community cap on emissions in 2013 will be no less crucial and a major political step. Current national targets, set through a mixture of history, competitive political

bargaining and the Commission's struggle for fairness are inherently invidious and will not be able to sustain the huge cuts required. The present phase of the European carbon market is less analogous to a common currency than to the former European Monetary System in which national currencies coexisted precariously within a band. A single community cap will in one stroke create a level playing field for the purchase of emission allowances by community enterprises, deepening and stabilising the market.

To win round member states, however, the Commission is proposing that they conduct the auctioning and collect and spend the revenue. All auctions will be open to companies throughout the Union. It is here that the difficulties - even contradictions - may appear. How are the auctions, with their revenue raising potential, to be allocated between member states? The Commission proposes allocation in proportion to the GDP of member states in 2005, with a potential "solidarity" adjustment in favour of poorer states that are expected to grow. A strong and fair financial regulation will be required.

Even so, it is hard to see the Union's confederal setup containing comfortably the stresses of 27 members jostling for the revenue from auctions and timing auctions sensibly within a single market. Pressure must grow for the management of the community's carbon currency to take the next step: the establishment of an agency or central bank which will both conduct auctions and have significant flexibility in buying and selling in the European carbon market. That could provide stability and sustain a target price. The central bank would also regulate the market, whose integrity is put at risk by misleading carbon "offsets" and speculative global flows. Such an agency or central carbon bank would have board members from all member states, like the European Central Bank and the Federal Reserve Board in the United States. It might operate through national agencies but must implement one policy, as does the European Central Bank.

Doubters have queried how a carbon bank could both auction a fixed quantity of emission entitlements and target a stable but rising carbon price. In fact this is just the kind of juggling which central banks engage in all the time as they work to an inflation target but follow other indicators like the money supply and endeavour to smooth market shocks. The political authority, the Council of Ministers and Parliament, will set the emissions cap and target for a European Carbon Bank but give it the flexibility to auction at discretion, buy and sell in the carbon market, and enforce the rules.

February 2008.

Chris Layton is chair of Action for a Global Climate Community and author of *A Community of the Willing; How Europe and the South can lead the world's response to climate change*. See [www.climatecommunity.org](http://www.climatecommunity.org)