

Is CO₂ actually a commodity? Carbon currencies need a central bank.

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Controversies are developing about the current evolution of the CO₂ prices in Europe. Because of economic slowing down, many people fear an over-allocation of allowances in the 2nd EU-ETS period, leading to a second collapse of CO₂ prices. Such an evolution would be extremely detrimental to the credibility of the system and would deter CO₂ emitters from investing in emission reduction projects.

Surprisingly, Jos Delbeke, Deputy Director-General, DG Environment European Commission, formally turned down, in January 2009, the idea of introducing a floor in the CO₂ price, arguing that such a public intervention would be contrary to the basic principles of cap & trades schemes which must rely on the market. A little bit naively, M. Delbeke also states that "The fact that the price has fallen in recent months is a sign of a rational market incorporating changing fundamentals in a timely fashion". Unfortunately, the collapse of prices is mainly due to the economic recession, the duration of which is unpredictable.

The International Emissions Trading Association is also opposed to any market management "which could limit the market's ability to behave rationally".

These opinions are respectable but forget that CO₂ allowances are just an instrument aiming at encouraging the emissions reduction. They consider CO₂ as a commodity, comparable to oil or electricity, whose price has an intrinsic meaning and is governed by the law of supply and demand. But CO₂ is not actually a commodity. It is not a physical substance, such as food, grains, metals, oil, etc, interchangeable with another product of the same type, and which investors buy or sell through spot or futures contracts. It is a commodity only insofar it can be sold or bought on the commodity exchanges. But it is a virtual product. It only exists by virtue of governmental decisions at the origin of the product and creating the scarcity around it. Claiming that public authorities must not intervene in the market is paradoxical if one considers that the EU-ETS is a bureaucratic construction, the pressure it exerts on the economy having been discussed at length by governments in a given economic context. If this context dramatically changes, there is no reason for not reconsidering some aspects, keeping in mind the key objectives of the system.

Furthermore, it is certainly illusory to believe that the carbon markets today behave rationally and leads to a fair carbon price corresponding to an economic optimum. The carbon markets are far from being organized, liquid transparent and permanent even if the EU-ETS has made significant progress towards this direction. The artificiality of the CO₂ prices is well illustrated by the discrepancies in the quotations around the world, in Europe as well as in USA (CCX or RGGI), Australia, Canada, without speaking of the voluntary markets.

As a matter of fact, CO₂ allowances are closer to currencies than to conventional commodities. But currencies are very fragile. It is a notional concept which permits exchanges but whose value is highly dependent on the confidence which can be placed in emitting institutions.

In France, everyone keeps the memory of the "assignats" which were created during the French revolution (1791) but completely lost their value in 5 years because of over-emissions and counterfeiting. All cap & trade systems have been victims, in their infancy, of over-allocation: UK-ETS, EU-ETS phase 1, CCS, NSW abatement scheme, very likely RGGI and more and more possibly EU-ETS phase 2. Many offset credits are also suspected of being worthless money. After the bankruptcy of the "assignats", Bonaparte decided to set up the "Banque de France" and to issue the "Franc Germinal" which remained for decades a model of stability.

We believe that all artificial constructions such as the CO₂ allowances need a regulatory institution such as a Central Bank. It is absolutely impossible to anticipate what may happen in the economies in the coming years. But one can agree on certain environmental objectives. Then, a central carbon bank could be entitled with the right of regulating the number of allowances put into circulation in order to remain on line with these objectives.

I agree with the notion of price corridor developed by Germany's economy minister, Michael Glos. There are a lot of ideas for technically implementing such a system and one should remember that the Euro started with the European currency snake (1972-1978) which was later transformed into the European Monetary System.

Such a corridor would provide the investors in low-carbon energies and in energy efficiency with the visibility they need. I believe it would also facilitate the progressive merging of the regional cap & trades systems which are currently under implementation around the world.

The losers may be the brokers whose fees are based on the volume of the transactions. But the EU-ETS is not an objective in itself. It is just an instrument supporting a policy.